

September 6, 2006

The Honorable Timothy M. Kaine  
Governor  
Commonwealth of Virginia  
Patrick Henry Building, 3<sup>rd</sup> floor  
Richmond, VA 23219

Dear Governor Kaine:

I am pleased to provide our report of monthly activities and financial update for the fiscal year ending June 30, 2006, as well as for the month of July 2006, as required in Section 58.1-4006 of the *Code of Virginia*.

Fiscal Year 2006 Lottery sales exceeded the prior year. Total sales of \$1.365 billion were \$31.4 million (+2.4%) higher than last year, but \$22.9 million (-1.7%) behind the forecast. Sales in all product categories exceeded the prior year, but the growth in scratcher sales were affected more than expected by the inception of North Carolina lottery sales. Daily games sales were also negatively affected by very low prize payouts, due to the luck of the draw. Fiscal Year 2007 began with July sales totaling \$99.2 million, down \$12.4 million (-11.1%) from last year, primarily due to lower advertised jackpots.

Fiscal Year 2006 net income of \$454.9 million was \$31.4 million (+7.4%) higher than the prior year's earnings, and \$21.4 million (+4.9%) ahead of the forecast. All of the excess earnings over forecast are attributable to lower than expected prize payouts during the year. Fiscal Year 2007 began with July profits totaling \$32.1 million, down \$1.0 million (-3.0%) from last year.

We are very proud of the year just ended and our record contributions toward public K-12 education funding in Virginia, and thank you for celebrating our record year with us at the news conference on August 22<sup>nd</sup>. As for Fiscal Year 2007, we continue to monitor the impact of the North Carolina Education Lottery on Virginia sales and profits. **It should be anticipated that the Virginia Lottery will continue to creatively address the challenge created by this new competition.** As always, we will participate in the statewide revenue re-forecasting process, coordinated through the Department of Taxation, this fall.

Please let me know if you have any questions or if you would like more information.

Very truly yours,

Sheila Hill-Christian

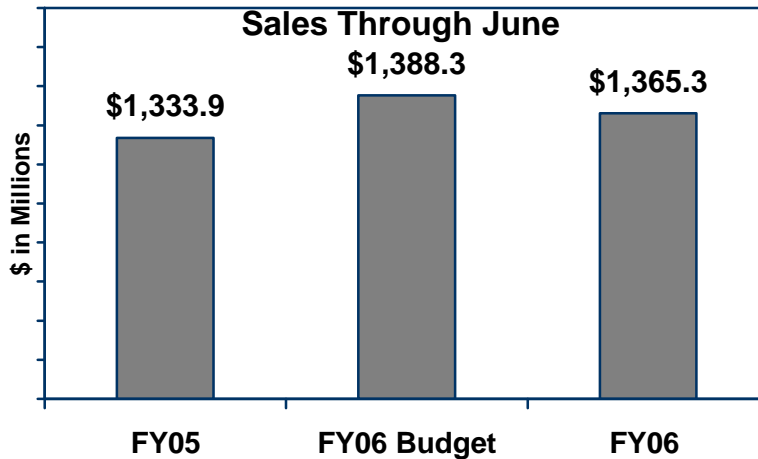
c: The Honorable John H. Chichester, Chairman – Senate Finance Committee  
The Honorable Vincent F. Callahan, Jr., Chairman – House Appropriations  
Committee  
The Honorable Harry R. Purkey, Acting Chairman – House Finance  
Committee  
The Honorable William H. Leighty, Chief of Staff – Office of the Governor  
The Honorable Jody M. Wagner, Secretary of Finance  
Mr. Richard D. Brown, Director – Department of Planning & Budget  
Mr. David A. Von Moll, State Comptroller  
Ms. Elizabeth B. Daley, Staff Director – Senate Finance Committee  
Mr. Robert P. Vaughn, Staff Director – House Appropriations Committee

**VIRGINIA LOTTERY**  
**Report to the Governor and**  
**Selected Members of**  
**the General Assembly**  
**September 6, 2006**

Fiscal Year 2006 Sales

Lottery sales for the 2006 fiscal year totaled \$1.365 billion, which was \$31.4 million (+2.4%) higher than the prior year, but \$22.9 million (-1.7%) less than the forecast.

Sales increased in all product categories. Scratcher sales were up \$9.8 million or 1.4% compared to last year, but \$29.8 million (-4.1%) behind budget. Daily games (Pick 3, Pick 4, and Cash 5) sales continued strong, up \$4.0 million or 0.9% over last year. Compared to budget, daily game sales of \$454.5 million were \$2.4 million (-0.5%) below forecast. Sales of the jackpot games, Mega Millions, Lotto South (through February) and Win for Life (beginning in March), increased \$17.6 million (+8.7%) over last year, with longer Mega Millions jackpot rolls resulting in advertised jackpots over \$250 million at least once each quarter. Compared to budget, jackpot sales exceeded the forecast by \$9.3 million, or 4.4%.



July 2006 Sales

Fiscal year 2007 began with sales of \$99.2 million, a decline of \$12.4 million (-11.1%) compared to July 2005. The most significant decline occurred in the jackpot games, down \$9.0 million due to lower advertised jackpots in Mega Millions. Scratcher sales were very near last year's level, and daily game sales were down nearly \$3 million.

Fiscal Year 2006 Expenses

The overall prize expense rate continued to decline (prize expense as a percent of sales), with the 56.7% rate 1.4% lower than last year and 1.9% lower than budget.

The scratcher prize rate increased 0.8% to 65.8%, and the daily games prize rate of 45.5% was 4.4% less than last year and 4.4% less than the statistically expected rate. Jackpot prize expenses were 50.9% of sales, down 1.8% from last year due to the favorable jackpot rolls and more favorable long-term bond rates.

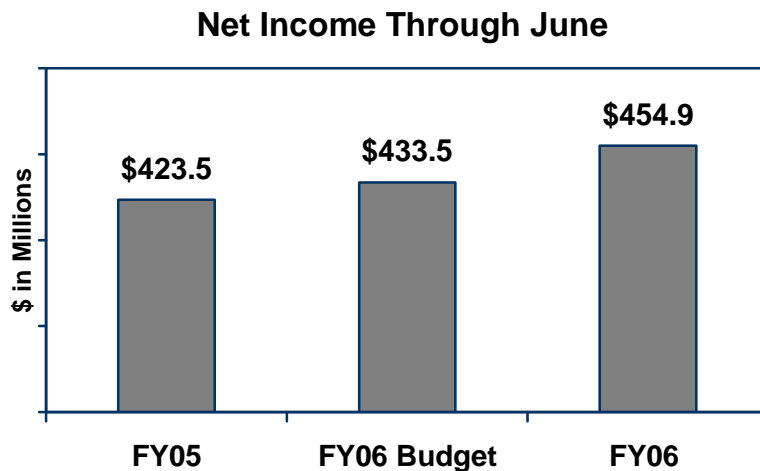
With the overall sales increase, retailers earned nearly \$0.6 million more than last year. Administrative operating costs, including ticket printing and distribution expenses, were \$3.6 million more than during the same period last year due to higher sales, the launch of the new Win for Life game, and technological investments.

#### July 2006 Expenses

The luck of the draw continued to dampen overall prize expense rates, with July daily games' prizes totaling only 44.4% of sales. Overall, prizes comprised 57.0% of total sales, compared to 59.9% of sales last July. Retailer compensation declined \$0.5 million due to the decline in sales, with the retailer compensation rate steady at 5.6%. Operating expenses totaled \$5.2 million, down \$0.5 million compared to July 2005.

#### Fiscal Year 2006 Net Income

Fiscal Year 2006 ended with record profits totaling \$454.9 million, \$31.4 (+7.4%) million ahead of last year and \$21.4 million (+4.9%) ahead of forecast. The significant increase in earnings over the forecast, in spite of lower than expected sales, is the direct result of lower than expected prize payouts during the year.



#### July 2006 Net Income

The lower overall prize expense rate offset much of the sales reduction, leading to July 2006 earnings of \$32.1 million, down \$1.0 million (-3.0%) compared to last year.

## CONTRIBUTIONS TO DEBT SETOFF & LITERARY FUND

Pursuant to the Setoff Debt Collection Act, the Lottery made payments to the Department of Taxation totaling \$49,286 in June, bringing the year-to-date total to \$827,064. Also, the Lottery transferred unclaimed prizes of \$745,684 in June, or \$14,033,804 for the year.

For July 2006, the Lottery made payments to the Department of Taxation totaling \$57,304. Unclaimed prizes totaling \$890,800 were also transferred to the Literary Fund for the month of July 2006.

## MEETINGS

The State Lottery Board held a regularly scheduled business meeting on Wednesday August 2, 2006, in Richmond. The Board reviewed financial results, planned promotional events, and upcoming games as part of their regular business. The next Board meeting is scheduled for October 18, 2006, in Richmond.

The Retailer Advisory Council will meet in Richmond on October 25, 2006. The Council is comprised of Lottery retailers, and members periodically meet to discuss retailer issues, upcoming products, and overall Lottery issues.

## NORTH CAROLINA LOTTERY UPDATE

As announced, the North Carolina Education Lottery (NCEL) began selling scratch tickets on March 30, 2006, and the multi-state jackpot game Powerball tickets on May 30, 2006. The NCEL also announced plans to begin offering daily Carolina Pick 3 and Carolina Cash 5 games in October, with drawings to be conducted seven days a week.

**The table below shows the localities most impacted by the North Carolina Education Lottery based on a 22-week period compared to the same period in 2005:**

Total Change	City or County	Total \$ Change
-44%	Carroll	-3,226,275
-39%	Greenville	-1,814,924
-31%	Mecklenburg	-3,683,777
-30%	Henry	-2,564,867
-26%	Emporia City	-1,321,414