

October 2, 2019

The Honorable Ralph S. Northam
Governor
Commonwealth of Virginia
Patrick Henry Building, 3rd floor
Richmond, VA 23219

Re: August 2019 Lottery Results

Dear Governor Northam:

I am pleased to provide our report of monthly activities and financial update for the month of August 2019, as required in §58.1-4006 of the *Code of Virginia*. Much of this information was previously provided to the House Appropriations and Senate Finance committees during legislative meetings on Sept. 16th and 17th.

August sales totaled \$172.8 million, down \$11.6 million (-6.3%) compared to the same month last year. The sales declines occurred across all product categories: instant scratch tickets, daily draw games, and multistate jackpot games. Our players continue to experience a cycle of “slow luck” in the daily games (Pick 3, Pick 4 and Cash 5), and jackpot levels in both the Powerball and Mega Millions multistate games have not grown to a significant enough level over several recent drawings to engage occasional players.

Periods of low prize payouts have a negative effect on Lottery sales but a positive short-term effect on profits. As a result, August monthly profits of \$48.9 million were only \$1.4 million (-2.7%) lower than last August. For the year to date, Lottery sales totaled \$341.1 million, a decline of \$23.9 million (-6.5%) compared to last year. Profits for the year so far totaled \$100.9 million, or \$2.6 million (+2.7%) more than last year because of overall lower prize expenses.

I appreciated the opportunity to speak at meetings of the House Appropriations and Senate Finance committees in September. We provided similar presentations to the Secretary of Finance and the Governor’s legislative and policy staffs. In each of the presentations, I discussed the impacts we are beginning to see due to increased competition in our market.

To date, the Lottery has recorded only a negligible impact from the introduction of historical horse racing devices at three Colonial Downs/Rosie’s Gaming Emporium sites beginning this past Spring. However, we are tracking a troubling decline in sales which we attribute to an increase in the number of unregulated and untaxed “gray machines,” which recently have proliferated inside retail stores where the Lottery conducts the bulk of its

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business. Our own count of these self-described games of skill indicates nearly 5,000 of these machines currently are located inside more than 1,500 Lottery-licensed retail stores – a five-fold increase from the approximately 1,000 so-called “skill machines” our staff counted at retail at the end of April.

We believe these gray machines are largely responsible for a more than six-percent decline in sales of Lottery products so far in FY20. This prompted us to alert lawmakers and Administration officials of an estimated \$140 million annualized decline in Lottery sales and a corresponding \$40 million reduction in expected Lottery profits for FY20.

At its quarterly meeting this month, the Lottery Board will be asked to consider adjustments to our previous forecasts for FY20. We will pass along any updated information to you so it can be reflected in the Administration’s budget process this Fall.

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

Sincerely yours,

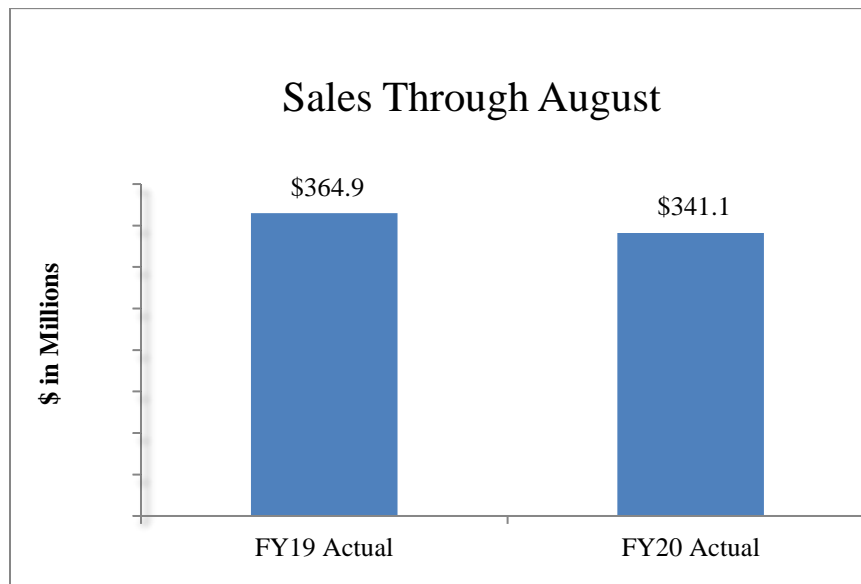
Kevin Hall

c: The Honorable Thomas K. Norment, Jr., Co-Chairman, Senate Finance Committee
The Honorable Emmett W. Hanger, Jr., Co-Chairman, Senate Finance Committee
The Honorable S. Chris Jones, Chairman, House Appropriations Committee
The Honorable R. Lee Ware, Jr., Chairman, House Finance Committee
The Honorable Clark Mercer, Chief of Staff, Office of the Governor
The Honorable Aubrey Layne, Secretary of Finance
Daniel S. Timberlake, Director, Department of Planning & Budget
David A. Von Moll, State Comptroller
April Kees, Interim Co-Director, Senate Finance Committee
Jason Powell, Interim Co-Director, Senate Finance Committee
Robert P. Vaughn, Staff Director, House Appropriations Committee
Ferhan Hamid, Chairman, Virginia Lottery Board

VIRGINIA LOTTERY
Report to the Governor and
Selected Members of
the General Assembly
As of August 31, 2019

Sales

Lottery sales for the fiscal year totaled \$341.1 million for the fiscal year through August. This represents a decline of \$23.9 million (-6.5%) compared to the prior year. Scratcher sales of \$186.8 million were \$13.4 million (-6.7%) lower than last year. Sales of daily games (Pick 3, Pick 4, and Cash 5) totaled \$108.8 million, down \$3.6 million (-3.2%) from last year. Sales in the jackpot games category (Mega Millions, Powerball, Cash for Life and Bank a Million) totaled \$34.3 million, a decline of \$10.1 million (-22.8%) compared to last year because of the Mega Millions jackpot growth to over \$500 million last year. Sales of Print n' Play games totaled \$10.8 million, \$2.9 million (+36.7%) higher than last year, supported by the introduction of a new game style featuring a rolling jackpot prize.



Expenses

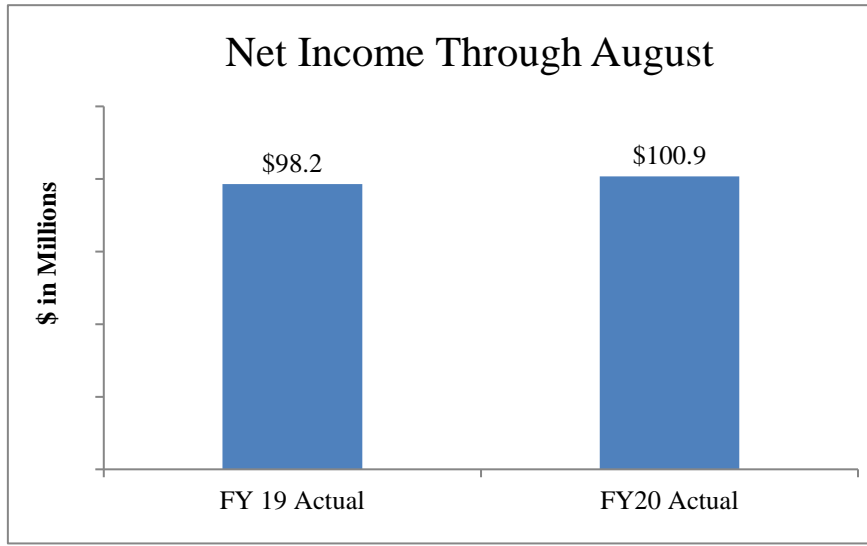
The overall prize expense rate (prizes as a percent of sales) for the year to date was 59.2%, significantly lower than last year's rate of 62.8%. The scratcher prize rate of 69.9% was higher than last year's rate of 69.5%. The daily games prize rate of 42.6% was significantly lower than last year's rate of 55.1%, and well below the statistically expected 50%. The jackpot games prize expense rate of 50.5% was lower than last year's rate of 51.1%, mainly due to unusual prize win activity in the Bank a Million game last year. It is important to note that significant fluctuations in prize expense rates occur during the short term, especially for games that have fixed prizes; however, overall long-term prize rates reflect outcomes more in line with statistical expectations.

With lower sales, retailers earned \$1.5 million less than last year, for a total \$18.7 million in earnings. Overall, retailers earned 5.5% of Lottery sales in commissions and incentives for the year so far, close to the usual 5.6% earnings rate.

Administrative operating costs, including gaming, ticket printing and distribution expenses, were 5.8% of sales, higher than last year's rate of 4.8%.

Net Income

The weakness in sales was offset by a much lower prize expense rate, leading to profits of \$100.9 million, an increase of \$2.6 million (+2.7%) compared to last year.



CONTRIBUTIONS TO DEBT SETOFF & LITERARY FUND

For the 2020 fiscal year to date, the Lottery made debt setoff collection payments to the Department of Taxation totaling \$332,473. Also, unclaimed prizes totaling \$885,820 were transferred to the Literary Fund so far this year.

MEETINGS

The Lottery Board will hold its next regular business meeting in Richmond on October 30, 2019.