

Iowa Lottery Authority

Performance Report

Performance Results Achieved
Fiscal Year 2005



Introduction

I am pleased to present the Iowa Lottery Authority's performance report for fiscal year 2005 (July 1, 2004, through June 30, 2005). This report contains information about the activities of the Iowa Lottery Authority during the past fiscal year.

The Iowa Lottery achieved record sales in its latest fiscal year and raised more than \$51 million for state programs. Here are some key financial highlights from fiscal year 2005:

- Lottery sales increased for a fourth straight year. For fiscal year 2005, Lottery sales totaled more than \$210.6 million, which marked the highest sales total for the lottery in its 20-year history. Overall, sales were up 1 percent in fiscal year 2005 following an 11 percent increase in fiscal year 2004 and a 3.6 percent increase in fiscal year 2003.
- The Lottery welcomed the addition of Casey's 350 Iowa convenience stores to its retailer base in fiscal year 2005. Installations of equipment in Casey's stores began in mid-September of 2004 and by late January, those installations were completed. Although the additions meant a one-time expenditure of about \$2 million by the lottery for satellite communications equipment, ticket-vending equipment and point-of-sale material for those locations during fiscal year 2005, the long-term benefits to the state will more than offset the cost in years to come.
- The Lottery, in partnership with amusement operators from across the state, continued its statewide deployment of TouchPlay machines throughout fiscal year 2005 in efforts to meet customer demand. By the end of June, the machines produced more than \$6.4 million in net TouchPlay machine revenues.
- Lottery proceeds for state programs were more than \$51 million, a decrease of about 8 percent from the previous year. The three main factors that affected the lottery's 2005 profits included: the cost of equipping Casey's General Stores locations in Iowa to sell lottery products; a reduction in other revenue of more than \$1 million resulting from a one-time MUSL prize reserve adjustment and a one-time Freeplay Replay prize reserve adjustment in fiscal year 2004; and a decrease in Powerball sales, which are expected to rebound for the upcoming fiscal year.

Sincerely,

Edward J. Stanek
Chief Executive Officer
Iowa Lottery Authority

Overview of the Iowa Lottery Authority

The Iowa Lottery was established in 1985 and began sales of products on August 22 of that year. The Lottery has always focused on results, and since its inception, has awarded more than \$1.88 billion in prizes and has raised more than \$934 million for state programs. The Lottery's mission is to conduct a statewide lottery in a secure, controlled manner so as to maximize net revenue while maintaining the dignity of the state of Iowa and the welfare of its people.

The guiding principles of the Iowa Lottery are:

- Develop and distribute products that are fun and exciting to Iowans;
- Maintain integrity and security in production and delivery of those products while utilizing the highest level of technology available;
- Educate and motivate the public to play Lottery games responsibly;
- Maintain the dignity of the Lottery through truthful, tasteful, and informative advertising;
- Develop an effective employee workforce that is professional, knowledgeable, skilled, and offers maximum service and reliability to retailers and players; and
- Maximize net revenues to the state.

The Lottery is guided by the leadership of Dr. Ed Stanek, Chief Executive Officer, and the five member Iowa Lottery Board. The Board and the CEO have joint responsibility for hiring and retaining key lottery staff members, for entering into major contracts, procuring the printing of instant and pull-tab tickets, for the purchase or lease of equipment or services essential to the operation of Lottery games, and for the purchase or lease of real estate.

The Lottery operates with approximately 117 employees separated into five divisions: security, finance, operations, sales, and marketing. Approximately 50 employees are assigned to Lottery Headquarters, currently located at 2323 Grand Avenue in Des Moines. These associates design games, draft and administer contracts, oversee ticket printing and security, validate and pay winning tickets, plan marketing, public relations, and promotional efforts, and perform accounting, information technology, and data processing duties. The Lottery also maintains several staff members at a warehouse facility in Ankeny. The remaining employees are sales representatives, regional managers, and support staff who work out of five regional offices located in Storm Lake, Council Bluffs, Cedar Rapids, Mason City, and Des Moines.

The Lottery offers four separate product lines: Instant, Pull-tab, On-line and TouchPlay. Instant games generally have a scratch-off latex covering that is removed by the player to identify winning tickets. For Pull-tab tickets, players open tabs to reveal whether a prize has been won. On-line games are "numbers" games where computerized tickets are generated from a terminal. TouchPlay tickets are dispensed as necessary from vending machines that have video monitors that display the results of the ticket while entertaining electronic tones indicate whether the ticket

has won a prize. The machines do not pay out money and tickets are automatically printed for prizes that exceed \$600. Players must redeem TouchPlay winning tickets of less than or equal to \$600 at the retail location at which it was bought. Jackpot tickets, or tickets winning in excess of \$600, must be redeemed at an Iowa Lottery office.

The Lottery's customer market is Iowans age 21 and older. The Lottery designs its products to appeal to a variety of demographics. Different game themes, price points, play action, and prize structures are used to broaden the appeal. The Lottery also identifies the legislative body as a customer market. A legislative program is in place to inform legislators about new games and public service programs. Legislators are shown how the Lottery complies with laws and regulations and are reminded how the Lottery helps the state of Iowa and maintains the dignity and welfare of its people.

Traditional Lottery products (Instant, Pull-tab and On-line tickets) are sold through licensed retail outlets throughout the state. Each outlet carries computer equipment for ticket validation that is linked through an intricate communications network to a central ticket system operated by the Lottery's on-line vendor, Scientific Games. The link to the central system records every transaction on the entire network to ensure the integrity of the system. With the data from the system, the Lottery monitors sales and validations, monitors the movement of inventory, collects accounts receivable, and determines retailer commissions. The network operates seven days a week, for approximately 21 ½ hours a day.

The Lottery has 2,534 traditional licensed retail outlets, which are visited on a weekly basis by a lottery sales representative. The sales reps make sure that each retailer has an adequate ticket supply, distribute point-of-purchase marketing and informational materials, and provide retailer training.

In addition to the traditional retail outlets, the Lottery issues licenses for the operation of certified TouchPlay machines. TouchPlay machines may only be placed in age-controlled environments. Currently, the Lottery has overseen the placement of over 3,900 machines and more TouchPlay machines continue to be deployed each week. Licensed retailers, or Amusement operators, provide and/or service the certified TouchPlay machines for these premise locations. There are 83 licensed TouchPlay amusement operators and currently three certified manufacturers: Oasis Gaming, of Omaha, Nebraska; Diamond Game Enterprises, Inc., of Chatworth, California; and Bally Gaming Systems of Reno, Nevada.

Once the equipment has been certified by the Lottery, premise retailers that wish to obtain machines may do so either through licensed Touchplay Amusement Operators or directly from the certified machine manufacturers. The premise retailer may negotiate the terms of any machine placement with the TouchPlay Amusement Operator. There are no exclusive rights for distribution or sale of any certified manufacturers' machines.

Each of the three certified manufacturers utilizes a system consisting of a central computer configuration with networked connections to individual premise sites that operate the TouchPlay machines. These links to the central systems record every transaction on the entire network to ensure the integrity of the system. With the data from the individual systems, the Lottery

monitors net sales, jackpot tickets issued, and is able to calculate and collect accounts receivable from the individual TouchPlay operators.

On July 1, 2003, the legislature recognized that as an entrepreneurial entity, the Iowa Lottery could operate more efficiently by being freed from the bureaucracy associated with state government and lifted some of its prior constraints by establishing the Iowa Lottery Authority, a public instrumentality of the state. As a result of that change, sales have continued to climb through fiscal years 2004 and 2005 and through the current fiscal year 2006.

In fiscal year 2005, the Iowa Lottery had record sales of \$210.6 million, paid prizes totaling more than \$113.4 million, and turned over nearly \$51.1 million in profits to the state coffers. The Lottery expended \$10.9 million in operations and almost \$6 million in advertising in fiscal year 2005.

The Department of Management has identified two core functions for the Iowa Lottery: Sales and Distribution and Resource Management.

Performance Plan Results

CORE FUNCTION

Name: Sales & Distribution

Description: The Lottery distributes lottery products throughout the state in a manner that maximizes revenues and recruits and maintains licensed retail outlets to help achieve this goal.

Why we are doing this: To generate revenues to the General Fund in order to provide financial support for state services.

What we're doing to achieve results: The Lottery strives to maintain an effective sales force, utilizes advertising to build customer awareness, and generates interest in products and specific games via special promotions. In late April 2004, statewide rollout began of the Lottery's TouchPlay machines. These machines resulted in net receipts of over \$6.4 million by the end of FY 2005. More TouchPlay machines continue to be deployed each week.

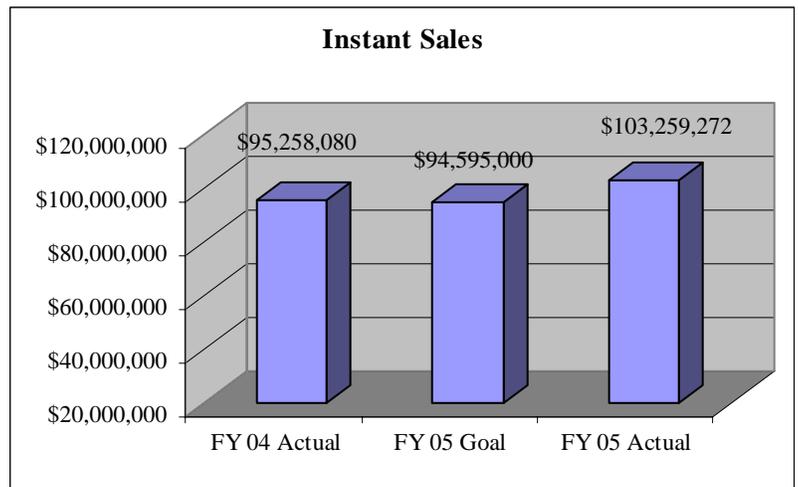
Results

Performance Measure: Sales of instant tickets

Performance Target: \$94.6 million

What was achieved: \$103.3 million

Data Source: Iowa Lottery Authority accounting records

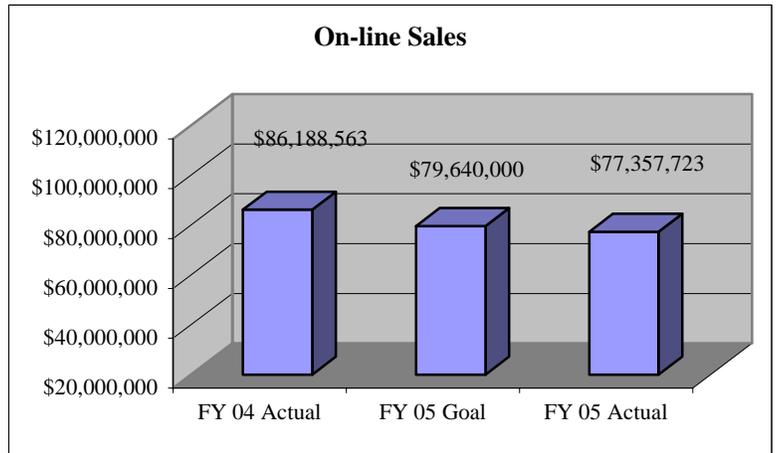


Performance Measure: Sales of on-line game tickets

Performance Target: \$79.6 million

What was achieved: \$77.4 million

Data Source: Iowa Lottery Authority accounting records

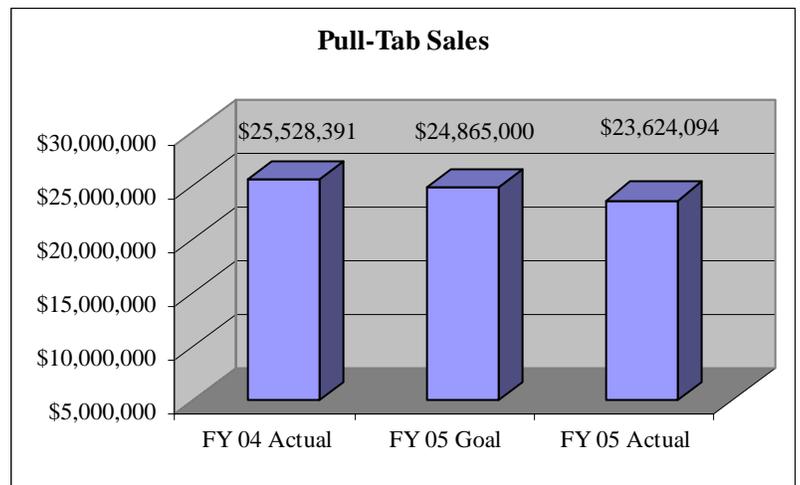


Performance Measure: Sales of pull-tab tickets

Performance Target: \$24.9 million

What was achieved: \$23.6 million

Data Source: Iowa Lottery Authority accounting records

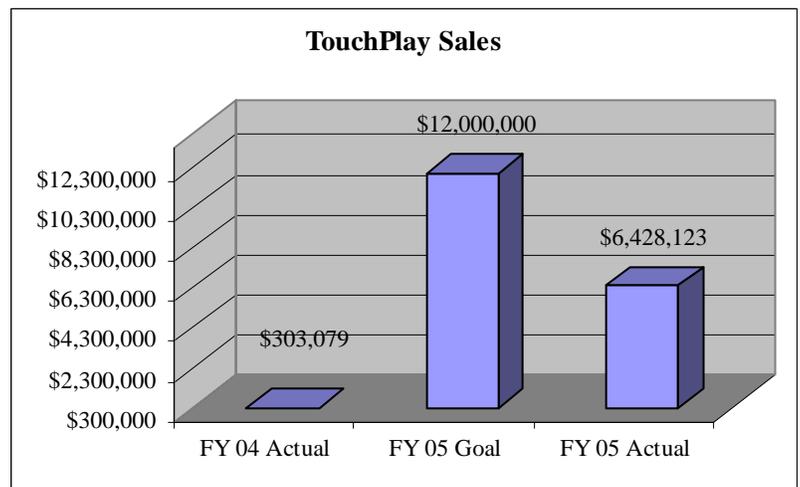


Performance Measure: Net Sales - TouchPlay

Performance Target: \$12 million

What was achieved: \$6.4 million

Data Source: Iowa Lottery Authority accounting records



Data Reliability: The Lottery's central computer system for on-line, instant and pull-tab products, which is linked to every licensed retailer in the state, records every transaction on the entire network in order to ensure the integrity of the system. In addition, the central computer systems operated for each of the three TouchPlay manufacturers are linked to every licensed premise in the state and records every transaction to ensure the integrity of each of these systems. The data obtained from these networks is 100% reliable.

Why We Use These Measures: The Legislature, the governor, and the public use sales data to generally determine how the Lottery is doing. Sales of different products are compared by the Lottery on a yearly basis in order to assess progress.

What Was Achieved: For FY 2005, instant ticket sales exceeded \$103 million, pull-tab sales were \$23.6 million, on-line game ticket sales were nearly \$77.4 million and TouchPlay net sales exceeded \$6.4 million.

Analysis of Results: Overall Lottery sales for fiscal year 2005 were up 1 percent, at \$210.7 million, compared to \$208.5 million for fiscal year 2004. TouchPlay revenue grew to \$6,428,123 in fiscal year 2005. Instant-scratch tickets, the Lottery's traditional sales leader, claimed that spot again in fiscal year 2005, with sales increasing by more than 8 percent to \$103.3 million. In addition, sales of Hot Lotto, an on-line game, rose more than 35 percent to \$10.4 million while sales of the Pick 4 on-line game increased by more than 22 percent to bring in more than \$2.0 million in sales for fiscal year 2005. Powerball on-line sales for the year, however, were down more than 17 percent to \$54.2 million. Also declining were pull-tab sales, which fell \$1.9 million from \$25.5 million in fiscal year 2004 to \$23.6 million in fiscal year 2005.

Factors Affecting Results: The Lottery designs its games to appeal to a variety of demographic groups. The main factors involved in the pull-tab sales drop are: the spread of illegal Ad-Tab games in Iowa and the prevalence of amusement devices in retail locations that also sell Iowa Lottery tickets. Research plays a significant role in the success of Lottery products and marketing efforts. A yearly baseline study supplies the Lottery with valuable player information, as well as public perceptions about the Lottery. Focus groups keep us attuned to players' feelings and opinions. Feedback from players and retailers are used to gauge product acceptance.

Resources Used: In FY 2005, the Lottery spent \$10.9 million on administrative expenses, under \$6 million on advertising, and had approximately 117 employees on staff. All these resources contributed to the total sales made by the lottery.

Performance Plan Results

CORE FUNCTION

Name: Resource Management

Description: Maintain integrity and security in production and delivery of lottery products while utilizing the highest level of technology available. Also maintain accurate and timely accountings of both incoming revenues and outgoing expenditures.

Why We Do This: The media, the Legislature, and the public closely scrutinize the actions of the Lottery. Because the Lottery's profits are deposited into the General Fund, it is essential to ensure that its resources are managed wisely in order to achieve maximum benefits for the state as a whole.

What We Do To Achieve Results: Internal integrity and security is paramount to the Lottery. Background checks are conducted on all potential employees and suppliers of major procurements before they can become members of the Lottery team. Strict licensing requirements, including background checks, ensure that only reputable retailers sell Lottery products. The Lottery's security division conducts retailer reviews and reports its findings to the Lottery's Board. The On-line game system integrity is tested daily by an internal control system. All TouchPlay systems and equipment must pass a rigorous certification process prior to distribution. All drawings are monitored and verified by an independent auditor. All sales reps are required to balance their ticket inventory on a weekly basis. Periodic performance evaluations and the resulting reports are also a must to ensure that the Lottery's integrity remains intact. The Lottery is subject to annual financial audits by the State Auditor's Office. A major accounting firm conducts an annual performance audit on the Lottery's on-line game system. Additionally, the Lottery's internal auditor reviews major processes, internal control procedures, and advertising contracts. Post-buy analysis of media plans ensures that advertising has the intended frequency and scope. Reports from all these sources help Lottery management to assess organizational performance and identify areas for improvement in order to ensure that the Lottery's resources are effectively managed.

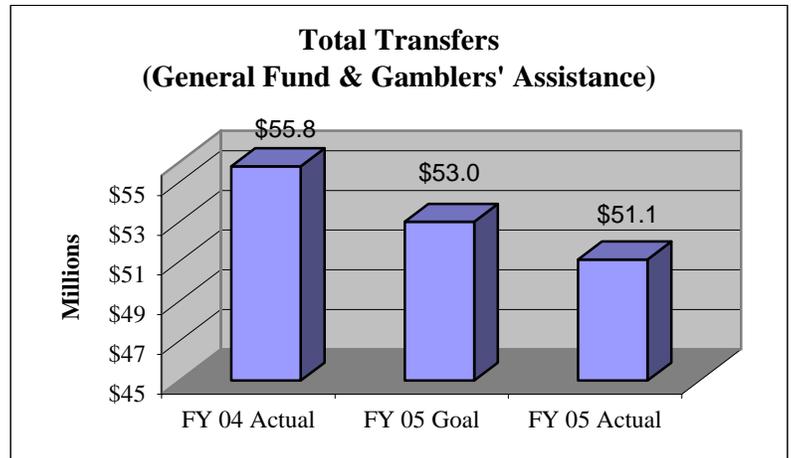
Results

Performance Measure: Total transfers to the state, including the General Fund & Gambler's Assistance Fund

Performance Target: \$53.0 million

What was achieved: \$51.1 million

Data Sources: Iowa Lottery Authority accounting records



Data Reliability: The Lottery's central computer system for on-line, instant and pull-tab products, which is linked to every licensed retailer in the state, records every transaction on the entire network in order to ensure the integrity of the system. In addition, the central computer systems operated for each of the three TouchPlay manufacturers are linked to every licensed premise in the state and records every transaction to ensure the integrity of each of these systems. The data obtained from these networks is 100% reliable.

Why We Use This Measure: Total transfers is the ultimate measure of how well the Lottery is operating because it accounts not only for sales, but also for how well resources are being used. The Lottery must ensure its resources are managed wisely in order to achieve maximum benefits for the state as a whole.

What Was Achieved: The Lottery transferred a total of \$51.1 million in fiscal year 2005. This total included over \$50 million in General Fund transfers and over \$1 million in transfers to the Gambling Treatment Fund.

Analysis of Results: Although overall sales achieved record levels, the decrease in Powerball sales, which has a higher profit margin than most other lottery products, combined with the cost of equipping the Casey's stores and decline in pull-tab sales, resulted in an overall decrease in profits transferred for fiscal year 2005 as compared to fiscal year 2004.

Factors Affecting Results: The main factors involved in the pull-tab sales drop are: the spread of illegal Ad-Tab games in Iowa and the prevalence of amusement devices in retail locations that also sell Iowa Lottery tickets. As noted above, the decrease in Powerball sales coupled with the

cost of equipping Casey's were contributing factors to the overall decrease in profits as well. In addition, other operating revenues decreased by approximately 80%. In fiscal year 2004, the Lottery received a one-time MUSL prize reserve adjustment totaling \$497,966 and a one-time revenue of \$840,087 remaining from the Freeplay Replay prize reserve funds. The last drawing for Freeplay Replay took place on September 20, 2003. During fiscal year 2005, one-time operating revenues only brought in a little over \$275 thousand.

Resources Used: In FY 2005, the Lottery spent \$10.9 million on administrative expenses, under \$6 million on advertising, and had approximately 117 employees on staff. All these resources contributed to the total transfers made by the lottery.

Resource Reallocations

Beginning in fiscal year 2004, the Lottery initiated a statewide launch of its new product line, TouchPlay. Throughout fiscal year 2005, the Lottery has continued to expand this product line, and placement of TouchPlay machines is expected to continue through the current and upcoming fiscal years. Management determined that at least one staff member would be needed to oversee and manage the TouchPlay program. Instead of hiring a new employee to manage the TouchPlay program, the Lottery decided to assign the new responsibilities to an existing position that had previously been assigned to our Promotions Department. The employee's previous duties have been delegated to other staff to assure that all tasks would continue to be accomplished.

Iowa Lottery Authority Contact Information

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Elaine Baxter, Burlington
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Timothy Clausen, Sioux City
Michael L. McCoy, Des Moines

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