















# TEXAS LOTTERY COMMISSION

2018 COMPREHENSIVE BUSINESS PLAN AND ANNUAL REPORT

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# TEXAS LOTTERY COMMISSION

2018 COMPREHENSIVE BUSINESS PLAN AND ANNUAL REPORT

SECTION 1: ANNUAL REPORT

# OPENING LETTERS MESSAGES FROM THE CHAIRMAN & EXECUTIVE DIRECTOR

Commissioners:
J. Winston Krause,
Chairman
Carmen
Arrieta-Candelaria
Peggy A. Heeg
Doug Lowe

Robert Rivera



## TEXAS LOTTERY COMMISSION

Gary Grief, Executive Director

Alfonso D. Royal III, Charitable Bingo Operations Director



The Texas Lottery continues to set new standards of excellence in fulfilling its mission to generate much-needed revenue for public education, veterans' assistance and other state causes. The Texas Lottery has consistently contributed more than \$1 billion annually to the Foundation School Fund, including record transfers of \$1.373 billion in Fiscal Year (FY) 2016. Texas school districts use monies from the Foundation School Fund to pay for teacher salaries, utilities, furniture, equipment and other operational expenses. Some of these funds are also earmarked to deliver special program services like bilingual education, special education, compensatory education, gifted and talented education, and career and technical education. In 2009, the Legislature authorized veteran-themed scratch ticket games with proceeds dedicated to the Texas Veterans Commission administered Fund for Veterans' Assistance providing

benefits to Texas veterans and their families. The Texas Lottery also generated record transfers to the Fund for Veterans' Assistance in FY 2016 topping \$14.7 million.

The agency is committed to accomplishing its mission consistent with the provisions of the State Lottery Act and the policy direction of the Texas Legislature. While continuing its focus on innovation, the agency is committed to ensuring that new products are authorized by Texas law, and do not include video lottery, casino gaming, internet-based lottery sales, fantasy sports or any other activities not authorized by law. The members of the Commission understand their responsibility to provide oversight to ensure the agency is conducting its operations fully within this framework.

The Texas Lottery continues to take a leadership role nationally and globally as an active member of the North American Association of State and Provincial Lotteries (NASPL), the Multi-State Lottery Association (MUSL), and the World Lottery Association (WLA). Our Executive Director Gary Grief currently serves as the president of the Multi-State Lottery Association. This Comprehensive Business Plan and Annual Report illustrates the agency's recent achievements, but more importantly it details the goals and key performance factors that are used to measure current and future success. The Texas Lottery's success story is not just in the numbers, but in the statewide economic impact to our retailers, prizewinners, vendors, employees and, most importantly, public education and veterans' assistance programs.

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J. Winston Krause, Chairman



Carmen Arrieta-Candelaria Peggy A. Heeg

Doug Lowe Robert Rivera



### **TEXAS LOTTERY COMMISSION**

Gary Grief, Executive Director

Alfonso D. Royal III, Charitable Bingo Operations Director



The Texas Lottery Comprehensive Business Plan and Annual Report details the results of the Texas Lottery's most recent full fiscal year in 2016. Before you read more about the Texas Lottery, I want to share with you some key facts.

As noted by our Chairman, the Texas Lottery exceeded all revenue records in FY 2016, marking the fifth consecutive year that record revenue levels were achieved, primarily supporting two good causes dear to the hearts of many Texans: Public Education and Veterans' Assistance programs.

We achieved these record results through a strong commitment to innovation, and collaboration with our vendors to bring "best in class," entertaining lottery products to our players. This approach delivered exciting products for our over 17,500 retailers to sell and our customers to play. Players and retailers

both won big in FY 2016 with \$3.27 billion paid in lottery prizes and over \$273.3 million paid in retailer commissions, bonuses and incentives, both all-time records.

The Texas Lottery also achieved an all-time sales record of \$5.068 billion in FY 2016. There were two significant contributing factors to this success. One was the continued innovation in our scratch ticket games that led to record sales for the category. In addition, a record \$1.6 billion *Powerball* jackpot in January 2016 also played a significant role. We achieved these record breaking sales results while focusing on Fiscal Accountability and cost containment, achieving an administrative expense rate of 4.4 percent of sales, one of the lowest administrative expenditure rates in the US lottery industry. Any unspent administrative funds achieved through cost saving measures are returned directly to the Foundation School Fund. All these accomplishments were made possible, in part, through the pride we take in our ability to effectively outsource certain functions to the private sector, appropriately manage large and complex contracts, and encourage the use of Historically Underutilized Businesses (HUBs) in Texas.

The Texas Lottery is also fully committed to Responsible Gaming and we encourage the public to "PLAY RESPONSIBLY" when participating in Texas Lottery games. We proudly serve as a contributing member of the National Council on Problem Gambling and we were recently recognized by the World Lottery Association for achieving Level 3 certification for our responsible gaming program. Additionally, the World Lottery Association awarded the agency with a Best Innovation Responsible Gaming Award related to our responsible gaming efforts. We are very proud of these achievements and look forward to continuing our efforts in this area.

On behalf of our entire staff, I look forward to sharing more information with you about the Texas Lottery on the following pages.

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 agency underwent Sunset reviews in both 2002 and 2004, but its Sunset bills failed to pass either time and the agency was continued in separate legislation. In 2012, the agency underwent Sunset review once again. The 83rd Legislature enacted the agency's Sunset legislation which continues the agency until September 1, 2025. Additionally, the legislation included a provision establishing a 10-member legislative review committee to study the impact of eliminating the state lottery along with studying certain aspects of charitable bingo. The legislative review committee issued its recommendations in a November 2014 report. One of its recommendations was that the Legislature should continue the Texas Lottery and the Texas Lottery Commission.

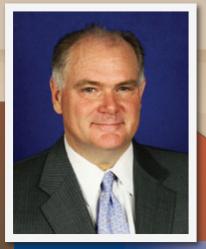
The State Lottery Act gives both the Commission and the executive director broad authority, together with the responsibility to exercise strict control and close supervision over all lottery games conducted in Texas to promote and ensure integrity, security, honesty and fairness in the operation and administration of the lottery. The five-member Commission sets policy, adopts all rules for the agency, approves major contracts 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



Carmen Arrieta-Candelaria
El Paso



J. Winston Krause, *Chairman Austin* 



Doug Lowe



Peggy A. Heeg Houston



Robert Rivera Arlington

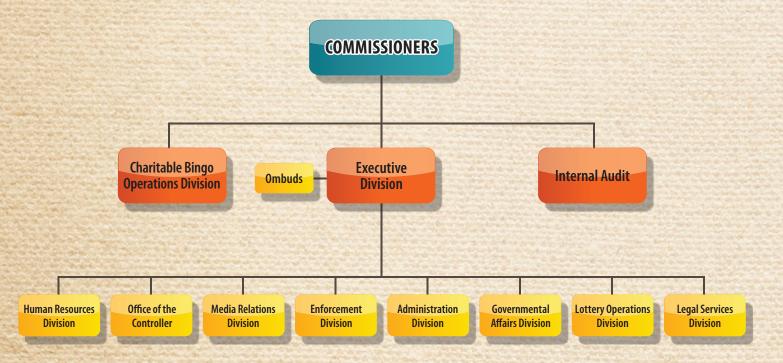


## TEXAS MODEL - IT WORKS FOR TEXAS!

#### **Management and Organizational Structure**

The Texas Lottery is overseen by a five-member Commission that sets policy, adopts 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 outsourced Internal Audit function. The agency's organizational structure is depicted below.

#### Texas Lottery Commission Organizational Chart

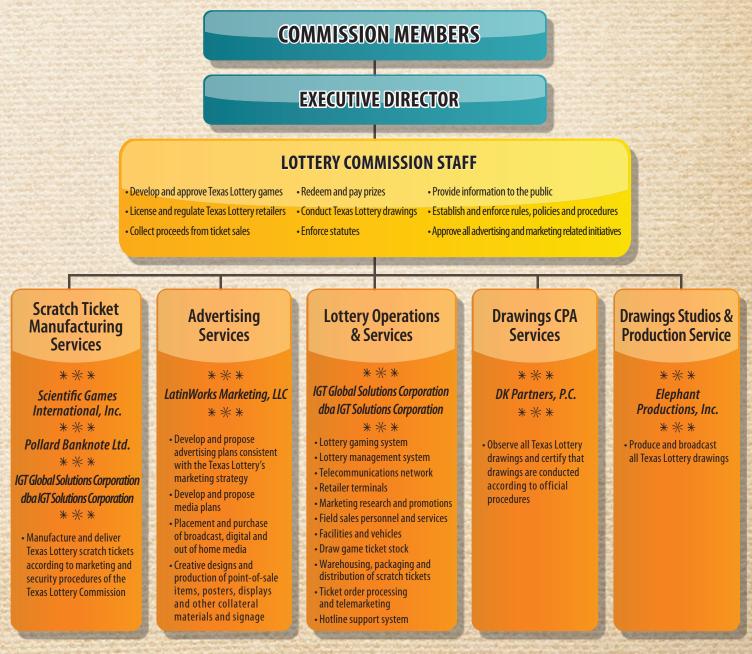


What sets the Texas Lottery Commission apart from other North American lotteries is the unique public-private structure of the agency. The members of the original Implementation Task Force of the Texas Lottery were the architects of what has become known within the lottery industry as the "Texas Model." 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 vendors 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 workforce 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 responsibilities as a government entity. Through its administration of Texas Lottery games, the Texas Lottery has a significant fiscal impact on 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 additional comprehensive planning beyond the state's standard five-year strategic planning process. 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's recommendations and subsequent statutory requirement.

Nearly 25 years after the first ticket was sold, millions of players continue to enjoy Texas Lottery games every day. In fact, the Texas Lottery is the fifth 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.

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 player interests if it is to continue its 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 those Texans who are not in favor of gaming. Therefore, this document highlights FY 2016 results and lays out initiatives carefully designed to ensure continued optimal revenue generation for the state of Texas in FY 2018-2020, while being mindful of all viewpoints.

2018 COMPREHENSIVE BUSINESS PLA



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 standard of security, integrity and responsible gaming principles, 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. All proposed innovations must be authorized by Texas law, and do not include video lottery, casino gaming, internet-based lottery sales, fantasy sports, or any other activities not authorized by law.
- **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.

<sup>\*</sup> Source: La Fleur's 2017 World Lottery Almanac (25<sup>th</sup> edition), "Worldwide Lotteries Ranked by 2016 Total Sales (excludes VLT Revenue)," p. 303.

# **SCRATCH AND DRAW PRODUCT HIGHLIGHTS**

**August 1, 2016:** The newest \$10 spotlight game, \$200 Million Payout, starts and is supported with a full advertising campaign. By including a \$1 scratch ticket, \$7 Million Payout, and a \$5 scratch ticket, \$27 Million Payout, the Texas Lottery creates a small family of games with the same look and feel.

**July 5, 2016:** Sales start just in time for back to school needs with Back to School Crossword. Back to School Crossword is the first crossword-themed scratch ticket to offer promotional second-chance drawing prizes including Apple® products like iPad Air 2® tablets, MacBook Air® laptops and family tech packages.

**April 18, 2016:** Cats vs. Dogs is available for sale at lottery retail locations after more than 1,700 dogs and cats were entered into the photo contest and nearly 25,000 votes were cast to determine the six dogs and six cats that are featured on the \$2 scratch tickets.

**April 4, 2016:** The Texas Lottery brings the excitement of Major League Baseball to Texas Lottery players by producing the *Texas Rangers* and *Houston Astros* scratch tickets. These games offer promotional second-chance drawing trip prizes to the World Series as well as popular branded merchandise prize packs.

March 7, 2016: The second Super Ticket<sup>™</sup>, *The Big Money Super Ticket*<sup>™</sup>, launches and generates impressive sales similar to the original Super Ticket launch. *The Big Money Super Ticket* is the third best-selling scratch ticket game for the year with \$102.9 million in sales.

**March 7, 2016:** Sales begin for *Texas Lottery Live!*. This unique scratch ticket game offers trip prizes to popular music festivals across the country and the Texas Lottery Live! branded music series provides marketing opportunities for the agency to support the game.

**February 21, 2016:** \$500,000 Money Mania is the first Texas Lottery scratch ticket game introduced where every ticket is a winner. This \$20 game offers prizes from \$5 to \$500,000.





Record Scratch Ticket Sales

\$3.72 billion

Record Revenue Transfers to the Fund for Veterans' Assistance

**\$14.7** *million* 

Record Revenue Transfers to the State



Record Total Product Sales **\$5.07 billion** 

Record Revenue Transfers to the Foundation School Fund

\$1.37 billion

\$1.39 billion



**September 21, 2015:** A scratch ticket featuring the increasingly popular television show, AMC® The Walking Dead®, is introduced just in time for the Halloween season.



**September 27, 2015:** The ninth draw game is added to the product portfolio that is as easy as 1-2-3! *Texas Triple Chance*™ is a daily game that offers players three chances to win the top prize of \$100,000 in every play. This unique draw game is available for \$2 per play per drawing. *Texas Triple Chance* is drawn Monday — Saturday nightly at 10:02 p.m. CT.



**November 2, 2015:** The 12<sup>th</sup> version of *Veterans Cash* is introduced to commemorate Veterans Day. Other non-veteran themed scratch tickets that support Texas veterans are released throughout the year based on inventory needs. A record \$14.7 million is transferred to the Fund for Veterans' Assistance during FY 2016.



**December 7, 2015:** The first \$5 *Super Loteria* scratch ticket launches and due to its popularity, a second version follows in February 2016. Similar to the \$3 *Loteria* game, the \$5 version is extremely successful and the February launched *Super Loteria* game ends the fiscal year ranked as the ninth best-selling scratch ticket game with sales of \$88.2 million.



**December 21, 2015:** The HIT family of games starts with \$1, \$2, \$5, \$10 and \$20 price points available for Texas players. The family offers top prizes ranging from \$5,000 to \$1,000,000. The \$20 HIT \$1,000,000 is the best-selling scratch ticket game in FY 2016 with \$143.3 million in total sales.



**January 13, 2016:** The *Powerball*® jackpot rolls up to a world record setting \$1.6 billion. This never-before-seen jackpot level creates a frenzy across the globe. Four lucky Texans win second-tier prizes in the drawing but the big winner is Texas education. The Texas Lottery generates sales of \$266.7 million during the jackpot roll up resulting in \$106.7 million for Texas' Foundation School Fund.





### Powerball<sup>®</sup> and Mega Millions<sup>®</sup>

Powerball and Mega Millions are the two 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. Both Mega Millions and Powerball game sales performance are highly dependent on jackpot levels. In an effort to boost jackpots and create better overall odds of winning non-jackpot prizes, the Multi-State Lottery Association (MUSL) approved a new version of the Powerball game that started on October 4, 2015. The Power Play feature was also changed to include a 10X multiplier when advertised annuitized jackpots are \$150 million or less. In January 2016, Powerball rolled up to a world record-setting jackpot of \$1.6 billion generating huge interest in the game and impressive sales gains for the fiscal year. Mega Millions also experienced a sales increase related to a \$540 million jackpot level attained toward the end of FY 2016.



#### 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 advertised annuitized jackpots starting at \$5 million and an add-on feature called Extra!. The Extra! feature was implemented in FY 2013 and has experienced continued growth since its introduction as more players learn about the benefits of the new feature. 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 multijurisdictional games, smaller in-state rolling jackpot games like Lotto Texas often struggle to compete and be relevant. However, Lotto Texas maintains the fourth-highest draw game sales position with FY 2016 sales totaling \$141.9 million.



## Texas Two Step<sup>®</sup>

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 produces the most jackpot winners in Texas each year with FY 2016 boasting 35 winning jackpot tickets sold. Research will be conducted in FY 2017 to determine if current, loyal Texas Two Step players have any interest in a game modification.



#### 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. Until recently, other new game introductions and national draw game initiatives have taken precedence over Cash Five changes based on their revenue potential. The agency researched several game modification options during FY 2016 to gauge player and retailer interest in potential game modifications. The research demonstrated limited potential for a game replacement. The agency will conduct additional related research in FY 2017 on potential Cash Five and Texas Two Step game replacement options. Results of research and financial analysis will determine whether a Cash Five game change is warranted. A determination to proceed with a game change will be evaluated in the context of other draw game initiatives and their potential sales and revenue impact.

# **DRAW GAME OVERVIEW**

# SUMMARY OF TLC DRAW GAME PORTFOLIO





### Pick 3<sup>™</sup> and Daily 4<sup>™</sup>

*Pick 3* and *Daily 4* are the Texas Lottery's three- and four-digit daily numbers games drawn four times a day, six days a week. *Pick 3* has consistently been one of the best-selling draw games and that was true again in FY 2016 as the game was ranked second in overall draw game sales, with \$260.2 million in sales. *Pick 3* 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. Following the introduction of the *Daily 4* game, *Pick 3* sales performance has moderated. It is believed that *Pick 3* players are migrating to *Daily 4*, a trend being experienced in other lottery jurisdictions around the country. 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 play type called "1-Off" was researched with players and retailers in 2016. However, research did not yield results sufficient to warrant proceeding with introduction of this play type. Additional replacement add-on feature research will be conducted in FY 2017. If research results and financial analysis are favorable the play type will be evaluated for inclusion in the draw game portfolio in FY 2018.



# All or Nothing™

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 other draw games in the Texas portfolio. All or Nothing, introduced in September 2012, features very good overall odds (1 in 4.5) and 10 ways to win a prize. All or Nothing is a unique game where players can win the top prize by matching all of their numbers or none of their numbers to the 12 numbers drawn. Sales for the All or Nothing game have not returned to levels seen for the game prior to suspension of sales in 2013 due to a game design issue brought to the agency's attention by IGT Solutions Corporation. To increase awareness and trial of All or Nothing, it was included in the new draw game promotion called Lone Star Lineup<sup>TM</sup> that was launched in September 2016 and features multiple Texas Lottery daily draw games sold together.



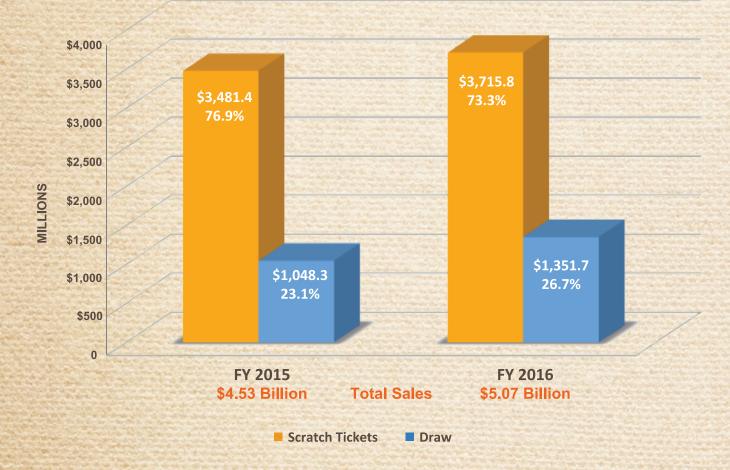
### Texas Triple Chance™

The agency's ninth draw game, *Texas Triple Chance*, was introduced on September 27, 2015. *Texas Triple Chance* is a game that also had a delayed launch due to the need to support national draw game initiatives, specifically the *Powerball* game changes noted in this section. This \$2 game offers players three Chances (sets of numbers) to win up to \$100,000 in every play. *Texas Triple Chance* was launched using the advertising slogan "It's As Easy as 1-2-3!" to convey the simplicity of game play. This was also the first game to launch with its own how-to-play video that could be watched by scanning a QR code printed on in-store point-of-sale pieces. Players select seven numbers from 1 – 55 while the agency draws 10 numbers from 1 – 55. If the player matches three or more numbers in any one *Chance*, the player wins a prize! The top prize of \$100,000 can be won by matching all seven numbers in any one *Chance* to the numbers drawn. *Texas Triple Chance* features the best overall odds of any draw game—1 in 3.6. The game received a good deal of product support but has struggled to find a loyal player base since its launch. It was also included in *Lone Star Lineup* in an attempt to increase player awareness and product trial.

# SALES AND REVENUE PRODUCT SALES PERFORMANCE CHARTS

# Texas Lottery FY 2016 Sales Comparison

through 08/31/2016 (in Millions)



#### Sales Comparison

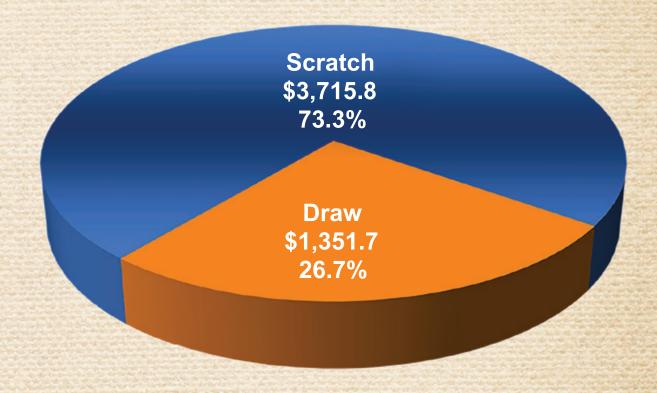
For FY 2016, the Texas Lottery recorded \$3.72 billion in scratch ticket sales, an increase of more than \$234 million and the highest scratch ticket sales in Texas Lottery history. Draw sales concluded the fiscal year with \$1.35 billion in total sales, an increase of more than \$303 million that can mainly be attributed to the world record setting *Powerball* jackpot of \$1.6 billion in January 2016. *Mega Millions* also experienced a large jackpot in July 2016, \$540 million, also contributing to the successful draw game sales year.

Total product sales for FY 2016 set an all-time sales record of over \$5.06 billion, exceeding the sales record set in FY 2015 by more than \$537 million. This is the first time in the Texas Lottery's history that sales levels reached the \$5 billion mark.

# SALES AND REVENUE PRODUCT SALES PERFORMANCE CHARTS

# Texas Lottery FY 2016 Sales by Game

through 08/31/2016 (in Millions)



Fiscal Year Sales: \$5.07 Billion

Totals may not sum due to rounding

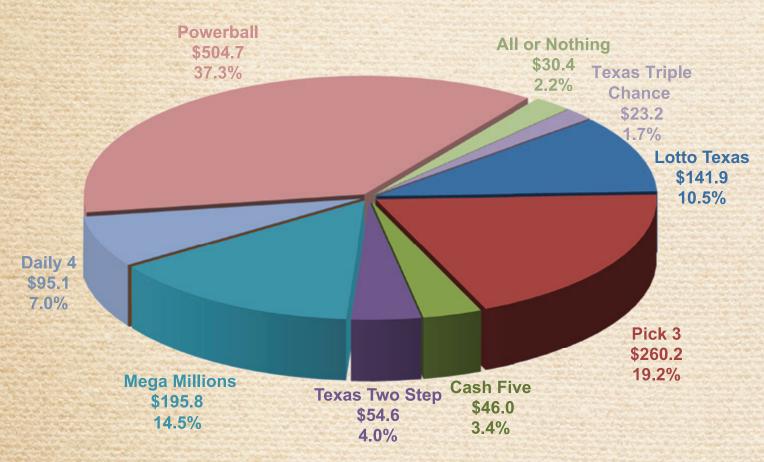
# Sales by Game

In FY 2016, scratch tickets represented approximately 73 percent of total sales and draw games represented approximately 27 percent of total sales. Draw games represented a larger percentage of total sales in FY 2016 than typically experienced in recent fiscal years due to the impressive draw game sales levels attained as a result of the world record \$1.6 billion *Powerball* jackpot.

# SALES AND REVENUE PRODUCT SALES PERFORMANCE CHARTS

# Texas Lottery FY 2016 Draw Sales by Game

through 08/31/2016 (in Millions)



#### Fiscal Year Draw Sales: \$1.4 Billion

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

Totals may not sum due to rounding

#### **Draw Sales by Game**

For FY 2016, *Powerball* was the best-selling draw game followed by *Pick 3* and *Mega Millions. Lotto Texas*, the agency's oldest draw game, was the fourth highest-selling draw game. *Powerball*'s world record setting jackpot during FY 2016 resulted in total *Powerball* and *Power Play* sales of \$504.7 million. \$266.7 million was generated alone during the roll up to the \$1.6 billion jackpot drawing on January 13, 2016.

*Pick 3*, drawn four times a day, six days a week, is a daily numbers game that does not rely on jackpot levels to drive sales. *Pick 3* sales of \$260.2 million represented a gain of \$3.4 million over the previous fiscal year. *Daily 4*, similar to *Pick 3* in game attributes and style of play, continued its year-over-year sales growth with a \$3.5 million gain and total sales of just over \$95 million.

# SALES AND REVENUE PRODUCT SALES PERFORMANCE CHARTS

# Texas Lottery FY 2016 Scratch Ticket Sales by Price Point

through 08/31/2016 (in Millions)



Fiscal Year Scratch Ticket Sales: \$3.72 Billion

Totals may not sum due to rounding

#### **Scratch Ticket Sales by Price Point**

The Texas Lottery realized \$3.72 billion in scratch ticket sales during FY 2016. The \$5 price point continued to be the best-selling price point totaling over \$1.2 billion in sales. The \$20 and \$10 price points were the next best-selling price points, respectively. Both of these price points included Spotlight games, which feature larger print runs and a significant quantity of appealing high-tier prizes compared to other scratch ticket games. Spotlight game offerings helped contribute to the sales success realized at these two price points. During FY 2016, the second *Holiday Game Book* was launched at the \$20 price point and the second Super Ticket (oversized ticket) was introduced at the \$10 price point. Both of these product initiatives contributed to the scratch ticket sales record achieved during the year.

## BENEFITING TEXAS

Since 1992, the Texas Lottery has generated more than \$25 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 Texas Lottery has contributed more than \$20 billion to the Foundation School Fund, which supports public education in Texas. In FY 2016, the Texas Lottery transferred \$1.373 billion to the Foundation School Fund, its single largest annual contribution to date.

The Texas Lottery Supports Texas Veterans. In 2009, legislation was passed directing the Texas Lottery to offer a scratch ticket game benefiting the Texas Veterans Commission Fund for Veterans' Assistance (FVA). Since that time, the Texas Lottery has contributed more than \$78 million for veterans programs. The FVA makes grants available to eligible charitable organizations, local government agencies and veterans service organizations that provide direct services to Texas veterans and their families. Approximately 89 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, additional games have been launched with the proceeds supporting the fund. In FY 2016, \$14.7 million was transferred to the Texas Veterans Commission, an all-time record.

**The Texas Lottery Supports Other State Programs.** As authorized by the Texas Legislature, other Texas Lottery funds, such as unclaimed prizes, contribute to other causes such as the multicategorical teaching hospital at the University of Texas Medical Branch at Galveston.

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 2016 financial results.

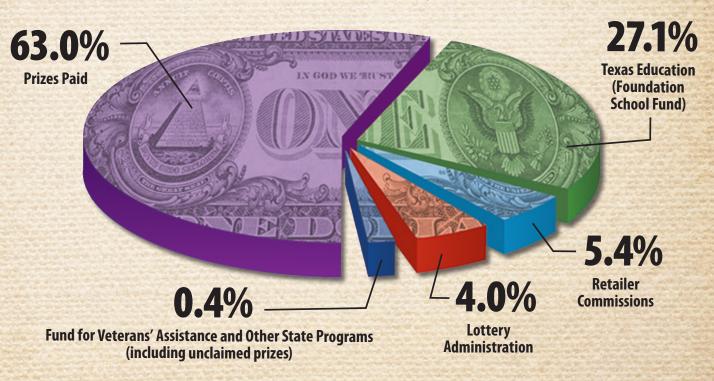


## SUPPORTING TEXAS EDUCATION AND VETERANS



**That's a Winning Story for Texas Education and Veterans.** 

# Where the Money Goes:



Percentage totals are rounded. \$14.7 million was transferred to the Texas Veterans Commission.

Information reflects audited FY16 figures

<sup>\*</sup>Prior to 1997, the proceeds were allocated to the General Revenue Fund and were contributed for the benefit of all state programs.



## RETAILERS

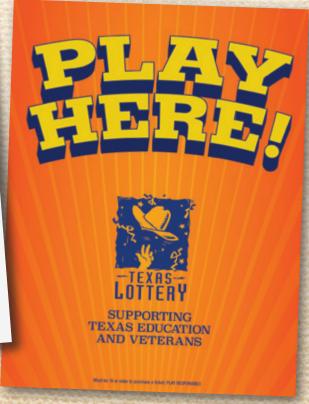
The Texas Lottery had 17,643 licensed retailers statewide offering lottery products at the end of FY 2016. The dedicated lottery retailer community is the critical bridge between

the lottery and its players. Lottery retailers work tirelessly to manage inventory, merchandise and sell lottery 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 2016 through the hard work of its licensed retailers. Lottery retailers reaped the benefits of their efforts by earning record-breaking commissions of \$253.51 million. Retailers also earned an additional \$18.23 million in sales performance-based incentive payments and \$1.57 million in bonuses for selling certain prizewinning tickets during the year. All told, retailers earned \$273.32 million in FY 2016.













# **TOP 10 Retailers in Texas**Galendar Year 2016

TOP 10 TOTAL SALES					
			City	CY 2016	
Rank	Retailer #	Name	ROSENBERG	\$4,996,798	
1	148558	RUDY'S STOP & SHOP	MCALLEN	\$4,550,696	
2	153705	TOWN & COUNTRY C S	CORPUS CHRISTI	\$3,265,669	
3	173887	PITTMAN'S QUICK MART	SAN ANTONIO	\$3,153,640	
4	132651	POTRANCO FOOD MART	BROWNSVILLE	\$2,864,759	
5	120337	EXXON FOOD STORE		\$2,559,827	
6	126336	MOBIL MART	CONVERSE	\$2,285,698	
_	140765	KWICK FOOD MART	PLAINVIEW		
7		ADRIAN'S MINI MART	ALICE	\$2,197,564	
8	179681		ALICE	\$2,176,628	
9	137897	YU MI'S	ROUND ROCK	\$2,145,563	
10	173466	Q & Q MART			

		P 10 SCRATCH	TICKET SALES	
			City	CY 2016
Rank	Retailer #	Name	ROSENBERG	\$3,363,902
1	148558	RUDY'S STOP & SHOP	MCALLEN	\$2,995,005
2	153705	TOWN & COUNTRY C S	CORPUS CHRISTI	\$2,621,376
3	173887	PITTMAN'S QUICK MART	SAN ANTONIO	\$2,614,525
4	132651	POTRANCO FOOD MART	BROWNSVILLE	\$2,213,249
5	120337	EXXON FOOD STORE	PLAINVIEW	\$2,192,935
6	140765	KWICK FOOD MART		\$1,981,380
7	137897	YU MI'S	ALICE	\$1,963,000
8	173466	Q & Q MART	ROUND ROCK	\$1,958,065
9	126336	MOBIL MART	CONVERSE	\$1,827,932
10	179681	ADRIAN'S MINI MART	ALICE	\$1,027,102
10	11.100			

9	126336	MOBIL MAKI	ALICE	\$1,827,932
10	179681	ADRIAN'S MINI MART	ALICE	
			FIVE CALES	
		TOP 10 CASH	FIVE® SALES	CY 2016
Rank	Retailer #	Name	City	\$119,706
Kunk	176334	BEA'S PLACE INC	SHINER	
		STOP N BUY	HOUSTON	\$66,755
2	117949	TOWN & COUNTRY C S	MCALLEN	\$64,761
3	153705		SAGINAW	\$44,071
4	178741	GNG 101	ROSENBERG	\$36,863
5	148558	RUDY'S STOP & SHOP	HOUSTON	\$32,309
6	210505	FIESTA MART #14	PEARLAND	\$31,540
7	421692	RANDALLS #1858		\$29,623
8	179192	QUICK N EASY	TOWBALL	\$29,603
	173887	PITTMAN'S QUICK MART	CORPUS CHRISTI	\$27,003
9	173847	SHOP & GO	DUNCANVILLE	\$28,090
10	1/304/	31101 4 00		

	TOP 10 TOTAL CASHES							
	City							
Rank	Retailer#	Name	ROSENBERG	\$2,601,133				
1	148558	RUDY'S STOP & SHOP	MCALLEN	\$2,117,431				
2	153705	TOWN & COUNTRY C S	SAN ANTONIO	\$1,936,349				
3	132651	POTRANCO FOOD MART	CORPUS CHRISTI	\$1,788,465				
4	173887	PITTMAN'S QUICK MART	BROWNSVILLE	\$1,499,061				
5	120337	EXXON FOOD STORE		\$1,472,539				
6	140765	KWICK FOOD MART	PLAINVIEW	\$1,445,040				
_	126336	MOBIL MART	CONVERSE					
7		Q & Q MART	ROUND ROCK	\$1,419,625				
8	173466	YU MI'S	ALICE	\$1,383,634				
9	137897	ADRIAN'S MINI MART	ALICE	\$1,306,400				
10	179681	AURIAN 3 MINI MANI						
			CTUING M SAL	FS				

	TOP	10 ALL OR NO	THING" SAL	-5
	IOP		City	CY 2016
Rank	Retailer #	Name	IRVING	\$43,414
1	135934	QUICK WAY CORNER STORE	IRVING	\$37,390
2	120459	KWIK-PIK FOOD STORE #8		\$37,098
3	176218	DEER PARK FOOD MART #101	DEER PARK	\$34,414
4	140033	QUICK TRACK	BEDFORD	\$32,476
5	598259	WALMART #1516 - FUEL	BORGER	\$31,306
		SNACK & TACKLE	SAN ANGELO	
6	148884	AVENUE STOP	LUBBOCK	\$30,702
7	181256		SAN ANTONIO	\$29,368
8	135525	THE KORNER STORE	THE COLONY	\$26,108
9	153816	MARKET ON THE SQUARE	YORKTOWN	\$25,954
10	155235	THE TEXAN #3	TOKK TOWN	
			TH GALES	

		TOP 10 DAILY	4 SALES	
			City	CY 2016
Rank	Retailer#	Name	CYPRESS	\$415,059
1	491501	KROGER #362	IRVING	\$284,373
2	135934	QUICK WAY CORNER STORE	DALLAS	\$282,169
3	106246	HAMPTON TEXACO	KILLEEN	\$217,999
4	597231	MICKEY'S #14	SAN ANTONIO	\$197,641
5	489062	HEB FOOD STORE #294		\$180,115
6	174488	EASY'S POP SHOP 2	PAMPA	\$138,542
_	146809	JOHNNY'S LIQUOR	CENTER	
7		ONE STOP FOOD STORE	DALLAS	\$135,124
8	146084		DALLAS	\$128,240
9	156804	WHEATLAND SHELL	ROSENBERG	\$126,516
10	148558	RUDY'S STOP & SHOP	KOJENDEKO	
			The second secon	20000000



WE SOLD

## 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. Responsible Gaming (i.e., responsible management and sale of lottery products) lies at the heart of the agency's commitment to providing its products to the public in an appropriate manner. The agency's mission must be achieved while also maintaining public confidence and trust that the agency's games are conducted fairly and securely with

a constant focus on "Integrity and Responsibility," one of the agency's core values. The agency's focus on integrity and responsibility 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, lottery retailers and to ensure the sale and validation of lottery tickets are performed in compliance with agency rules.

A number of regulatory and educational activities serve the social responsibility standards of the agency and its customers. Specific areas of emphasis include vendor and licensee compliance, consumer protection, hotline support, retailer surveys and inspections, investigation of complaints or questionable activities related to lottery games, close supervision and monitoring 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 scratch and draw game tickets prior to validation by a retailer. These devices include countertop Check-a-Ticket terminals as well as self-service lottery vending machines. To facilitate player access and convenience, the agency



coordinates with the lottery operator to evaluate high-volume locations that merit placement of multiple self-check devices. Additionally, customer displays and distinct audible tones at sales terminals provide player verification of the prizewinning status of tickets validated by retailers. The agency is focused on creating an environment where players can participate in the

games and independently verify the winning or non-winning status of their tickets as well as the value of prizes won.

Within the Lottery Operations Division, the Security Department ensures the security and integrity of lottery drawings and ticket validations. The Security Department monitors lottery drawings and validation processes to ensure that they are conducted in compliance with applicable laws, rules, regulations, policies and procedures. The Security Department works with the Austin Claim Center to verify and confirm the legitimacy of high-dollar draw game prizes, and all questionable claims are submitted to the Security Department for review and investigation. The Security Department also works closely with the scratch ticket manufacturers, scratch ticket testing vendor and the Products Department to ensure that all scratch tickets are fully tested, secure and of the highest quality before being released for sale.

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 suspicious activity.

The Texas Lottery continues to expand existing programs and initiatives to protect and enhance the security of lottery games, systems, drawings and operational facilities. The goal is to provide additional protection for lottery consumers, follow up on complaints and ensure retailers comply with rules related to various aspects of lottery sales including prize validation and payments.



The Texas Lottery has initiated a significant number of consumer protection-related initiatives:

- Dual validation receipts (one Player Copy and one Retailer Copy)
- "Sign Your Ticket" public awareness campaign
- One-step validation Secure Shield™ barcode on scratch tickets
- Player-activated terminals for self-checking winning status of tickets
- · Self-check terminal locator on website
- Enterprise Series MultiMedia (ESMM) monitor display of validation messages to player
- Terminal inquiry/validation tones
- Security Spotlight on website
- Development and implementation of monitoring tools and reports related to validation and claim activity
- Membership in and active support of the Responsible Gaming initiatives of the National Council on Problem Gambling (NCPG), the World Lottery Association (WLA) and North American Association of State and Provincial Lotteries (NASPL)

# SOCIAL RESPONSIBILITY (CONT'D)

CUALES SON LAS SEÑALES DE PROBLEMAS DE JUEGO?

migos acerca de problemas

VHAT ARE THE SIGNS OF GAMBLING PROBLEM?

re is no physical test that indicates gamblin avior, but here are some signs to look for:

Borrows money to cover gambling debts

Gambles when feeling bored or distressed
 Lies to family and friends about gambling

Tries to win back money lost

Is absent for long periods of time

Encouraging responsible participation in lottery games is a top agency priority. The agency helps bring awareness to this issue through its ongoing PLAY RESPONSIBLY

public information initiative focused on reminding 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, scratch and draw game tickets, advertising and media releases. The initiative features the agency's PLAY RESPONSIBLY website page where consumers can find helpful information and links to outside problem gambling resources. The agency website also provides retailers with a training video to assist in identifying signs of problem gambling and options for assisting customers.

As a member of NCPG, WLA and NASPL the Texas Lottery actively supports the Responsible Gaming initiatives of all of these organizations. Since 2004, the Texas Lottery has participated in the annual Problem Gambling Awareness Month campaign, a grassroots



public awareness and outreach effort of the NCPG. 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.

In 2014, the agency expanded its focus on Responsible Gaming by leveraging training resources (video training and print education materials) developed by NCPG and NASPL to provide dedicated training to its entire customer support team. These training tools have also been incorporated into retailer classroom training and training materials for lottery sales representatives employed by the lottery operator. The training focuses on identifying the signs of problem gambling along with critical helpline and counseling resources to combat problem gambling. In addition, the Texas Lottery produces and maintains distribution of a PLAY RESPONSIBLY pamphlet available at Texas Lottery retail locations and the agency's 16 statewide claim centers. The pamphlet contains information about problem gambling and resources for obtaining assistance.

After receiving WLA Level 2 Responsible Gaming certification in 2015, the agency embarked on an aggressive plan to expand its Responsible Gaming program and address action items identified in the Level 2 gap analysis. These efforts resulted in achievement of WLA Level 3 certification in 2016.

In 2016, the agency launched a mobile application providing a convenient platform to expand the public's access to Texas Lottery game information and enhance the provision of player support services. The application features "Check Your Ticket" functionality providing an added layer of consumer protection as players have the ability to conveniently verify the winning status of tickets on their mobile device. Neither this platform, nor agency social media initiatives offer ticket sales. All purchases of lottery games must occur at a licensed lottery location or from a physical Texas Lottery location. The Texas Lottery does not propose enabling the sale of tickets over mobile devices or the internet.

The agency will continue to focus on developing enhancements to the application to provide increased information access and service convenience to lottery customers while protecting the integrity of games and processes.

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, the Texas Lottery continues to add to the significant level of security in place to protect consumers and support retailer licensees related to Texas Lottery games.



# TEXAS LOTTERY COMMISSION

2018 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 2018 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 the Sunset Advisory Commission's 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, the Sunset Advisory Commission recommended additional enhancements to the agency's business planning process. Additionally, the 83<sup>rd</sup> Legislature enacted HB 2197, the Lottery Commission Sunset bill, which includes a statutory requirement to develop a comprehensive business plan. The statutory provision, Section 466.028 of the Texas Government Code is detailed below:

Sec. 466.028. COMPREHENSIVE BUSINESS PLAN. (a) The commission shall develop a comprehensive business plan to guide the commission's major initiatives. The plan must at a minimum include: (1) specific goals for the agency; and (2) an evaluation of: (A) the agency's overall performance; (B) the effectiveness of specific programs and initiatives; (C) the ongoing efficiency of agency operations; (D) the amount of lottery revenue that is generated for state purposes other than the payment of prizes; and (E) the factors affecting the amount of lottery revenue received and disbursed, including ticket sales and administrative efficiency. (b) The commission, as frequently as the commission determines appropriate, shall review the comprehensive business plan and at least annually hold a public meeting to discuss the plan or updates to the plan.

Added by Acts 2013, 83rd Leg., R.S., Ch. 993 (H.B. 2197), Sec. 2, eff. September 1, 2013.

The Texas Lottery has been successful in producing more than \$1 billion in revenue for the state of Texas each year for the last 13 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 product mix and design of games offered, number and quality of lottery retailers, legislative budget decisions, and agency administrative efficiency. While the most 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 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 incorporating key 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 2018, 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 are the primary distribution channel for selling the state's lottery products to consumers and are critical to the ultimate success of the Texas Lottery in generating revenue for the state. 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 potential retailer to ensure only qualified businesses receive licenses. The agency must efficiently implement these review processes to enable businesses to complete and/or continue licensure in order 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. Each new licensee receives comprehensive training prior to the start of ticket sales and ongoing refresher training is provided for employees as new product initiatives and equipment are introduced and as needed to address specific retailer issues. 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 supports retailers with time-sensitive needs, such as reporting ticket theft or damage and ordering scratch 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 agency business hours Monday through Friday. Agency staff enters and updates retailer information, coordinates ownership transfers and lottery terminal moves, processes license terminations, performs retailer records maintenance, and responds 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 staff also works closely with retailers to ensure prompt payment following a non-sufficient fund EFT bank account sweep. The agency's hotline also responds to inquiries from potential licensees and provides current licensees with information and instruction on the portfolio of games offered for sale.

The agency has also consistently invested significant time and resources in the area of technological support for its retail licensees. In the interest of providing enhanced customer service to licensed retailers, the agency converted from the web-based Retailer Services Center to the new online Lottery Services Portal (LSP), available to retailers in 2015. LSP provides existing and potential retailers with the convenience and ability to apply for or renew a lottery license, manage their lottery license information and access to download numerous reports for managing ticket inventory and financial matters related to the lottery.

Player ticket self-check (Check-a-Ticket) technology was introduced at licensed retail locations 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 80 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.

Current state-of-the-art lottery sales terminals provide retailers with easy access to game information and efficient transaction times, thus reducing retailer labor costs. Retailers have the option to display lottery player information via one of two available playstation styles, each designed



to provide brand-identifiable, compact merchandising. By designating space in their retail environment for a playstation, retailers are able to provide players easy access to playslips and game information away from the sales counter thus reducing transaction time at the register. Retailers are encouraged to display the lottery's Enterprise Series Multi Media (ESMM) monitor near the point of purchase to increase player awareness of lottery games and features. Over 90 percent of retailers feature an ESMM, which also displays player transaction information and important non-lottery messaging including AMBER, Silver, Blue and Endangered Missing Person Alerts. Electronically updated, dual-jackpot signs in two sizes offer retailers the convenience of providing their customers with the most current *Powerball* and *Mega Millions* 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 this commitment, the agency regularly surveys its retailer base to determine the level of satisfaction with the services being provided. The agency has a target of 95 percent satisfaction levels (measured as scores of "good" or "excellent"). In the four most recent fiscal years (FY 2013 – 2016), the agency has exceeded this target.

#### **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. The agency is focused on ongoing efforts to continue to expand the available reporting and training tools through continued enhancement of the retail Lottery Services Portal and the introduction of a web-based training module, Lottery Learning Link, which will provide retailers with 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, active lottery retailer locations that have not incurred a violation within the current fiscal year to the total number of licensed, 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 Administrative 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 transactions, 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 to 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 monitors 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 receipts (one Player Copy and one Retailer Copy)
- Split/floating validation numbers (VIRN) on scratch tickets
- Removing validation codes from scratch tickets
- "Sign Your Ticket" campaign
- Player-activated terminals for self-checking winning status of tickets
- Self-check terminal locator on website
- Terminal inquiry/validation tones
- Player transaction display devices at point of purchase
- 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 tickets

The agency has established a progressive disciplinary process for retailer violations of the State Lottery Act and Lottery Administrative 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 while implementing secure technologies and processes that enhance confidence for both players and retailers in conducting lottery transactions.

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 to prevent the actions of 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 lottery gaming system offers an expansive data warehouse of 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 both the lottery playing and selling experiences.

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 the Texas Lottery will continue to achieve a goal of 98 percent of the active 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 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 scratch 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 Lottery Services Portal 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 and agency rules.

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 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 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 and all appropriate collection actions have been exhausted.

The agency has established a target goal for CBD to not exceed .02 percent of lottery 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 2014	FY 2015	FY 2016
Total Sales	\$4,384,597,063	\$4,529,700,425	\$5,067,517,923
Bad Debt Expense	\$283,041	\$373,183	\$171,575
Bad Debt Expense as a % of Sales	0.0065%	0.0082%	0.0034%

Source: Texas Lottery Performance Measures

The combined three-year collection rate translates to collecting 99.99 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 imagine. 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 addition, the agency continuously works to improve the support provided to retailers regarding their financial commitments. In 2015, the agency launched the web-based Lottery Services Portal, which in addition to providing retailers with the ability to manage their lottery sales license online, provides access to new and enhanced reports for managing ticket inventory and financial matters related to the lottery.

In coordination with the North American Association of State and Provincial Lotteries (NASPL), the Texas Lottery has developed a new settlement method for packs of scratch tickets to provide a streamlined accounting process to aid in lottery sales reconciliation. Retailers may choose to have all their packs settle 21 days after each pack is activated. Texas Lottery staff will work with retailers to examine the financial impact of using the 21-day settlement method in lieu of the traditional settlement method of packs settling at 45 days after activation for sale and/or when 70 percent of

the low tier prizes have been claimed. Feedback from some retailers indicated that having all scratch ticket packs settle via a single parameter would simplify retailer accounting. Through initiatives to improve support provided to retailers in their financial relationship with the Texas Lottery and by maintaining an effective sales collection program, 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

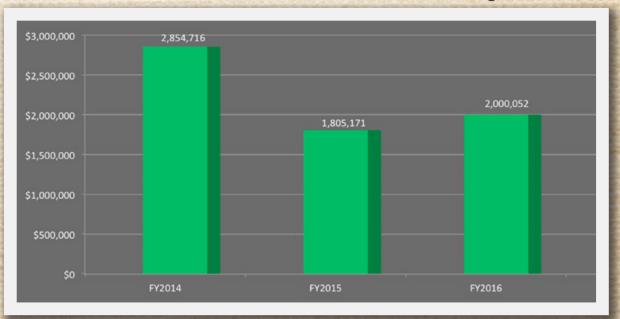
#### Background

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 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 saw substantial increases in amounts collected in recent fiscal years culminating with FY 2013 representing the highest amount ever collected by the Texas Lottery at \$3.88 million. In the last three fiscal years, the monies collected have declined substantially. Total monies collected for the most recent three-year period were \$6.66 million.

# **Dollars Collected via the Debt Set-Off Program**



Source: Texas Lottery Performance Measures

### **Challenges and Opportunities**

The Texas Lottery has consistently collected substantial debts on behalf of the state. While these results and their benefits to the state of Texas are significant, it is important to note that the funds collected are a function of variables that the agency does not influence or control. The metric is influenced by the volume of people claiming prizes at lottery claim centers that owe monies to the state and the amounts that those individuals owe to the state. It is believed that economic events and the overall health of the economy may also have a significant impact on this metric. The agency saw collections rise substantially during the Great Recession and has now seen collections decrease substantially as the health of the overall economy has continued to improve.

#### **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 agency has evaluated historical collections, sales growth in recent years and the current trend of declining collections, which may be attributed to economic variables in establishing a target of \$1.85 million for collections in FY 2017. The agency is anticipating that collections will fall more in line with the range for collections during FY 2015 and FY 2016.

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 Texas education and veterans' assistance programs, it is critical that lottery products are conveniently and widely available at a variety of locations where a broad diversity of consumers have the opportunity to purchase lottery tickets.

Sustained and strategic retailer expansion supports the potential for increased revenue to the state and offers tremendous benefits to the public in the form of convenience. By offering lottery products at a broader number of diverse locations, consumers can more conveniently evaluate purchase of the product. Additionally, offering lottery allows businesses to expand their relationship with their customers, limiting the need for their customers to make their lottery purchases at other business locations.

The Texas Lottery is committed to its core value of Customer Responsiveness by working to provide a convenient licensing environment for businesses and implementing administrative processes that enhance efficiency for licensees in interacting with the agency. Through its relationship with the lottery operator, national industry organizations, and the retail community, the agency works to understand the unique challenges faced by existing and potential lottery retailers. The agency works to identify and implement solutions within its regulatory framework that ensure the security and integrity of the lottery while addressing the needs of retail businesses.

#### **Challenges and Opportunities**

The lottery retailer base represents a dynamic business environment in which 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 size of the retailer base. The agency works to support existing retailers while recruiting new retailers to ensure a stable, but growing, product distribution channel.

The lottery retailer base contains a variety of trade styles. However, convenience and grocery stores, considered to be traditional lottery trade styles, are dominant, representing more than 88 percent of licensed locations and more than 96 percent of Texas Lottery sales. As the marketplace has become more competitive among these businesses, they are expanding into non-traditional business lines to remain competitive including food and beverage (including on-premise beer and wine) service. As these businesses pursue the Texas Alcoholic Beverage Commission licenses required for these services, significant challenges have arisen to licensure for lottery ticket sales and additional administrative burdens may be placed on the Texas Lottery to ensure compliance with licensure requirements.

Efforts to recruit businesses in non-traditional lottery trade styles present other challenges. Businesses that do not currently offer lottery are often focused on higher-profit-margin products that more easily correlate to bottom-line revenue. Scratch ticket products can present operational concerns associated with inventory control/shrinkage and the potentially labor-intensive nature of the product.

Additionally, the Texas Lottery, lottery operator and 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: 1) lack of standardized licensing and accounting processes across jurisdictions, 2) unavailability of new technologies providing retailer back-office accounting and 3) absence of real-time connectivity to sales and lottery inventory information.

Recruitment efforts also are challenged by some businesses' perception that selling lottery products may not align with their business models.

#### **Key Initiatives and Goals**

The key strategy for licensing new Texas Lottery retailers requires continued focus on the needs and concerns of both traditional and non-traditional trade styles by providing innovation and enhanced services.

Working in coordination with NASPL and other U.S. lotteries, Texas recently implemented a 21-day pack settlement process for scratch tickets which aids some licensees in streamlining accounting and inventory reconciliation processes. This new settlement class is considered to be an imperative step toward expansion with non-traditional, national retailers who refuse to manage accounting functions differently across the jurisdictions where they operate. This standardized settlement process may also benefit existing licensees. The agency will continue to examine policies and procedures that can enhance the convenience of conducting lottery business transactions and mitigate identified barriers to lottery licensure.

The agency and the lottery operator, who is primarily responsible for retailer recruitment efforts, implement a strategy of encouraging non-lottery retailers to pilot lottery sales at a small number of their locations. This has created the opportunity for some chains in non-traditional trade styles to explore trial sales of the product to see the benefits and convenience of offering lottery to their customers without having to make a full chain commitment. Some recent pilot sales programs have led to expansion to new chain locations. These pilot efforts continue and discussions are ongoing with other businesses previously hesitant to embrace the lottery category.

Continued expansion of on-premise beer and wine service models at grocery and convenience stores presents unique licensure and administrative oversight challenges to the agency. The agency recognizes the significance of these challenges in these two primary lottery trade styles representing over 96 percent of current Texas Lottery sales and will continue to examine opportunities to adapt to these changes in the business landscape. The agency has recommended in its Strategic Plan the enactment of legislation to allow for continued licensure of these traditional lottery trade styles that now offer limited on premise beer and wine consumption.

Exercising the agency's core value of Customer Responsiveness, the processes for timely facilitation of information from retailer inquiries about becoming a lottery retailer are reviewed and revised on an ongoing basis. Recent collaboration with the lottery operator and agency staff yielded a streamlined communication model to enhance the distribution of potential-retailer inquiries received by claim centers and Lottery Operations to the lottery operator recruitment staff.

Regardless of the challenges or trade-style category, the Texas Lottery is invested in growing the licensed retailer base through sustained and strategic recruitment efforts in coordination with the lottery operator allowing for better product accessibility by a broad diversity of consumers and the potential for increased revenue to the state. From FY 2011 to FY 2015, the retailer base grew by an average of 115 retailers annually. Retailer expansion efforts in FY 2016 resulted in a net gain of 240 retailers due, in part, to acquisitions and new store openings by licensed chain retailers. It is anticipated that retailer growth in Fiscal Years 2017 and 2018 will be more in line with the recent historical average of 115. The agency is committed to working with the lottery operator and NASPL locally and nationally to identify and implement strategies to continue growth in the retailer base.

# RETAILER INCENTIVE PROGRAM

#### Background

The goal of the Texas Lottery's retailer incentive program is to optimize the value of funding allocated by the Texas Legislature for the program in order to generate incremental revenue for the state. The agency works to ensure that the program incentivizes licensed lottery retailers based on sales performance while mitigating financial risks associated with the program.

The Texas Lottery received authorization and funding from the Texas Legislature, via rider, for an additional one-half (0.5) percent allocation of gross sales for retailer 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 paid to retailers.

In determining the optimal structure for this program, the Texas Lottery engaged in a study of other U.S. 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

incentivizes retailers based exclusively on performance. The program has undergone modifications over the years to optimize the revenue benefit to the state.

The program is designed to allow for some modifications and supplemental features while maintaining the integrity of the basic structure. Currently, the program allows for the agency to implement a primary incentive program, traditionally 13 weeks in duration, while simultaneously introducing a secondary program of shorter duration focused on specific product sales performance. Two secondary programs have been previously implemented, both focused on increasing sales of the  $Pick 3^{TM}$  daily draw game.

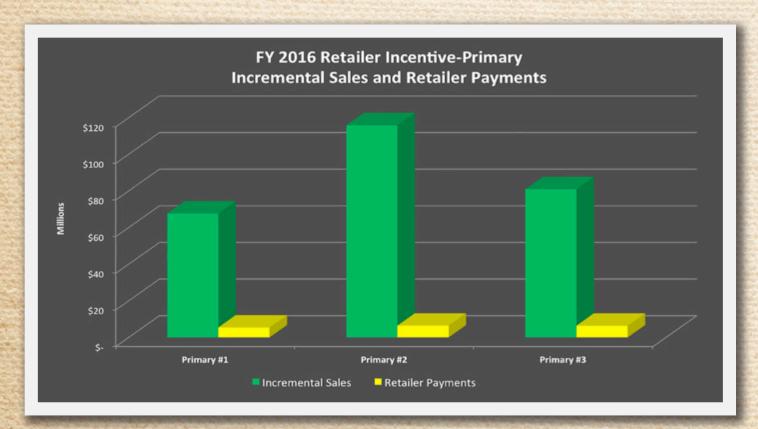
From inception of the program in September 2009, through the end of FY 2016, the agency has completed 20 individual primary retailer incentive programs plus two secondary programs. Qualifying retailers have generated more than \$1.47 billion in additional sales, yielding more than \$262.42 million in incremental revenue for the state. Based on their sales performance, these retailers received more than \$108.87 million in incentive payments.



While focusing on revenue generation, the agency has also designed the program to significantly mitigate risk to the state by focusing on same-store, year-over-year sales growth. Retailers receive incentive payments only if they meet their program sales growth goals, thus producing incremental sales and revenue for the state. In addition, each individual program incentive period 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 for a given period, all payments are reduced by an equal percentage in order not to exceed the allocated program budget. This ensures the agency does not exceed its appropriation for the overall program and allows for ongoing introduction of programs to encourage sales increases and incremental revenue to the state. Drawing entries and prizes included as a part of each incentive period are not impacted by the budget limitations, as they are accounted for as a part of the initial incentive period budget.

The chart below depicts the three primary incentive programs run during FY 2016. It illustrates the retailer payments made and the related incremental sales impact of each program.

# **FY 2016 Retailer Incentive Programs**



### **Challenges and Opportunities**

The Texas Lottery is a leader in the U.S. lottery industry in utilizing a sales performance-based program for retailer incentives based on true same-store sales performance. As an industry leader in this area, the agency continually evaluates its incentive programs to ensure their design is appealing to retailers, resulting in increased levels of participation, sales and revenue performance. The retailer participation rate has grown from 6 percent for the first incentive program, to an average of 46 percent for the three primary programs in FY 2016.

As new features and products are explored for inclusion in the incentive programs, the ability to provide retailers access to timely, comprehensive reporting on their progress toward incentive goals is critical to their participation and confidence in the integrity of the program. The agency will continue to collaborate with the lottery operator to develop and implement reporting tools and enhanced communication support for retailers related to the program. While retailer participation is important, the agency will continue to ensure that each program incorporates challenging retailer goals and focused product emphasis that will optimize revenue to the state.

#### **Key Initiatives and Goals**

The Texas Lottery has created a performance-based retailer incentive program with an emphasis on financial risk mitigation consistent with its core value of Fiscal Accountability. With this risk-averting structure in place, the ongoing goal of the agency is to optimize retailer participation and maximize the program's revenue generating benefits to ensure positive revenue from appropriated funding from the Texas Legislature. The agency will continue to accomplish these balanced objectives 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 which may impact future performance.

The agency is committed to achieving the program's goal by identifying opportunities to modify program parameters based on the results of past programs and new business environment variables 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 goal of the Texas Lottery's advertising efforts is to efficiently and appropriately engage in communication and education with the public about the numerous products offered by the agency each year. The agency makes considerable efforts to effectively allocate its advertising dollars to reach the public and enhance awareness of Texas Lottery games and remains committed to the goal of enhancing the efficiency of its advertising. The agency is also mindful of statutory provisions that guide the type of messaging the agency may 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-fifth of adult Texans who are not in favor of gaming in any form.<sup>1</sup>

### **Challenges and Opportunities**

The Texas Lottery's advertising budget has declined substantially over time. Concurrently, there have been dynamic changes occurring in the advertising industry, the state of Texas and the markets in which the agency must communicate about its products. The following table summarizes and compares the impact of these changes and some of the major challenges impacting the Texas Lottery's advertising communications over time.

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# Texas Lottery Advertising Overview December 2016

	FISCAL YEAR 1993	FISCAL YEAR 2016
Impact of Inflation	\$40 million base appropriated advertising budget	\$32 million base appropriated advertising budget \$40 million in 1993 dollars equates to \$66 million in 2016 Adjusted for inflation, \$32 million in 2016 equates to \$19.4 million 1993 dollars
	12.6 million Texans 18 or older	19.5 million Texans 18 or older
	\$3.17 ad spend per capita	\$1.64 ad spend per capita \$3.17 ad spend per capita in 1993 dollars equates to \$5.23 in 2016 Adjusted for inflation, \$1.64 in 2016 equates to \$0.99 in 1993 dollars
Increase in Products	Two products:  Lotto Texas Scratch games (2)	Ten products + 4 unique add-on features:  Pick 3 with Sum It Up!  Cash Five  Daily 4 with Sum It Up!  All or Nothing  Lotto Texas with Extra!  Texas Two Step  Mega Millions with Megaplier  Powerball with Power Play  Texas Triple Chance  Scratch games (approx. 90 launched annually)
Product Life Cycle	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.
Free Media Exposure	Extensive free coverage of winners, 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.

(Table continues on the following page)

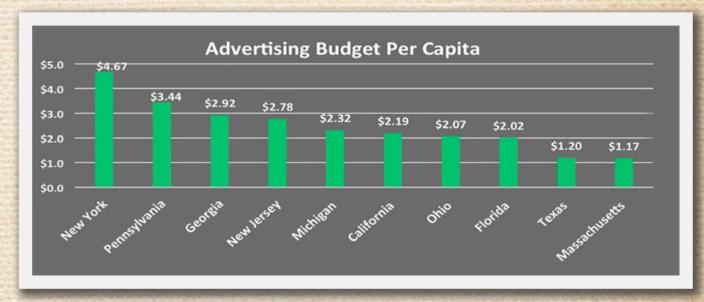
<sup>&</sup>lt;sup>1</sup> Respondents to the Q4 2016 Tracking Study who answered "agree" to "strongly agree" (ratings of 5, 6, and 7) with the statement "I am morally opposed to gambling in any form."

# Texas Lottery Advertising Overview December 2016 (cont'd)

	FISCAL YEAR 1993	FISCAL YEAR 2016
Texas Ethnicity	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 62 percent of the total 18-49 year old population, further solidifying its current minority-majority status in the years to come. <sup>1</sup> 1 Office of the State Demographer, "Population Projects for the State of Texas 2010-2050 by Single Years of Age"
Media Proliferation	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 is becoming more difficult to reach large groups of consumers for the same level of media expenditures.
Pay at the Pump	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.

#### **Key Initiatives and Goals**

The agency is committed to the goal of enhancing the efficiency of its advertising. This includes efforts to internally review and challenge past advertising strategies. By focusing, in coordination 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 2016 World Lottery Almanac, Texas ranks 39<sup>th</sup> of 44 reporting state lotteries in advertising budget per capita² and had the lowest per capita advertising spending among the top 10 performing U.S. lotteries³ as measured by total sales. See graph below.



Source: La Fleur's 2017 World Lottery Almanac

The agency also engages in efforts to seek input from third-party unbiased resources to evaluate the efficiency of the agency's advertising efforts. This includes the 2014 analysis of "The Impact of Advertising on Lottery Sales in the State of Texas," performed by the Texas A&M Mays Business School. Additionally, the agency procured vendor services in FY 2014 through FY 2016 to complete an advertising media review of the advertising services vendor's purchase and placement of advertising media to evaluate the efficiency of these expenditures. The Texas Lottery has applied recommendations from these efforts to subsequent media purchases and plans to undertake additional external advertising media reviews in an effort to identify further efficiency opportunities.

Additionally, the Texas Lottery has implemented a media placement verification program in response to a State Auditor's Office review of the agency's advertising contract. This verification program will provide assurance that purchased media is airing in market by third-party vendors consistent with agreed-upon placement requirements.

<sup>&</sup>lt;sup>2</sup> La Fleur's 2017 World Lottery Almanac, U.S. lotteries' FY 16 ad budgets as % of sales, p. 280

<sup>&</sup>lt;sup>3</sup> La Fleur's 2017 World Lottery Almanac, Worldwide Lotteries Ranked by 2016 Total Sales (excluding VLT revenue), p. 303

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 limited 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.

#### **Need For Budgetary Expansion**

General Appropriations Bill, Strategy A.1.8., Mass Media Advertising Contract(s) – The Texas Lottery's limited advertising budget acts as an impediment to reaching consumers about lottery products. The purchasing power and reach of the agency's mass media advertising budget has declined significantly over the 24 years of the agency's existence due to budget decreases, the effects of inflation and significant changes to the advertising media landscape. The agency's advertising budget appropriation has remained at \$32 million or less for 10 consecutive fiscal years. These realities have worked to limit the value of advertising expenditures. The agency has identified the following options for future consideration: 1) a new rider to appropriate advertising budget as a percentage of sales, or 2) an increase to the straight-line appropriation for advertising. Based on research performed by Texas A&M University evaluating the effectiveness of Texas Lottery advertising, the agency believes the benefits include additional generation of revenue for the Foundation School Fund and the Fund for Veterans' Assistance. However, the Legislature is currently considering significant reductions to the current advertising budget which would further limit agency advertising expenditures to communicate about its products.

#### **Experiential Marketing**

The Texas Lottery consistently adapts marketing strategies to evolve with the changing media landscape. As broadcast viewership declines, alternative cost-effective media strategies such as experiential destination and event marketing offer new opportunities to drive brand awareness and product education and/or trial. Experiential marketing engages the consumers in a fun and entertaining environment.

The Texas Lottery currently engages consumers directly through experiential marketing partnerships across the state. Marketing relationships with top-tier organizations allow the agency to leverage

consumer passion points such as sports (NASCAR®, NBA®, NFL®, MLB®, F1™) and music (Austin City Limits Live, Sound and Cinema and other music events) to reach adult Texans on the go.

#### **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 understands that the introduction of new technology for use with lottery games is a sensitive topic with many members of the public and is very mindful that the Texas Legislature provides the policy framework to administer the lottery. Therefore, the Texas Lottery strongly believes that any questions regarding the sale of lottery tickets via the internet are policy decisions to be determined by the Texas Legislature. Licensed Texas Lottery retailers are the only source for purchase

of Texas Lottery tickets, and those tickets must be purchased in-person at a licensed retailer location using one of the approved methods of play.

That said, the Texas Lottery does engage its players directly through an opt-in email or text messaging program that provides winning numbers, current estimated jackpot alerts, scratch ticket information and general news and alerts. The Texas Lottery also developed and launched a mobile application in September 2016 to increase the public's access to Texas Lottery game information and player support

services. Draw game players can now easily view current jackpot amounts and winning numbers on their mobile devices. Scratch ticket game players can use a locator to find retail locations that are carrying their favorite scratch ticket game. Players can scan both draw and scratch ticket games and use "Check Your Ticket" functionality. This feature provides an added layer of consumer protection as players now have the ability to conveniently verify the winning or non-winning



status of tickets on their mobile devices. The mobile app provides a convenient and fun platform for lottery players to access important lottery information.

The Texas Lottery's advertising expenditure goal is to achieve optimal efficiency in advertising spending to reach adult Texans and communicate effectively with them about the Texas Lottery and its many products. The agency continues to implement and evaluate new opportunities to enhance the efficiency of its advertising. The agency has also established strict advertising sensitivity guidelines to ensure that its advertising is not of a nature that unduly influences any person to purchase lottery products and that the nature of its advertising is representative of the integrity of the lottery brand. To this end, the agency works to communicate with its customers in a transparent fashion regarding product attributes while ensuring that it does not over-promise regarding participation in lottery games. The agency continues to develop new tools and resources, such as its mobile application, enhancements to its website, and information available at retail to help consumers make informed decisions regarding participation in its products.

# PRODUCT MIX AND GAME PORTFOLIO MANAGEMENT

### Background

The goal of the Texas Lottery's Product Mix and Game Portfolio Management program is to offer lottery players the best entertainment experience available through the responsible management and sale of its products to generate revenue for the state of Texas.

The Texas Lottery is situated in a mature market in which 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 has consistently ranked among the top-selling lotteries in the United States, ranking fifth and exceeded only by New York, California, Florida and Massachusetts.<sup>4</sup>

The *Games of Texas* are the body of products that the Texas Lottery makes available to the playing public. The Texas Lottery offers two product categories: scratch ticket games and draw games. The agency currently offers nine draw games, including four unique add-on features offered on five of its draw games, and approximately 90 scratch ticket games annually constituting the current game portfolio. New games and game enhancements are continually being developed to keep Texas Lottery games innovative and exciting for players.

### **SCRATCH TICKET GAMES**

Scratch ticket games are preprinted tickets with symbols hidden under a removable covering. The player scratches off the covering and determines instantly whether or not the ticket is a winner. Scratch tickets include a variety of themes, play styles, and prize structures in order to offer an attractive game mix to players. Scratch ticket games are offered across a range of price points from \$1 to \$50 and offer prizes ranging from \$1 to \$7.5 million.

While draw games have a set number of drawings scheduled each week, scratch ticket games offer the possibility of immediate winning experiences with cash and non-cash prizes. Most scratch 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.

#### **DRAW GAMES**

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 sales terminal by choosing the Quick Pick option. The Texas Lottery conducts independently certified drawings on a set schedule to determine a set of winning numbers for these types of games.

The Texas Lottery's current draw game offerings include two multi-jurisdictional games: Powerball with the add-on feature Power Play, and Mega Millions with the add-on feature Megaplier. The other games in the Texas Lottery's portfolio are unique to Texas and are operated by the Texas Lottery. These include 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, All or Nothing and Texas Triple Chance. Lotto Texas, Texas Two Step, Powerball and Mega Millions are rolling jackpot-style games. The remaining draw games are daily drawing games. These games feature fixed or pari-mutuel top prizes (non-rolling) and they are drawn at least once per day. The Texas Lottery conducts drawings for its games six days per week (Monday through Saturday). Some daily games are drawn up to four times daily.

The Texas Lottery applies a strategic, long-term view to the development of products and management of its scratch ticket and draw game portfolios. The agency plans its game portfolio at least one fiscal year at a time ensuring a range of well-planned product offerings for Texas Lottery players. A summary of scratch ticket and draw game challenges, opportunities, key initiatives and goals are outlined below along with efforts in the area of product portfolio support operations.

<sup>&</sup>lt;sup>4</sup>La Fleur's 2016 World Lottery Almanac. 24<sup>th</sup> edition. Edited by Terri Markle, Bruce La Fleur, and Byron La Fleur. Rockville, Maryland: TLF Publications, Inc., "Worldwide Lotteries Ranked by 2015 Total Sales (excludes VLT revenue)," p. 303.

#### **Challenges and Opportunities**

#### **SCRATCH TICKET GAMES**

The Texas Lottery's efforts to keep scratch tickets fresh and interesting for the consumer often must focus on unique opportunities to tweak existing game designs, incorporate new proprietary printing/production options to the tickets, and utilize well-recognized brands and licensed properties, 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.

#### **DRAW GAMES**

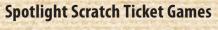
One of the most significant differences between the scratch and draw game playing experiences is the time that elapses between buying the ticket and finding out if the ticket is a winner. In addition, the development and introduction process for draw game concepts requires significantly more planning and lead time than scratch ticket games. New draw games and game changes typically require research, administrative rulemaking and extensive system software development. Draw games differ from scratch tickets, as scratch ticket games serve as their own communication vehicle or marketing due to visible placement at the point of purchase at retail. Draw game tickets are printed via a sales terminal upon a player request and are far more difficult to market requiring significant advertising support for game introductions and ongoing awareness. These additional requirements for draw games present challenges limiting the agency's ability to frequently introduce new games or make rapid changes to existing games.

Historically, draw games have relied primarily on jackpot levels to drive sales and revenue generation. 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 - \$2 wager.

#### **Key Initiatives and Goals**

#### **SCRATCH TICKET GAMES**

In order to be responsive to the changing tastes and preferences of consumers, the Texas Lottery must actively explore new scratch ticket game opportunities and unique product enhancements that hold the most promise for generating incremental revenue for the state. The agency has pursued the following scratch ticket game innovations in recent years and they will continue to be critical components of future success.



Utilizing industry best practices, a Spotlight or Mega game is a game that typically has a larger than normal print run with an increased prize payout. The larger quantity and increased payout allow for the creation of many "call-out" features on the front of the ticket that are appealing to players. The Texas Lottery successfully launched its first Spotlight game in FY 2009 at the \$20 price point. The agency continues to develop new versions of the Spotlight game concept and has extended the offering to the \$10 price point in recent years.

#### **Growth of Core Scratch 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 regularly produce new games. The Texas Lottery strives to identify unique products that both resonate with players and offer the potential to become core offerings. Examples of current core games are *Break the Bank* (\$2), *Weekly Grand* (\$2), *Bingo* (\$2 and \$5), *Crossword* (\$3, \$5 and \$10), *Loteria* (\$3, \$5 and \$10) and *Bonus Break the Bank* (\$5). The Texas Lottery will continue to identify games that it believes can achieve this level of player loyalty.

#### **Game Suites**

Game suites are a group of scratch ticket games with the same game theme and play style introduced across a variety of price points. The Texas Lottery has leveraged successful elements of its Spotlight games to enhance the appeal of suites. The prize structures for each of these games are designed so top prizes are higher than most other games at the same price point. The games are typically produced with larger print quantities to create a higher volume of prizes at specific prize tiers. Additionally, the use of the same game theme (or branding) across the suite allows the agency to place advertising support behind the games to promote the various attributes that may be appealing to players. The Texas Lottery introduces at least one game suite per fiscal year. In FY 2016, the HIT series was introduced and three of the games from that suite were included in the top 15 best-selling scratch games for the year.

#### **Play Books**

Play books (or Game Books) are a proprietary scratch ticket product produced by one of the Texas Lottery's scratch ticket manufacturing vendors, Pollard Banknote Limited. Just as its name suggests, a play book is a book of scratch ticket games combined and grouped with multiple pages. A play book typically sells for \$20 and the multiple games packaged together provide a value proposition to the player. The Texas Lottery launched its first-ever play book during the 2014 holiday season and it was very well received by players. The second version, *Holiday Game Book*, was introduced in October 2015.

#### **Oversized Tickets**

While the typical width of scratch tickets is four inches, oversized tickets range in width from eight inches to twelve inches and can be as long as sixteen inches. Oversized scratch tickets feature numerous



games creating play value for consumers. All three scratch ticket manufacturing vendors produce their own branded version of an oversized ticket. The Texas Lottery introduced its first oversized ticket, *Super Ticket 7's*, at the \$10 price point in spring 2015 and it quickly became the best-selling \$10 scratch ticket in the history of the Texas Lottery with over \$78 million in sales during the fiscal year. The agency continues to develop and launch oversized tickets with successful sales results and is planning its first oversized licensed property scratch ticket game launch in FY 2017.

#### **Multi-Cultural Games**

The population of Texas has grown more ethnically diverse over time and the state has reached minority-majority status in recent years. Hispanic population growth has been one of the significant contributors to this trend. The Texas Lottery is focused on ensuring that it offers games that are culturally relevant to all Texans in general and, in doing so, has also worked to ensure that it develops games that are culturally relevant to its Hispanic consumers in particular. The Texas Lottery began offering *Loteria*, a bingo-style game with historical roots in Mexico, several years ago. The game has been extremely popular with lottery players and the agency has expanded this category to a variety of price points (\$3, \$5 and \$10) and made *Loteria* a component of the agency's core scratch game offerings. The agency has also introduced other games with Spanish language titles, such as *Explosion De Dinero*, and launched its first-ever, fully Spanish language scratch ticket game, *Fiesta de Gananacias*, in spring 2017. These games have resonated very positively with consumers and the agency will continue to develop and introduce games in this space to appeal to the Texas Lottery's diverse customer base.

#### **Products Geared to Appeal to New Players**

As a mature 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 game (scratch and draw) offerings. Licensed/branded scratch ticket games and scratch ticket games that feature unique prizes represent a significant portion of the agency's strategy to reach new audiences.

**Licensed/Branded Games** – Well-recognized brands and licensed properties that have strong consumer affinity can reach consumers who may have lapsed in their lottery participation or who have not considered a lottery product trial in the past. The Texas Lottery has recently offered games featuring well recognized brands such as WWE®, MLB®, the Dallas Cowboys and the Houston Texans. The Texas Lottery has several new licensed/branded scratch ticket games in planning and under evaluation.

**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 tickets into promotional second-chance drawings. The Texas Lottery's new mobile application takes this convenience one step further and allows players to enter promotional second-chance drawings directly from their smartphones by simply scanning a barcode.

#### **Unique Production Features for Scratch Ticket Games**

While many of the game design changes made by scratch ticket manufacturers have been subtle, new production methods are available that can be marketed to consumers. One example that the agency has leveraged successfully is where the removable scratch covering 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 production method involves printing play areas on the front and back of tickets. This offers players more play action without increasing the size of the ticket.

All of these concepts have been highly successful in driving incremental sales and revenue for the portfolio in recent years and are a significant area of strategic focus for the agency in developing the scratch ticket portfolio each fiscal year. New variations on these concepts continue to be developed to capitalize on their popularity with players and agency staff continues to monitor the industry to identify new scratch game product innovations that can be offered in Texas to keep the games fun and fresh for Texas players such as:

**Pouched Tickets** - multiple tickets are combined in a cellophane pouch to create a value-added game for the player.

**Die Cut Tickets** – tickets can be shaped into designs other than the typical square or rectangular shape allowing the ticket to stand out from the others in the dispensers. The die cut shape typically ties to the theme of the game and/or playstyle.

**Break-Open Tickets** – similar to pull-tabs, perforated windows within the ticket design expose the scratch play areas. These tickets add motion and sound to the act of playing scratch tickets.

**Embossed Tickets** – scratch ticket paper stock can be embossed with almost any design which adds texture and provides a tactile difference for the players. Design elements such as this make the ticket unique and attractive to many players.

**Special Inks and Other Printing Options** – multiple unique ink and printing options provide various visual and tactile effects to make the games attractive including fluorescent inks, pearlescent inks, inks that feel like sand or water, inks that shine like metal or glow in the dark.

While continuing its focus on keeping administrative expenses in check, the agency will continue to evaluate and utilize these and other added-value features that may increase player enthusiasm and, in turn, produce additional game sales and revenue.

#### **DRAW GAMES**

The Texas Lottery has expanded the variety of draw game products that it offers to its customers in recent years, including the introduction of *Texas Triple Chance* and *All or Nothing*. However, draw games are limited in the variety of design options that result in truly new game concepts. With a full portfolio of draw game offerings, the Texas Lottery is working with the lottery operator to explore design modifications to existing games, new play types and add-on features while monitoring the industry for new draw game concepts that may appeal to Texas players. Areas of current focus are detailed below.

#### **Price Point Expansion**

Scratch ticket games have benefited greatly from the ability to offer players different value propositions across a wide variety of price points. This has proven to be a far more substantial challenge for the lottery industry for draw games, as multi-million dollar jackpots have been offered for years for a single dollar. However, growth in the price point offerings for draw games remains critical to the long-term success of this portion of the product portfolio. The Texas Lottery has invested significant time and resources working in this area.

Along with other U.S. lottery jurisdictions, the Texas Lottery participated in the expansion of the popular *Powerball* game from a \$1 to a \$2 price point in January of 2012. The Texas Lottery followed up on this effort by introducing the *All or Nothing* game at a \$2 price point. *All or Nothing* became the second \$2 game in the Texas Lottery's draw game portfolio and the first \$2 daily game. 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. The Texas Lottery introduced the third \$2 draw game, *Texas Triple Chance*, in September 2015. Due to the importance of draw game price point growth, the Texas Lottery remains committed to identifying new games that will resonate with Texas players at varying price points.

#### Multi-Jurisdictional Jackpot Game Portfolio Management

The multi-jurisdictional organizations that oversee *Powerball* and *Mega Millions* continue to evaluate opportunities to modify these games to ensure that their appeal is optimized with players. As a participant in both games, the Texas Lottery remains interested in actively participating in any future discussions involving changes related to the *Powerball* and/or *Mega Millions* games. Both games are significant contributors to draw game sales and the jackpots they are capable of generating can have a dramatic impact on fiscal year sales and revenue performance.

#### **Add-on and Wager Type Features**

Add-on features, such as *Megaplier*, *Power Play*, *Sum It Up!* 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.

The Texas Lottery is currently working with the lottery operator to evaluate and test add-on and play type features for the *Pick 3* and *Daily 4* games. Retailer and player research was conducted on a play type that is being offered in other lottery jurisdictions called "1-Off." "1-Off" has to be licensed by a third party vendor and the Texas Lottery had to evaluate the costs vs. revenue projections before determining whether to pursue this new wager type. The research did not yield results sufficient to warrant proceeding with this play type. The Texas Lottery, in conjunction with the lottery operator, is continuing to research other add-on features in FY 2017 to determine if they resonate with Texas players.

#### **Draw Game Cross Promotion**

The Texas Lottery has been successful in designing scratch ticket games that feature or highlight games from its draw game portfolio. A prize in these scratch ticket games is a free play in the associated draw game. These games have the beneficial effect of introducing scratch ticket game players to the Texas Lottery's draw game products. The agency launched an *All or Nothing*-themed scratch ticket game in the summer of 2014 and is working on plans to launch a scratch ticket based on the popular daily game *Pick* 3. The agency will continue to identify opportunities to cross-promote scratch and draw games.

#### **Game Modification Research**

Cash Five is a mature game that has experienced sales declines over time. The Texas Lottery worked with the lottery operator and conducted research in FY 2016 to gauge player and retailer interest in potential game modifications. The research results demonstrated limited potential for a game replacement. The Texas Lottery will continue to work with the lottery operator on the design and testing of new game matrices for certain Texas-based draw games, including Texas Two Step, in FY 2017 to identify games that might benefit from a refreshed matrix and/or playstyle.

#### Packaged Draw Game Play (Lone Star Lineup)

The Texas Lottery ended FY 2016 by putting the finishing touches on a package of draw games for ease of purchase by players. *Lone Star Lineup* allows the agency to promote lesser played daily games and potentially expand draw game product trial. The lottery has little control of the multijurisdictional jackpot games that are mainly driven by large jackpot rolls and will look to promote daily in-state draw games with increased visibility with vehicles like *Lone Star Lineup*. This promotional bundle offers players \$6 worth of plays for \$5 and includes *Pick 3*, *Daily 4*, *All or Nothing*, *Cash Five* and *Texas Triple Chance*. This initiative required a significant software development effort and the promotion launched on September 2016. The *Lone Star Lineup* software design allows the flexibility to rotate games in and out of the package based on draw game strategic plans for the fiscal year.

#### **Draw Game Promotions**

The scratch ticket portfolio has been successful by utilizing licensed properties and brands that are well-known and have strong customer loyalty. Many of these licensed property games involve second-chance promotional drawings to giveaway experiential prizes. In FY 2016, the Texas Lottery

executed a contract with Alchemy 3 to run a *Powerball* Power Cruise promotion. During the planned 2017 promotion, players can enter their *Powerball* tickets to collect symbols and earn entries into drawings for a chance to win an exclusive cruise trip. These promotions allow draw games to leverage popular brands in the same way that scratch tickets have. The agency is working with the lottery operator and Alchemy 3 on the necessary programming for the Luck Zone and the Texas Lottery app in order to launch this promotion in 2017.

#### **Texas Lottery App**

With a focus on player convenience, the Texas Lottery spent a large amount of time and effort in FY 2016 working towards the introduction of a new mobile app in FY 2017. The app allows users to scan and check tickets for winning status, create and save their favorite numbers so that a Texas Lottery retailer can scan the QR code and print a draw game ticket for purchase, view current jackpot amounts and winning numbers, scan tickets to enter promotional second-chance drawings, and locate the nearest lottery retailer. This initiative illustrates the agency's commitment to convenience but also to security and integrity as players now have the ability to use the app to see if their ticket are winners.

The agency places a significant emphasis on player education and clear communication about its products. The agency works to achieve transparency across all of its operations emphasizing security and integrity and working to maintain the public's trust and confidence in the operation of all lottery games. These efforts, combined with the agency's approach to strategically planning the game portfolio and product mix, optimizes the agency's sales and revenue generation ability. This rigorous process focused on continually improving Texas Lottery products allows the agency to consistently deliver entertaining lottery products for lottery players.

While the agency has achieved substantial growth in scratch game sales, the draw game portion of the portfolio presents a more significant challenge to sales growth and expansion over time. The initiatives detailed above have and will contribute to the agency's efforts to maintain sales levels for the draw game portfolio. Promoting new player product trial and keeping the category fresh and new for existing players remains critical to achieving the agency's mission.

#### GROSS SALES AND NET REVENUE

#### Background

The goal of the Texas Lottery's efforts to increase Gross Sales and Net Revenue are directly consistent with its mission 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.

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#### **GROSS SALES**

Gross sales increases alone do not ensure net revenue growth. However, in an environment of Fiscal Accountability, gross sales are tied to net revenue as a critical driver in generating incremental monies for public education, veterans' assistance and other worthy state causes.

Since FY 2009, the Texas Lottery has experienced significant sales growth. Several different strategic sales initiatives contributed to this achievement, including innovations to the stratch ticket portfolio, 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. The table below illustrates the growth in sales over the three most recent full fiscal years.

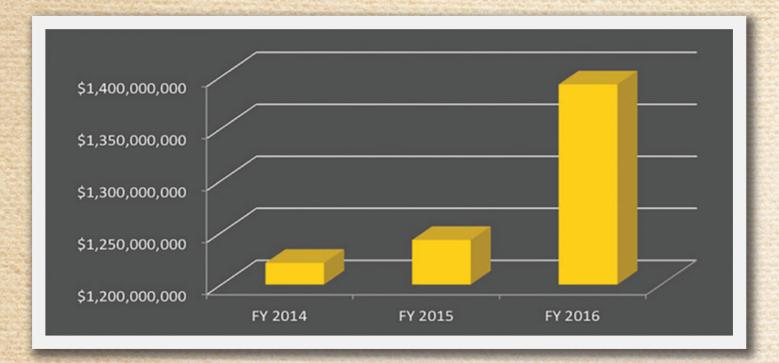
	SALES ACTUAL	SALES ACTUAL	SALES ACTUAL
	FY 2014	FY 2015	FY 2016
	(IN MILLIONS)	(IN MILLIONS)	(IN MILLIONS)
Total Sales	\$4,384.60	\$4,529.70	\$5,067.52

#### **NET REVENUE**

The Texas Lottery's primary goal is to generate net revenue for the state. Every agency program, goal and initiative is designed directly or indirectly 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*. While investing in these important areas of the agency regulatory and operational responsibilities, the agency places a significant emphasis on administrative efficiency.

The agency's continued focus on fiscally responsible operations help convert the benefits of gross sales increases to net revenue contributions. These efforts culminated in a record revenue year in FY 2016, with total transfers to the state exceeding \$1.39 billion, marking the  $13^{th}$  consecutive year the Texas Lottery has generated more than \$1 billion in contributions to the state of Texas. In FY 2016, \$1.37 billion went to the Foundation School Fund and \$14.7 million was transferred to the Fund for Veterans' Assistance, administered by the Texas Veterans Commission. Over the last three years, lottery net revenue transfers have averaged 4.79 percent growth annually. (See graph on next page.)

#### **Total Transfers to State**



#### **Challenges and Opportunities**

#### **GROSS SALES**

While proud of the agency's sales results over the last several years, the agency recognizes these sales levels will be challenging to sustain. Due to the variability of sales of the multijurisdictional jackpot games, it is anticipated that draw game sales and revenue will decline from FY 2016 levels. The Texas Lottery faces competition from other gaming activities, both legal and illegal, in Texas and in surrounding states. The Texas Lottery is also a mature lottery offering a full suite of scratch ticket games with price points ranging from \$1 to \$50 along with nine different draw games, including a wide selection of daily draw games and in-state and multijurisdiction 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, the Legislature is contemplating significant reductions to the agency's advertising budget and may not approve a scratch ticket budget rider that would allow the agency to continue to bring new, innovative scratch ticket products to lottery customers. These deliberations have not concluded at the time of this writing and all agency projections related to Gross Sales and Net Revenue are based on continued funding of the agency's advertising budget at current funding levels and approval of the scratch ticket rider. These projections would be significantly altered if the situation changes.

#### **NET REVENUE**

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-plus 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. 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.

#### **Key Initiatives and Goals**

The Texas Lottery establishes key strategic initiatives and goals that emphasize Gross Sales and Net Revenue expansion and continue the agency's commitment to efficient, responsible operations.

#### **GROSS SALES**

Texas Lottery gross sales have benefited from the agency's continued focus on key initiatives and goals that have been implemented in recent years, including changes to the lottery operator contract, launching and continuing to enhance the Retailer Incentive Program, and the implementation of several product initiatives that have helped to fill out and supplement the product portfolio. It should be noted that the most significant sales benefits of these initiatives have already been achieved.

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, competition from other forms of gaming, weather conditions, and the level of jackpots on certain draw product offerings (jackpot "rolls"). The agency is focused on goals tied to agency performance, with an emphasis on controllable variables that influence the outcome of these goals.

These include the following goals, which are detailed earlier in the Business Plan along with planned Action Items:

- Retailer Distribution Product 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.

The agency recognizes that future growth related to these goals will occur through execution at a more tactical level.

At the time of this writing, the agency anticipates FY 2017 sales, while significantly exceeding FY 2015 sales, will fall below FY 2016 gross sales levels. The agency has achieved strong growth in its scratch product category in FY 2017 and anticipates record sales in that category once again. However, the agency has struggled to match the draw product sales achieved in FY 2016, which were fueled by a \$540 million Mega Millions jackpot and the world record \$1.6 billion Powerball jackpot. It is anticipated that the agency will continue to achieve strong sales growth in the scratch product category during FY 2018 while maintaining draw game sales at similar levels to those anticipated for FY 2017. The agency recognizes that future growth will occur through execution at a more tactical level related to the performance factors in this plan. The agency's FY 2018 sales performance goals based on these factors are detailed in the chart below.

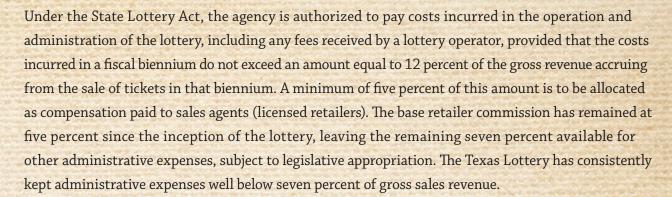
## **Sales Projection Table**

	SALES ACTUAL FY 2016 (IN MILLIONS)	SALES PROJECTION FY 2017 (IN MILLIONS)	SALES GOAL FY 2018 (IN MILLIONS)
Scratch Product	\$3,715.81	\$3,812.05	\$3,964.53
Draw Product	\$1,351.71	\$1,092.41	\$1,092.41
Total Sales	\$5,067.52	\$4,904.46	\$5,056.94

#### **NET REVENUE**

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.)



The agency has a keen focus on its day-to-day administrative expenses, and this focus continues to yield efficiencies over time. However, as noted previously, limited opportunities exist in the near term for significant cost reductions that might yield further administrative efficiencies. The agency will continue its commitment to determining new ways to achieve greater efficiency in its operations for the benefit of the state.

The agency is confident in its ability to continue to generate significant revenue for the Foundation School Fund, the Fund for Veterans Assistance and other state programs. The agency expects a slight decrease in net revenue contributions to the state in FY 2017, as the year thus far has lacked substantial jackpots that drive significant draw game sales such as those seen in FY 2016. Net revenue for FY 2018 is expected to resume the net revenue growth trajectory that the agency has achieved in recent years driven by continued development of innovative scratch products. Projected revenue is detailed in the chart below.

## **Revenue Projection Table**

	REVENUE ACTUAL FY 2016 (IN MILLIONS)	REVENUE PROJECTION FY 2017 (IN MILLIONS)	REVENUE GOAL FY 2018 (IN MILLIONS)
Total Revenue	\$1,392.31	\$1,281.00	\$1,312.01















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