




M E M O R A N D U M

Date: June 30, 2022

To: California State Lottery Commission

From: Alva V. Johnson 
Director

Prepared By: Nicholas Buchen
Deputy Director, Finance Division

Subject: Item 9(b) – Fiscal Year 2022-23 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) 2022-23 presents a sales goal of \$8.54 billion and is estimated to provide nearly \$1.81 billion to public education.

BACKGROUND

Attachment I to this memo presents the Lottery's proposed FY 2022-23 budget, which reflects a sales goal of \$8.54 billion and is estimated to result in approximately \$1.81 billion in supplemental funding for California public education. This proposed budget includes resources to responsibly maintain operational growth as well as the resources necessary to implement the Lottery's FY 2022-23 Business Plan. 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 current multi-year strategic plan and drive bottom-line contributions to education. All goals and major initiatives tie back to one or more of the Lottery's six strategic objectives:

- Modify operations to ensure health and safety and to recover from depressed sales
- Revisit retail strategies to adapt to the new consumer preferences
- Grow draw game sales, particularly jackpot games and Hot Spot
- Defuse the barriers to play by changing consumer perceptions
- Better inform the public and stakeholders about the Lottery

- Transform the corporate culture in the Lottery organization

DISCUSSION

The proposed Business Plan for FY 2022-23 revolves around five key objectives that combine strategies to drive sales and funding for education next year and initiatives to maintain growth in subsequent years. The five key objectives are:

- Maintain Scratchers interest and play in view of increased competition for the entertainment dollar
- Focus efforts to reinvigorate retail
- Create opportunities to grow sales of draw games, particularly jackpot games and Hot Spot
- Defuse barriers to play by continuing to improve knowledge and perceptions about the Lottery
- Transform and modernize the Lottery

Development of the Lottery's FY 2022-23 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 the Lottery's business operations as well as industry trends.

This comprehensive assessment of sales goals, the funding needed to deliver those goals, and the resulting contribution to education culminates in the proposed FY 2022-23 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 2022-23 budget.

A summary of the elements of the proposed FY 2022-23 budget is presented on the following pages:

Sales

Total sales for all Lottery products are projected to be \$8.54 billion for FY 2022-23; this represents a decrease of \$418 million, or 4.7 percent from the estimated year-end sales levels for FY 2021-22. Except for Mega Millions, each game has a projected year-over-year decrease in sales because the Lottery experienced much higher sales than typical in FY 2021-22 due to certain consumers spending significantly more on the Lottery than

they otherwise would have given that they were either unable to participate or uncomfortable with participating in other forms of entertainment and leisure during the pandemic. As consumers are now resuming various other leisure and entertainment activities and are readjusting their associated spending accordingly, the Lottery's sales projections for FY 2022-23 fall short of the sales anomaly the Lottery experienced in FY 2021-22 (despite the FY 2022-23 sales projection still representing a growth trajectory as compared to prior fiscal years).

Mega Millions sales are projected to increase in FY 2022-23 despite consumers recalibrating their entertainment and leisure spending because the game had relatively low jackpots throughout the current fiscal year, which significantly reduced sales; the sales projection for FY 2022-23 assumes Mega Millions will have more typical roll patterns based on odds.

The following chart compares the FY 2021-22 year-end estimate with proposed sales goals for the FY 2022-23 budget.

Fiscal Years Comparison Chart

Comparison of Revenues			
FY 2021-22 Estimated Year-End Sales and Proposed FY 2022-23 Budget			
(Dollars in Thousands)			
Sales:	Year-End Estimate FY 2021-22	Proposed Budget FY 2022-23	Difference
Scratchers®	\$6,940,000	\$6,580,000	\$(360,000)
Multi-State Jackpot Games	935,000	910,000	(25,000)
SuperLotto Plus®	245,000	240,000	(5,000)
Hot Spot	402,000	392,000	(10,000)
Daily Games	436,000	418,000	(18,000)
Total Sales	\$8,958,000	\$8,540,000	\$(418,000)

Expenses

The following section describes costs associated with the FY 2022-23 budget.

Prize Expense

Prize expense is estimated to total \$5.7 billion in FY 2022-23. This is a decrease of \$212.6 million (3.6 percent) from the estimated FY 2021-22 prize expense mainly due to the decreased sales projection. 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 67.0 percent of projected sales for FY 2022-23, which is within the range of 65 percent to 67 percent that was recommended as being ideal in an analysis that was conducted for the Lottery last year 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 2022-23 are estimated to be just over \$1.0 billion, an increase of \$3.3 million (0.3 percent) from estimated expenses for FY 2021-22. This year-over-year change primarily reflects the strategic investment in FY 2022-23 Business Plan initiatives and operational improvements to help achieve and sustain future growth.

Retailer compensation costs are estimated to total \$588.5 million for FY 2022-23. This amount represents a decrease of \$31.9 million (5.1 percent) from projected FY 2021-22 retailer compensation costs and is primarily associated with the lower sales goals projected for FY 2022-23.

Gaming costs are budgeted at \$154.2 million for FY 2022-23, which is a decrease of \$731.6 thousand (0.5 percent) from the FY 2021-22 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. This year-over-year decrease is attributable to the decreased sales projection but is partially offset by the increased use of licensed properties and specialized printing features slated for Scratchers games in FY 2022-23 as well as projected increased costs in ticket delivery.

Excluding the reserves, retailer compensation and gaming costs account for 71.4 percent of the Lottery's administrative expenses for FY 2022-23. 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 2022-23 Business Plan initiatives and funding for operational improvements which, combined, account for the vast majority of the projected year-over-year increase in this budget category.

Personal Services costs increases are mainly due to the proposed addition of 45.0 new positions for FY 2022-23. Attachment II reflects the cost for these proposed 45.0 new positions as well as the additional expenditures needed to meet the Business Plan and other program needs.

Also included within administrative expenses for FY 2022-23 is a \$5.0 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 \$64.3 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 2022-23 budget contains sales goals of \$8.54 billion, a 4.7 percent decrease from estimated sales for FY 2021-22. This level of sales, combined with the other elements in the budget, is estimated to generate nearly \$1.81 billion in contributions to California public schools. With an uncertain economic outlook facing California, the Lottery takes pride in being able to sustain annual funding to education exceeding the \$1.5 billion mark for what will be eight consecutive years beginning with FY 2015-16.

The \$8.54 billion sales goal and the approximately \$1.81 billion estimated contribution to education for FY 2022-23 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 2022-23 as reflected in the attached documents.

Attachments