

The Ohio Lottery Commission

Oral Budget Testimony Regarding the Fiscal Year 2012/2013 Biennium Budget

Senate Hearing Date – Friday, May 6, 2011

Chairman Widener, Vice Chair Jones, Ranking Member Skindell, and members of the Finance Committee, thank you for allowing me this opportunity to provide budget testimony on behalf of the Ohio Lottery Commission.

My name is Dennis Berg and I am the interim Director of the Ohio Lottery Commission.

I have provided you a supplemental document to my oral testimony. Included in this document is information about the history of the Ohio Lottery, the economic benefits derived from the operation of the Lottery, a list of frequently asked questions and answers for your reference, as well as other informative exhibits. This budget submission does not include any provisions for Video Lottery Terminals or consideration of privatization models. In essence, the budget submitted anticipates operating the Lottery under its current business model.

To start, I would like to update the committee on the status of the Ohio Lottery.

There are 44 lotteries operating in the United States. The Ohio Lottery, which ranks ninth in sales, is considered a leader and a well respected lottery in the gaming industry. Since 1974, the Lottery has generated over \$17.5 billion in profits.

I am pleased to report to you that the Lottery's financial condition is strong. In fiscal year 2010, the Lottery set an all time sales record of \$2.5 billion in ticket sales. Fiscal

year 2010 represented the ninth consecutive year of increased sales growth. Ohio is one of only four U.S. lotteries that have recorded consecutive year-over-year sales growth for nine or more years. (Ohio, New York, Maryland and Nebraska).

Total Lottery sales were positively impacted by the growth in the Keno product line, the addition of the multi-state Powerball game in late fiscal year 2010, and strong sales results in the instant ticket product line.

In fiscal year 2010, the Lottery contributed \$728.6 million to the Lottery Profits Education Fund, exceeding the budgetary commitment by over \$23 million. Through the first ten months of fiscal year 2011 (July-April), the Lottery continues to realize strong sales and profit results. In fact, the Lottery realized record instant ticket sales in eight out of the last ten months. Through April, sales are up \$106 million over last fiscal year. To date the Lottery has transferred \$18.3 million more to the Lottery Profits Education Fund compared to transfers made last year through the same period.

After all operating expenditures and prize payments are accounted for, the Lottery realizes, on average, profit of nearly \$2.0 million per day. The Lottery also generates over \$2.0 million in profits per year, per employee. Last year, core operating expenses came in at roughly 4.4 percent of each dollar sold.

Lottery products are sold through a network of roughly 8,900 retail establishments. Last fiscal year, Lottery retailers earned over \$153 million in sales commissions and bonuses. The Lottery is vital to many small and large business owners. In addition to the commissions and bonuses earned from selling lottery products, retailers realize additional customer foot traffic, resulting in ancillary sales in other products such as soft drinks, milk and bread.

BUSINESS CHALLENGES

Despite the recent accomplishments by the Lottery, the agency must be prepared to face changes in the business environment. Being in existence for over 36 years, the Ohio Lottery is considered a mature lottery with few traditional game option strategies remaining, absent the expansion of the lottery in other trade channels. In addition, the Lottery faces stiff competition from various other gaming options.

In addition to the casinos bordering Ohio, Issue 3 authorized four casinos to operate in State of Ohio. The actual impact the casinos will have on Lottery revenues in this upcoming biennium is dependent on the actual opening dates. These opening dates are moving targets. For purposes of this budget submission, it is anticipated that none of the casinos will be operating for a significant period of time during fiscal year 2012. However, several if not all casinos could become operational during fiscal year 2013.

Although research has been performed in the lottery industry to project the negative impact of casino gaming on lottery revenues, it is difficult to specifically determine the impact, as many complex factors and variables come into play. Nevertheless, the general consensus points to a downward trend in sales for at least a couple of years.

According to the research, the Lottery could see a reduction in sales in the range of 4.5% to 6.5%. For purposes of this budget submission, the Lottery has taken a conservative approach and is assuming a 5.0% decline across the board in Lottery sales in fiscal year 2013.

Slot machine style devices continue to appear in bars, taverns and free standing gaming parlors throughout the State of Ohio. These games pose one more competitive challenge to the Lottery, thereby shrinking the number of discretionary dollars available.

Despite the introduction of Keno which has helped the Lottery's bottom line, the agency continues to struggle to maintain its traditional retailer base. As smaller retailer outlets close their doors, national big box retailers have consolidated the retail market. These national retail outlets are reluctant to sell Lottery products as they do not embrace the Lottery as being part of their overall business model. As consumer shopping and spending patterns shift, the Lottery is challenged to establish new Lottery retailer channels in this altering market environment.

BIENNIUM BUDGET REQUEST

The Ohio Lottery is charged with the goal of maximizing profits to education through the sale of Lottery products. The Lottery is an enterprise fund of the State of Ohio and receives no general revenue fund support.

Nearly 50% of the Lottery's operating budget is directly tied to sales volume. In essence, when sales increase, operating expenses increase and vice-versa if sales decline.

The Lottery's operating budget supports the efforts to generate revenue through the sale of lottery tickets. The Lottery has estimated sales of roughly \$2.5 billion in fiscal year 2012 with a core operating budget of \$121.3 million, down slightly from fiscal year 2011. This core budget includes funding for payroll and purchased personal services and items in the maintenance category which includes, but is not limited to; telecommunications, facility leases, auditing fees, and office supplies. Expenses incurred in the equipment category consist primarily of much needed capital investments in information technology and vehicle replacement.

Major contractual expenses are necessary to support the Lottery's advertising programs and gaming service contracts, including the gaming computer system, instant ticket printing and the paper supplier for printing online ticket stock and bet cards.

Prizes can be paid either by state warrant, cashed at a lottery retailer, or paid at participating bank location, depending on the prize amount. The budget request for direct prize payments and annuity prizes serves mainly as a pass-through account allowing the Lottery to pay prize winners by state warrant.

Lastly, the Lottery continues its agreement with the Attorney General's office to provide oversight, administration and monitoring of Charitable Bingo licensing. The Lottery also contracts with the Ohio Department of Drug and Alcohol Addiction Services for the support of problem gambling services.

CONCLUSION

The goals and objectives of the budget address the maximization of sales and net profits for transfer to the Lottery Profits Education Fund. The Lottery strongly believes that the expected sales levels, supported by the requested appropriations within this biennium budget, provide for the successful achievement of the Lottery's goals and objectives. The Lottery has committed to transfer \$711 million in fiscal year 2011. By exercising its philosophy of fiscal responsibility, the Lottery expects to increase its commitment to the Lottery Profits Education Fund in fiscal year 2012 to \$717.5 million. Due to the planned openings of four casinos, the Lottery is taking the conservative approach and anticipates a decline in Lottery profits in fiscal year 2013. The projected transfer for fiscal year 2013 is set at \$680.5 million.

The Lottery understands its responsibility to provide funding for education in the State of Ohio. I am confident of the Lottery's continued ability to add to the over \$17.5 billion that it has produced in profits.

I appreciate your attention today and will now be pleased to answer any questions that you may have. Several Lottery staff members have accompanied me today and are available to provide more support on specific components of our budget request and business operations.

Thank you for allowing me the opportunity to present this testimony to you.