

October 26, 2006

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

Dear Governor Kaine:

I am pleased to provide our report of monthly activities and financial update for the month of September 2006, as required in Section 58.1-4006 of the *Code of Virginia*.

Sales for the month of September 2006 totaled nearly \$108 million, an increase of \$2.4 million (+2%) over last month, but a decline of \$6.9 million (-6%) compared to September 2005. For the year to date, sales totaled \$312.8 million, which was \$30.2 million (-9%) less than the same period last year. September net income totaled \$34.6 million, for year to date earnings of \$97.9 million, down \$5.5 million (-5%) compared to the same period last year.

We have completed our revised revenue forecast for the current biennium and reviewed the details with the State Lottery Board. As such, the Board forwarded to you the revised net income projection of \$405.4 million for the current fiscal year, and \$405.4 million for fiscal year 2008. While this is a decline, it represents our best estimate of revenues from current operations, including the current retailer compensation structure and statutory authority. It is our hope to exceed these estimates, through our continual monitoring of consumer preferences and industry trends.

Fiscal Year 2007 has begun with declining sales, as anticipated when comparing Virginia Lottery sales pre- and post-launch of the North Carolina Education Lottery. It should be anticipated that the Virginia Lottery will continue to creatively address the challenge created by this new competition.

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

Very truly yours,

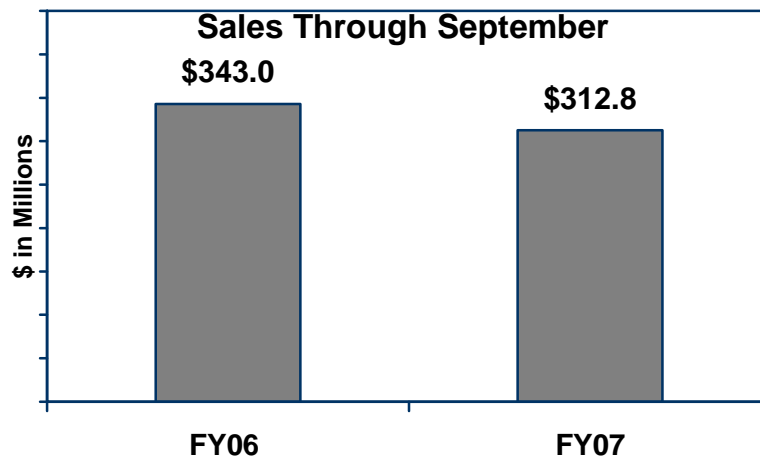
Sheila Hill-Christian

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
October 26, 2006

Sales

Lottery sales for the fiscal year through September 2006 were \$312.8 million, which was \$30.2 million (-8.8%) less than during the same period last year. Sales declined across all product categories, with the largest decline in Jackpot sales, down \$20.6 million (-34.7%) due to lower advertised jackpots because of more frequent jackpot wins. Daily games (Pick 3, Pick 4, and Cash 5) sales were down \$3.3 million (-2.9%) compared to last year. Scratcher sales declined \$6.3 million (-3.7%) compared to last year as a result of the competition from North Carolina.



Expenses

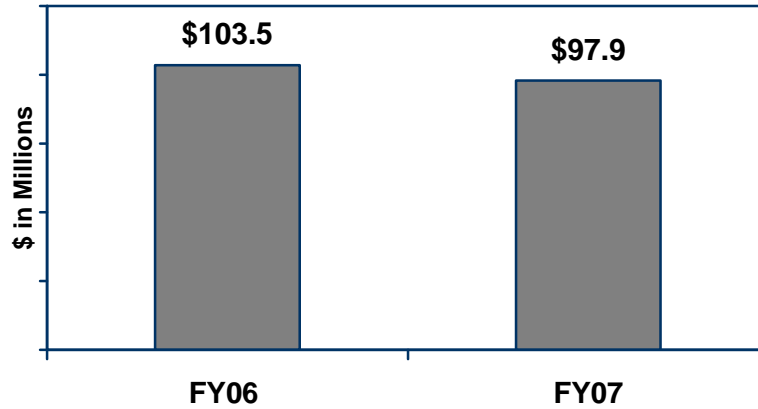
The overall prize expense rate (prize expense as a percent of sales) of 58.3% was 1.1% less than last year. The scratcher prize rate increased 0.2% to 66.3%; the daily games prize rate of 50.0% was on target with statistical expectations, and 2.6% lower than last year's rate.

With the overall sales decrease, retailers earned nearly \$1 million less than last year; however, the compensation rate for the year to date is a strong 5.8%, up 0.2% from last year as a result of strong participation in retailer incentive programs. Administrative operating costs were \$2.1 million less than during the same period last year.

Net Income

The 8.8% sales decline was offset somewhat by lower prize and operating expenses, resulting in net income through September of \$97.9 million, down \$5.5 million (-5.3%) compared to last year at this point.

Net Income Through September



CONTRIBUTIONS TO DEBT SETOFF & LITERARY FUND

Pursuant to the Setoff Debt Collection Act, the Lottery made payments to the Department of Taxation totaling \$40,564 in September, bringing the year-to-date total to \$299,451. Also, the Lottery transferred unclaimed prizes of \$861,519 in September, or \$2,667,553 for the year.

MEETINGS

The State Lottery Board held a regularly scheduled business meeting on Wednesday October 18, 2006, in Richmond. The Board reviewed financial results, planned promotional events, upcoming games, and the revised Lottery revenue forecast as part of their regular business. The Board also welcomed its newest member, Ms. Cynthia D. Lawrence.

The Retailer Advisory Council met in Richmond on October 25, 2006. The Council is comprised of Lottery retailers, and members met with Lottery staff 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 began offering daily Carolina Pick 3 games on October 6, and will introduce Carolina Cash 5 on October 27. North Carolina daily games will offer drawings seven days a week. The table below shows the localities most affected by the North Carolina Education Lottery. Based on the period of July 1st, 2006 through October 15th, 2006, the five counties on the North Carolina border with the greatest percentage sales loss versus the same period in the prior year are:

Total %Change	City or County	Total \$ Change
-52%	Carroll	-\$2,524,358
-38%	Greensville	-\$1,138,434
-35%	Henry	-\$1,979,970
-34%	Mecklenburg	-\$2,663,040
-28%	Grayson	-\$164,362