

January 25, 2007

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 December 2006, as required in Section 58.1-4006 of the *Code of Virginia*.

Sales for the month of December 2006 totaled nearly \$116.5 million, a decline of \$7.7 million (-6 %) compared to December 2006. For the year to date, sales totaled \$642 million, which was \$60.3 million (-9%) less than the same period last year. December net income totaled \$41.1 million, for year to date earnings of \$208.6 million, down \$15.1 million (-7%) compared to the same period last year.

Fiscal Year 2007 continues to reflect declining sales, as anticipated when comparing Virginia Lottery sales pre- and post-launch of the North Carolina Education Lottery. The Virginia Lottery will continue to creatively address the challenge created by this new competition. One such initiative is the launch of Sunday drawings for our existing daily game products – Pick 3, Pick 4, and Cash 5 – giving our players two additional chances to play and win these games each week. Beginning with the initial Sunday drawing conducted January 7, 2007, players have responded favorably with sales for each successive week growing over the prior week. Overall, Sunday draw sales have occurred in line with our initial projections.

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

Very truly yours,

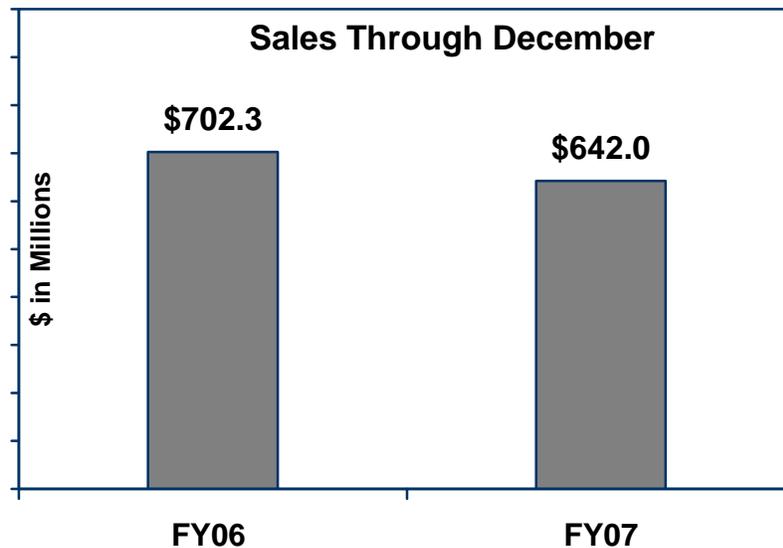
Sheila Hill-Christian

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
January 25, 2007

Sales

Lottery sales for the fiscal year through December 2006 were \$642 million, which was \$60.3 million (-8.6%) less than during the same period last year. Sales declined across all product categories, with the largest decline in Jackpot sales, down \$47.8 million (-39.2%) due to lower advertised jackpots because of more frequent jackpot wins. Daily games (Pick 3, Pick 4, and Cash 5) sales were down \$6.7 million (-2.9%) compared to last year. Scratcher sales declined \$5.8 million (-1.7 %) compared to last year as a result of the competition from North Carolina.



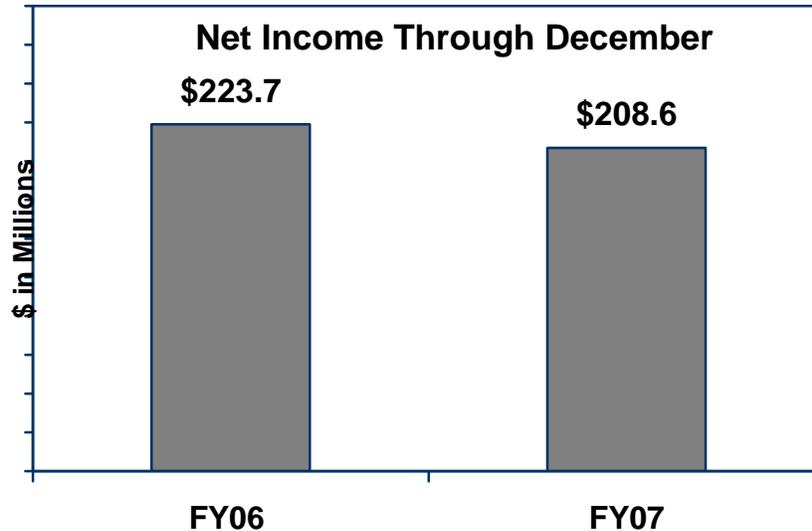
Expenses

The overall prize expense rate (prize expense as a percent of sales) of 57.4% was 0.6% less than last year. The scratcher prize rate of 66.1% was up slightly (0.2%); the daily games prize rate of 46.8% was lower than statistical expectations, and 2.5% lower than last year's rate.

With the overall sales decline, retailers earned nearly \$2.8 million less than last year; however, the compensation rate for the year so far stands at 5.6%, slightly ahead of last year. Administrative operating costs were \$2.4 million less than during the same period last year.

Net Income

The overall sales decline (-8.6%) was offset somewhat by lower prize and operating expenses, resulting in net income through December of \$208.6 million, down \$15.1 million (-6.7%) compared to last year at this point.



CONTRIBUTIONS TO DEBT SETOFF & LITERARY FUND

Pursuant to the Setoff Debt Collection Act, the Lottery made payments to the Department of Taxation totaling \$52,477 in December, bringing the year-to-date total to \$502,816. Also, the Lottery transferred unclaimed prizes of \$1,128,308 in December, or \$6,195,096 for the year.

NORTH CAROLINA LOTTERY UPDATE

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, 2006, and Carolina Cash 5 on October 27, 2006. North Carolina daily games 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 January 15th, 2007, 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 |
|---------------|----------------|-----------------|
| -56% | Carroll | -\$5,211,833 |
| -45% | Greenville | -\$2,552,322 |
| -38% | Henry | -\$4,041,086 |
| -37% | Mecklenburg | -\$5,550,768 |
| -30% | Grayson | -\$327,435 |

MEETINGS

The State Lottery Board conducted a regularly scheduled business meeting on Wednesday January 24, 2007, in Richmond. The Board reviewed financial results and upcoming games as part of their regular business.

On Wednesday January 17, 2007, I was invited to speak to the members of the Senate Finance Committee about the current status of Lottery revenues, and the North Carolina Education Lottery impact on sales of Virginia Lottery products. I also discussed with the members upcoming plans to offer different products to help offset the sales decline experienced so far this year.