



# TEXAS LOTTERY COMMISSION

2016 COMPREHENSIVE BUSINESS PLAN  
AND ANNUAL REPORT

# Table of Contents

## SECTION 1: ANNUAL REPORT

Message from the Chairman .....	4
Message from the Executive Director .....	5
Texas Lottery Commission Overview: History .....	6
Meet the Commissioners .....	7
Texas Model: Management and Organizational Structure .....	8
Executive Summary: Commitment to Texans .....	10
Vision Mission and Core Values .....	11
Instant Product and Draw Product Highlights .....	12
Draw Game Overview .....	14
Sales and Revenue Product Performance Charts .....	16
Benefiting Texans .....	20
Where the Money Goes .....	21
Players .....	22
Retailers .....	24
Social Responsibility.....	26

## SECTION 2: KEY BUSINESS PERFORMANCE FACTORS

Opening Narrative.....	29
Percentage of Retailers Satisfied with the Texas Lottery.....	30
Percentage of Licensees with No Recent Violations .....	32
Percentage of Bad Debt to Lottery Sales .....	35
Dollars Collected Via the Debt Set-Off Program .....	37
Retailer Distribution Channel Expansion .....	38
Retailer Incentive Program .....	41
Advertising Expenditures and Efficiency.....	43
Product Mix and Game Portfolio Management .....	49
Gross Sales .....	62
Net Revenue .....	65

# TEXAS LOTTERY COMMISSION

## 2016 COMPREHENSIVE BUSINESS PLAN AND ANNUAL REPORT

## SECTION 1: ANNUAL REPORT



# OPENING LETTERS

## MESSAGES FROM THE CHAIRMAN & EXECUTIVE DIRECTOR

### Commissioners:

J. Winston Krause,  
Chairman

Jodie G. Baggett

Jeff Meador

John W. Townes, III

Mary Ann Williamson



## TEXAS LOTTERY COMMISSION

Gary Grief, Executive Director    Alfonso D. Royal III, Charitable Bingo Operations Director



The Texas Lottery has enjoyed record-breaking sales and revenue results for the past several years. Having served as a member of the Texas Lottery Commission since 2009, I am proud of the agency's work in fulfilling its mission to generate revenue for public education, veterans' assistance and other worthy state causes. Beginning with the first ticket sold in 1992 through the end of the most recent fiscal year in 2014, the Texas Lottery has generated more than \$22 billion in revenue for the state of Texas.

The Lottery Commission's Sunset legislation enacted by the 83<sup>rd</sup> Legislature included a provision establishing a 10-member legislative review committee to study the impact of eliminating the state lottery and the revenue impacts of doing so. The Committee issued its report in November 2014 stating "the loss

of state funding for education and other valuable programs and the loss to Texas businesses would be gravely detrimental to the state," and concluded "the Legislature should continue the Texas Lottery."

The Texas Lottery continues to set new standards of excellence in its mission to generate revenue for the state of Texas. The Texas Lottery continues to contribute more than \$1 billion annually to the Foundation School Fund, administered by the Texas Education Agency. 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-off games with proceeds dedicated to the Texas Veterans Commission administered Fund for Veterans' Assistance. Through Fiscal Year 2014, the Texas Lottery has generated more than \$39 million in revenue to the fund for the benefit of Texas veterans and their families.

This Comprehensive Business Plan and Annual Report will illustrate the record achievements attained over the past several years, but more importantly it details the business plan goals and key performance factors that are used to measure that success. The Texas Lottery's success story is not just in the numbers, but in the statewide impact to our retailers, prizewinners, vendors, employees and, most importantly, public education and veterans' assistance.

J. Winston Krause, Chairman



### Commissioners:

J. Winston Krause,  
Chairman

Jodie G. Baggett

Jeff Meador

John W. Townes, III

Mary Ann Williamson



## TEXAS LOTTERY COMMISSION

Gary Grief, Executive Director

Alfonso D. Royal III, Charitable Bingo Operations Director



The staff of the Texas Lottery is pleased to present the Texas Lottery's Fiscal Year 2016 Comprehensive Business Plan and Annual Report. This report details the results of the Texas Lottery's most recent full fiscal year in 2014, but more importantly it communicates who we are, our role in the Texas economy, and the agency's business plan for executing its mission in the coming years.

Before you learn more about the Texas Lottery, we want to share with you a few key facts. We are excited to report that FY 2014 was the 11<sup>th</sup> consecutive year that the Texas Lottery generated more than \$1 billion in contributions to the state of Texas. The Texas Lottery continues to succeed in its mission to generate revenue for the state of Texas, primarily supporting two good causes dear to the hearts of many Texans: **Public Education** and **Veterans' Assistance**.

By any measure, FY 2014 was the most successful year in the history of the Texas Lottery. The agency achieved record sales and revenue transfer levels. We reached these accomplishments through our ongoing commitment to our Core Values and by maintaining a laser focus on our mission to generate revenue for the state of Texas through the responsible management and sale of entertaining lottery products.

The agency was fiscally responsible in our expenditures and in structuring our contracts with outside vendors, achieving one of the lowest administrative expense rates as a percentage of sales (4.61 percent) in the U.S. lottery industry. This rate continues to be well below the 7 percent allowed by statute.

The instant (scratch-off) product category continues to be the primary driver of lottery sales growth with the category providing 1.8 percent growth in sales. The category set a sales record for the 5<sup>th</sup> consecutive year with \$3.28 billion in sales. The Texas Lottery also paid out \$2.74 billion in prizes to lottery players and record commissions and bonuses to our more than 17,000 valuable retailer partners.

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

Nationally and globally, the Texas Lottery continues to take a leadership role as a member of the two largest multi-jurisdictional lottery organizations, the North American Association of State and Provincial Lotteries (NASPL) and the Multi-State Lottery Association (MUSL). I am proud to serve as Chair of the MUSL Powerball Game Group and Immediate Past President of NASPL.

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

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

Gary Grief, Executive Director

## TEXAS LOTTERY COMMISSION OVERVIEW

### *Texas Lottery Commission History*

The Texas Lottery was established through a vote of the Texas Legislature and Texas voters in 1991 and began sales operations on May 29, 1992, under the oversight of the Texas Comptroller of Public Accounts. On September 1, 1993, the Texas Lottery Commission was created as a standalone agency to administer the Texas Lottery. The Legislature also transferred regulatory authority for charitable bingo to the Texas Lottery Commission on April 1, 1994. The State Lottery Act gives both the Commission and the executive director broad authority, together with the responsibility to exercise strict control and close supervision over all lottery games conducted in Texas to promote and ensure integrity, security, honesty, and fairness in the operation and administration of the lottery. The five-member Commission sets policy, adopts all rules for the agency, 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



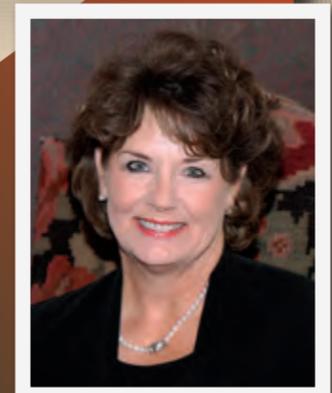
Mary Ann Williamson



J. Winston Krause, *Chairman*



John W. Townes, III



Jodie G. Baggett



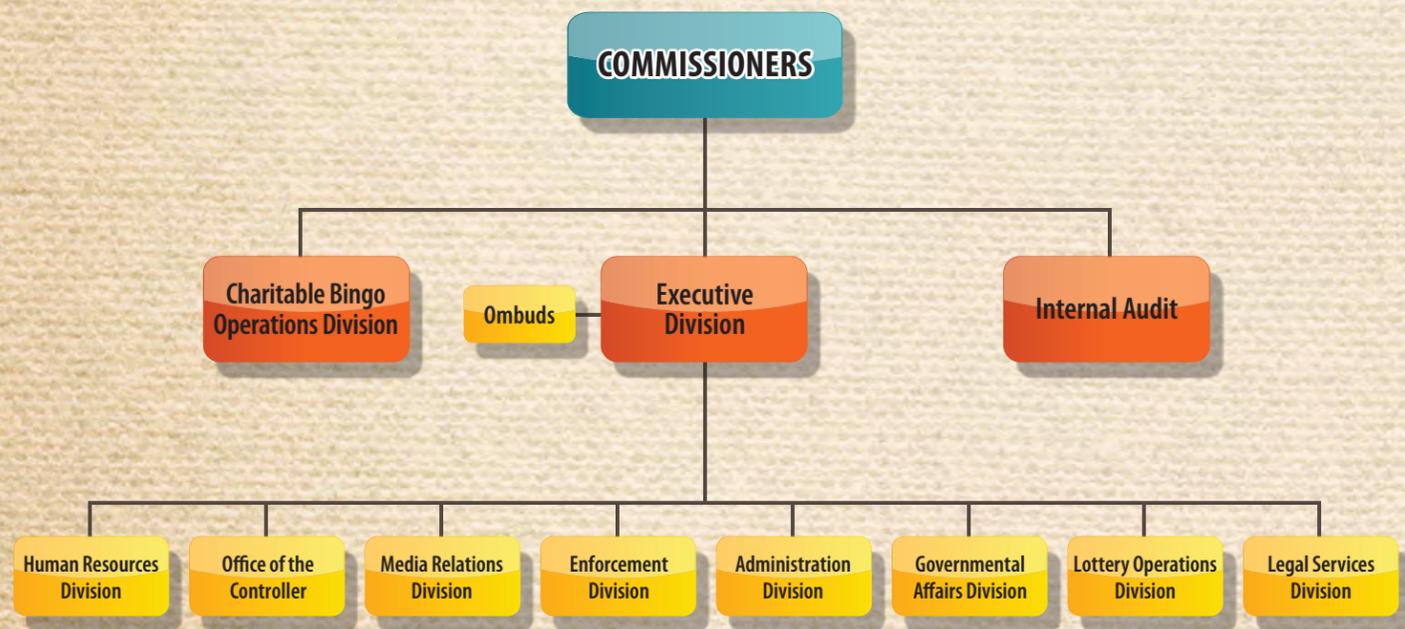
Jeff Meador

# TEXAS MODEL – IT WORKS FOR TEXAS!

## Management and Organizational Structure

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

### Texas Lottery Commission Organizational Chart

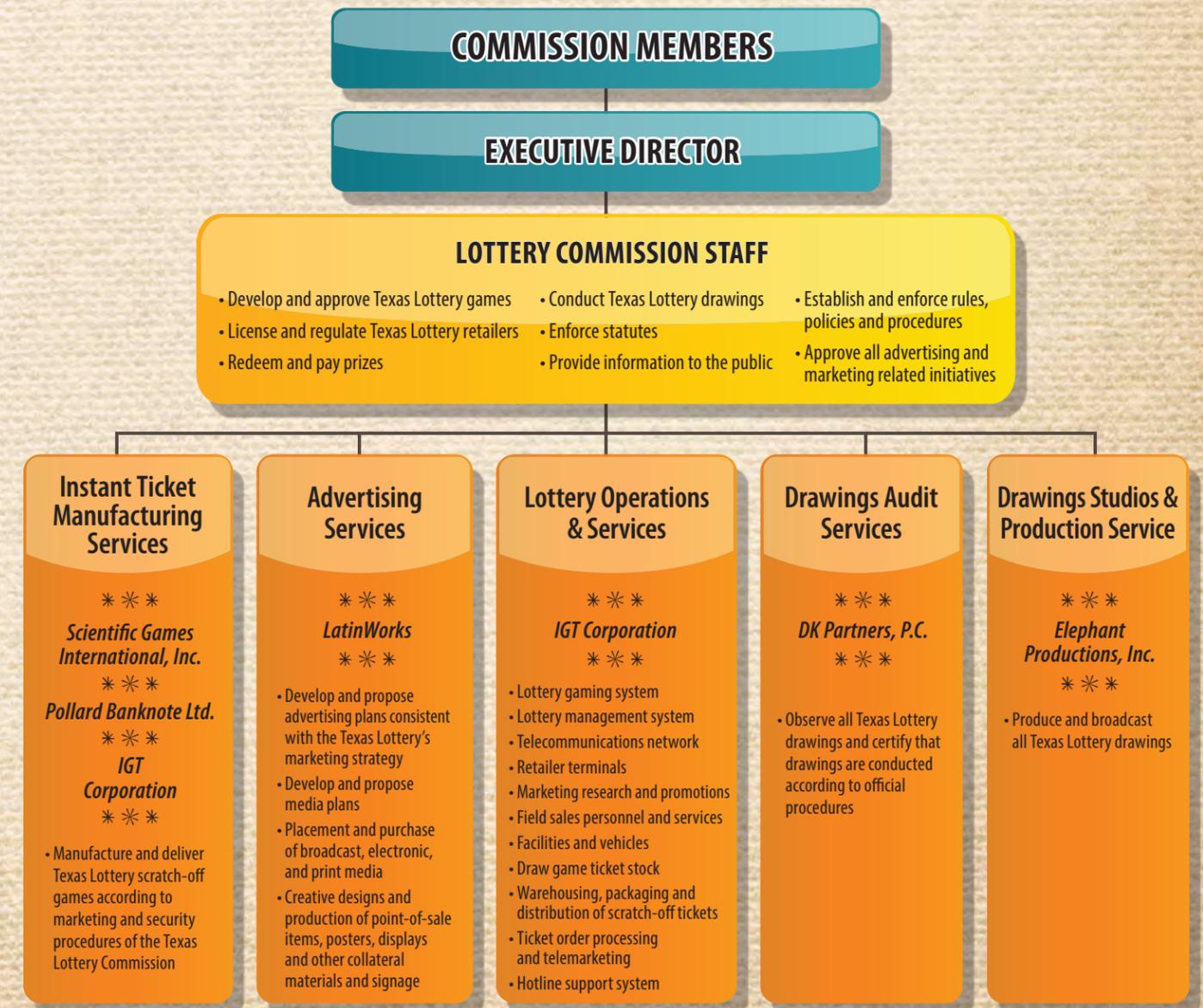


What sets the Texas Lottery Commission apart from other North American lotteries is the unique public-private structure of the agency. The members of the original Implementation Task Force of the Texas Lottery were the architects of what has become known within the lottery industry as the “Texas Model.” 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 work force as compared to similarly sized lotteries (e.g., California and Florida)
- Incentivized sales organization
- Enhanced resource allocation capabilities associated with market change
- Greater flexibility in customer responsiveness

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



# EXECUTIVE SUMMARY

## **Commitment to Texans**

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

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

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

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

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 high level of support for Texas education, Texas veterans and other good causes in the coming years. Concurrently, the agency is respectful of and sensitive to the viewpoints of those Texans who are not in favor of gaming. Therefore, this document highlights FY 2014 results and lays out initiatives carefully designed to ensure continued optimal revenue generation for the state of Texas in FY 2016, while being mindful of all viewpoints.

## VISION

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

## MISSION

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

## CORE VALUES

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

# INSTANT PRODUCT AND DRAW PRODUCT HIGHLIGHTS



**September 9, 2013:** Pick 3™ and Daily 4™ drawings are expanded from two to four times a day every Monday - Saturday.



**September 9, 2013:** Capitalizing on the brand equity of the Weekly Grand game, the Weekly Grand suite launches featuring annuity games at the \$1, \$2, \$5 and \$10 price points.



**October 3, 2013:** All or Nothing™ game is recognized as the "Best New Online Game" at the North American Association of State and Provincial Lotteries (NASPL) Annual Trade Show and Conference in Rhode Island.



**October 19, 2013:** Mega Millions game changes featuring larger starting and faster growing jackpots, a \$1 million second-tier prize and better odds of winning any prize. The Megaplier® add-on feature is also expanded to include a 5X multiplier meaning players can win up to \$5 million without winning the jackpot.



**November 4, 2013:** 10<sup>th</sup> edition of the Veterans Cash game introduced to honor Veterans Day.

**December 17, 2013:** The Mega Millions jackpot advertised at \$636 million is the 2<sup>nd</sup> highest jackpot ever reached for the Mega Millions game and the 2<sup>nd</sup> highest lottery jackpot in North American history. After sales are totaled, the actual jackpot is \$648 million.

**December 30, 2013:** Introduction of the new multiplier suite of games begins with the full introduction completed in January. This major product initiative is supported with a full advertising campaign and the suite yields extraordinary sales performance.



**January 22, 2014:** The Power Play® feature of the Powerball® game is modified with a new multiplier feature. The second-tier Power Play prize becomes a set \$2 Million.

## Achieving our Mission and Breaking Records!

Record Instant Product Sales  
**\$3.28 billion**

Record Total Product Sales  
**\$4.38 billion**

Record Revenue Transfers to the Fund for Veterans Assistance  
**\$11.5 million**

Record Revenue Transfers to the Foundation School Fund  
**\$1.20 billion**

Record Revenue Transfers to the State  
**\$1.22 billion**

**July 21, 2014:** \$200,000,000 Cash Blowout, the newest \$10 Spotlight game is introduced. This spotlight game features ten \$1,000,000 top prizes and ten \$100,000 second-tier prizes.



**July 21, 2014:** The Dallas Cowboys and Houston Texans games launch and feature one-of-a-kind experiential prizes as well as season tickets and autographed jerseys.



**June 27, 2014:** Texas sells its 11<sup>th</sup> Mega Millions® jackpot ticket worth \$33 Million.



**June 9, 2014:** 10X Super Fast Cash launches featuring Dream Racing experiences and Circuit of the Americas prize packages.



**April 28, 2014:** Texas Dream Home begins and offers players a second-chance to win \$500,000 to build a DR Horton® Dream Home, room makeovers or The Home Depot® Gift Cards.



**March 3, 2014:** On the Money, the first non-military themed game that benefits the Fund for Veterans Assistance, launches with a call-out on the front of the ticket, "Helping Texas Veterans." This new strategy helps the Texas Lottery and Texas Veterans Commission reach record revenue return to the Fund for Veterans Assistance.



## Powerball and Mega Millions

Powerball and Mega Millions are the two multi-jurisdictional, rolling jackpot games played across the nation. Each game has its own add-on multiplier feature that allows players to increase their non-jackpot prizes – Power Play and Megaplier. Due to the design of each base game, both Powerball and Mega Millions have the ability to generate jackpots in the hundreds of millions of dollars, which garner national media attention and player interest while having a dramatic impact on sales. The Mega Millions game was modified in October 2013 with changes featuring larger starting jackpots, faster growing jackpots, a \$1 million second tier prize and better

odds of winning any prize. The Megaplier add-on feature was also expanded with the addition of a 5X multiplier meaning players can win up to \$5 million without winning the jackpot. Both Mega Millions and Powerball game sales performance are highly dependent on jackpot levels. FY 2014 was a successful year for Mega Millions with large jackpots driving sales performance, while Powerball had just the opposite experience with a lack of high jackpots during the fiscal year. The Multi-State Lottery Association (MUSL) is currently researching possible changes to the Powerball game in an effort to boost jackpots and create added-value for players.



## Lotto Texas®

Lotto Texas was the first draw game introduced in Texas in November 1992. It is Texas' original in-state rolling jackpot game with jackpots now starting at \$5 million and an add-on feature called Extra! Lotto Texas is a mature game that has experienced sales declines over time, but the game maintains a relatively loyal following. With the large jackpots often generated by the multi-jurisdictional games, smaller in-state rolling jackpot games like Lotto Texas often struggle to compete and be relevant. However, Lotto Texas maintains the fourth highest draw game sales position with FY 2014 sales totaling \$154.3 million.



## Texas Two Step®

Texas Two Step is also an in-state rolling jackpot-style game similar to Lotto Texas but on a smaller scale, with jackpots starting at \$200,000. Texas Two Step has a loyal player base and experiences consistent sales at lower-level jackpots. Like other jackpot games, as the jackpot climbs, sales increase. Texas Two Step produces the most jackpot winners in Texas each year with FY 2014 boasting 35 winning jackpot tickets sold.



# DRAW GAME OVERVIEW

## SUMMARY OF TLC DRAW GAME PORTFOLIO



### 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 the best overall odds (1 in 4.5) of any Texas draw game and 10 ways to win a prize. Players embraced the game and it generated \$63.6 million in sales in its first year. Due to a game design issue that was brought to the agency's attention by IGT Corporation, sales were suspended from June to August 2013 so rule changes could be made that implemented a liability cap and protected the Lottery's financial integrity. The All or Nothing game delivered \$46 million in FY 2014 and the decline is attributed to the sales suspension period for the game.

### Cash Five®

Cash Five is the agency's five-digit daily game with a roll-down feature. When there is not a top-prize ticket sold for a drawing, the prize funds allocated to the top-prize tier "roll-down" to the second prize tier and that prize amount increases accordingly. Cash Five was originally introduced in 1995 and was modified in 2002. It is also a mature game that has been experiencing sales declines. The agency continues to evaluate this game for modification and/or replacement and expects to conduct game research in FY 2016. Other new game introductions and national draw game initiatives have taken precedence over Cash Five changes based on their revenue potential. Game alternatives will be pursued when appropriate based on individual draw game and portfolio performance.

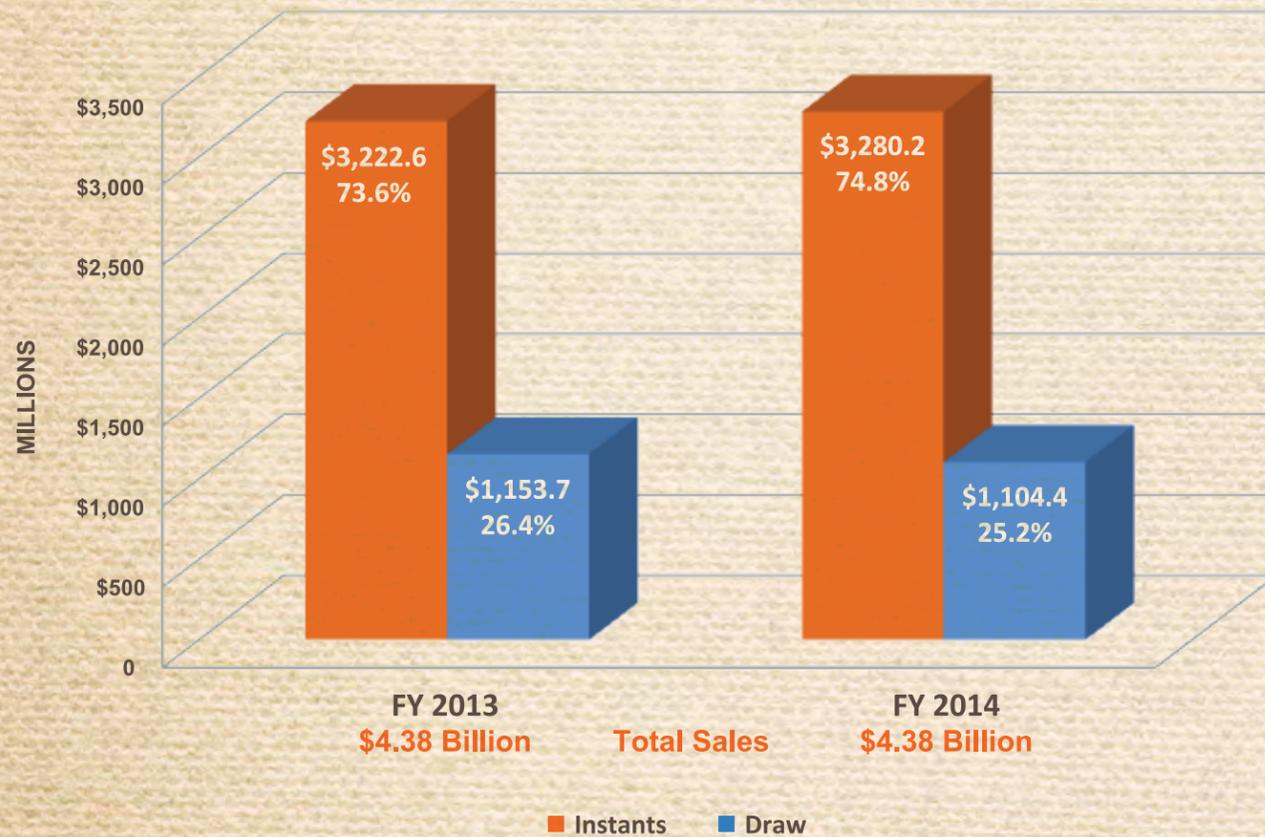
revenue goals. Daily 4 has experienced sales growth every year since its introduction in 2007. While sales of the Daily 4 game have increased, there have been slight annual declines in Pick 3 sales performance. It is believed that Pick 3 players are migrating to Daily 4, a trend being experienced with similar games 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 is being considered for both Pick 3 and Daily 4 with the possibility of player and retailer research occurring some time in FY 2015.

### Pick 3 and Daily 4

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 2014 as Pick 3 surpassed all other draw games including both multi-jurisdictional rolling jackpot games. Pick 3's sales success, \$259 million this past year, illustrates that non-jackpot style games are well-received by players and are a critical component of the portfolio for reaching sales and

### Texas Lottery FY 2014 Sales Comparison

through 08/31/2014 (in Millions)



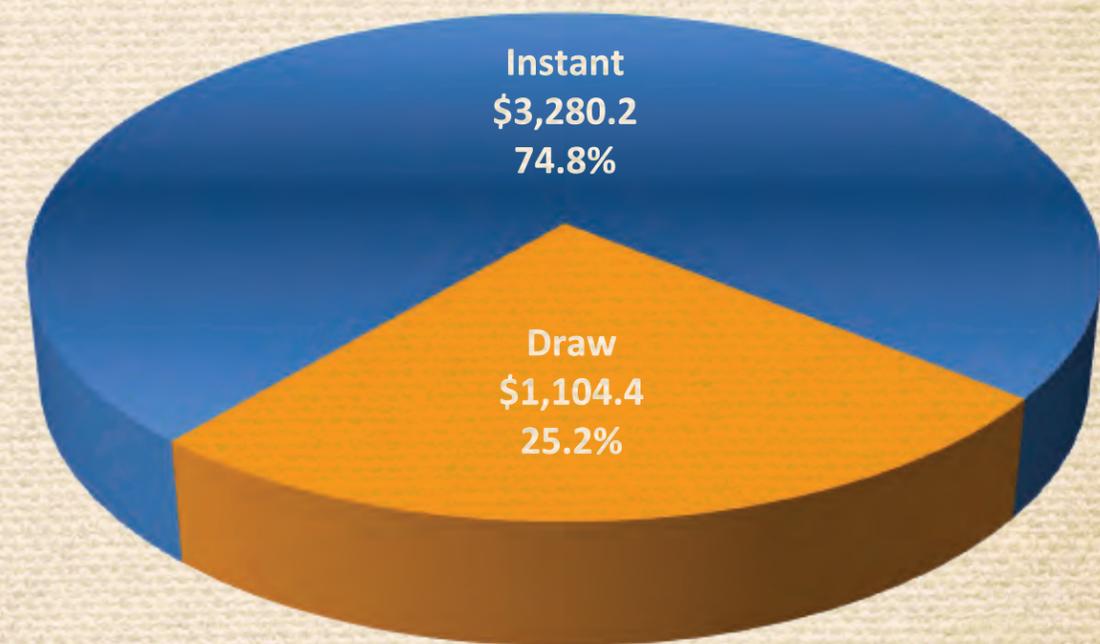
#### Sales Comparison

For FY 2014, the Texas Lottery recorded \$3.28 billion in instant (scratch-off) ticket sales, an increase of more than \$57 million and a new sales record that marked the best year of instant ticket sales in the history of the agency. Draw sales concluded the fiscal year with \$1.10 billion in total sales, a decline of approximately \$50 million that can mainly be attributed to a lack of large jackpots on the *Powerball* game.

Total product sales for FY 2014 set an all-time sales record of over \$4.38 billion, exceeding the sales record set in FY 2013 by \$8.3 million.

### Texas Lottery FY 2014 Sales by Game

through 08/31/2014 (in Millions)



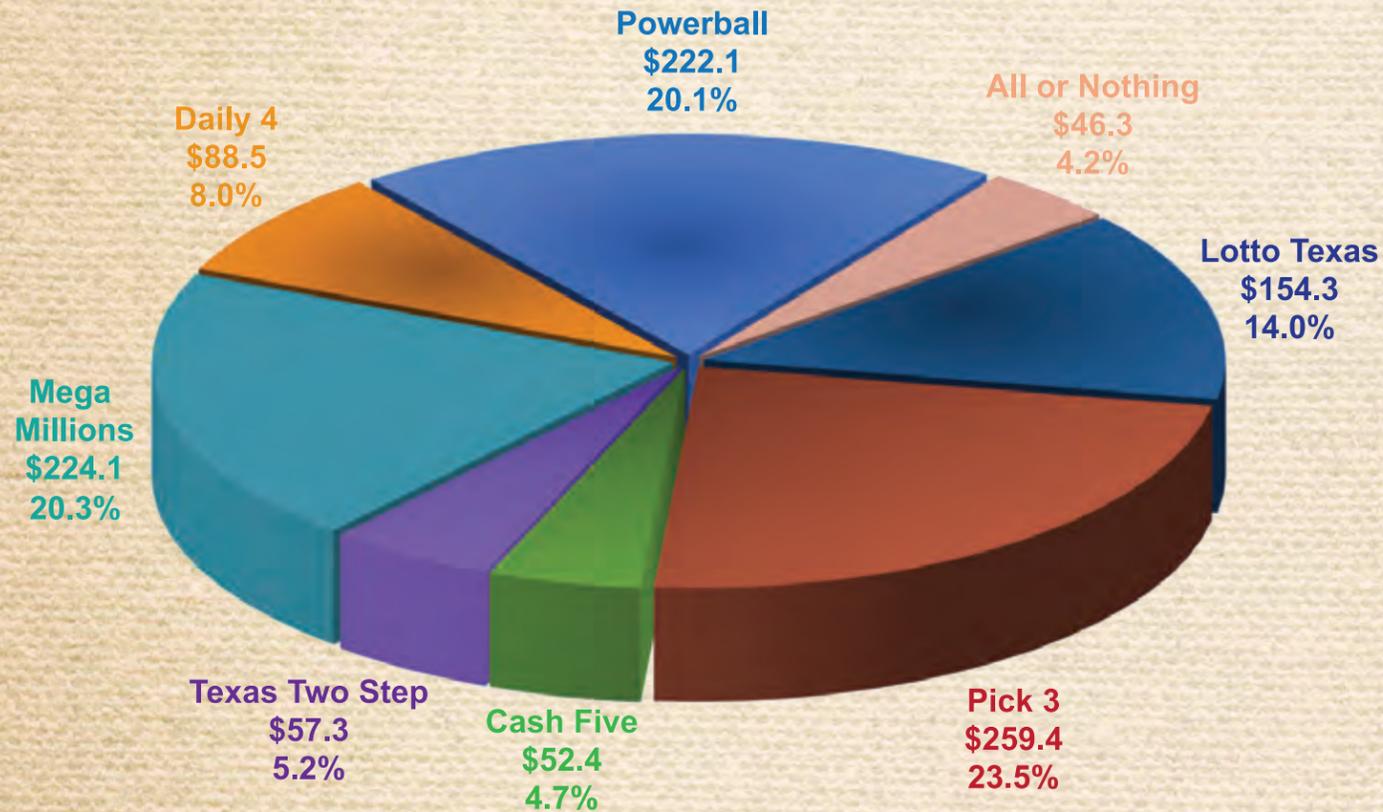
Fiscal Year Sales: \$4.38 Billion

#### Sales by Game

In FY 2014, instant games represented approximately 75 percent of total sales and draw games represented approximately 25 percent of total sales. This product mix is typical for Texas where instant games have accounted for the majority of total sales for many years. Instant games have many qualities that aid in marketing them to potential players including, but not limited to, a variety of price points, game themes and play styles.

### Texas Lottery FY 2014 Draw Sales by Game

through 08/31/2014 (in Millions)



Fiscal Year Draw Sales: \$1.1 Billion

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

#### Draw Sales by Game

For FY 2014, *Pick 3* was the best-selling draw game followed by *Mega Millions* and *Powerball*. *Lotto Texas*, the agency's oldest draw game, was the fourth highest-selling draw game. *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. An advertised \$636 million *Mega Millions* jackpot in December 2013 followed by an advertised \$400 million jackpot in March 2014 propelled *Mega Millions* into the second best draw game sales position with an \$86.7 million gain over the previous year. *Powerball* jackpots in 2014 reached a high of \$400 million, substantially lower than the jackpot levels reached in FY 2013, causing *Powerball* to experience a year-over-year decline of approximately \$108 million.

### Texas Lottery FY 2014 Instant Sales by Price Point

through 08/31/2014 (in Millions)



Fiscal Year Instant Sales: \$3.28 Billion

#### Instant Sales by Price Point

The Texas Lottery realized \$3.28 billion in instant game sales during FY 2014. The \$5 price point continues to be the best-selling price point totaling over \$1 billion in sales. The \$10 and \$20 price points were the next best-selling price points, respectively. Both of these price points include Spotlight games, which feature larger print runs and a significant quantity of appealing high-tier prizes compared to other instant games. Spotlight game offerings helped contribute to the sales success realized at these two price points.

## BENEFITING TEXANS

Since 1992, the Texas Lottery has generated more than \$22 billion in revenue for good causes in the state of Texas, including education, veterans' services and other important state programs. Through strict adherence to our vision, mission and core values, the Texas Lottery is dedicated to ensuring that these benefits continue.

**The Texas Lottery Supports Texas Education.** Since 1997\*, the vast majority of Texas Lottery proceeds—totaling more than \$17 billion—have been transferred to the state of Texas' Foundation School Fund supporting public education in Texas. In FY 2014, the Texas Lottery transferred \$1.203 billion to the Foundation School Fund.

**The Texas Lottery Supports Texas Veterans.** Legislation was passed in 2009 directing the Texas Lottery to create and offer an instant scratch-off game for the benefit of the Fund for Veterans' Assistance administered by the Texas Veterans Commission. The Fund awards reimbursement grants to eligible charitable organizations, local government agencies, and Veterans Service Organizations that provide direct services to Texas Veterans and their families. Over 90 percent of the revenue contributed to the Fund is derived from the sales of the Texas Lottery veterans' games. The first game was introduced in FY 2010 and since that time 12 additional games have been launched with the proceeds supporting the fund. Through FY 2014, the Texas Lottery has transferred \$39.0 million in proceeds for the benefit of Texas Veterans and their families.

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

The chart to the right provides a breakdown of an average dollar spent on lottery games and illustrates "Where the Money Goes," based on FY 2014 financial results.



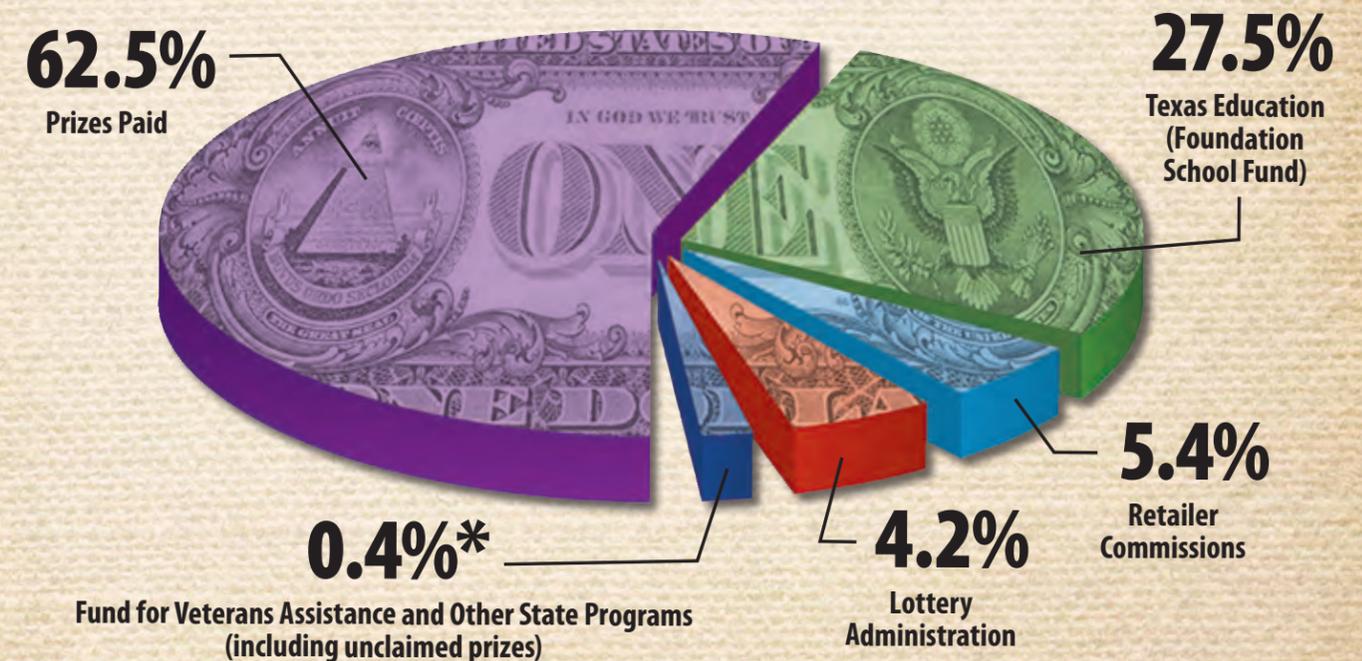
### SUPPORTING TEXAS EDUCATION AND VETERANS

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

# \$17 BILLION IN 17 YEARS

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

## Where the Money Goes:



\*Percentage totals are rounded.  
\$11.5 million was transferred to the Texas Veterans Commission.

Information reflects audited FY14 figures

# PLAYERS

The Texas Lottery strives to consistently deliver on its core value of “Innovation” in offering new and entertaining lottery products to its players. We offer our players a wide selection and diversity of products. Whether it is a new draw game or the latest instant (scratch-off) game, we want our players to have fun when they choose to *Play the Games of Texas*. We strive to provide exemplary service to the people of Texas and we seek feedback that we use in the

development of our products. Players embraced the games offered by the Texas Lottery with record sales levels in FY 2014. They experienced the excitement of playing and the joy of winning with over \$2.74 billion in prizes paid.



# RETAILERS

The Texas Lottery had 17,210 licensed retailers statewide offering lottery products at the end of FY 2014. The dedicated lottery retailer community is the critical bridge between the lottery and its players. Lottery retailers work tirelessly to manage inventory, merchandise and sell games, pay prizes and educate the public on how to play the *Games of Texas*.

The Texas Lottery reached record sales and revenue levels in FY 2014 through the hard work of its licensed retailers. Lottery retailers reaped the benefits of their efforts by earning record-breaking commissions of \$219.54 million. Retailers also earned an additional \$15.99 million in sales performance-based incentive payments and \$1.98 million in bonuses for selling certain top prize and/or jackpot winning tickets during the year. All told, retailers earned approximately \$237.51 million in FY 2014.



# SOCIAL RESPONSIBILITY

The Texas Lottery's mission is to generate revenue for the state of Texas through the responsible management and sale of entertaining lottery products. This must be achieved while maintaining public confidence and trust that the agency's games are conducted fairly and securely with a constant focus on "Integrity and Responsibility," 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.

The agency accomplishes this through a number of regulatory and educational activities serving the social responsibility standards of the agency and its customers. Specific areas of emphasis include vendor and licensee compliance, consumer protection, jurisdictional complaint monitoring/hotline support, retailer surveys and inspections, 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 16,900 devices which provide lottery players with the ability to check the winning status of instant and draw game tickets prior to validation by a retailer. These devices include counter-top Check-a-Ticket terminals as well as self-service lottery vending machines. Additionally, customer displays and distinct audible tones at sales terminals provide player verification of the prize-winning status of tickets validated by retailers. The agency is focused on creating an environment where players can participate in the games

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

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



The Texas Lottery's Play Responsibly public information initiative reminds consumers that the Texas Lottery Commission encourages conscientious participation in its games. The initiative was launched in August 2003 and continues today with the Play Responsibly message positioned in public communications, including how-to-play brochures, retailer and player publications, point-of-sale materials, instant and draw game tickets, and news releases. The initiative features the agency's Play Responsibly web page where 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.

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

As a member of the National Council on Problem Gambling, the North American Association of State and Provincial Lotteries and the World Lottery Association, the Texas Lottery actively supports the problem gambling initiatives of these organizations. The agency helps bring awareness to this issue by encouraging consumers to play responsibly and since 2004, has participated in the annual Problem Gambling Awareness Month campaign, a grassroots public awareness and outreach effort of the National Council on Problem Gambling. The goal of this campaign is to educate the general public and health care professionals about problem gambling and raise awareness about the help that is available both locally and nationally.



# TEXAS LOTTERY COMMISSION

## 2016 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 2016 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 83rd 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 11 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, 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 while incorporating new performance measurement tools to ensure that progress is being made in achieving critical agency goals and to allow opportunities for improvement to be quickly identified. The following section of the report walks through 10 key performance factors and associated goals for FY 2016, 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 retailer to ensure only qualified businesses receive licenses. The agency must be efficient in completing these review processes to allow businesses to complete and/or continue licensure and be in a position to offer lottery products at a time consistent with their business needs. The agency also focuses heavily on retailer education to ensure that licensees fully understand the responsibilities and business impact of being a lottery retailer. A variety of training initiatives and collateral materials focus on licensee rules and requirements, financial and accounting procedures, lottery products and equipment operation.

The Texas Lottery dedicates extensive resources to support licensed retailers in their day-to-day relationship with the agency and consumers. This begins with licensure and continues throughout a retailer's history with the agency. Each new licensee receives comprehensive training prior to the start of ticket sales and refresher training for new clerks or games is provided as needed. 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-off tickets.

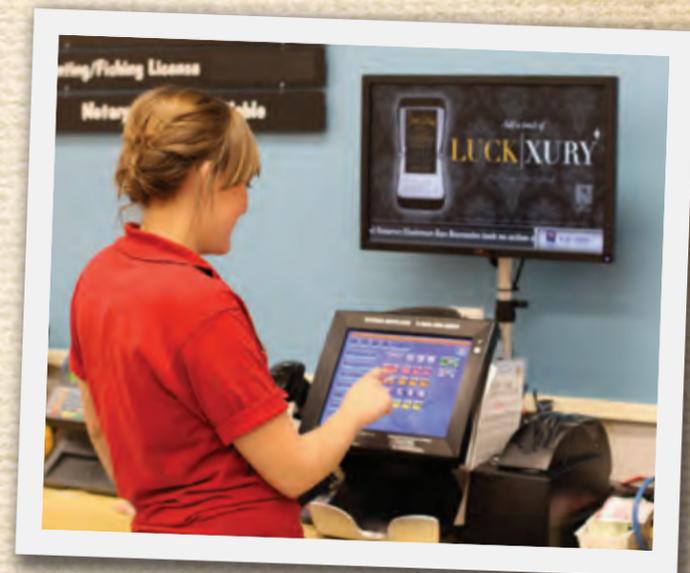
The agency's second hotline supports all aspects of the agency's regulatory functions related to retailer licensing and accounting matters and is available during agency business hours Monday through Friday. Agency staff enter and update retailer information, coordinate ownership transfers and lottery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

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

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

With the award of a new lottery operator contract in December 2010, all retailers received new sales terminals in 2011, which provided improved transaction times, thus reducing retailer labor costs. The contract also included new play stations, designed with space for player Check-a-Ticket devices reducing the space requirements for lottery at the retail location. Retailers were furnished electronic monitors for displaying player transactions, lottery marketing messaging and other important non-lottery messaging including Amber, Silver and Blue Alerts. Electronically updated, dual-jackpot signage was introduced at licensed locations, offering 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 its commitment, the agency surveys its retailer base to determine the level of satisfaction with the services being provided. The agency historically had set a target of 93 percent satisfaction levels (measured as scores of "good" or "excellent") recently increasing its satisfaction standard goal to 95 percent. In the four most recent fiscal years (FY 2011-2014), the agency has exceeded this target and achieved satisfaction level scores exceeding 96 percent.



## Challenges and Opportunities

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

## Key Initiatives and Goals

The Texas Lottery recognizes that the success of its retailer licensees is inextricably tied to the agency's achievement of its mission to generate revenue for the state through the responsible management and sale of entertaining lottery products. Timely, effective support and exceptional service are necessary to ensure retail success and the staff is committed to delivering against these standards. Additionally, the staff is working on a new web-based retailer interface called the Lottery Services Portal which will replace the existing Retailer Services Center. The Lottery Services Portal, which is anticipated to launch in calendar year 2015, will provide additional reporting tools and significantly enhanced opportunities for licensees to conduct their business with the lottery via the Internet, including the ability to submit license applications online. A second web-based module, the Lottery Learning Link, will provide retailers quick access to refresher training on specific lottery topics from terminal functionality to game features. Through our "Customer Responsiveness" commitment, the staff is intent on continuing to exceed our goal of a 95 percent retailer satisfaction level.

## PERCENTAGE OF LICENSEES WITH NO RECENT VIOLATIONS

### Background

The Texas Lottery is committed to maintaining the public trust by protecting and ensuring the security of lottery games. This performance metric reports the ratio (by percentage) of currently licensed, 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 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 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 receipt (one for players and one for retailers)
- Split/floating validation numbers (VIRN)
- Removing validation codes
- "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-off tickets

The agency has established a progressive disciplinary process for retailer violations of the State Lottery Act and rules. Every effort is made to ensure timely and consistent application of progressive disciplinary remedies up to and including the revocation of sales licenses. The agency recognizes the need to protect consumers while simultaneously not inconveniencing or disrupting the daily business activities of honest retailers. As the vast majority of retailers serve their customers in an ethical and forthright manner, it is critical for the agency to balance consumer protection with retailer motivation to sell lottery tickets. The agency's mission to generate revenue for the state of Texas is supported by making every effort to ensure fun, positive lottery player experiences 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 information on all aspects of lottery transactions and system activities that can be leveraged by the agency through enhanced reporting tools to ensure secure operations. The Security Department and Enforcement Division are at the forefront of leading the agency in these initiatives.

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

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

### **Background**

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

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

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

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

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

	FY 2012	FY 2013	FY 2014
<b>Total Sales</b>	\$4,190,815,913	\$4,376,286,456	\$4,384,597,063
<b>Bad Debt Expense</b>	\$361,399	\$289,311	\$283,041
<b>Bad Debt Expense as a % of Sales</b>	0.0086%	0.0066%	0.0065%

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 dream of. A collection rate this high is made possible through dedicated staff committed to all aspects of the agency's collection efforts.

### Challenges and Opportunities

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

### Key Initiatives and Goals

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

## DOLLARS COLLECTED VIA THE DEBT SET-OFF PROGRAM

### Background

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

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

The program has seen substantial increases in amounts collected in recent fiscal years. Total monies collected for the three-year period were \$9.42 million with FY 2013 representing the highest amount ever collected by the Texas Lottery at \$3.88 million.

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



Source: Texas Lottery Performance Measures

## **Challenges and Opportunities**

The Texas Lottery has seen impressive growth in its collections of debts on behalf of the state. 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 the number of prizewinners owing monies to the state who claim prizes at claim centers. There are a number of variables that the agency does not influence or control that impact this metric. The metric is influenced by the volume of people owing monies to the state and the amounts that those individuals owe. Economic events may also be a contributor to this metric. It is likely, however, that the success that the agency has experienced in gross sales growth in recent years is a contributing factor to the growth of these collections. Lottery sales increases translate into greater participation and an increase in the overall number of prizewinners who claim prizes at claim centers.

## **Key Initiatives and Goals**

As noted, the Texas Lottery does not directly influence this performance factor. The agency's focus on its sales and revenue goals has an indirect impact that may influence collection performance. When accounting for historical collections and recent growth, the agency has established a target of \$2,500,000 for collections in 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 are offered the opportunity to purchase lottery tickets.

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

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

Convenience and grocery stores are considered to be "traditional" lottery trade styles. Although the base contains a variety of trade styles, convenience and grocery stores are the dominant trade-style segments. Together, these two trade styles comprise nearly 90 percent of licensed locations and 97 percent of Texas Lottery sales. Other common retail trade styles—such as general merchandise, pharmacy and big box (e.g., Costco, Target, Home Depot), which have not broadly incorporated the lottery category into their business models are typically categorized as "non-traditional" lottery trade styles.

In spite of a dynamically changing business environment, the agency has been able to maintain a relatively stable retailer base over its history. However, the period from FY 2000 to FY 2007 reflected a moderate decline from a peak of 16,767 licensed locations to 16,211. Beginning in 2008, the agency placed renewed emphasis on retail distribution channel expansion efforts in coordination with the lottery operator, IGT, which is primarily responsible for licensee recruitment activities under its contract with the agency. This emphasis continues in the current Lottery Operations and Services contract which began September 1, 2011. Since FY 2008, the retailer base has grown each year, surpassing 17,200 in FY 2014.

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

These cumulative efforts resulted in expansion of the distribution channel from 16,211 retailers at the end of FY 2007 to 17,210 retailers at the end of FY 2014, representing a 6 percent increase.

## **Challenges and Opportunities**

The Texas Lottery and IGT must continue ongoing efforts to sustain and enhance their effective relationship with retailers within traditional lottery trade styles, while actively pursuing opportunities to expand into non-traditional lottery trade styles.

There are several challenges to retail distribution channel expansion. Business (trade-style) models that do not include lottery are often focused on higher-profit-margin products that more easily correlate to bottom-line revenue. As lottery products typically produce lower profit margins than many other retail products, prospective retailers' interest in adding the lottery category can be limited. Also, the instant product category can present operational concerns associated with inventory control/shrinkage and the potentially labor-intensive nature of managing lottery products. In addition, there are challenges specific to Texas relating to certain permits held by retailers for the sale of alcoholic beverages. These concerns can serve as a barrier to interest in licensure.

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

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

### Key Initiatives and Goals

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

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

Regardless of the trade style category, the Texas Lottery is invested in growing the licensed retailer base through sustained and strategic recruitment allowing for better product accessibility for the public and the potential for increased revenue to the state. From FY 2010 to FY 2013, the retailer base grew by an average of 115 retailers annually. Retailer expansion came in just under the 115 retailer growth target established in FY 2014 with 107 net retailers gained during the year. In coordination with the lottery operator, the agency has again set a goal of meeting the FY 2010 to FY 2013 retailer growth average of 115 for FY 2015.

## RETAILER INCENTIVE PROGRAM

### Background

The Texas Lottery received authorization and funding from the Texas Legislature, via a 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 that is 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 incentivized retailers based exclusively on performance. The program has undergone modifications over the years to optimize the revenue benefit to the state. The current retailer incentive programs use a two-phase approach to reward retailers who meet and exceed their sales goal:

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

At the end of FY 2014, the agency had completed 14 individual retailer incentive periods since the program began in September 2009. Qualifying retailers have generated more than \$914.01 million in additional sales, yielding more than \$161.17 million in incremental revenue for the state. These retailers received more than \$70.87 million in incentive payments based on their sales performance.

The chart on the following page depicts the three incentive program periods during FY 2014, illustrating the retailer payments made and the related sales impact of each program.



## FY 2014 Retailer Incentive Program Payments and Sales Impact



### Challenges and Opportunities

The Texas Lottery is the only U.S. lottery that utilizes an ongoing performance-based program of retailer cash 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 42 percent for the three programs in FY 2014. This represents an incremental retailer participation increase from the 37 percent average in FY 2013. While retailer participation is important, the agency must also ensure that each program incorporates challenging retailer goals and focused product emphasis that will optimize revenue to the state.

### Key Initiatives and Goals

The agency has designed the program to significantly mitigate risk to the state by focusing on same-store, year-over-year sales growth. Retailers only receive incentive payments 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 to not exceed the allocated program budget. This ensures the agency does not exceed its appropriation for the overall program. 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.

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. 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 staff will report annually, or more frequently as directed by the Commission, on attainment of these ongoing retailer incentive program goals.

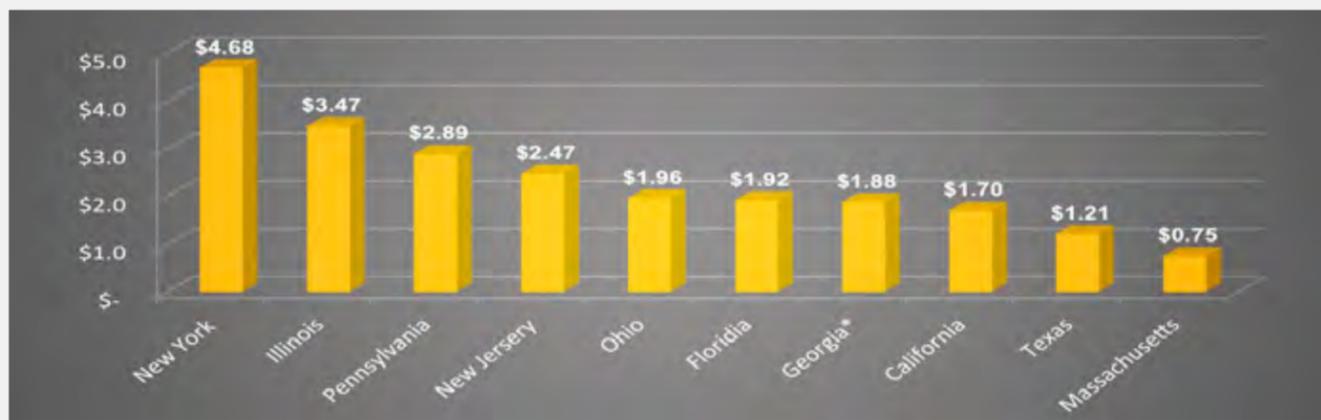
## ADVERTISING EXPENDITURES AND EFFICIENCY

### Background

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

Research performed by the Texas A&M Mays Business School was conducted in 2014 to determine the impact of advertising on lottery sales in the state of Texas. The research models in the Texas A&M report suggest that advertising has a positive and significant effect on lottery sales. More specifically, the results suggest that a 10 percent decrease in advertising (expenditures) would result in a 17 percent decrease in lottery sales. Total advertising expended across all media in FY 2014 was \$32.15 million. Against this scenario in FY 2014, a 10 percent decrease (increase) of \$3.21 million in the advertising budget would reduce (increase) sales by \$74.50 million. This decrease (increase), in turn, would translate to a revenue loss (gain) of \$20.50 million for the state of Texas. The Texas A&M modeling further concluded that if the long-term impact of advertising were to be considered, the potential impact to sales and revenue for the state would be even greater.

## Advertising Budget Per Capita



Source: La Fleur's 2014 World Lottery Almanac

### Challenges and Opportunities

The purchasing power and reach of the Texas Lottery's advertising budget has declined significantly over the nearly 23 years of the agency's existence. The Texas Lottery's appropriated advertising budget has diminished in nominal dollars from \$40 million in 1993 to \$32 million in 2014. However, the effects of inflation are even more pronounced. An advertising budget of \$40 million in 1993 dollars would equate to \$65.5 million in 2014 dollars, adjusted for inflation. Add to that a greatly expanded product mix, and it becomes apparent that the agency faces significant challenges in advertising and communicating with the public about all of its products. In 1993, lottery products consisted of one draw game (*Lotto Texas*) and two instant games. Today, the Texas Lottery offers eight different draw games with four unique add-on features and approximately 80 to 90 instant games each year.

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

Since 1993, the population of Texans over the age of 18 has increased by 54 percent from 12.6 million to 19.4 million in 2014. Additionally, the population of Texas has become more ethnically diverse, reaching minority-majority status in recent years. The increased population and decreased appropriated

advertising budget have combined to lower per capita advertising expenditures over this period by 52 percent from \$3.17 to \$1.65. By focusing with its advertising vendor on the efficiency of its advertising and developing an annual advertising execution strategy, the Texas Lottery continues to be one of the top-selling lottery jurisdictions in the nation, while operating with one of the lowest per capita advertising budgets in the industry. According to the LaFleur's 2014 World Lottery Almanac, Texas ranks 33<sup>rd</sup> of 40 reporting state lotteries in advertising budget per capita and 9<sup>th</sup> among the top 10 performing lotteries (ranked by sales per capita).

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

	FISCAL YEAR 1993	FISCAL YEAR 2014
<b>Impact of Inflation</b>	\$40 million base appropriated advertising budget	\$32 million base appropriated advertising budget \$40 million in 1993 dollars equates to \$65.5 million in 2014 Adjusted for inflation, \$32 million in 2014 equates to \$19.6 million 1993 dollars
	12.6 million Texans 18 or older	19.4 million Texans 18 or older
	\$3.17 ad spend per capita	\$1.65 ad spend per capita \$3.17 ad spend per capita in 1993 dollars equates to \$5.19 in 2014 Adjusted for inflation, \$1.65 in 2014 equates to \$1.01 in 1993 dollars
<b>Increase in Products</b>	<b>Two products:</b> <i>Lotto Texas</i> Scratch-off games (2)	<b>Nine products</b> <b>+ 4 unique add-on features:</b> <i>Pick 3 with Sum It Up!</i> <i>Cash Five</i> <i>Daily 4 with Sum It Up!</i> <i>All or Nothing</i> <i>Lotto Texas with Extra!</i> <i>Texas Two Step</i> <i>Mega Millions with Megaplier</i> <i>Powerball with Power Play</i> Scratch-off games (approx. 80-90 launched annually)
<b>Product Life Cycle</b>	Lottery product was brand new, generating immense excitement and interest.	Lottery products are mature, meaning that advertising dollars must work harder to create player excitement and interest in the games. New games, game changes and add-on features continue to be introduced, all requiring additional advertising support.

	FISCAL YEAR 1993	FISCAL YEAR 2014
<b>Free Media Exposure</b>	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.
<b>Texas Ethnicity</b>	Population was made up of a significant majority of Caucasians.	Population is much more diverse with a minority-majority population. Texas is the second most populous state in the nation and the third fastest-growing, with the majority of the growth being driven by Hispanics, followed by African-American and Asian communities. By 2016, the multi-cultural population of Texas is forecasted to account for 61 percent of the total 18-49 year old population, further solidifying its current minority-majority status in the years to come.
<b>Media Proliferation</b>	Players were easy to reach frequently via network TV and radio advertising.	The advertising industry has encountered dramatic challenges with the proliferation of new media choices for consumers, including exponential cable channel expansion, streaming radio, the role of the Internet and social media, all factors that limit advertising exposure. Additionally, the rapid adoption of tablets and continued expansion of smartphones, DVR usage and content-streaming create even greater opportunities for consumers to time-shift programming, potentially affecting advertising exposure. This market dilution means it is becoming more difficult to reach large groups of consumers for the same level of media expenditures.
<b>Pay at the Pump</b>	Because pay-at-the-pump technology was new and limited, most people went into the store to pay for gas, allowing for exposure to lottery products.	Most stores have pay-at-the-pump technology and about 64 percent of consumers use it, requiring advertising to work harder to drive players into the store for lottery products.

### Statutory Limitations on Types of Advertising

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

### Key Initiatives and Goals

With statutory restrictions on the Texas Lottery’s advertising and limitations on the agency’s appropriated advertising budget, advertising efficiency is the most critical tool at the agency’s disposal to maintain its ability to reach consumers and communicate about new and existing lottery products. The agency remains committed to the goal of enhancing the efficiency of its advertising. This includes efforts to internally review and challenge past advertising strategies and efforts to engage third-party unbiased resources to evaluate the efficiency of the agency’s advertising efforts. This includes the 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 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 this effort to future media purchases and is undertaking further 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.

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

### Tiered-Media Markets

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

## Social Media

The Texas Lottery must work to reach new consumers using non-traditional advertising and communication vehicles. Social media is at the forefront of these efforts and has become an increasingly important component of the Texas Lottery’s efforts to reach and communicate with adult Texans. The agency currently communicates with consumers about its products through social media resources including Facebook, Twitter, YouTube and Instagram. The Texas Lottery social media platforms were developed in compliance with the Texas Department of Information Resources social media policy and guidelines. The agency continually monitors the social media landscape for appropriate opportunities to advertise via these platforms and to reach and communicate with adult Texans about lottery products.

## Consumer Electronic Communications and Applications

The Texas Lottery 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 is who 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 valid 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 e-mail or text messaging program that provides winning numbers, current estimated jackpot alerts, instant game information and general news and alerts. The Texas Lottery is also developing a mobile application to increase the public’s access to Texas Lottery game information and player support services. Draw game players will be able to easily view current jackpot amounts and winning numbers on their mobile devices. Scratch-off players will be able to use a locator to find retail locations that are carrying their favorite scratch-off game. Players will also be able to scan both draw and scratch-off game tickets and use “Check Your Ticket” functionality. This feature provides an added layer of consumer protection as players will have the ability to conveniently verify the winning or non-winning status of tickets on their mobile device. The mobile app will provide a convenient and fun platform for lottery players to access important lottery information. The Texas Lottery plans to roll out the mobile app in FY 2016.



## General Background

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

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

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

The *Games of Texas* are the body of products that the Texas Lottery makes available to the playing public. These include instant games and draw games. The agency currently offers eight draw games, including four unique add-on features offered on five of its draw games, and approximately 80 to 90 instant games annually constituting the current game portfolio.

## INSTANT TICKET GAMES

### Background

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

<sup>1</sup> *La Fleur's 2014 World Lottery Almanac*. 22<sup>nd</sup> edition. Edited by Terri Markle, Bruce La Fleur, and Byron La Fleur. Rockville, Maryland: TLF Publications, Inc., “Worldwide Lotteries Ranked by 2013 Total Sales (excludes VLT and Keno revenue).”

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

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

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

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

### Challenges and Opportunities

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

### Key Initiatives and Goals

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



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

Historically, the Texas Lottery launched new games once every two weeks. In FY 2014, the lottery operator, IGT, recommended a new instant product management strategy that reduced the number of game introductions to once every four weeks and increased the ticket quantities ordered for new, non-core games. Theoretically, non-core games would have more time in market and thus gain the dedication and interest of players, reducing the competition for open dispenser space with core product offerings.

Observations of launch strategies in other lottery jurisdictions led the lottery operator to believe that this practice would benefit instant game sales by facilitating a Plan-o-Gram that would be easier to manage, allow for the placement of and focus on core games, and therefore advance core game and overall sales.

After several months of monitoring sales of the new introduction schedule, it was determined that this plan did not align with long-established player expectations in Texas. Texas players and retailers have come to expect a consistent stream of new games and when that frequency decreased, so too did player participation. While the plan offered clear product marketing opportunities, these were outweighed by player product expectations in the marketplace. The agency determined it was necessary to swiftly restore the plan back to the prior twice-per-month (and more frequently if needed, based on sales levels) game introduction schedule. Players and retailers responded positively to the restored game introduction strategy and sales levels began to increase again, yielding another record-breaking year of instant sales in FY 2014. Such experimentation is important to ensuring that the agency is optimizing its product strategies, but players are the ultimate arbiter of the agency’s product offerings and the agency listens closely to player feedback.

### Spotlight Game Offerings

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

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

This game was very successful for the agency in terms of sales and revenue generation, resulting in sales of \$420,597,540 and revenue of \$61,605,387 during the first full year of sales. Capitalizing on the success of *\$500,000,000 Blockbuster*, the agency introduced *\$500 Million Frenzy* in March 2011 and

\$500,000,000 *Extreme Cash Blast* in August 2012. These games were equally well-received by both retailers and consumers.

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

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

In the summer of 2014, the next \$10 Spotlight game, *\$200 Million Cash Blowout*, was introduced, and a new \$20 Spotlight game, *\$500,000,000 Cash*, will launch during FY 2015. Based on the sales and revenue results with Spotlight games, the agency will offer these games as a part of its key instant product offerings.

### Growth of Core Instant Product Offerings

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

To further this effort, the Texas Lottery strived to capitalize on the strength of the *Weekly Grand* brand by creating a "family" or suite of games using the *Weekly Grand* brand. The \$2 *Weekly Grand* has been a top-selling game since its launch in the early 1990's. In September 2013, a *Weekly Grand* suite was introduced—\$1 *Weekly Half Grand*, \$2 *Weekly Grand*, \$5 *Bonus Weekly Grand* and \$10 *Super Weekly Grand*. The \$10 *Super Weekly Grand* game ranked 3<sup>rd</sup> in instant game sales for FY 2014, \$5 *Bonus Weekly Grand* ranked 8<sup>th</sup> and \$2 *Weekly Grand* ranked 15<sup>th</sup>. These games performed well. However, the Texas Lottery and lottery operator are exploring a new design for its next annuity suite of games anticipated to be

received even more positively by players. In the summer of 2015, the *Set for Life* suite will be introduced to replace the *Weekly Grand* annuity suite. Based on sales results of *Set for Life*, a determination will be made related to future offerings of annuity suites and their resonance with players.

### Game Suites

In addition to *Weekly Grand*, the Texas Lottery introduced another suite of games, called the multiplier suite, in early 2014. These games received full advertising support including TV, radio, billboard and in-store POS. This suite offered five different games at the \$1, \$2, \$5, \$10 and \$20 price points—5X *The Cash* (\$1), 10X *The Cash* (\$2), 20X *The Cash* (\$5), 50X *The Cash* (\$10) and 100X *The Cash* (\$20). The games have performed well and all were reprinted in order to keep up with player demand. The \$20 game, 100X *The Cash*, was the best-selling instant game in FY 2014 with sales of \$147.3 million, while the \$10 game, 50X *The Cash*, was the second best-selling game with sales of \$108.8 million. Capitalizing on the success of this suite, the Texas Lottery has launched a new suite of multiplier games in early 2015.

### Play Books

Play books are a proprietary instant game product produced by one of the Texas Lottery's instant ticket manufacturers, Pollard Banknote Limited. Just as its name suggests, a play book is a book of instant games combined and grouped with multiple pages. A play book typically sells for \$20 and contains multiple games packaged together providing a value proposition to the player. Other jurisdictions have launched play books containing extended play games like *Crossword* or *Bingo*, or have created game books with all games in the book containing a consistent themes (e.g., 7's, gems, or casino-style games).

Based on the positive sales experiences of other lotteries, the Texas Lottery decided to launch its first-ever play book during the 2014 holiday season. Towards the end of FY 2014, agency staff worked closely with the vendor on the design of the *Holiday Game Book* in preparation for its launch in early FY 2015. *Holiday Game Book* was a strong performer leading the agency's holiday suite of offerings and staff is already preparing for next year's version of the *Holiday Game Book*. The *Holiday Game Book* launched October 20, 2014 and ranked as the best-selling instant game for the next eleven weeks with sales totaling over \$59 million during that time period.

### Super Tickets

Super Ticket is an oversized instant ticket with numerous games on it creating play value for consumers. While the typical width of instant game tickets is four inches, Super Tickets range in width from eight inches to twelve inches and can be as long as sixteen inches. These tickets require special dispensers for display and sale. *Holiday Game Book* referenced above had similar characteristics in that it too required special dispensers. The agency is able to leverage the use of the dispensers used for the *Holiday Game Book* to offer Super Ticket. The Texas Lottery plans to introduce its first Super Ticket at the \$10 price point in spring 2015.

## Products Geared to Appeal to New Players

As a mature, 23-year-old lottery, the Texas Lottery recognizes that in order to remain relevant and continue to grow, it must attract new players. The Texas Lottery must also achieve this goal within the framework of its traditional lottery (instant and draw) game offerings. Offering licensed/branded instant games and instant games that feature unique prizes represents a significant portion of the agency's strategy to reach new audiences.

### Licensed/Branded Products

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

### Luck Zone Player Internet Site

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

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

While many of the game design changes made by instant ticket manufacturers have been subtle, new production methods are being developed that can be marketed to consumers. One example that the agency has leveraged successfully is where the removable scratch-off 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 new 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. While continuing its focus on keeping administrative expenses in check, the agency will evaluate these and other added-value features that may increase player enthusiasm and, in turn, produce additional game sales and revenue.

## Background

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

The Texas Lottery's current draw game offerings include *Powerball* with the add-on feature *Power Play*, *Mega Millions* with the add-on feature *Megaplier*, *Lotto Texas* with the add-on feature *Extra!*, *Pick 3* with the add-on feature *Sum It Up!*, *Daily 4* with the add-on feature *Sum It Up!*, *Cash Five*, *Texas Two Step* and *All or Nothing*. A new draw game, *Texas Triple Chance*, has been approved by the Texas Lottery Commission and is planned for launch in early FY 2016.

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

Until January 2010, *Mega Millions* was comprised of Texas and 11 other member states including California, Georgia, Illinois, Maryland, Massachusetts, Michigan, New Jersey, New York, Ohio, Virginia and Washington. In October 2009, a historic cross-selling agreement was reached between the *Mega Millions* member states and the Multi-State Lottery Association (MUSL), which operates *Powerball*, to allow *Mega Millions* states to sell *Powerball*, and *Powerball* states to sell *Mega Millions*. Starting January 31, 2010, *Mega Millions* and MUSL member states could begin offering both games. The Texas Lottery Commission adopted the *Powerball* game rule at the January 6, 2010, Commission meeting, authorizing



the executive director to sign the necessary agreements for Texas to begin selling *Powerball* on January 31, 2010. Offering both multi-jurisdictional jackpot games with large population bases has created the opportunity for longer jackpot rolls and record-breaking jackpots, resulting in increased revenue to the Foundation School Fund.

Currently, the *Powerball* starting jackpot is \$40 million and numbers are drawn twice per week. Like *Mega Millions*, *Powerball* also has a multiplier feature, called *Power Play*. For an extra \$1 per play, players can increase their non-grand/jackpot prizes by two, three, four or five times. The Match 5 prize (2<sup>nd</sup>-tier prize) with *Power Play* is \$2 million; all other prize tiers are multiplied by the *Power Play* number that is drawn. In January 2012, the price of a *Powerball* ticket increased from \$1 to \$2. This was a major initiative for the lottery industry to increase the price point on a well-known and strongly recognized jackpot-style draw game brand. In FY 2014, *Powerball* sales declined due to a lack of high jackpot amounts that drive excitement and participation in the game. Market research has been conducted with both players and retailers to test various game concepts that should increase jackpots and create added-value for players. MUSL is continuing to evaluate potential changes to the game that will most likely be made in FY 2016.



*Pick 3* is a daily non-jackpot game that has typically realized consistent year-over-year sales growth since its inception in October 1993. The game experienced its first sales decrease in FY 2008, due to the addition of the *Daily 4* game. Even with this anticipated cannibalization caused by *Daily 4*, *Pick 3* continues to be one of the agency's best-selling draw games, illustrating that non-jackpot style games can be effective in reaching sales and revenue goals. *Sum It Up!* is an add-on game concept first introduced with the *Daily 4* game and then added to *Pick 3* in November 2007. For an additional wager, players can win if the sum of their three numbers matches the sum of the three numbers drawn in the applicable drawing. This provides players a chance to win even if they do not win on the base game. In September 2013, *Pick 3* drawings increased from two daily drawings to four times daily, six days a week.



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



*Texas Two Step* is a rolling jackpot-style game similar to *Lotto Texas*, but on a smaller scale, with jackpots starting at \$200,000. *Texas Two Step* began in May 2001 and was originally drawn twice per week, on Tuesdays and Fridays. However, after Texas joined *Mega Millions*, *Texas Two Step* draw days were changed to Mondays and



Thursdays to avoid direct competition with *Mega Millions*, which had the same Tuesday/Friday draw schedule. *Texas Two Step* has a loyal player base and experiences consistent sales at lower-level jackpots; however, it does respond like any other jackpot game in that, as the jackpot climbs, sales increase.

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



*All or Nothing* is a unique and different draw game because it offers two ways to win the top prize: by matching all of the numbers drawn or by matching none of the numbers drawn. Players can become disappointed by not matching any numbers when they play lottery draw games. In *All or Nothing*, not matching any numbers wins \$250,000! The *All or Nothing* game also allowed the Texas Lottery to introduce two new drawing times (10 a.m. and 6 p.m.), making it the first Texas game to offer players the opportunity to play and win up to four times per day. The *All or Nothing* draw game also provides the best overall odds of winning out of all the games in the Texas draw game portfolio—1 in 4.5. In addition to the \$250,000 top prize, *All or Nothing* also offers lower-tier prizes of \$2, \$10, \$50 and \$500, depending on how many numbers the player does or does not match in the drawing. Tickets for *All or Nothing* are \$2 per play and the game has a 12-of-24 matrix. *All or Nothing* became the second \$2 game in the Texas Lottery's draw game portfolio (joining *Powerball*) and the first \$2 daily game. Designing and introducing draw games at higher price points—a very successful strategy in the instant product portfolio—is a primary goal of the agency. The successful launch of *All or Nothing* was an important milestone. The unique attributes of *All or Nothing* and its price point positioning resulted in the game being recognized in 2013 by the North American Association of State and Provincial Lotteries (NASPL), as the Best New Draw Game introduced in the industry. Due to a game design issue that was brought to the agency's attention by IGT Corporation, sales were suspended from June – August 2013. Rule changes were implemented during this period to add a liability cap to protect the financial interests of the state in conducting the game. Once sales resumed for the game, sales declined due to speculation amongst players and retailers about the reason for the temporary cessation of sales. The agency has committed advertising and communications efforts to address concerns regarding the game, but sales have not returned to prior levels.



## Challenges and Opportunities

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

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

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

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

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

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

## Key Initiatives and Goals

### Price Point Expansion

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

The Texas Lottery has conducted research on other new \$2 draw game concepts that would also be positioned at the \$2 price point along with *Powerball* and *All or Nothing*. The agency is preparing to launch *Texas Triple Chance* on September 27, 2015. The *Texas Triple Chance* game features a \$2 price point that gives players three chances or sets of numbers and provides three ways to win in each play. The Commission approved the new game rule in February 2014, but directed staff not to begin sales or expend agency funds to implement *Texas Triple Chance* pending the issuance of a Texas Attorney General opinion reviewing the game (pursuant to Request No. 1185-GA). A favorable opinion was received in August 2014 from the Attorney General’s office. However, the development and launch of the national premium game, *MONOPOLY MILLIONAIRES’ CLUB*, prevented the agency from introducing the *Texas Triple Chance* game in early FY 2015. The scheduling of the *Powerball* game change, originally planned for April then July of 2015, by the Multi-State Lottery Association has also impacted potential launch windows for *Triple Chance*. Now that *Powerball* changes have been pushed back further, the agency has scheduled the launch of the *Triple Chance* game.



The National Premium Game (NPG), *MONOPOLY MILLIONAIRES’ CLUB*, was developed by Scientific Games, an industry instant ticket manufacturer and gaming systems provider, and implemented by 23 lottery jurisdictions in October 2014 with many other U.S. lottery jurisdictions anticipated to join in early 2015. This \$5 draw game concept incorporated numerous promotional game features in addition to the base game matrix and introduced a strong licensed property brand into the draw game portfolio. The National Premium Game looked to leverage the Monopoly® brand to create new play experiences and offer added value through promotional second-chance drawings where players enter for an opportunity to be selected to join a studio audience for a chance to compete for prizes during a nationally televised game show. This unique promotional draw game feature offered players a new game element not typically offered with drawing games.

The game offered at a new, higher price point, with a significant degree of play complexity, struggled to resonate with players. Sales for the game did not meet the lottery industry's projections and continued to decline nationally following its introduction. After careful review, the Texas Lottery decided to suspend sales of the game after the drawing on December 12, 2014, because of the prize liability risk created by the unexpected low sales of the game. The other 22 lotteries that offered the game subsequently decided to suspend sales of the game on December 26. The agency continues to be interested in opportunities to offer drawing games at the \$2 price point and above. However, the *MONOPOLY MILLIONAIRES' CLUB* experience illustrates the challenge the industry faces in creating a compelling game at the \$5 price point.

### **Evaluation of Jackpot Game Portfolio**

The Texas Lottery will actively participate in the discussions involving changes related to the *Powerball* game. Both *Mega Millions* and *Powerball* 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 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.

### **Draw Game Cross Promotion**

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

### **Cash Five Game Modification Research**

*Cash Five* is a mature game that has experienced sales declines over time. The Texas Lottery plans to explore options to modify or replace the current *Cash Five* game. Due to several recent national game initiatives and other in-state draw game opportunities offering greater revenue potential, there has not been an appropriate time in the game software development cycle or adequate advertising support dollars available to pursue *Cash Five* changes. The agency expects to conduct game concept research in FY 2016 and, if appropriate, will proceed in planning game modification or replacement.

### **Pick 3 and Daily 4 – Add-on and Wager Type Features**

The Texas Lottery is currently working with the lottery operator to evaluate add-on and other wager type features that are being offered elsewhere in the lottery industry to determine if there are opportunities to bring new and different game features to players of these games. Should the evaluation process lead to promising opportunities, research testing of these new features will be performed with Texas players to determine their resonance in Texas.

### **Packaged Draw Game Play**

The Texas Lottery also plans to explore packaging or bundling draw games for ease of purchase by players. This initiative, tentatively referred to as Lone Star Line-Up, would allow the agency to promote lesser played games and to potentially expand draw game product trial. This initiative also requires a significant software development effort and implementation would be coordinated with other draw game and software initiatives such as *Triple Chance*, *Powerball*, the Retailer Lottery Services Portal and the Texas Lottery Mobile Application development effort. The roll-out of this concept would most likely focus first on promotional event trial and/or limited time seasonal offerings.

### **Draw Break Reduction**

In an effort to increase sales and offer players more time to purchase tickets for their favorite games, the agency reviewed the feasibility to reduce draw break (the period where sales cease to allow for the conduct of drawings for the game) duration in FY 2014. Based on time studies by the Draw Team, a recommendation was made to reduce all draw breaks by two minutes. The agency reduced draw breaks from 15 minutes to 13 minutes and implemented the required software changes effective April 13, 2015.

### **Operational Review**

During FY 2014, the agency completed a review of its operations with Camelot Global, a leading advisor and lottery solution provider to lotteries around the world. Camelot assisted the agency in identifying potential opportunities to further enhance its performance. The Texas Lottery used this information as a baseline to work with the lottery operator, IGT, to evaluate these opportunities and their viability for the Texas Lottery's operations. For those opportunities that showed promise, joint review committees comprised of Texas Lottery, IGT Texas and IGT Corporate staff have been formed to evaluate and review all aspects of the Texas Lottery's operations with an emphasis on draw product strategy, marketing communications and retail execution. The work of these committees is ongoing and the agency believes these efforts will continue to improve the Texas Lottery's already strong day-to-day product and marketing operations in concert with IGT and will benefit sales and revenue generation.

# GROSS SALES

## Background

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

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

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

	SALES ACTUAL FY 2012 (IN MILLIONS)	SALES ACTUAL FY 2013 (IN MILLIONS)	SALES ACTUAL FY 2014 (IN MILLIONS)
<b>Total Sales</b>	\$4,190.82	\$4,376.29	\$4,384.60

Total sales for the three-year period grew 4.6 percent, culminating in record sales of \$4.38 billion in FY 2014. FY 2014 represented only a slight increase in sales from FY 2013.

There are a number of controllable and uncontrollable variables that impact lottery sales. Examples of variables outside the agency’s control include general economic conditions in the state, weather conditions, and the level of jackpots on certain draw product offerings (jackpot “rolls”). The focus of the business plan is the establishment and monitoring of goals associated with key factors tied to agency performance, with an emphasis on controllable variables that influence the outcome of these perfor-

mance factors. Arguably, every performance factor tracked and monitored in this plan contributes to the agency’s gross sales and, ultimately, net revenue for the state. However, there are certain factors and key operational functions that are more obvious in their direct impact on efforts to grow sales.

These include the following:

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

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

## Challenges and Opportunities

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

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

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

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

## Key Initiatives and Goals

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

At the time of this writing, the agency anticipates FY 2015 sales comparable to the record-breaking sales achieved in FY 2014. The agency has seen a continued softening of draw game product sales during the first half of FY 2015. This softening has been offset by continued growth in the instant game product category. However, with this overall flattening of sales and recognition that future growth will occur through execution at a more tactical level related to the performance factors in this plan, it is anticipated that the agency will see a slight retrenchment in overall gross sales performance in FY 2016 as detailed in the chart below.

	<b>SALES ACTUAL FY 2014 (IN MILLIONS)</b>	<b>SALES PROJECTION FY 2015 (IN MILLIONS)</b>	<b>SALES GOAL FY 2016 (IN MILLIONS)</b>
<b>Instant Product</b>	\$3,280.23	\$3,348.43	\$3,365.17
<b>Draw Product</b>	\$1,104.37	\$1,048.92	\$1,022.39
<b>Total Sales</b>	\$4,384.60	\$4,397.35	\$4,387.56

These projections reflect a slight increase in overall sales for the instant product portfolio in FY 2016 sales. However, the draw product portfolio is anticipated to continue to experience a slight decline. As noted in the Product Mix and Game Portfolio Management section of this plan, the agency has identified potential opportunities for new and modified draw game offerings that would support sales. However, the sales impact of these initiatives is not anticipated to reverse current draw product sales performance overall.

## NET REVENUE

### Background

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

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

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

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

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

Under the State Lottery Act, the agency is authorized to pay costs incurred in the operation and administration of the lottery, including any fees received by a lottery operator, provided that the costs incurred in a fiscal biennium do not exceed an amount equal to 12 percent of the gross revenue accruing

from the sale of tickets in that biennium. A minimum of 5 percent of this amount is to be allocated as compensation paid to sales agents (licensed retailers). The base retailer commission has remained at 5 percent since the inception of the lottery, leaving the remaining 7 percent available for other administrative expenses, subject to legislative appropriation. The Texas Lottery has consistently kept administrative expenses well below 7 percent of gross sales revenue.

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

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

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

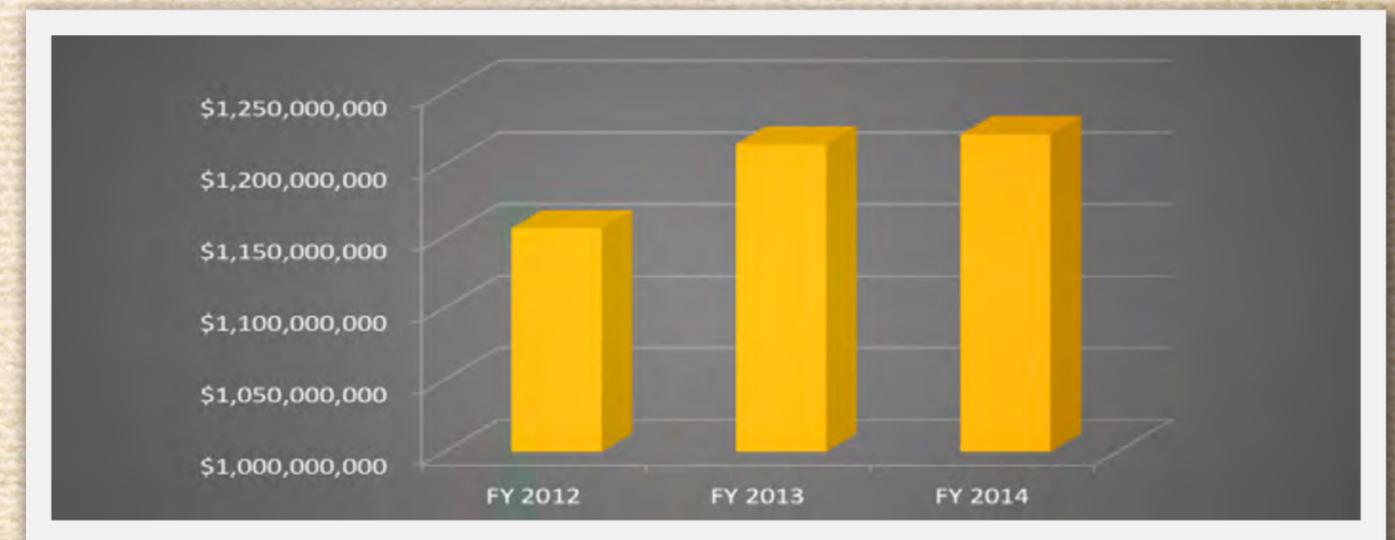
Additionally, the agency was able to achieve significantly reduced pricing under the new contract.

Under the prior contract, the lottery operator compensation rate was 2.6999 percent of sales. Under the new contract, this was reduced to 2.2099 percent of sales. This reduction has resulted in savings to the state thus far of over \$19 million annually beginning September 1, 2011, and it is anticipated that more than \$173 million in savings will be recognized over the nine-year base term of the contract.

The agency has a keen focus on its own day-to-day administrative expenses, and this focus continues to yield efficiencies over time. For example, the agency has restructured its operations on multiple occasions, including the consolidation several years ago of the Marketing and Lottery Operations divisions of the agency into one operating unit. This restructuring yielded salary savings and allowed the agency to streamline its strategic execution in support of lottery revenue. The agency has also reduced the number of claim centers from 24 to 16, while maintaining the agency's commitment to Customer Responsiveness. The agency's comprehensive efforts resulted in administrative expenses of less than 4.6 percent of total sales, inclusive of vendor contract expenses, in FY 2014.

The agency's continued focus on its performance factors culminated in a record revenue year in FY 2014, with total transfers to the state exceeding \$1.22 billion, marking the 11<sup>th</sup> consecutive year the Texas Lottery has generated more than \$1 billion in contributions to the state of Texas. In FY 2014, \$1.203 billion went to the Foundation School Fund. The Fund for Veterans' Assistance, administered by the Texas Veterans Commission, and other programs as determined by the Legislature also benefit from lottery proceeds. Over the last three years, lottery net revenue transfers have grown 6.16 percent annually, representing overall growth of 5.64 percent during that time.

## Total Transfers to State



Source: Texas Lottery Audited Financial Statement

## Challenges and Limitations

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

Further opportunities to enhance administrative efficiency will be limited. As a mature 20-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, such as those previously identified. In addition, the agency has had tremendous success in negotiating favorable pricing and services with its vendors. Although the agency has strenuously emphasized Fiscal Accountability, limited opportunities exist in the near term for significant cost reductions that might yield further administrative efficiencies.

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

## Key Initiatives and Goals

The agency is confident in its ability to continue to generate significant revenue for the Foundation School Fund and other state programs. However, the agency foresees the potential for a slight decline in net revenue contributions to the state in FY 2015 and 2016 from the record levels attained in FY 2014, as detailed in the chart below.

	REVENUE ACTUAL FY 2014 (IN MILLIONS)	REVENUE PROJECTION FY 2015 (IN MILLIONS)	REVENUE GOAL FY 2016 (IN MILLIONS)
<b>Total Revenue</b>	\$1,220.72	\$1,190.75	\$1,183.96

This projected net revenue performance in FY 2015 and 2016 would result in the third- and fourth-highest revenue transfers to the state in the history of the lottery.



## TEXAS LOTTERY COMMISSION

P.O. BOX 16630

AUSTIN, TEXAS 78761-6630

PHONE 512.344.5000

FAX 512.478.3682