Maryland Lottery and Gaming

FY 2020 Budget Presentation

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Table of Contents

Page 3 Overview

Page 4 Lottery Sales and Revenue Comparisons – Fiscal Year 2017–2018

Page 5 Gaming Revenue Comparisons – Fiscal Year 2017-2018

Page 6 DLS Issues and Recommended Actions

Overview

In fiscal year 2018, Maryland Lottery and Gaming contributed more than $1.252 billion to the State of Maryland to support good causes, such as the Maryland Education Trust Fund; public health and safety; horseracing and more. $575.6 million was generated through lottery operations and $676.9 million was contributed by the casinos.

In fiscal year 2018, record lottery sales of $2.043 was achieved, increasing by $111 million or 5.8% over the previous fiscal year. Refer to page 4 for a breakdown of sales. Other notable fiscal year 2018 highlights include record profits totaling $575.6 million, commissions paid to retailers totaling $153.7 million and prizes paid to players totaling $1.246 billion.

Maryland's casino industry continued to grow in fiscal year 2018, the first time that all six of Maryland's casinos were operating for a full fiscal year. Gaming revenue at these six casinos totaled $1.679 billion, a $258 million or an 18.2% increase compared to fiscal year 2017. The casinos' $496.7 million contribution to the Maryland Education Trust Fund increased $45.5 million or 10% compared to the previous fiscal year.

Lottery Sales and Revenue Comparison

Fiscal Year 2017-2018

SALES:	FY 2017	% of Total Sales	FY 2018	% of Total Sales	DIFFERENCE	% of Change
MEGA-MILLIONS	66,344,693	3.4%	88,555,640	4.3%	22,210,741	33.5%
POWERBALL	100,133,706	5.2%	111,194,931	5.4%	11,061,225	11.1%
KENO	303,244,462	15.7%	291,409,988	14.3%	-11,834,474	-3.9%
RACE TRAX	180,398,545	9.3%	192,584,289	9.4%	12,185,743	6.8%
PICK 3	239,153,635	12.4%	235,402,012	11.5%	-3,751,622	-1.6%
PICK 4	291,588,159	15.1%	296,206,896	14.5%	4,618,737	1.6%
MULTI-MATCH	24,018,675	1.2%	28,952,844	1.4%	4,934,169	20.54%
BONUS MATCH-5	19,799,308	1.0%	19,658,089	1.0%	-812,570	-0.7%
5 CARD CASH	5,545,217	0.3%	5,646,303	0.3%	10,086	1.8%
CASH4LIFE	16,193,704	0.8%	13,173,716	0.6%	-3,019,988	-18.6%
INSTANT	676,752,574	35.0%	750,888,512	36.8%	74,135,938	11.0%
ITLM	8,372,989	0.4%	9,121,117	0.5%	748,228	8.9%
TOTAL	1,931,545,666	100%	2,042,794,337	100%	111,248,564	5.8%
REVENUE:						
LOTTERY TOTAL	524,902,592	27.1%	575,672,412	28.2%	50,769,820	9.7%
STADIUM AUTHORITY	40,000,000	2.1%	40,000,000	2.0%	0	0.0%
VETERANS TRUST	70,173	0.0%	76,575	0.0%	6,402	9.1%
INTERNATIONAL RACE FUND	1,000,000	0.0%	1,000,000	0.0%	0	0.0%
GENERAL FUND	483,832,419	25.0%	534,595,837	26.2%	50,763,418	10.5%

Gaming Revenue Comparison

Fiscal Year 2017-2018

	Fiscal Year 2017	Fiscal Year 2018	Difference	% of Change
Gaming Revenue	**$1,420,942,363**	**$1,678,966,409**	**$258,024,046**	**18.2%**
Education Trust Fund	$451,206,895	$496,663,610	$45,456,716	10.1%
Casino Operators	$819,389,044	$996,857,938	$177,468,894	21.7%
Horse Racing	$63,048,641	$71,219,399	$8,170,758	13.0%
Local Impact Grants	$47,481,444	$56,792,606	$9,311,162	19.6%
MLGCA	$9,310,058	$10,457,130	$1,147,072	12.3%
Small, Minority, and Women-Owned Businesses (SMWOB)/ General Fund	$12,949,485 (SMWOB)	$15,361,244 (General Fund)	$2,414,759	18.7%
Local Jurisdictions	$17,556,796	$31,614,481	$14,057,685	80.1%

Department of Legislative Services (DLS) Issues and Recommended Actions

SLGCA should comment on the reduction in the number of lottery retailers in the State since fiscal year 2015.

Although it appears that the number of retailers has decreased since 2015 some of this decrease is caused by churn in the retail network. Approximately 10% of the lottery network turns over in a given year. Each retailer that has sales in a fiscal year is counted as a retailer so it is highly possible that during fiscal year 2015 there was a higher than usual turnover. Since 2015, the number of retailers has remained relatively constant. The Agency would like to note, that despite the reduction in the number of retailers since 2015, sales have increased each year. Specifically, from 2015 to 2018, sales have increased by $282 million or 16%; therefore, the Agency deems any change in the retail network to be immaterial and not impacting overall operations.

The Agency does its best to recruit new retailers but is often hindered by the lack of staffing to perform these duties. In order to adequately recruit new leads through-out the State, a team dedicated to recruitment efforts is necessary. However, the Agency only has two individuals dedicated to full-time recruitment functions.

The Department of Legislative Services (DLS) recommends eliminating five long-term vacant positions at SLGCA.

The Agency does not agree with the recommendation. One of the vacant positions was in the budget department and one was in the accounting department. For the past three years, the individual in charge of these departments has been heavily involved in the conversion of the new lottery gaming system. This conversion required a substantial amount of time and also revamped the day-to-day operations of these departments as well as other departments. A conscious decision was made to hold off filling the budget position so that the individual would have time to properly train the person. The accounting position was also left vacant to allow for the lottery system conversion to be complete so that day-to-day duties could be re-determined. The Agency had plans to fill both of these positions early in calendar year 2019.

Another one of the vacant positions is the Director of Procurement. This individual retired three years ago and has come back to the Agency in a contractual position. The Procurement Director has an over-whelming amount of State Procurement experience and the Agency hired him back as a contractual employee to assist in the procurements of our major contracts (lottery gaming system, advertising, television drawings). A full-time procurement position is needed when this individual decides to leave the Agency.

For one of the positions, the Agency has conducted recruitments on three separate occasions. Each recruitment either resulted in a lack of qualified individuals or the inability to meet salary expectations. The Agency continues to recruit for this position.

The remaining position is assigned to the product development department. This position has been vacant due to turnover in the Chief Marketing Officer (CMO) position. The Agency wanted to wait until it hired a permanent CMO so that their input could be obtained regarding the job responsibilities of this position. This position will play a key role in furthering the growth of instant ticket sales.

SLGCA should comment on the rapid increase in lottery advertising spending and the assumptions used to generate the projected fiscal year 2020 revenue increase.

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The Maryland Lottery has been chronically underfunded in its marketing and advertising budget for several years. Ten years ago, the marketing budget was roughly $20 million, but was cut about 40% to $12 million in subsequent years. The result was that lottery sales actually declined in 2013 and 2014. Beginning in 2015, the marketing budget began to be gradually restored each year, generating record sales in years 2016, 2017 and 2018. The 2020 recommendation is for a total marketing budget of $21 million, finally getting back to the level of ten years ago. The marketing spend in recent years has been focused on our instant game category, which is a strategic priority for the Maryland Lottery based on performance comparisons with other high-performing US lotteries. In the lottery industry, instant ticket sales represent about 50% to 60% of sales; in Maryland, we were only at 30% four years ago. But we have increased instant ticket sales by double-digit percentages four years in a row, with the category now generating 37% of sales.

For several years, we have strongly advocated increased marketing spending, referencing excellent research done in other states that demonstrated the positive incremental Return-on-Investment (ROI) of increased advertising and marketing. Advertising spending is usually expressed as a percentage of sales, a metric known as the ad/sales ratio. In the lottery industry, the average ad/sales ratio across all U.S. lotteries is 1.2%. In Maryland, it was only 0.7%.

For example, the New York Lottery engaged an econometrics-based brand research agency to study the relationship between advertising, sales and profits. The findings actually showed that an incremental dollar of advertising generated $3 to $5 of incremental profit. (As an aside, the New York Lottery is the largest and most profitable in the country, with a total marketing budget of $92 million.) The research findings showed that advertising spending had a strongly positive ROI even at levels of ad/sales ratios up to 3%. The Texas Lottery conducted a similar study and the results were even higher ($1 ad spend = $7 profit).

With our strong track record of driving sales growth with higher advertising spending, we believe there is more opportunity to generate even higher sales, particularly in instant tickets, with increased advertising. The Agency is committed to producing $12 million in higher profits from the $3 million increase in advertising spend.

SLGCA should comment on the impact of legalizing sports betting on State revenues.

The Agency is following developments in sports betting very closely. Any discussion of revenue potential requires many assumptions about how the category is structured and organized. Variables include things like bet types (e.g., parlay, single game, in-play), venues (e.g., lottery retailers, casinos, retail betting shops, etc.), distribution channels (e.g., bricks-and-mortar, online, mobile), competition and tax rates. And very importantly, policy makers must understand that sports betting is a large, volatile, high-risk and low-margin business.

One of the major arguments for legalized sports betting is to take market share away from the very large illegal market that already exists. To be successful, legal operators need to be highly competitive with their illegal counterparts, who pay no taxes and have very low costs and can afford very high payouts. This will argue for relatively low tax rates, contrary to what Pennsylvania has done with their 36% tax rate; it remains to be seen if that is a successful approach.

Another large variable is the bet type, where the largest potential comes from single game and in-play betting, vs. the much smaller potential of parlay-style betting (as Delaware has had for many years at lottery retailers). However, in-play bets are essentially only possible with online and mobile distribution, since placing bets must be done in an extremely short and timely manner.

Another argument for sports betting suggests that its real value lies not in its ability to generate profit, but rather in its capacity to draw traffic to bricks-and-mortar facilities, especially casinos. By attracting a new segment of players, the casinos (and the state) will benefit from the incremental play on more lucrative games like slot machines and table games. If that is a primary policy objective, then that will drive the choices on bet types, venues and distribution.

The range of gross gaming revenue estimates mentioned in the analyst's report ($34 to $68 million per DLS), implies total wagers (handle) of $680 million to $1.36 billion, assuming a 5% margin. Given that New Jersey, in its first six months of sports betting, has generated about $1 billion in handle, that kind of range for Maryland is plausible. To bring that back to actual money for the state, a 10% tax rate would generate $3.4 to $6.8 million. Although DLS assumed a 20% tax rate, such a rate may make Maryland uncompetitive against the illegals and against neighboring states (New Jersey taxes sports betting at 8.75% at casinos. 13% for casinos online and 14.25% for racetracks online).

Keep in mind that these revenue estimates assume that all forms of sports betting are available in the state, and therefore may be a best-case scenario. If sports betting is restricted to brick-and-mortar facilities and is taxed at a higher rate, revenue potential for the state will be lower, although the casinos will benefit from increased traffic and presumably higher levels of play on existing games. If sports betting is restricted to parlay bets at lottery retailers, again, revenue potential would be constrained.

Maximizing revenue potential requires a very broad definition of sports betting, embracing multiple outlets, all bet types and mobile/internet capability. A more limited menu of offerings, for example, at casinos, can generate moderate revenue while keeping Maryland's gaming industry competitive with neighboring states.

SLGCA should comment on its disbursement of funds directly to the Maryland Thoroughbred Purse Account and the Maryland-Bred Race Fund without budgetary authority, rather than to DLLR as budgeted.

The Agency was approached by DLLR and was requested to transfer $2,275,000 directly into the Maryland Thoroughbred Purse Account and the Maryland-Bred Race Fund by the first of every month. DLLR advised us that the money needed to be in these accounts by the first of the month and that they could not wait until our full transfer, which typically occurs by the sixth business day of each month. As requested, the Agency made these transfers through the transmittal process. Nevertheless, the Agency is working with DBM to determine how and when to make these transfers moving forward.