

February 23, 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 the financial update for the month of January 2007, as required in Section 58.1-4006 of the *Code of Virginia*.

Sales for the month of January 2007 totaled \$113.6 million, an increase of \$5.5 million (+5 %) compared to January 2006. This is the first time this fiscal year that monthly sales totaled more than the same month last year. This is particularly positive because January 2007 compares sales after the inception of the North Carolina Education Lottery, versus sales last year before that Lottery began selling products. For the year to date, sales totaled \$755.6 million, which was \$54.8 million (-7%) less than the same period last year. January net income totaled \$30.6 million, for year to date earnings of \$239.2 million, down \$20.9 million (-8%) compared to the same period last year.

Compared to the Lottery forecast, year to date sales of \$755.6 million are \$7.4 million (+1%) ahead of projections. Scratcher and daily game product sales are ahead of projections, while jackpot product sales are significantly lower than expected due to the frequency of jackpot wins and lower than expected advertised jackpots. Net income of \$239.2 million through January was nearly \$9 million ahead of projections, mainly due to lower than projected prize expense for scratcher tickets and lower administrative expenses. Cumulative prize expense for the daily game products is very near projections, and may fluctuate significantly in the short term depending upon the random numbers drawn. Prize expense is the most significant Lottery expense, and is a volatile factor that influences net income.

Fiscal Year 2007 continues to reflect an overall decline in total sales, as anticipated when comparing Virginia Lottery sales pre- and post-launch of the North Carolina Education Lottery. However, the decline in scratcher ticket sales, the product comprising more than half of all Virginia Lottery sales, has steadily slowed. The January launch of Sunday drawings for daily game products has helped offset

some of the sales reduction attributed to the NC Lottery competitive offerings, and the February 4, 2007, launch of Fast Play Bingo provides a new product offering for players. The Virginia Lottery will continue to creatively address the challenges created by this new competition, particularly along the North Carolina border.

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

Very truly yours,

Sheila Hill-Christian

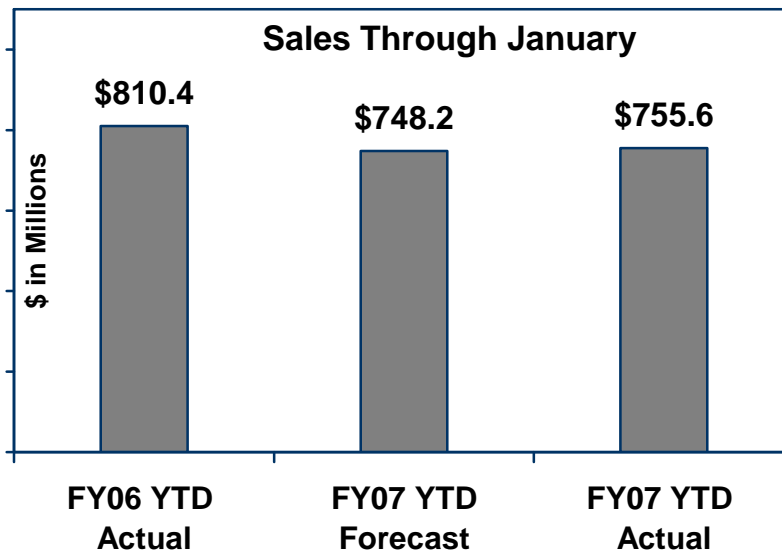
- c: The Honorable John H. Chichester, Chairman – Senate Finance Committee
- The Honorable Vincent F. Callahan, Jr., Chairman – House Appropriations Committee
- The Honorable Harry R. Purkey, Acting Chairman – House Finance Committee
- The Honorable William H. Leighty, Chief of Staff – Office of the 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
February 23, 2007

Sales

Lottery sales for the fiscal year through January 2007 were \$755.6 million, which was \$54.8 million (-6.8%) less than during the same period last year. Sales declined across all product categories, with the largest decline in Jackpot sales, down \$46.6 million (-34.5%) due to lower advertised jackpots because of more frequent jackpot wins. Daily games (Pick 3, Pick 4, and Cash 5) sales were down \$4.4 million (-1.6%) compared to last year. Scratcher sales declined \$3.8 million (-0.9 %) compared to last year as a result of the competition from North Carolina.

Compared to the forecast, total sales were \$7.4 million (+1.0%) higher than projected through January. The \$7.8 million shortfall in jackpot sales (-8.1%) was more than offset by stronger sales of scratcher tickets (up \$9.0 million or 2.3%) and daily game products (up \$6.2 million or 2.4%).



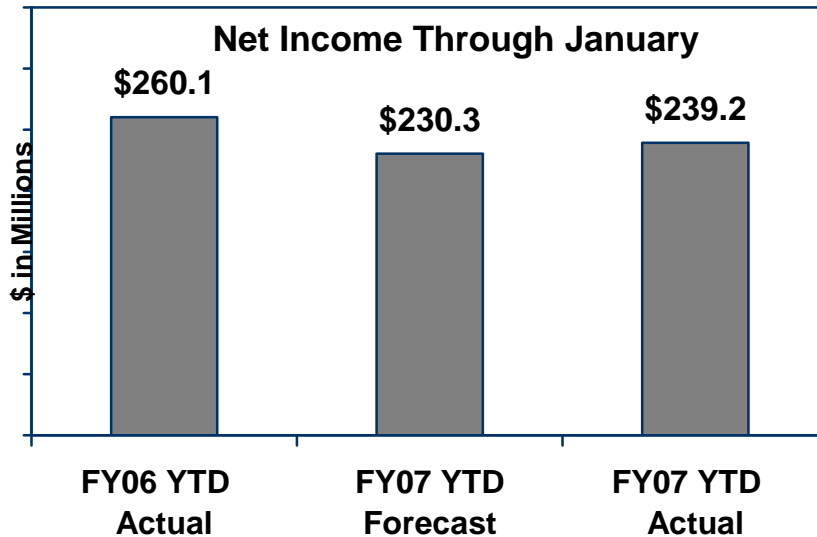
Expenses

The overall prize expense rate (prize expense as a percent of sales) of 58.3% was 0.4% higher than last year, but 0.1% lower than forecast for the year. The scratcher prize rate of 65.8% was down slightly compared to last year (-0.1%) and the current forecast (-0.7%); the daily games prize rate of 50.1% was 1.3% higher than last year and 0.8% higher than statistical expectations.

With the overall sales decline, retailers earned nearly \$2.4 million less than last year; however, the compensation rate for the year so far stands at 5.6%, slightly ahead (+0.1%) of last year. Administrative operating costs were \$2.6 million less than during the same period last year, with the overall spending rate of 4.9% less than forecast for the year.

Net Income

The overall sales decline (-6.8%) and slightly higher prize expenses (+0.5%) were offset somewhat by lower operating expenses, resulting in net income through January of \$239.2 million, down \$20.9 million (-8.0%) compared to last year at this point. Compared to the forecast, net income was \$8.8 million ahead of forecast for this point in the year, due to stronger sales (+1.0%) and lower operating expenses.



CONTRIBUTIONS TO DEBT SETOFF & LITERARY FUND

Pursuant to the Setoff Debt Collection Act, the Lottery made payments to the Department of Taxation totaling \$137,620 in January, bringing the year-to-date total to \$640,436. Also, the Lottery transferred unclaimed prizes of \$729,553 in January, or \$6,924,649 for the year.

NORTH CAROLINA EDUCATION 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 February 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	-\$5,916,298
-46%	Greensville	-\$3,028,868
-37%	Mecklenburg	-\$6,339,964
-36%	Henry	-\$4,475,039
-30%	Grayson	-\$381,233