



M E M O R A N D U M

Date: June 24, 2021

To: California State Lottery Commission

From: Alva V. Johnson 
Director

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Subject: Item 9(b) – Fiscal Year 2021-22 Budget

ISSUE

Pursuant to California State Lottery (Lottery) policy, the Lottery is required to present the California State Lottery Commission (Commission) with a proposed annual budget each June. The budget prepared for Fiscal Year (FY) 2021-22 presents a sales goal of \$8.45 billion and is estimated to provide nearly \$1.86 billion to public education.

BACKGROUND

Attachment I to this memo presents the Lottery's proposed FY 2021-22 budget, which reflects a sales goal of \$8.45 billion and is estimated to result in approximately \$1.86 billion in supplemental funding for California public education. This proposed budget includes the resources necessary to implement the FY 2021-22 Business Plan. In conjunction with proposed operational growth resources, these business initiatives provide balanced tactics in delivering sales growth and providing investments for continued growth in contributions to public education in future years.

The budget represents the plan to deploy strategies to further the Lottery's three-year strategic plan and drive bottom-line contributions to education. All goals and major initiatives tie back to one or more of the following three themes that our strategic objectives revolve around:

- Adapting to the “New Normal” from the pandemic
- Transforming the Lottery into a mature yet modern and nimble organization
- Building trust and confidence among stakeholders and the public in general

DISCUSSION

The proposed Plan for FY 2021-22 revolves around five key objectives that combine strategies to drive sales and funding for education next year and initiatives to deliver growth in subsequent years. The five key objectives are:

- Respond to emerging needs from recent events and trends
- Focus efforts to reinvigorate retail
- Strengthen sales in jackpot games
- Defuse the barriers to play by changing perceptions
- Transform the Lottery organization

Development of the Lottery's FY 2021-22 budget began by zero-basing divisional operating expense budgets. A preliminary sales projection was used to determine the availability of resources to fund proposed tactics and address operational improvements to drive increased sales and contributions to public education. The Business Plan initiatives were developed by reviewing our business operations as well as industry trends.

This comprehensive assessment of sales goals, the funding needed to deliver those goals, and the contribution to education culminates in the proposed FY 2021-22 budget presented for approval. A summary of the proposed Business Plan initiatives with their associated costs and the proposed resources to address operational growth and other improvements are included in this issue memo as Attachment II. Funding for the cost of the initiatives and other revisions reflected in Attachment II are included in the proposed FY 2021-22 budget.

A summary of the elements of the proposed FY 2021-22 budget is presented below:

Sales

Total sales for all Lottery products are projected to be \$8.45 billion for FY 2021-22; this represents a \$44.3 million, or a 0.5 percent increase over estimated year-end sales levels for FY 2020-21.

The chart below compares the FY 2020-21 year-end estimate with proposed sales goals for the FY 2021-22 budget. Following the chart is background information for the sales goals for each product type.

Fiscal Year's Comparison Chart

Comparison of Revenues			
FY 2020-21 Estimated Year-End Sales and Proposed FY 2021-22 Budget			
(Dollars in Thousands)			
Sales:	Year-End Estimate FY 2020-21	Proposed Budget FY 2021-22	Difference
Scratchers®	\$6,394,000	\$6,530,000	\$136,000
Multi-State Jackpot Games	937,500	837,000	-100,500
SuperLotto Plus®	260,300	241,000	-19,300
Hot Spot®	374,300	395,000	20,700
Daily Games	439,600	447,000	7,400
Total Sales	\$8,405,700	\$8,450,000	\$44,300

Scratchers

Projected sales in the Scratchers product line is expected to increase \$136 million to a total of \$6.5 billion. This sales goal represents a 2.1 percent increase from estimated FY 2020-21 year-end sales. The projected increase is primarily due to an increase in the number of new games being launched in FY 2021-22 as compared to the current fiscal year. Specifically, there will be 52 new games being introduced in FY 2021-22, which is an increase of 5 games compared to FY 2020-21.

Multi-State Jackpot Games

The \$837 million sales goal proposed for the Multi-State Jackpot games represents a decrease of 10.7 percent or \$100.5 million below estimated year-end sales for FY 2020-21.

This year-over-year decline is from decreased Mega Millions® sales in FY 2021-22 reflecting the Lottery's conservative forecasting approach, which does not assume the frequency of extremely large but uncommon jackpots that produced year-end sales beyond budgeted projections in FY 2020-21. The projection for the Multi-State jackpot games also takes into account having more jackpot signs at Lottery retail locations, and the Powerball® projection reflects the addition of a third weekly draw (on Mondays) beginning in August of 2021.

SuperLotto Plus

Sales for SuperLotto Plus are projected to be \$241 million for FY 2020-21, which is \$19.3 million or 7.4 percent less than the projected year-end sales estimate. The SuperLotto Plus jackpot rolled for approximately half of the entire FY 2020-21, and the FY 2021-22 does not assume this same atypical performance.

Hot Spot

Hot Spot sales are estimated to total \$395 million in FY 2021-22, which is a \$20.7 million or 5.5 percent increase above the year-end sales projection. The projected increase in sales is primarily based on growth in playership in traditional retail locations such as convenience stores and gas stations. This growth likely stems from both the Lottery's public website and the Lottery's mobile application offering an option to view the draw results for this game.

Daily Games

The proposed sales goal for Daily Games (Fantasy 5, Daily 3, Daily 4, and Daily Derby®) is \$447 million, a \$7.4 million (1.7 percent) increase from the projected year-end sales level for FY 2020-21. The projected increase in Daily Games sales is primarily due to planned expansion of jackpot signs displaying the top prizes in Fantasy 5 and Daily Derby, the assumed retention of Scratchers and jackpot game players who recently added the Daily Games to their repertoire, and the addition of a Powerball draw on Mondays, which could bring more Lottery consumers to retail to potentially boost Daily Games ticket sales.

Expenses

The following section describes costs associated with the FY 2021-22 budget.

Prize Expense

Pursuant to Lottery policy, the Director is required to make a determination that prize payout levels across all games have been optimized for the coming fiscal year to ensure that funding for education is maximized annually. Since Scratchers sales account for more than 75 percent of total revenues and the Lottery has more direct influence on the sale of these tickets, the Lottery ran several product plan scenarios for Scratchers to identify the optimal mix yielding the highest contribution to education. The combined impact of this effort is prize expense totaling 66.7 percent of projected sales for FY 2021-22, which is within the range of 65 percent to 67 percent that was recommended as being ideal in the recent analysis that was conducted for the Lottery to determine the optimal prize payout rate.

Administrative Expenses

Administrative expenses include retailer compensation, gaming costs, and operating costs. The Lottery Act caps administrative expenses at 13.0 percent of total annual revenues.

Excluding the reserve for insurable risk and administrative spending reserve, total administrative expenses for FY 2021-22 are estimated to be just over \$1.0 billion, an increase of \$59.8 million (6.3 percent) over expected FY 2020-21 expenses. This year-over-year growth reflects the increased sales projection as well as supports strategic investment in FY 2021-22 Business Plan initiatives and operational improvements.

Retailer compensation costs are estimated to total \$583.0 million for FY 2021-22. This amount represents an increase of \$3.0 million (0.5 percent) above expected FY 2020-21 retailer compensation costs and is directly associated with the higher sales goals projected for FY 2021-22.

Gaming costs are budgeted at \$162.0 million for FY 2021-22, which is an increase of \$15.9 million (10.9 percent) from the FY 2020-21 year-end projection. This budget category includes the cost of operating the gaming system, gaming equipment installation and maintenance, and production and distribution of Scratchers tickets. Some of this year-over-year growth is attributable to the increased sales projection, but it also reflects an increased use of licensed properties for Scratchers games as well as increased delivery costs from the Lottery deploying more five-game launches of new Scratchers games.

Excluding the reserves, retailer compensation and gaming costs account for 73.4 percent of the Lottery's administrative expenses for FY 2021-22. The remaining administrative expenditures comprise operating costs, which include personnel costs, advertising/marketing costs, and other overhead costs. Operating costs also contain the funding and resources required to execute the FY 2021-22 Business Plan initiatives and funding for operational improvements. The cost associated with employees and maintenance of internal systems and infrastructures represent the core of the increased operating costs.

Personal Services costs increases are mainly due to the end of the Personal Leave Program and the addition of a general salary increase for most employees. Also, as shown in Attachment II, the proposed budget includes establishing 28.0 new positions and an additional \$7.3 million to meet the Business Plan and program expansion needs.

Also included within administrative expenses for FY 2020-21 is a \$5 million reserve for insurable risk to cover fiscal exposures for the areas of our organization that we are continuing to self-insure, as well as a \$78.4 million administrative spending reserve to act as a safeguard against future uncertainties. The administrative spending reserve also

provides the Commission and the Lottery with the flexibility to take advantage of opportunities to increase funding for education that may emerge over the upcoming year. The administrative spending reserve is an element of the 13 percent of total revenues specified for administrative expenses. Pursuant to provisions of the Lottery Act, the entire unspent amount within both the administrative spending reserve and the reserve for insurable risk will be transferred directly to public education.

Summary

The proposed FY 2021-22 budget contains sales goals of \$8.45 billion, a 0.5 percent increase over expected sales for FY 2020-21. This level of sales, combined with the other elements in the budget, is estimated to generate nearly \$1.86 billion in contributions to California public schools. With a still-recovering economy, the Lottery takes pride in being able to sustain annual funding to education exceeding the \$1.5 billion mark for what will be seven consecutive years beginning with FY 2015-16.

The \$8.45 billion sales goal and the \$1.86 billion estimated contribution to education for FY 2021-22 are based on executing a vast array of Business Plan initiatives designed to result in the sustainable growth of future revenues. The proposed budget includes a balanced approach between actions that enable the Lottery to sustain growth in sales and contributions to public education in years to come.

RECOMMENDATION

Staff recommends that the Commission approve the Lottery's budget for FY 2021-22 as reflected in the attached documents.



FISCAL YEAR 2021-22 PROPOSED BUDGET

(Dollars in Thousands)

SALES	FY 2020-21	% of	FY 2021-22	% of	Difference
	Year-End Estimate	Sales	Proposed Budget	Sales	
Scratchers	\$6,394,000	76.1 %	\$6,530,000	77.3 %	\$136,000
Powerball	408,200	4.9 %	409,000	4.8 %	800
Mega Millions	529,300	6.3 %	428,000	5.1 %	-101,300
SuperLotto Plus	260,300	3.1 %	241,000	2.9 %	-19,300
Hot Spot	374,300	4.5 %	395,000	4.7 %	20,700
Fantasy 5	176,800	2.1 %	180,000	2.1 %	3,200
Daily 3	186,900	2.2 %	190,000	2.2 %	3,100
Daily 4	38,000	0.5 %	38,000	0.4 %	0
Daily Derby	37,900	0.5 %	39,000	0.5 %	1,100
TOTAL, ESTIMATED SALES	\$8,405,700	-	\$8,450,000	-	\$44,300

PRIZE EXPENSE	FY 2020-21	Prize	FY 2021-22	Prize	Difference
	Year-End Estimate	Payout %	Proposed Budget	Payout %	
Scratchers	\$4,550,993	71.2 %	\$4,644,136	71.1 %	\$93,143
Powerball	192,666	47.2 %	204,500	50.0 %	11,834
Mega Millions	263,094	49.7 %	214,000	50.0 %	-49,094
SuperLotto Plus	130,150	50.0 %	120,500	50.0 %	-9,650
Hot Spot	235,809	63.0 %	252,800	64.0 %	16,991
Daily Games	216,111	49.2 %	222,606	49.8 %	6,495
2nd Chance - Scratchers	5,200	-	5,200	-	0
2nd Chance - Draw Games	3,900	-	3,900	-	0
Prize Expense Savings	-21,159	-	-30,000	-	-8,841
TOTAL, PRIZE EXPENSE	\$5,576,764	66.3 %	\$5,637,642	66.7 %	\$60,878
NET SALES AFTER PRIZE EXPENSE	\$2,828,936	-	\$2,812,358	-	-\$16,578

ADMINISTRATIVE EXPENSES	FY 2020-21	% of	FY 2021-22	% of	Difference
	Year-End Estimate	Sales	Proposed Budget	Sales	
Retailer Compensation:					
Commission	\$490,893	5.8 %	\$493,480	5.8 %	\$2,587
Cashing Bonus	48,921	0.6 %	49,179	0.6 %	258
Special Handling	36,145	0.4 %	36,335	0.4 %	190
Incentives	4,035	0.0 %	4,000	0.0 %	-35
Gaming Costs:					
Gaming Contract (IGT)	120,502	1.4 %	120,945	1.4 %	443
Administrative Retailer Fees	-20,055	-	-20,743	-	-688
Gaming Monitor Fees	-513	-	-558	-	-45
Scratchers Ticket Costs	39,277	0.5 %	53,809	0.6 %	14,532
Scratchers Delivery and Support Costs	6,964	0.1 %	8,611	0.1 %	1,647
Subtotal, Retailer & Gaming Costs	\$726,169	8.6 %	\$745,058	8.8 %	\$18,890
Operating Costs:					
Personal Services	\$108,704	1.3 %	\$121,227	1.4 %	\$12,523
Marketing Budget Plan	70,487	0.8 %	84,975	1.0 %	14,488
Contractual Services	17,690	0.2 %	24,577	0.3 %	6,888
Depreciation	16,974	0.2 %	17,727	0.2 %	753
Operating Expense	15,220	0.2 %	21,497	0.3 %	6,277
Reserve for Insurable Risk	0	0.0%	5,000	0.1 %	5,000
Administrative Spending Reserve	0	0.0%	78,439	0.9 %	78,439
Subtotal, Operating Costs	\$229,075	2.7 %	\$353,442	4.2 %	\$124,367
TOTAL, ADMINISTRATIVE EXPENSES	\$955,243	11.4 %	\$1,098,500	13.0 %	\$143,257

CONTRIBUTION TO EDUCATION	FY 2020-21	FY 2021-22	Difference
	Year-End Estimate	Proposed Budget	
CONTRIBUTION TO EDUCATION	\$1,873,692	\$1,713,858	-\$159,834
Unclaimed Prizes	19,405	49,700	30,295
Interest Income	3,516	10,000	6,484
TOTAL AVAILABLE FOR EDUCATION	\$1,896,613	\$1,773,558	-\$123,055
TOTAL CONTRIBUTION TO ED WITH RESERVES	\$1,896,613	\$1,856,997	-\$39,617

*Numbers may not add due to rounding.



FISCAL YEAR 2021-22

SUMMARY OF FUNDING NEEDS BY OBJECTIVE
(Dollars in Thousands)

Objective	Positions	Cost
Respond to Emerging Needs from Recent Events and Trends	2.0	\$427
Focus Efforts to Reinvigorate Retail	5.0	\$420
Strengthen Sales in Jackpot Games	1.0	\$281
Defuse the Barriers to Play by Changing Perceptions	0.0	\$262
Transform the Lottery Organization	17.0	\$5,178
Administrative Support	3.0	\$697
Total FY 2021-22 Initiatives and Other Revisions	28.0	\$7,265