BRIEFING DOCUMENT:
Lottery Sales & Sustainability Outlook

09/08/16F

INTRODUCTION

Current trends in technology, gambling, the economy, and culture are changing the way adult Oregonians define, access and consume entertainment. To remain relevant and sustain its significant level of contribution to Oregon's economy, the Oregon Lottery must assess its current and future strengths, weaknesses, opportunities, and threats. The following document discusses current and expected trends that will likely impact the Oregon Lottery's standing as one of a broadening range of gambling and entertainment options available to Oregonians through multiple channels.

The development and implementation of strategies that leverage opportunities and address threats to the Lottery's sustainability may potentially require a commitment – by the Lottery and the State - to revisit the Lottery's current operational framework and invest in resources and innovations needed to thoughtfully execute on those strategies. This document serves as an initial step in requesting guidance from the Lottery's Commission to begin the work of identifying initiatives aimed at sustaining current sales levels or responsibly driving growth, developing timelines and KPIs for achieving our goals, and securing the resources required to ensure successful execution.

BACKGROUND

TECHNOLOGY	• Omni-channel entertainment alternatives have proliferated, creating more competition for consumers' entertainment wallet and attention. • The Lottery is investing in gaming systems with the ability to offer new capabilities and much more information about our sales – the Oregon Lottery will require the staffing and data infrastructure to leverage them.
GAMBLING/ GAMING	• Competition for a share of consumers' attention and gambling/gaming wallet continues to grow– whether it's sports wagering, free/"free-mium" gaming, card rooms, casinos, or mobile-based augmented reality games such as Pokémon Go. Innovations within the gaming and gambling landscape are occurring more quickly than ever before. For the most part, the Oregon Lottery has continued to offer the same games in the same ways for over 30 years. • A new casino in LaCenter is 40% of the way toward completion, with an expected launch in spring 2017. The Office of Economic Analysis is estimating that the Lottery will lose $65 million per year to this new casino. Additional casinos in Oregon, including in Portland, continue to be contemplated. • Lottery and casino game vendors, such as IGT (Double-Down) and Scientific Games (Bally's iGaming platform) continue to prepare for the further expansion of online gambling sponsored by casinos and lotteries, and are already assisting a handful of lotteries in selling lottery games over the Internet.
ECONOMY/ RETAIL	• The rebounding economy and Oregon Lottery's investments in Video Lottery and Scratch-its infrastructure and marketing have allowed the Lottery to rebound toward FY08 levels in *nominal* dollars. However, when sales are adjusted for inflation, a different story emerges: eleven years without novelty or expansion in game categories or sales channels has resulted in flat playership trends and sales that lag behind levels achieved before the economic downturn. • Our on-premise retailers sell Video Lottery, which reflects 70% of Lottery sales. Although the Oregon Lottery on-premise retailer base has decreased 6% since 2008, Video Lottery sales have increased over that time. But economic pressures, such as growing real estate prices and an increase to the minimum wage, could result in the continued shrinking of this important retail segment.
CULTURE/ DEMOS	• According to the Oregon Office of Economic Analysis, Millennials (born 1981 – 2000) make up 27% of the Oregon population. It is unclear whether the limited range of play motivators addressed by the Oregon Lottery's current game portfolio will capture the same portion of this market as it has among previous generations (now 45+).

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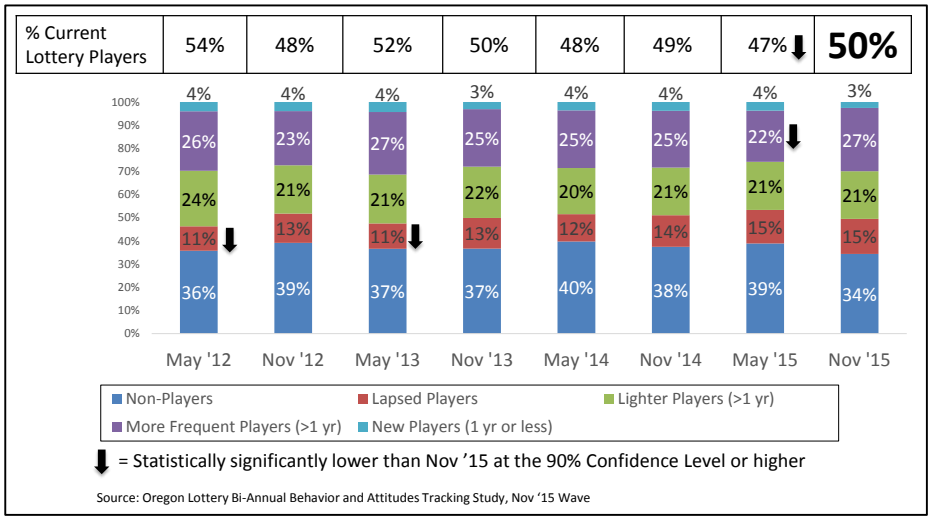
PLAYERSHIP LEVELS REMAIN FLAT – BUT AS WAGES HAVE INCREASED, SO HAVE LOTTERY SALES

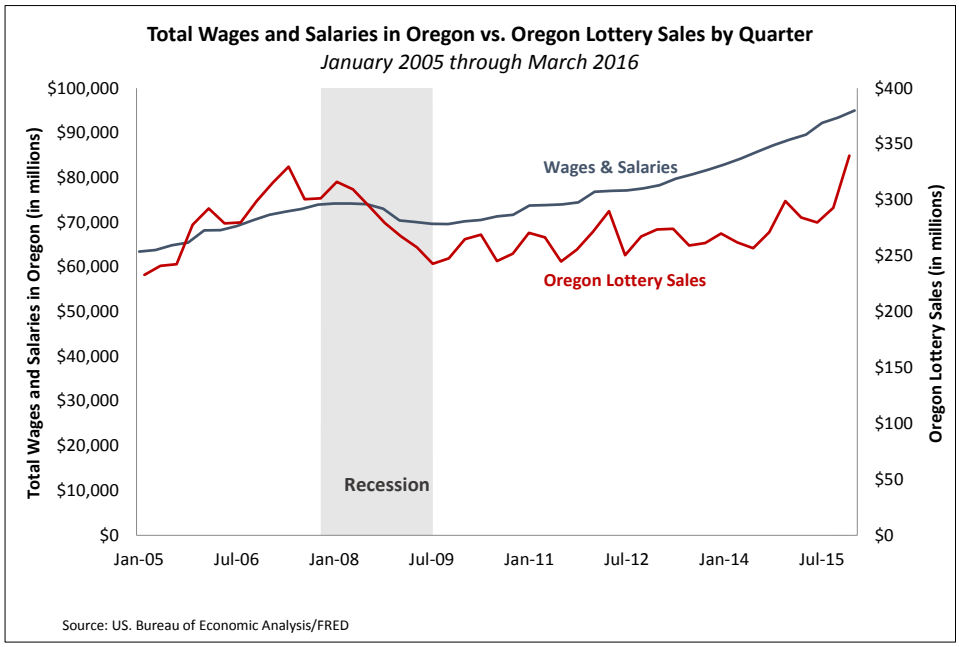
Lottery playership levels have been relatively flat since 2012, with past-year play generally hovering around 50% of adult Oregonians. Findings from consumer research conducted by the Lottery indicate that Lottery games address a limited subset of play drivers that motivate consumers to play. Lottery players consider our games to be easy and quick to play, a fun past-time, and offer the chance to win large and small prizes.

However, with a static game portfolio, the Lottery is currently unable to expand its player base by appealing to consumers looking for games that:

- Require skill/knowledge to win
- Allow players to compete or collaborate with each other
- Are challenging/hard to master
- Help players connect with their friends/family
- Offer short duration games with very large jackpots
- Allow betting on sporting events



Oregon Lottery sales trends mirror those for Oregon wages and salaries – as wages have gone up or down, so have Lottery sales.



Consumer spending on Oregon Lottery games as a percentage of total wages has remained relatively steady at between .3% - .46%.

When considering all forms of gambling, ECONorthwest estimates that Oregonians' share of income spent on *any* kind of gambling has not varied by more than .5% between 1994 and 2013.

Whether examining Lottery spend or spending on gambling overall, Oregonians' share of wallet has remained about the same as a percentage of income.

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COMPETITION FOR A SHARE OF CONSUMERS' GAMBLING/ENTERTAINMENT WALLET CONTINUES TO PROLIFERATE

Although the Lottery's product portfolio has not significantly changed since 2005, the gambling, gaming, and technology landscape has.

Internet/Mobile:

- Sports wagering: Daily Fantasy Sports (e.g., DraftKings, FanDuel).
- "Free-mium" gaming: Popular mobile games, such as Clash of Clans, Candy Crush, Farmville, and Words with Friends. These games are initially free to play, but offer a variety of popular add-ons for purchase to enhance the play experience.
- Internet poker sites: Such as PokerStars or Party Poker.
- Augmented reality games, such as Pokémon Go. While this particular game's popularity may be short-lived, interest in augmented reality and virtual reality games is expected to grow. In an article by research firm Alter Agents, the market for these games is expected to reach $150 billion by 2020.

Lotteries in Europe and Canada have been offering Internet-based games for several years. More recently, U.S. jurisdictions have acknowledged the growing trend of accessing entertainment, making purchases, and gambling online – Georgia, Michigan, Minnesota, Illinois, and Delaware all currently offer an array of iLottery products.

Lotteries currently offering online sports and poker believe they offer a recognized, trustworthy option for online gambling to their consumers – also offering the unique benefit of recirculating a portion of sales back into their states/provinces. While the percent of total lottery revenue from online games in these jurisdictions has generally remained in the single digits, these lotteries believe it is important to carve out a small presence in the online gambling landscape.

Lottery and casino game vendors, such as IGT (Double-Down) and Scientific Games (Bally's iGaming platform) continue to prepare for the further expansion of online gambling sponsored by casinos and lotteries.

Brick and Mortar:

- A new casino in LaCenter is 40% of the way toward completion, with an expected launch in spring 2017. The Office of Economic Analysis is estimating that the Lottery will lose $65 million per year to this new casino. Other additional casinos continue to be contemplated.
- According to the online poker room information resource, Poker Atlas, there are at least 17 poker rooms in or near Oregon, primarily located in Portland and Eugene.

THE LOTTERY'S PLAYER BASE IN 2025 WILL HAVE DIFFERENT EXPECTATIONS FOR ENTERTAINMENT, HOW THEY LEARN ABOUT IT, AND HOW IT'S DELIVERED TO THEM

Oregon Lottery players generally reflect the same demographic profile as adult Oregonians, overall. Those 35-54 represent the largest age group. Most are white. Two in ten have a Bachelor's degree. Approximately one third have household incomes of less than $40,000, while another third live in households with incomes of $50,000 or more.

A,B,C = Statistically significant at the 95% confidence level
Source: Lottery Behavior and Attitude Tracking Study combined waves May 2011 to May 2015.

		A Current Players n=4,434	B Lapsed / Non-Players n=4,566	C Adult Oregonians (Age 18+) n=9,000
AGE	18 to 24	10%	13% A,C	12% A
	25 to 34	19% B	16%	17%
	35 to 54	40% B,C	30%	35% B
	55 to 64	14%	14%	14%
	65 or older	17%	27% A,C	22% A
GENDER	Female	49%	53% A	51% A
	Male	51% B,C	47%	49% B
ETHNICITY	Caucasian/White	86%	85%	85%
	Hispanic/Latino	3%	4%	4%
	African American	1%	1%	1%
	Asian/Pacific Is.	1%	2%	2%
	Native American	3% B	2%	2%
	Other	1%	1%	1%
	Did not disclose	4%	5%	5%
EDUCATION	Some high school or less	5%	4%	5%
	High school diploma/GED	20% B	18%	19%
	Some college/tech school	34% B,C	28%	31% B
	Bachelor's degree	22%	22%	22%
	Graduate school/ degree	16%	25% A,C	20% A
	Did not disclose	3%	3%	3%
INCOME	Under $20K	15%	16%	16%
	$20K but less than $40K	18% B	16%	17%
	$40K but less than $50K	7%	8%	8%
	$50K but less than $75K	15% B,C	12%	13% B
	$75K but less than $100K	22%	20%	21%
	Did not disclose	23%	28% A,C	26% A

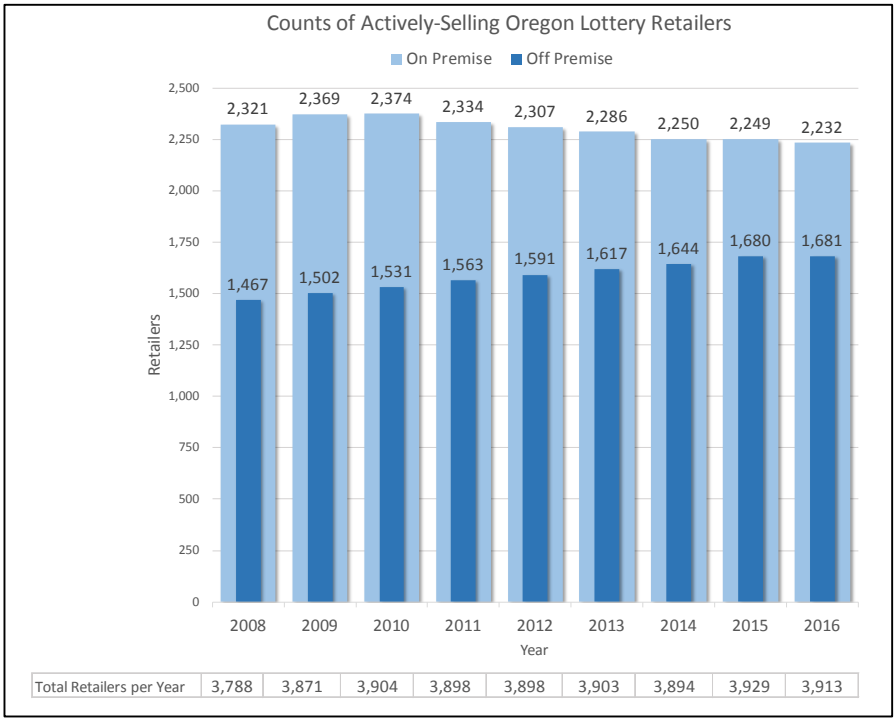
According to the Oregon Office of Economic Analysis, Millennials (born 1981 – 2000) currently make up 27% of the Oregon population. They are now the largest generation in the U.S. (overtaking Baby Boomers). The post-Millennial generation, sometimes referred to as Generation Z, are "digital natives" – a phrase coined by U.S. author Marc Prensky to describe a generation that has never known a time without the Internet, computers or mobile devices.

Some experts in the gaming field believe that interest in Lottery games corresponds with a consumer's lifestage – as a consumer reaches middle age, and discretionary income and commitments increase, lottery games provide a more appealing form of entertainment.

It seems doubtful, however, that the limited range of play motivators addressed by the Oregon Lottery's current game portfolio or its single-channel purchasing model through retailers will appeal to the same portion of the Millennial market, or Generation Z (once it comes of age) as it has among previous generations (now 45+). Millennials are accustomed to learning about products, consuming their entertainment, and making purchases all through their smartphones.

MOUNTING ECONOMIC PRESSURES AND COMPETITION FOR ON-PREMISE LOTTERY RETAILERS

- Since 2008, the number of on-premise retailer locations has decreased by 6%. This decrease has been particularly pronounced in the Portland and Tri-Counties areas, where the retailer base has decreased by 15% and 8%, respectively.
- Real estate costs in the Portland area are increasing as more people move into the state and more businesses open, resulting in higher overhead costs to buy residential and/or commercial real estate.
- Additionally, a tribal casino in La Center - the Ilani - is slated to open for business by spring 2017. The Ilani will be located within 20 miles from 83 Oregon Lottery on-premise retailers who represent 5.2% of Video Lottery sales - $45,328,693 in FY16.
- A 2016 analysis of the U.S. casino industry conducted by Nathan Associates, Inc., reports that although the U.S. economy remains on a slow growth trajectory, many local and regional markets have shown flat or declining gaming revenue trends.



- When analyzing the market using metrics and benchmarks identified by Nathan Associates for measuring market saturation, Oregon meets or exceeds thresholds. These indicators suggest that any increases in gaming revenue will be driven by population and income growth, rather than by greater gambling competition in Oregon. Additional gambling venues will likely compete for the same dollar, rather than drive an increase in overall gambling spend.

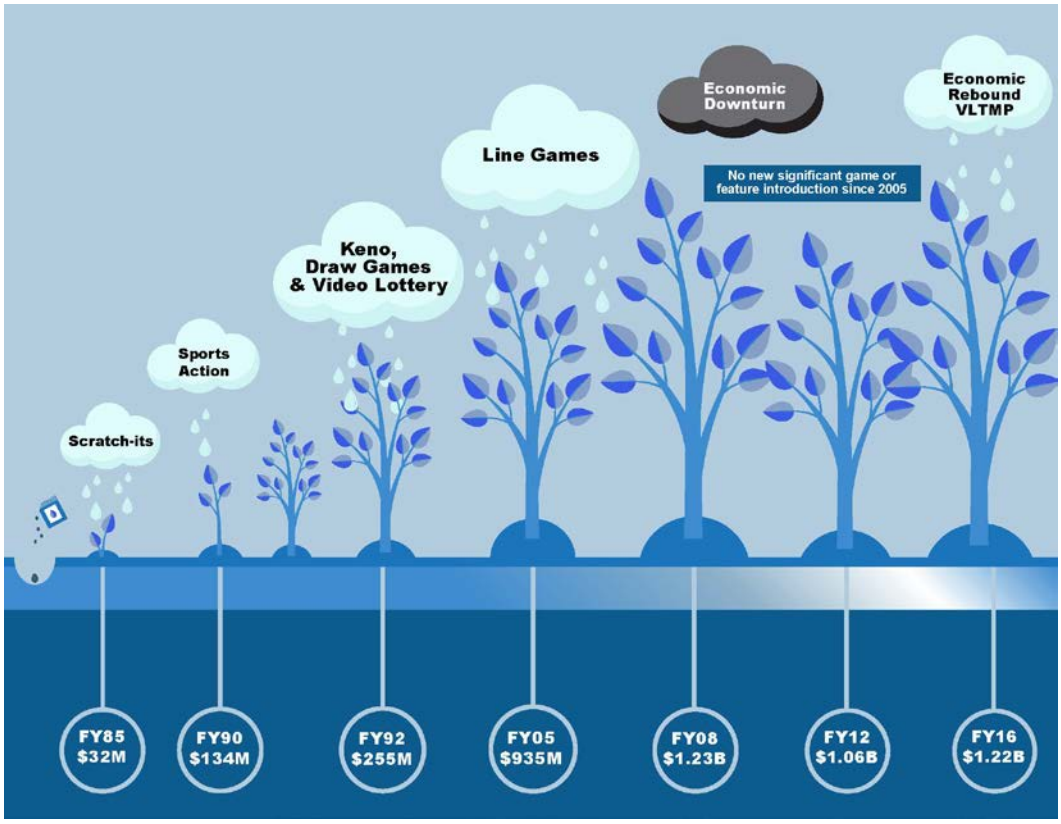
	Oregon Lottery	All Oregon Gaming	Saturation Level
Gaming Machines per 1,000 Adults (21+)	4.1	6.9	6 to 7
Gaming Machines per $1 Billion in Disposable Personal Income	79.4	133.6	100.0
Gross Gaming Revenue per Capita (21+)	$425.29	$632.04	$500.00
Gross Gaming Revenue as a Ratio of Disposable Personal Income	0.8%	1.2%	0.8%
Win per machine per day	$200.54	N/A	$200.00

GROWTH – OR SUSTAINABILITY – WILL REQUIRE INNOVATION

The launch of Video Lottery line games in 2005 was the last significant addition to the Oregon Lottery's game portfolio. For the last 11 years, no new game or feature has been launched to appeal to consumer segments beyond the typical Lottery player demographics.

And while the Oregon Lottery's retailer base is a successful channel for selling Lottery games, retailers themselves understand that consumer purchasing preferences are changing.

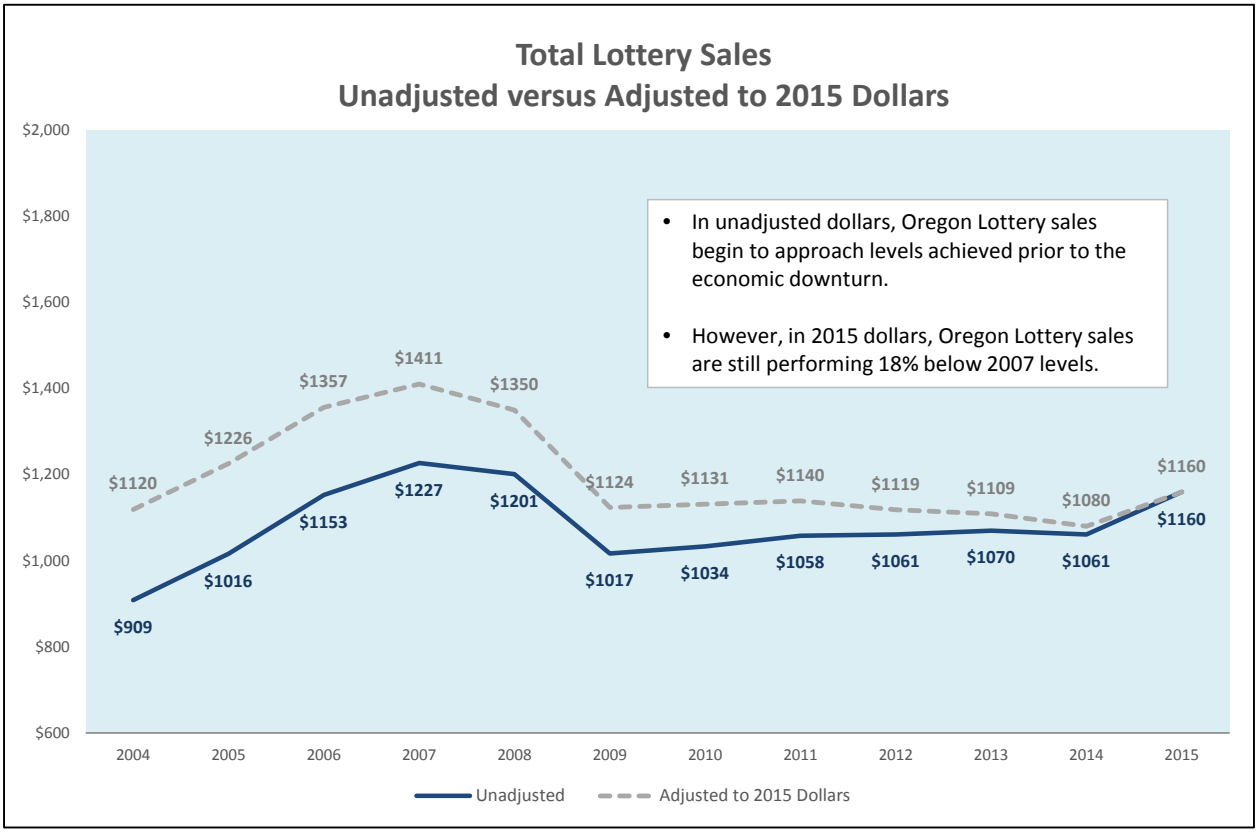
Large, retail chains such as Wal-Mart are investing in offering fully integrated mobile solutions. 7-11 is testing drone delivery services. They realize that tomorrow's consumers will expect increased convenience and choices in what, where, and how they purchase goods.



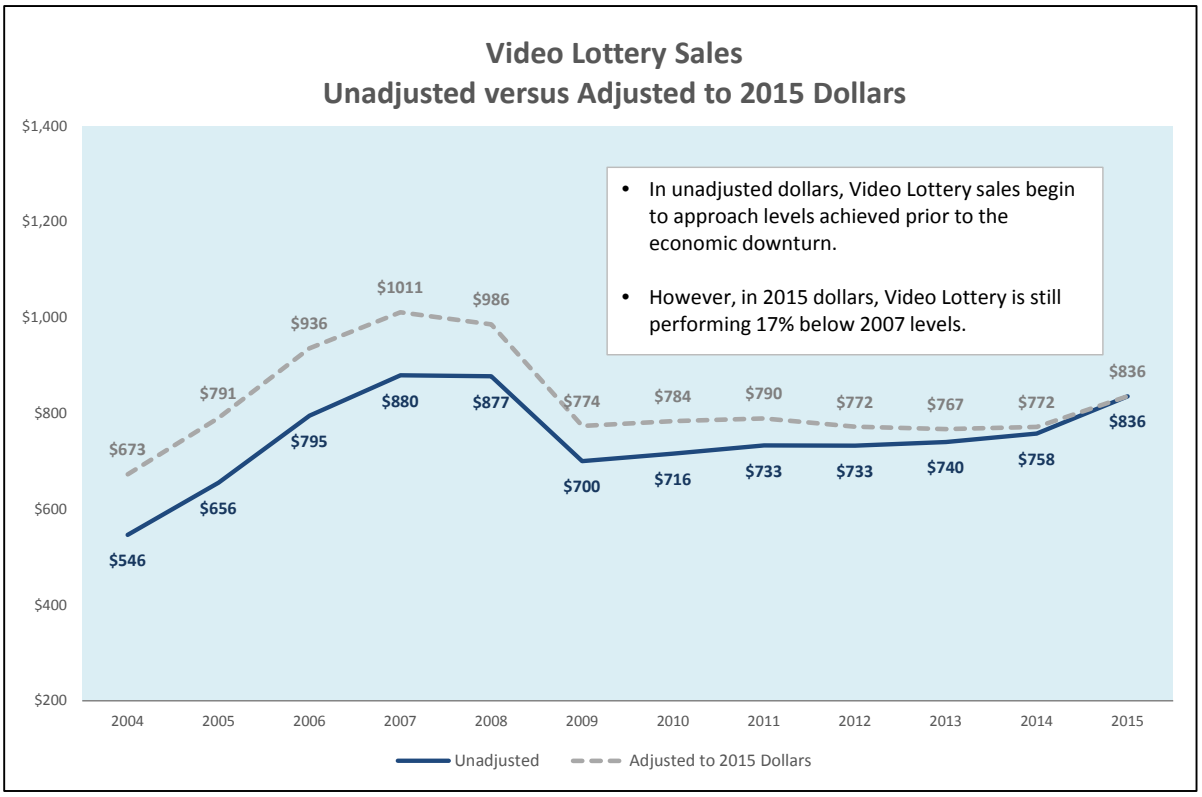
WHEN ADJUSTED FOR INFLATION, LOTTERY SALES HAVE NOT FULLY REBOUNDED SINCE 2007

The following graphs illustrate the different trends that emerge when sales are adjusted to account for inflation. After Oregon Lottery sales peaked in 2007, sales decreased steeply during the economic downturn and were stagnant through 2014. Only in 2015 did we begin to see a meaningful up-tick in Lottery sales.

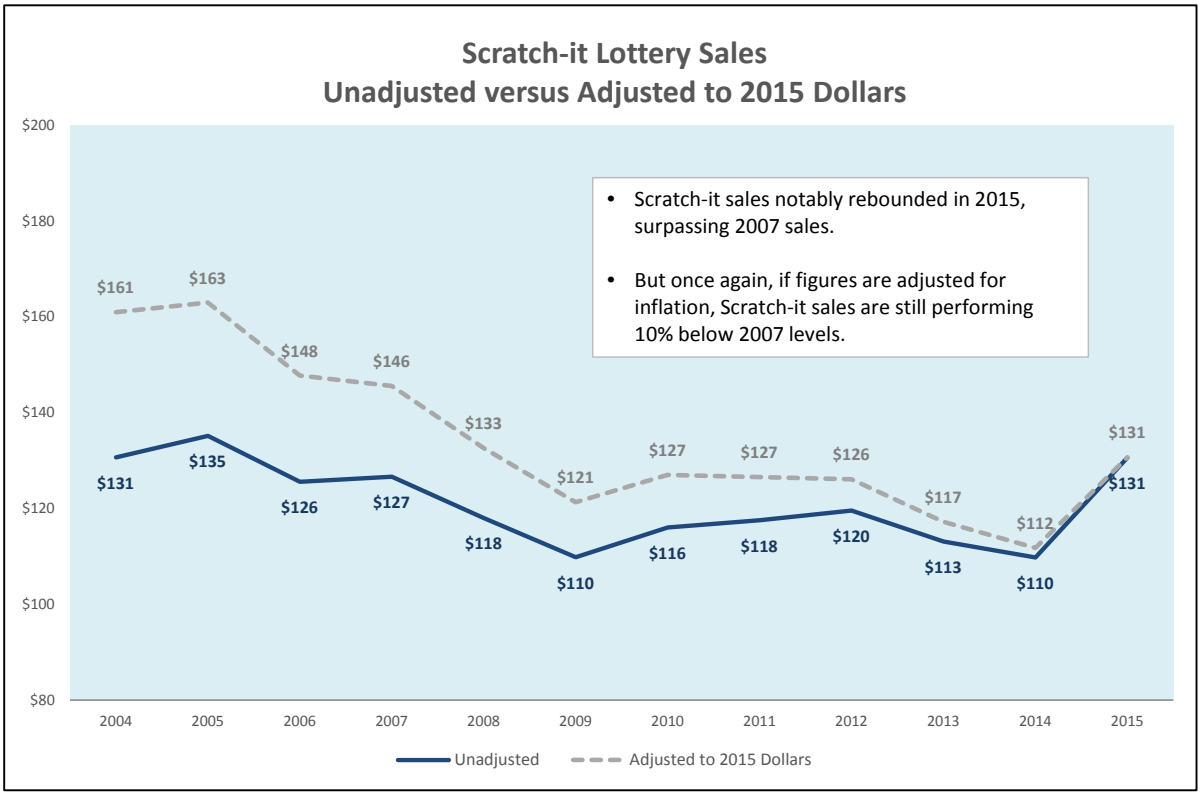
However, if past sales figures are adjusted to 2015 dollars to account for inflation, the Oregon Lottery continues to lag well behind its 2007 sales peak.



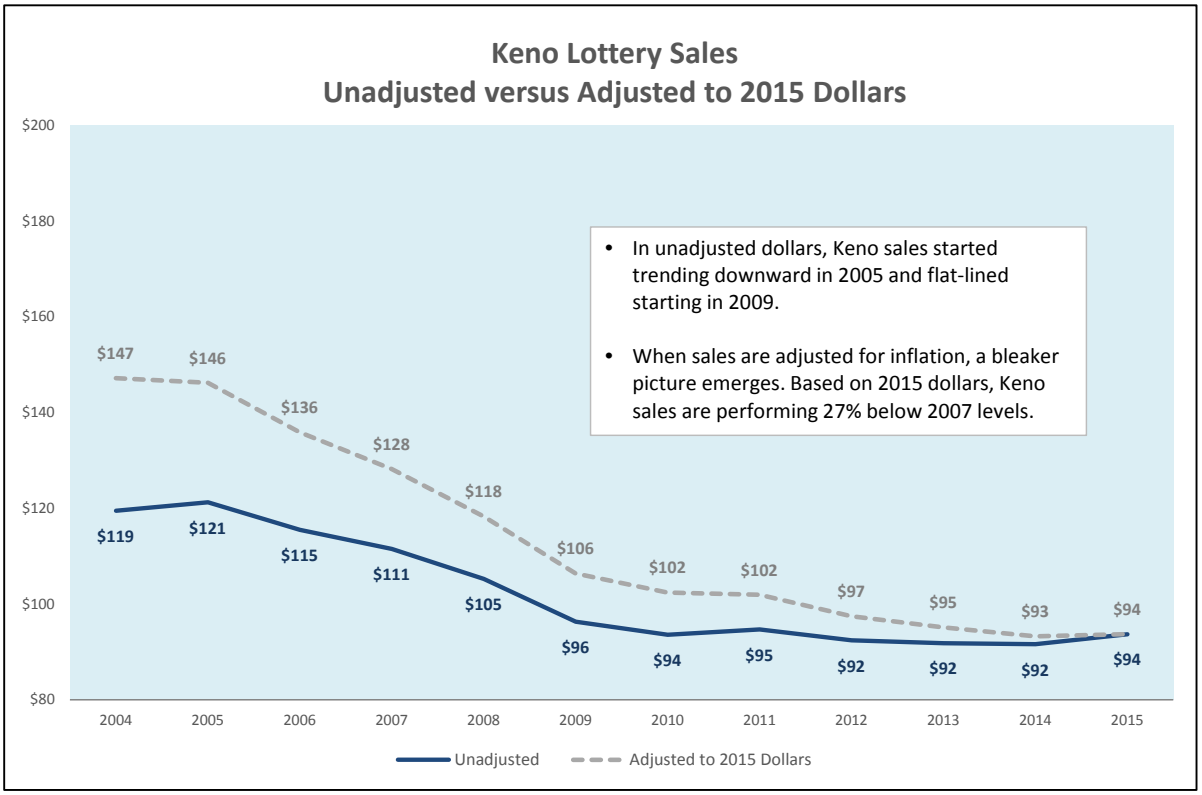
A comparison of sales trends based on unadjusted and adjusted sales for each main Lottery game category is presented on the pages that follow.

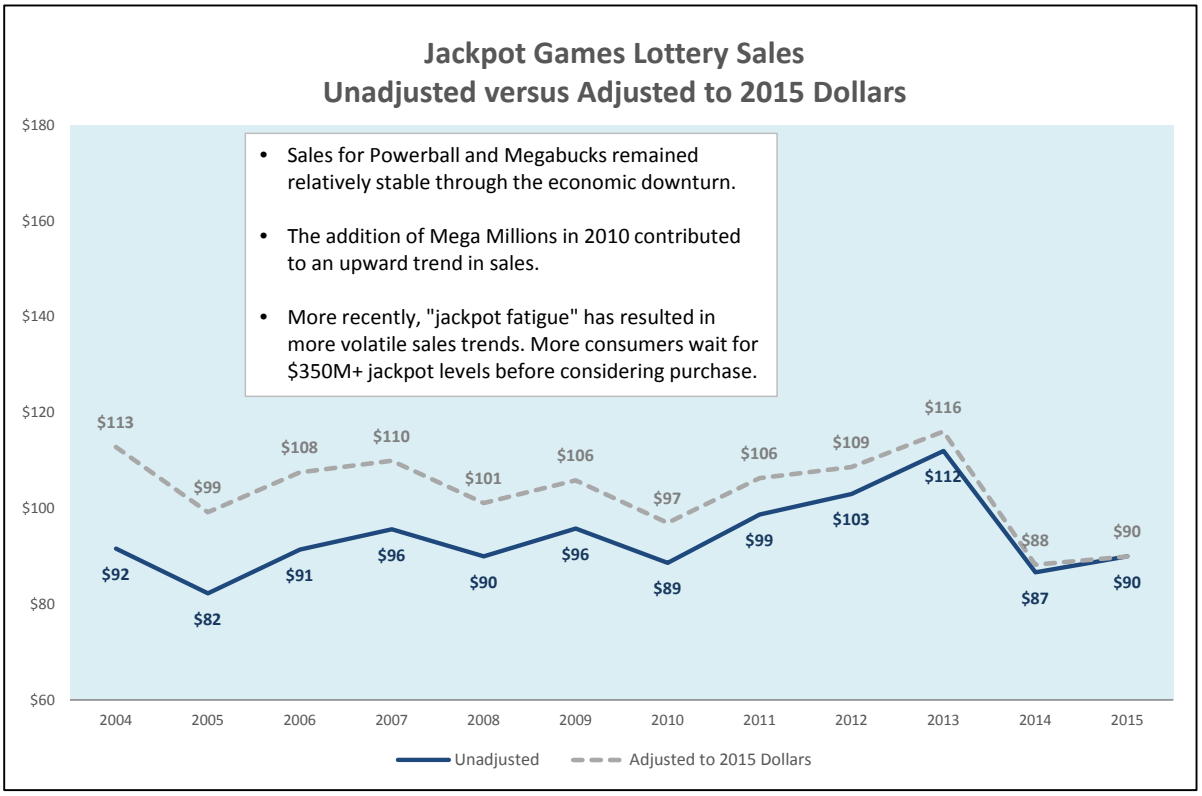


- In unadjusted dollars, Video Lottery sales begin to approach levels achieved prior to the economic downturn.
- However, in 2015 dollars, Video Lottery is still performing 17% below 2007 levels.



- Scratch-it sales notably rebounded in 2015, surpassing 2007 sales.
- But once again, if figures are adjusted for inflation, Scratch-it sales are still performing 10% below 2007 levels.


Keno Lottery Sales
Unadjusted versus Adjusted to 2015 Dollars
$200
$180
$160
$140
$120
$100
$80
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
$147
$146
$136
$128
$118
$106
$102
$102
$97
$95
$93
$94
$119
$121
$115
$111
$105
$96
$94
$95
$92
$92
$92
$94
In unadjusted dollars, Keno sales started trending downward in 2005 and flat-lined starting in 2009.
When sales are adjusted for inflation, a bleaker picture emerges. Based on 2015 dollars, Keno sales are performing 27% below 2007 levels.
Unadjusted
Adjusted to 2015 Dollars


Jackpot Games Lottery Sales
Unadjusted versus Adjusted to 2015 Dollars
$180
$160
$140
$120
$100
$80
$60
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
$113
$99
$108
$110
$101
$106
$97
$106
$109
$116
$88
$90
$92
$82
$91
$96
$90
$96
$89
$99
$103
$112
$87
$90
Sales for Powerball and Megabucks remained relatively stable through the economic downturn.
The addition of Mega Millions in 2010 contributed to an upward trend in sales.
More recently, "jackpot fatigue" has resulted in more volatile sales trends. More consumers wait for $350M+ jackpot levels before considering purchase.
Unadjusted
Adjusted to 2015 Dollars