



2005

statement of intent

for the financial years ending 30 June 2006-2008



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This statement of intent for the New Zealand Lotteries Commission (NZ Lotteries) meets the requirements of section 139 of the Crown Entities Act 2004. It is for the financial years ending 30 June 2006, 2007 and 2008. The statement sets out the overall intentions and objectives of NZ Lotteries during this three-year period.

Introduction

Our Purpose

To provide safe gaming that allows New Zealanders to play and win while contributing money back to New Zealand communities.

Our Goal

Our primary goal is to continue to generate improved earnings so that we are able to maximise the contribution we make to numerous New Zealand communities. At the same time we endeavour to minimise the incidence of any problem gambling and under-age gambling associated with our products.

We will achieve this by creating winning outcomes for all our stakeholders – our customers, our shareholder the government, our retail network and other business partners, and our staff.

Our Role

New Zealand Lotteries Commission (NZ Lotteries) is New Zealand's only gaming provider with a pure community-benefit funding model. Lotto, our flagship game, has become a national icon.

Lotto was introduced as a result of a 1985 report *Sport on the Move*, which saw the new game as a source of extra revenue for recreation, arts, sport and community projects. The government of the day noted that the income from the existing Golden Kiwi lottery appeared to have peaked. And so NZ Lotteries was established in 1987, with Lotto's first draw being held on 1 August that year.

Alongside Lotto, NZ Lotteries other products are Lotto Powerball, Lotto Strike, Keno and Instant Kiwi.

Public Perceptions of NZ Lotteries

Our community-benefit funding model means that we are perceived differently from other gaming providers¹. The public believes that NZ Lotteries has an established history and presence in New Zealand society. We are seen as a source of large-scale community funding whose games are regarded as “fun” or a harmless flutter rather than gambling. As an organisation we are subject to stringent government reporting and monitoring requirements.

NZ Lotteries retail network of more than 730 “Lotto Shops” employs more than 3,600 people. It is the largest single retail network in New Zealand and we are seen as a leader in retail developments, a position we aim to retain as we continue to expand our retail network.

Supporting the Community

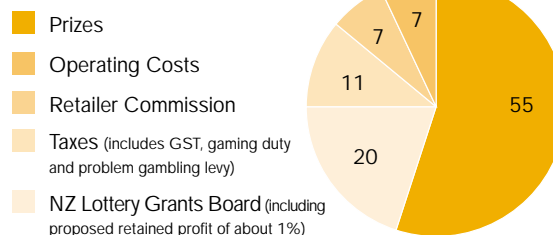
NZ Lotteries earnings are passed to the New Zealand Lottery Grants Board (NZ Lottery Grants Board) and flow on to directly benefit the broader community.

Since its creation, NZ Lotteries has contributed more than \$2 billion to the NZ Lottery Grants Board. About twenty per cent of NZ Lotteries sales go directly to the community – see *Figure 1*.

¹ CM Research (2001), *NZLC Survey of Public Attitudes to Gaming*

Figure 1: How Lotteries Money is Spent*

For every \$1 from combined sales:



* Based on forecast results for the year ended 30 June 2005

New Zealanders strongly support this community-benefit model: that the profits from gaming should be used primarily for community and charitable purposes. Since 1985, the Department of Internal Affairs’ five-yearly survey of public attitudes towards gaming has found consistently that more than 90 per cent of New Zealanders support this objective².

We are a major supplier of funding for Sport & Recreation New Zealand, Creative New Zealand and the New Zealand Film Commission. The activities of New Zealand’s artists, film-makers and high-achieving sportspeople provide inspiration for us all. They act as a major catalyst in creating a positive sense of identity for New Zealand and New Zealanders.

The remainder of the NZ Lottery Grants Board’s funding supports around 3,400 grass roots community activities and projects each year. This type of community funding directly helps develop vibrant communities.

² Department of Internal Affairs (2000), *Public Attitudes Towards Gaming Survey, 2000 (Part II)*, p 16

Allocations by the NZ Lottery Grants Board 2005–2006	
Total available for allocation 2005–2006:	\$ 110,120,000
Allocated to:	\$
Regional Community Committees	
Northland	965,875
Auckland	4,735,683
Waikato	1,862,123
Bay of Plenty/Gisborne	1,606,280
Hawke's Bay	834,256
Taranaki	568,464
Manawatu/Wanganui	1,066,883
Wellington/Wairarapa	1,781,887
West Coast/Nelson/Marlborough	1,043,892
Canterbury/Kaikoura	2,035,638
Otago/Southland	1,312,019
	17,813,000
National Community Committee/Subcommittees	
National Community Committee	10,800,000
Individuals with Disabilities Subcommittee	3,547,000
Pacific Provider Development Fund	200,000
	14,547,000
TOTAL Community Committees	32,360,000
Specialist Distribution Committees	
Environment and Heritage	7,349,000
Health Research	2,560,000
Marae Heritage and Facilities	5,531,000
Minister's Fund	150,000
Outdoor Safety	6,650,000
	22,240,000
TOTAL Lottery Distribution Committees	54,600,000
Statutory Bodies	
Creative New Zealand	18,600,000
Sport & Recreation NZ (SPARC)	28,220,000
NZ Film Commission	8,100,000
NZ Film Archive (via NZ Film Commission)	600,000
	55,520,000
TOTAL ALLOCATION 2005–2006	110,120,000

Source: NZ Lottery Grants Board and Department of Internal Affairs

Responsible Play

One of NZ Lotteries statutory functions under the Gambling Act 2003 is to maximise profits, subject to ensuring that any risks of problem gambling and under-age gambling associated with our products are minimised.

NZ Lotteries and its retail network conduct all aspects of lottery business in a professional and responsible manner. All efforts are made to provide a safe, friendly and responsible play environment that adheres to legislative and regulatory requirements.

For most people, playing lottery games is fun and rewarding entertainment and lotteries provide a clear net community benefit. There are, however, a very small number of people for whom playing our games can create gambling problems.

The limited impact our games have in this area is reflected in provisional problem gambling figures for the 2004 year which show that at most 0.6%, or 13, of the 2,236 gamblers who received face-to-face counselling for the first time cited our products as their primary mode of gambling. This is slightly lower than in 2003 when 0.8%, or 16, of the 2004 gamblers who presented for face-to-face counselling for the first time cited our products as their primary mode of gambling.³

While lotteries rarely cause problem gambling, NZ Lotteries supports programmes that help protect and support people most at risk through an annual contribution to the Problem Gambling Levy.

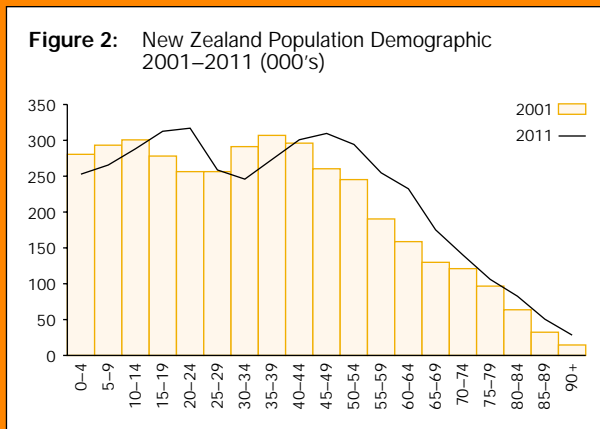
NZ Lotteries will continue to contribute to harm prevention and minimisation initiatives through its responsible play strategy and consultation on game changes and new games. It will participate in problem gambling conferences and research programmes and be a member of the Ministry of Health's Interim Data Advisory Committee as it develops, and starts to implement, its integrated problem gambling strategy.

³ Problem Gambling Intervention Services in New Zealand. Provisional 2004 figures for face-to-face counselling as at 13 May 2005. Gambling Helpline 2004 statistics, for gamblers who presented for telephone-based counselling for the first time, are still to be published, as is a combined total of gamblers who received either face-to-face or telephone-based counselling during 2004. These provisional figures exclude 159 new face-to-face clients who did not provide data on their primary gambling mode.

Operating Environment

Population and Lifestyles

NZ Lotteries only operates within New Zealand, a market that has a relatively slow growing and ageing population – see *Figure 2*. The resident population of New Zealand was estimated at 4.09 million at 31 March 2005 and population growth was estimated to be 38,600, or 1 percent, during the year to March 2005. Natural increase contributed 28,600 to population growth and net migration contributed 10,000 during the same period. Half of New Zealand's population was over 35 years of age at 31 December 2004 and about one in eight were aged 65 years and over.⁴



Source: Statistics New Zealand

The ethnic diversity of New Zealand's population has changed significantly since the beginning of Lotto in 1987. Population growth is focused on Auckland which has much greater ethnic diversity than other cities. Only 65% of Auckland's current population was born in New Zealand compared with a national average of 81%.⁵

When Lotto first started, crowding around the TV on a Saturday night was the social engagement of the week. Eighteen years later, New Zealanders live more mobile and social lives with a corresponding growth in movie theatre complexes, live entertainment and a burgeoning café and restaurant culture. Those at home on a Saturday night now have far greater choice between satellite and free-to-air television, along with electronic and other home entertainment options.

New Zealand Gaming Industry - Regulatory Environment

NZ Lotteries operates in a complex regulatory environment involving strict legislative boundaries, complex stakeholder relationships and a high level of scrutiny. Changing existing games, or introducing new ones, requires long lead times. On the other hand, this environment means we are able to offer stakeholders transparency and total integrity in terms of processes and communication with the community.

The Gambling Act 2003

The Gambling Act was enacted in September 2003, marking the beginning of a new era for New Zealand's gaming industry after a lengthy period of uncertainty.

⁴ Department of Statistics, *National Population Estimates*, March 2005 quarter.

⁵ Statistics New Zealand 2001, *New Zealand Census of Population & Dwellings*.

The Act introduced strong harm prevention and minimisation measures and allocated responsibility for funding and implementing problem gambling services, and developing a strategic plan for preventing and minimising gambling harm, to the Ministry of Health.

The Act established the Gambling Commission and disestablished the Casino Control Authority whose residual functions were integrated into the functions of the Department of Internal Affairs and the Gambling Commission. The Act provided that no new licences for casinos would be issued.

It placed a total market cap on gaming machines, limiting to nine the number of gaming machines per venue licensed since October 2001 and strengthened controls on the gaming machine environment, including the mandatory monitoring of gaming machines.

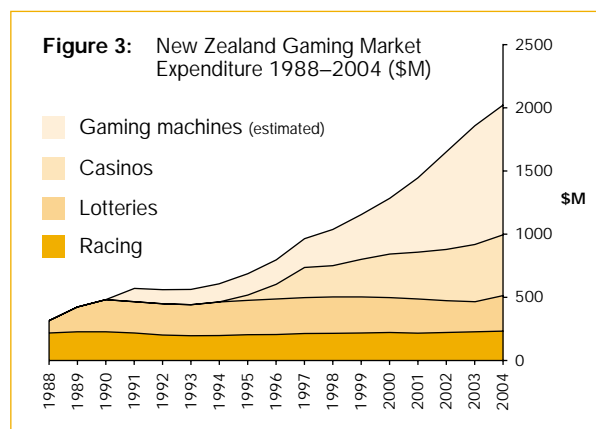
The New Zealand Racing Board and racing clubs are permitted to operate gaming machines in TABs and racing clubs and the TAB can continue selling its products online.

For NZ Lotteries, the Act raised the minimum age restriction on our Instant Kiwi product to 18 years, effective 1 July 2004 and incorporated harm minimisation requirements into our statutory functions. The Act allows NZ Lotteries to offer remote interactive gaming products in accordance with guidelines which will be developed and agreed to with government regulators.

Interactive products will not be offered until after a new gaming system is introduced in mid 2006 and the consultation processes previously outlined are completed. The statutory responsibilities placed with the Ministry of Health under the Act require NZ Lotteries to consult with it on harm minimisation issues, particularly when changing existing games and developing new games.

Competition

Over the past 18 years, the gaming market in New Zealand has grown rapidly and overall consumer participation has increased significantly. Until 2004, in the face of stiff competition from gaming and other competitors, expenditure on NZ Lotteries products remained relatively static, and our share of the gaming market progressively declined as new entrants grew rapidly – see *Figure 3*.



Source: Department of Internal Affairs – Gambling Expenditure Statistics 2004⁶

In 2004, expenditure in the New Zealand gaming market grew by 9%. Expenditure on NZ Lotteries products increased to 14% of total gaming expenditure during the same period, the first time it has increased since 1994. Gaming machines outside of casinos account for more than half the total gaming expenditure in New Zealand.

⁶ Gambling statistics derived from the Department of Internal Affairs website www.dia.govt.nz, which also has accompanying explanations on the data.

Some of the market share growth in 2003/2004 was a result of the two large Powerball jackpotting runs in the first half of that financial year. Growth in 2004/2005 and beyond will come from the successful development of new and existing NZ Lotteries products, a continuation of effective marketing and advertising and a significant increase in the number of retail outlets selling our products.

Direct Competitors

NZ Lotteries direct competitors within the gaming industry provide intense competition with their gambling products, typically offering rapid return reinvestment opportunities.

TAB

- Offers racing and sports betting, retail and web channels and gaming machines.

Non-casino gaming machines

- As at 31 March 2005, the Department of Internal Affairs estimated that there were 22,159 gaming machines in pubs and clubs with 568 societies operating them from 1,838 venues. This amounts to approximately one machine for every 135 New Zealanders aged 18 or over⁷.
- Prior to the passing of the Gambling Act 2003, the trend had been for a rapid increase in the number of gaming machines. The Act capped the number of gaming machines per venue to nine and since then there has been a consequential decline in the number of machines each quarter. However, profits have continued to increase.

- The Act also legislated for the stricter monitoring of gaming machines. All gaming machines must be connected to electronic monitoring by 19 March 2007.
- Jackpot devices linking gaming machines within a venue have been operating for several years. Loyalty programmes for gaming machines in pubs and clubs are prohibited.
- From 1 April 2005, operators of gaming machines in pubs and clubs have been required to provide customers with information on problem gambling.
- From 1 October 2005, operators will also be restricted from jackpot advertising and using jackpot branding.

Casinos

- The Act provides for no more casino licences to be granted.
- In 2004, player expenditure in casinos was more than 70% higher than that spent on NZ Lotteries products with casino expenditure increasing by nearly a third in the past three years.
- From 1 April 2005, operators of gaming machines at casino venues have been required to provide customers with information on problem gambling.
- From 1 October 2005, operators at these venues will also be restricted from jackpot advertising and using jackpot branding.

Interactive gaming

- A variety of overseas internet-based options are available to New Zealanders and these are increasing all the time.

International lottery blocs

- Such blocs already exist in the United States and Australia and there are lottery alliances involving Asian countries, the United Kingdom, France, Spain and other European countries.

⁷ Statistics New Zealand. The estimated resident population of New Zealand aged 18 years or over, as at 30 June 2004, was 2,994,100.

Indirect Competition

Indirect competition for New Zealanders' discretionary dollars continues to intensify:

Pay television

- Sky and TelstraClear have nearly 600,000 subscribers paying an average of just under \$55 a month for their services.

Home entertainment

- Videos and DVDs are very common, offering choice and ease of use at an increasingly low cost.
- Sky will introduce a TiVo-style digital video recorder (DVR) device in 2005. Based on international experience this is expected to further fragment consumers' media consumption.

Mobile phones

- There are more than three million mobile users in New Zealand representing 75% of the population⁸.
- Users are being offered high-speed data and content delivery, mobile commerce is emerging and there are interactive competitions which can reach a broad player base.

The internet

- More than 80% of New Zealanders now have access to the internet and it is growing in importance as a communications vehicle⁹.
- Computers and high-speed internet access are becoming cheaper, interactive content is becoming mainstream, and e-mail is a popular communication and marketing tool.

Technology Trends

Our traditional retailers and the players they serve will continue to be the dominant lottery sales channel for the foreseeable future. Our main priority, therefore, is to continue our efforts to maximise sales of our existing products through our retail network.

However, an increasing number of prospective customers' consumer preferences do not match our current distribution channels and the products on offer. In the future, we are looking at offering products over a variety of channels in order to capture as much of the market as possible while also increasing traditional retail sales year on year.

Investing in a new gaming system, due to be implemented mid 2006, is necessary because the current system is configured to operate over a telecommunications protocol, the support for which is to be discontinued. Our retail network will consequently enjoy new benefits including up-to-date in-store terminals. In addition, the new system will provide the core functionality for making our products available over new channels such as the internet.

⁸ Vodafone NZ estimate as per their website May 2005.

⁹ Neilsen/NetRatings Market Intelligence April 2005

Economic Environment

The following is a summary of a report provided by Infometrics in May 2005 for the purpose of assisting NZ Lotteries in its planning for the three years ending 30 June 2008.

New Zealand's economic growth is expected to slow over the coming 12 months due to declining net migration, capacity constraints and tighter monetary policy. A slight easing in fiscal policy may provide some offsetting effect.

The following is a list of other relevant assumptions about the economy:

- Gross domestic product (GDP) growth is expected to slow to around 2.8% by 2006/2007 after rising by an estimated 4.4% for 2004/2005.
- Growth in retail sales is expected to soften this year, but is still expected to exceed the rate of overall economic growth.
- Aggregate real disposable income grew by an estimated 5% over 2004/2005.
- Slower employment growth is likely to cause slower income growth of 2–2.5% over the forecast period.
- Unemployment has continued declining and is now less than 4%. A further decline to just above 3% is projected for 2005/2006, with small increases thereafter.
- Inflation is likely to be around 3% over the next two years due to tight capacity, pressure on wage rates and higher prices for traded goods due to rising international commodity prices and an easing of the recent strength in the New Zealand dollar.
- Interest rates are now around 7% and close to their expected peak, but any room for rate reductions as the housing market slows may be limited by high inflation, with ninety day bill rates unlikely to fall below 6% over the forecast period.
- The New Zealand dollar trade weighted index (TWI) has climbed to above 70, although further rises are unlikely. However, the TWI is expected to remain above 65 through to 2006/2007.
- Taxation will be levied on NZ Lotteries products on the same basis as in the past (that is, there will be no changes in GST or lottery duty). NZ Lotteries is exempt from income tax but pays GST on net gaming revenue (sales less prizes) under the Goods and Services Tax Act 1985 and lottery duty at 5.5% of sales under the Gaming Duties Act 1971.

Strategies

The strategic initiatives laid down in 2003/2004 remain the guiding principles in 2005/2006.

Products and Customers

The aims of this strategy are:

- to attract more players by strengthening the appeal of our games using effective and appropriate marketing and promotional initiatives
- to create more opportunities for our customers to play and win taking into account the new Gambling Act environment with its focus on harm minimisation.

Distribution

The aims of this strategy are:

- to provide a flexible, cost-effective retail model that meets the needs of a changing population
- to move to an environment in which customers may, if they wish, purchase our products electronically.

Technology

The aims of this strategy are to:

- ensure that our gaming system is capable of delivering our products cost-effectively and reliably through an expanded distribution network
- develop our technology roadmap for the future – interactive games, interactive channels and improved business processes.

Organisational Identity

The key outcomes of this strategy will be:

- successful implementation of the new organisational identity
- a strengthened public perception that all NZ Lotteries games offer the opportunity to win prizes, that the proceeds are used to enhance the New Zealand way of life and that they are conducted with complete integrity.

Winning Team

The aims of this strategy are to foster an environment that:

- promotes teamwork and success
- enables effective delivery of products and support mechanisms
- encourages effective capture of market innovations.

Operational Efficiency and Processes

The aim of this strategy is to:

- strengthen our focus on cost management to improve operational efficiency and drive down costs.

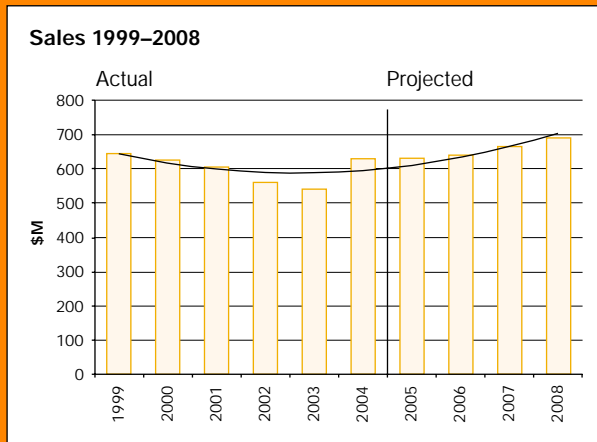
Connecting with Stakeholders

The aims of this strategy are to:

- raise awareness of the benefits arising for the community from our profits
- improve the quality of our communications with our customers, retailers, staff, government and associated political and industry stakeholders.

Financial Targets for the 2005/2006 Financial Year

Sales



From 1999 to 2003, sales decreased for four years in succession. A marked turnaround was achieved in 2003/2004. This result was achieved by realising the potential of three very large Powerball jackpots and implementing other sales, marketing and public relations initiatives.

The 2004/2005 results will be similar to those for 2003/2004, reflecting the revenue volatility caused by Powerball. In the first half of 2004/2005, the Powerball jackpot exceeded \$5 million on just five weeks compared with sixteen weeks for the same period in the previous year.

This was countered by successful sales promotions, increased Instant Kiwi ticket streams and product advertising, and a lift in average weekly sales for Lotto after the significant changes made to that game in August 2004.

These efforts were supported by:

- an increase in the number of retail outlets from 640 to 736
- improved advertising and promotion
- the start of a network refurbishment programme aimed at refreshing our retail presence, reducing the in-store space requirement to sell our products and allowing the freed-up space to be used for the sale of other products as appropriate.

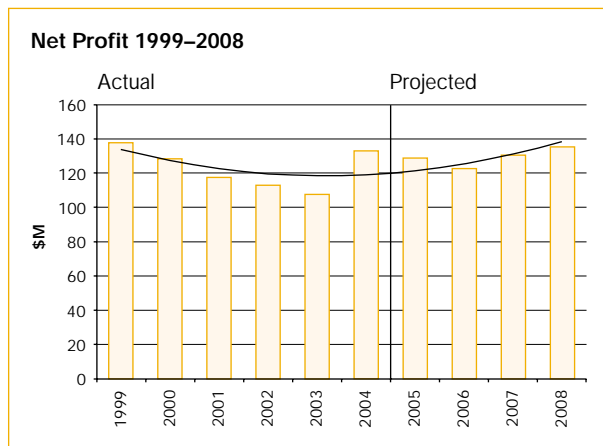
We are looking to continue to increase the size of our retail network. Our basic objective is for our retailer/population ratio to reach a level similar to that enjoyed in Queensland, Australia.

Much opportunity still exists to increase play frequency and attract new players. A new mid-week game is under consideration for launch later in 2005, a long-signalled initiative whose introduction will no doubt be welcomed by retailers. A mid-week product generating foot traffic and extra sales is a long held wish of our retailers. The extra buying opportunities created by our additional retail outlets will assist with the successful launch of this game and sales of our other products.

In the longer-term, the extra features offered by our replacement gaming system, due to go live in mid 2006, will allow our retailers to be even more effective. It also has the potential to allow us to create more sales channels for our customers, including remote interactive gaming, although we expect our retail channel to remain the primary sales vehicle. Shifting to an Internet Protocol (IP) network at the same time will provide an extremely high level of telecommunications reliability for our retail network.

These initiatives are key to achieving our objective of maximising our contribution to the New Zealand community. At the same time, we will continue to promote policies and practices, such as our Responsible Play Code of Practice and in-store training, that ensure we meet the Gambling Act's requirement to minimise the risk of problem or under-age gambling. A new Responsible Play mark is being developed for launch from July 2005.

Earnings



Decreasing sales over several years led to an associated fall in profitability. However, in 2003/2004 buoyant sales, assisted by the three big Powerball jackpots, gave a large boost to profits. Earnings are projected to continue the reversed trend recorded since 2003/2004, even allowing for the volatility of Powerball.

Earnings in 2005/2006 are projected to continue increasing based on the introduction of a new game, increased distribution channels and strengthened communications.

Products

Significant changes to simplify and strengthen the Lotto game, including the introduction of the “Winning Wheel”, were successfully implemented in August 2004. Customer reaction has been almost uniformly positive and we have seen weekly sales of Lotto lift by an average of 10% since the changes.

We promote our lottery products using value-adding programmes such as car and holiday cruise promotions. Promotions continue to be successful at attracting infrequent players into our Lotto games with the attraction of multiple numbers of tangible prizes.

Keno sales have increased since it became a game with two draws a day in May 2004. Keno’s potential will be further developed after the new mid-week game is introduced.

Instant Kiwi continues to record good growth after being in decline for several years. This is attributed to improved marketing, an increase to 12 ticket streams, better advertising support, a static dispenser format in all stores and the new sales opportunities created by the extra outlets. Continued growth will come from new designs and game structures for key Instant Kiwi streams and increased distribution as our retail network continues to expand.

We are planning to introduce a new mid-week jackpotting game later in 2005. Consultation with the Ministry of Health and Department of Internal Affairs regarding the game has commenced.

As noted earlier under “Technology Trends” the replacement gaming system will provide us with the core functionality for making our products available through new electronic channels. Providing gaming products by this means is known as “remote interactive gaming” or “RIG”. High-level work will begin on determining what form of RIG will be offered once the new gaming system goes live in mid 2006 and when we have the technical capacity, as well as the legal ability, to offer such games. Part of this work will focus on the harm prevention and minimisation measures that will need to be introduced in conjunction with any interactive products.

Key Financial Objectives

Our budget for 2005/2006 is based on realistic objectives given the unpredictability of Powerball's jackpotting cycle. Large prize offers create sizeable increases in sales and earnings. The effect on results of introducing the proposed new mid-week game is also difficult to predict with any degree of precision.

NZ Lotteries key financial objectives for the 2005/2006 financial year are:

- to achieve gross sales of \$640 million
- to achieve a net surplus of \$123.1 million
- to transfer \$114 million to the NZ Lottery Grants Board
- to hold expenditure at \$49.2 million.

Corporate Responsibility and Social Accountability

Corporate Citizen and Integrity Performance Measures

During the period 1 July 2005 to 30 June 2006, NZ Lotteries plans to:

- conduct all draws on time for Lotto (including Lotto Powerball), Keno, and any new draw games introduced during the year
- comply with all provisions of the Gambling, Fair Trading, Commerce, and Consumer Guarantees Acts
- ensure that all of our advertising complies with the standards set by the Advertising Standards Authority
- monitor Problem Gambling Counselling National Statistics with the aim of ensuring that no more than 2% of problem gamblers who seek counselling for the first time cite NZ Lotteries products as their primary mode of gambling.

Responsible Play

Initiatives for the period 1 July 2005 to 30 June 2006 to ensure NZ Lotteries harm prevention and minimisation responsibilities under the Act are met, include:

- a periodic review of our *Code of Practice for Responsible Play* and a companion brochure that are carried in all Lotto outlets, on our website and integrated into retail network training programmes
- continued vigilance to ensure compliance with the age restriction for playing Instant Kiwi supported by in-store communications and training
- the introduction of a Responsible Play mark which will appear on our website, corporate collateral and at point of sale
- continue to research the impact of our products on the community
- participation in responsible gaming surveys conducted by the World Lottery Association
- ongoing consultation with the Ministry of Health and the Department of Internal Affairs and problem gambling service providers on issues around preventing and minimising harm
- representation on the Ministry of Health's Interim Data Advisory Group.

Performance Targets

Financial Performance Targets	Estimate* 2004/2005	Budget 2005/2006	Projection 2006/2007	Projection 2007/2008
a) Total sales (\$m) (GST inclusive)	630.0	640.0	664.0	690.0
b) Net profit (\$m)	128.9	123.1	131.0	136.0
c) Paid to NZ Lottery Grants Board (\$m)	121.9	114.0	131.0	136.0
* The 2004/2005 estimate is based on 11 months' unaudited actual results and an estimate for June 2005.				
Note: All financial information is GST exclusive unless described otherwise.				
Other Targets	Estimate* 2004/2005	Budget 2005/2006	Projection 2006/2007	Projection 2007/2008
a) Annual per capita sales (adults 18 and over) [†]	\$208	\$209	\$215	\$221
b) Share of retail spending [†]	1.5%	1.6%	1.6%	1.6%
[†] GST-inclusive figures.				
[†] NZ Lotteries uses retail sales (excluding automobiles and automobile products) as measured by the Department of Statistics in its retail trade survey. The most recent survey is for actual sales for the last four quarters to March 2005.				
These targets allow NZ Lotteries to monitor the efficiency and effectiveness of its business. A favourable performance by NZ Lotteries on the above targets should also be reflected in its financial results, all other things being equal. Targets (a) and (b) above can be affected by regional and national demographic trends, retail shopping developments and trading patterns.				
Capital Expenditure	Estimate* 2004/2005	Budget^{††} 2005/2006	Projection^{††} 2006/2007	Projection 2007/2008
Capital expenditure (\$m)	10.6	32.0	11.0	4.0
^{††} The major item of capital expenditure in the 2005/2006 and 2006/2007 years relates to the estimated cost of the new gaming system and associated equipment. Support for the current telecommunications protocol used for the data links between NZ Lotteries central system and its retail network is due to be discontinued in 2006. Accordingly, this investment is required in order to ensure that NZ Lotteries products can continue to be sold through its retail network following conversion of those data links to the Internet Protocol (IP). In addition the current in-store terminals in the retail network are becoming obsolete and will be replaced. The new system will also provide NZ Lotteries with the core functionality necessary for conducting remote interactive gambling (RIG). A project team has been established to lead the process of determining the nature and extent of NZ Lotteries participation in RIG once a new gaming system has been installed.				

Summarised Financial Statements

The following financial statements are based on the accounting policies set out on pages 22 and 23.

Statement of Financial Performance	Estimate 2004/2005 \$000	Budget 2005/2006 \$000
Sales (including GST)	630,000	640,000
Cost of sales	465,000	474,115
	165,000	165,885
Other revenue	10,600	6,460
	175,600	172,345
Operating expenses	46,700	49,229*
Net surplus	128,900	123,116
Statement of Financial Position	Estimate 2004/2005 \$000	Budget 2005/2006 \$000
ASSETS EMPLOYED		
Investments	67,461	45,394
Current assets	6,100	7,550
Fixed assets	12,341	41,351
Total assets employed	85,902	94,295
FUNDS EMPLOYED		
Current liabilities	43,900	43,600
Prize reserve account	10,029	10,591
Long-term liabilities	2,063	3,000
Equity	29,910	37,104
Total funds employed	85,902	94,295
<p>*Operating expenses budgeted for 2005/2006 reflect the estimated costs of launching the new mid-week game and expenses associated with the establishment of the replacement gaming system and related systems to be located in new Auckland premises. By way of comparison, operating expenses in 2000/2001 amounted to \$48.6 million.</p>		

International Benchmarking

Comparing lotteries is a complex business and any comparisons are no more than a guide to overall performance. Lotteries vary in their regulatory frameworks, social and cultural environments, physical terrain for providing services, the potential numbers and relative economic wealth of their players, degree of state control, cost structures and amount of competition within their markets. The degree of variation is so great that no simple, overall comparison can ever be strictly valid.

A comparison with Australian lotteries shows that their prize sizes, number of games offered, spend per capita and distribution footprint are all greater than our own. For example, in New Zealand we have an average of 1.7 lottery retailers per 10,000 people compared with 2.4 retailers per 10,000 people in Queensland and 3.5 retailers per 10,000 people in South Australia¹⁰.

All overseas jurisdictions have their Lotto games spread through the week as opposed to all linked on one day, as in New Zealand. Despite this, the sales figures above show that NZ Lotteries is performing to a reasonable level internationally.

In its March 2005 issue, *Lottery Business*, a quarterly supplement to the *International Gaming and Wagering Bulletin*, assesses all 41 US State lotteries on a series of effectiveness and efficiency measures. Instead of the usual per-capita comparisons, Lottery Business used aggregated personal-income figures for each US State to calculate the percentage of personal income spent on lottery sales.

The *Lottery Business* approach gives an effectiveness or market-penetration measure that is not distorted by some lottery markets having more citizens with higher levels of disposable income. NZ Lotteries has adopted this methodology and applied it to its own performance as a means of international benchmarking. This year NZ Lotteries ranking has improved in three of the four categories.

NZ Lotteries ranked as follows for the 2003/2004 financial year:

¹⁰ Lotterywest, *Australasian Lotteries Industry Report YTD March 2005*; Queensland has a similar population to New Zealand.

1. Effectiveness and market-penetration measure:
Fiscal 2003/2004 sales as a per cent of US State personal income.
NZ Lotteries comparative ranking is 9th at 0.65%.
2. Fiscal effectiveness measure:
Fiscal 2003/2004 government revenue as a per cent of US State personal income.
NZ Lotteries comparative ranking is 11th at 0.19%.
3. Efficiency measure:
Ranked by cents spent to generate one sales dollar in fiscal 2003/2004*.
NZ Lotteries comparative ranking is 22nd at 14.3 cents.
* Economies of scale, population density, the percentage of rural and urban outlets, the amount of competition, commission fees, as well as telecommunications, advertising, and office accommodation costs all affect the relative cost structures of different lotteries.
4. Fiscal efficiency measure:
Fiscal 2003/2004 revenue generated for community and government as a per cent of gross revenue (sales minus prizes)*.
NZ Lotteries comparative ranking is 24th at 65.6%.
* This measure uses gross revenue figures, and so evens out the effect of lower prize payouts between lotteries.

Technical notes to this particular international benchmarking comparison:

- US State personal income figures were for the calendar year 2004.
- US State lotteries revenue and expense results were predominantly for the year to 30 June 2004.
- New Zealand personal income figures are consistent with the definition used for US personal income figures. They were derived from Statistics New Zealand's Household Income and Outlay Account for the year to 31 March 2004.
- NZ Lotteries revenue and expenses were for the year to 30 June 2004. GST has been treated as being fully paid to the government. However, NZ Lotteries receives credits of approximately \$10 million because of the GST it pays on services from its suppliers. These credits have been treated as being ultimately paid to the government by those suppliers.

Previous Year's Performance

This section sets out NZ Lotteries success in achieving its key corporate objectives. Because of the legislative timing of the statement of intent, figures for 2004/2005 can only be estimates. Actual results, based on audited financial statements, will be shown in NZ Lotteries 2004/2005 annual report.

NZ Lotteries achieved its operational objectives and also projects to meet its financial objectives, except in relation to operating expenditure.

We expect that we will exceed our budgeted profit of \$119.3 million by \$9.6 million. Operating expenses are expected to exceed budget by about \$3.3 million. The total transfer to the NZ Lottery Grants Board is projected to be \$121.9 million, \$7.9 million above budget.

Success in Meeting Key Strategic Objectives for 2004-2005

Objectives	Assessment
Simpler games, more games, more often	A simplified and strengthened Lotto game was successfully introduced in August 2004. Instant Kiwi expanded to 12 ticket streams and to a static dispenser format in all stores. A new mid-week game concept was developed for further consideration.
Distribution "anywhere, anytime"	As at 30 May 2005, 116 new retail outlets were opened, taking the network total to 736, and 97 stores were refurbished. New Master Agency and Retail Agency agreements were implemented. New training programmes were implemented.
Technology "anywhere, anytime"	Rigorous RFP and RFI procurement processes for the new gaming and MIS systems, and IP network were completed. Contractual negotiations with the selected suppliers were substantially completed. The new systems will be operational in 2006. A technology roadmap was developed. The website was upgraded.
A brand that is all about winning and the community	A new corporate identity was developed and integrated into the new retail design and corporate documentation. Significant media coverage of winners was generated by Lotto game changes.
A winning team	A new performance management system was introduced. A staff survey was conducted to provide attitudinal benchmarks. A Wellness Programme was implemented.
Operational efficiency	Expenditure as a proportion of sales for 2004/2005 was projected to be 7.4% compared to 6.6% in 2003/2004 and 7.4% in 2002/2003.
Communications that win the hearts and minds of our stakeholders	Good relationships were maintained with all key stakeholders. A joint branding strategy and Memorandum of Understanding for brand alignment was agreed with the NZ Lottery Grants Board. A Responsible Play Code of Practice and Responsible Play brochure were completed. A new advertising campaign has researched positively with customers.

Success in Meeting Previous Year's Corporate Citizen and Integrity Performance Measures

The performance measures for the 2004/2005 year were as follows:

- Conduct all draws on time for Lotto (including Lotto Powerball), Daily Keno, and any new draw games introduced by NZ Lotteries during the year.

Not fully achieved: For Lotto draw 899 on 18 September 2004, extra Winning Wheel tickets were drawn as a special promotion. A technical problem caused a delay in the announcement of all winners until 9pm instead of 8pm as scheduled.

During the televised Lotto draw 918 on 15 January 2005, there was a time delay due to a technical problem during rehearsals. As a consequence, the Powerball draw was run off air and results were confirmed on the 9pm draw.

- Comply with the provisions of the Gaming and Lotteries, Fair Trading, Commerce, and Consumer Guarantees Acts.

Achieved: During the 2004/2005 year, the Commission committed no offences against the Gaming and Lotteries, Fair Trading, Commerce, and Consumer Guarantees Acts.

- Ensure that all of our advertising complies with the standards set by the Advertising Standards Authority.

Achieved: No complaints about the Commission's advertising were upheld by the Advertising Standards Complaints Board during 2004/2005.

- Monitor Problem Gambling Counselling National Statistics with the aim of ensuring that no more than 2% of problem gamblers who seek counselling for the first time cite NZ Lotteries products as their primary mode of gambling.

Achieved: The Problem Gambling Counselling in New Zealand 2004, National Statistics show that 0.6%, or 13, of the 2,236 gamblers who received face-to-face counselling for the first time cited our products as their primary mode of gambling.¹¹

Responsible Play

Initiatives in response to NZ Lotteries responsibility under the Gambling Act 2003 to ensure that the risks of problem gambling and under-age gambling are minimised included establishing a *Code of Practice for Responsible Play* and a companion brochure that from 1 July 2004 have been carried in all Lotto outlets, on the NZ Lotteries website and integrated into retail network training programmes.

To ensure compliance with the age restriction for playing Instant Kiwi increasing under the new Act to 18 years from 1 July 2004, our retailers were provided with training and appropriate in-store communications material.

NZ Lotteries also participated in responsible gaming surveys conducted by the World Lottery Association.

¹¹ Problem Gambling Intervention Services in New Zealand. Provisional 2004 figures for face-to-face counselling as at 13 May 2005. Gambling Helpline 2004 statistics, for gamblers who presented for telephone-based counselling for the first time, are still to be published, as is a combined total of gamblers who have received either face-to-face or telephone-based counselling during 2004. The combined total is expected to be less than 1%. These provisional figures exclude 159 new face-to-face clients who did not provide data on their primary problem gambling mode.

Regulatory, Organisational and Financial Framework

Legislative Authority

The activities of NZ Lotteries are specifically authorised and controlled through the Gambling Act 2003, the Public Finance Act 1989 and the Crown Entities Act 2004. (Most of the provisions of the Gambling Act 2003 came into effect 1 July 2004, superseding the Gaming and Lotteries Act 1977).

This legislative framework gives NZ Lotteries four main statutory functions which are:

- to promote, organise and conduct New Zealand lotteries (currently Lotto, Lotto Strike, Lotto Powerball, Instant Kiwi and Keno) for the purpose of generating profits for distribution by the NZ Lottery Grants Board, or for a community purpose for which a special purpose lottery is promoted under section 245 of the Gambling Act 2003
- to maximise profits so generated, subject to ensuring that the risks of problem gambling and under-age gambling are minimised
- to make rules regulating the conduct and operation of New Zealand lotteries under section 243 of the Gambling Act 2003
- to advise the Minister of Internal Affairs on matters relating to New Zealand lotteries.

NZ Lotteries is required to act within the Government's general policy in relation to New Zealand lotteries. We submit our annual budget to the Minister of Internal Affairs for approval and comply with any written direction given by the Minister and tabled in Parliament.

Transfer of profits to the NZ Lottery Grants Board

All profits surplus to NZ Lotteries approved capital-expenditure requirements are transferred to the NZ Lottery Grants Board for distribution. Payments to the NZ Lottery Grants Board are made quarterly.

The Organisation

Heading NZ Lotteries are five board members, all of whom are appointed by the Government. The board members are responsible for overall policy and direction.

Day-to-day running of NZ Lotteries is the responsibility of its chief executive and the other members of its senior management team.

NZ Lotteries operates from offices in Auckland and Wellington. Commercial operations are conducted from Auckland. Some of our sales and training personnel, whose role is to support our network of retailers, are field based. Corporate support is in Wellington.

Parallel computer installations are retained at two sites, for risk management and security purposes.

Corporate Governance: External Relationships

Before the start of each financial year, NZ Lotteries submits a budget and business plan to the Minister of Internal Affairs for approval (including a budgeted profit transfer to the NZ Lottery Grants Board).

Responsibility for advising the Minister on NZ Lotteries activities sits with the Crown Company Monitoring Advisory Unit.

NZ Lotteries complies with section 139 of the Crown Entities Act 2004 by providing the Minister of Internal Affairs with an annual statement of intent. This document sets out NZ Lotteries plans for the next three years. It also contains specific performance measures and financial targets for the coming financial year.

After the end of each financial year, NZ Lotteries delivers to the Minister an annual report of its proceedings and operations during the year, together with a copy of its audited accounts and the report of Audit New Zealand on those accounts. This report is tabled in Parliament as required by schedule 4, section 24(3) of the Gambling Act 2003. After its annual report is published, NZ Lotteries may be requested to appear before Parliament's Government Administration Committee to answer questions about NZ Lotteries financial performance.

NZ Lotteries also produces a half-yearly report on its operations. Unlike the budget estimate, annual report and statement of intent, this half-yearly report is not a statutory requirement, but NZ Lotteries believes that all stakeholders (including the responsible Minister) benefit from the provision of this information.

Corporate Governance: Within NZ Lotteries

The board meets at least monthly and additional meetings are held as required. The chief executive and chief financial officer attend all meetings.

Year-to-date financial information is provided for every board meeting. The board monitors any variances from its approved operating and capital expenditure budget.

The board has two committees: an Audit and Risk Committee and a Remuneration Committee.

The Audit and Risk Committee currently consists of two board members. It meets officials from Audit New Zealand, NZ Lotteries auditors. This committee, with the assistance of the senior management team, is responsible for matters of compliance. Final approval of NZ Lotteries accounts is confirmed by the Audit and Risk Committee prior to endorsement by the full board.

NZ Lotteries received an "excellent" rating from Audit New Zealand in its most recent audit in three of the five assessment categories – financial control systems, service performance information and information systems and service performance management. Financial management and financial management information systems, the other two categories, were both rated "good", the second highest rating.

The Remuneration Committee currently consists of two board members who are delegated by the Commission to deal with strategic employment issues.

The senior management team is responsible for the Disputed Prize Claims Committee, which adjudicates on disputed prize claims up to \$250,000 from players with management's decisions subsequently endorsed by the board. Disputed claims for over this amount are dealt with directly by the board.

Statement of Accounting Policies

Reporting Entity

NZ Lotteries financial statements are prepared subject to the provisions of the Gambling Act 2003 and the Crown Entities Act 2004.

Accounting Convention

The financial statements are prepared under the modified historical cost accounting method. The land and building owned by NZ Lotteries is revalued periodically. The financial statements comply with the Financial Reporting Standards and Statements of Standard Accounting Practice issued by the Institute of Chartered Accountants of New Zealand. In particular, they are prepared under FRS-24.

Employee Entitlements

Provision is made in respect of the liability for annual and long-service leave on an actual entitlement basis. In addition, provision is made for future long-service leave entitlements based on the portion of those entitlements that relates to periods of service up to the end of the financial year. The liability is based on current rates of pay and includes superannuation contributions if applicable.

Financial Instruments

The most significant financial instrument transactions entered into by NZ Lotteries relate to investments that include on-call funds, bank bills and government stock.

Investments are recorded at cost, adjusted in the case of government stock by the amortisation of any premium or discount included in the purchase price. Interest is recognised as income on the accrual basis.

Interest on investments relating to unpaid prizes and the prize reserve account is credited directly to the prize reserve account. Interest on other investments is credited in the Statement of Financial Performance.

The value of investments held fluctuates as changes in market interest rates occur. However, as NZ Lotteries is primarily a short-term investor, the extent of such fluctuations in value is limited.

NZ Lotteries policy is to confine its investments to instruments issued, or guaranteed, by either the New Zealand government or registered New Zealand banks. Although investments are normally held to maturity, they are readily marketable and therefore may be regarded as liquid assets.

Fixed Assets and Depreciation

All fixed assets are recorded initially at cost. The net current value of the land and building is assessed by an independent valuer every three years and the book values are adjusted accordingly.

Depreciation of fixed assets, other than freehold land (which is not depreciated), is calculated on a straight-line basis so as to allocate the cost of the assets, or the revalued amount, over their estimated useful lives as follows:

Gaming computers and associated equipment	1–5 years
Personal computers and associated equipment	3 years
Leasehold improvements	5 years
Draw equipment	5 years
Furniture and fittings	10 years
Motor vehicles	4 years
Office equipment	5 years
Building – Structure	25 years
Building – Services	15 years
Building – Fit out	8 years

Goods and Services Tax (GST)

All items in the financial statements are exclusive of GST, with the exception of amounts due from retailers for current games, trade receivables, moneys received or receivable for games not drawn at balance date, and trade creditors.

Leases

Operating Leases

Leases where the lessor effectively retains substantially all the risks and benefits of ownership of the leased item are classified as operating leases. Operating lease expenses are recognised on a systematic basis over the period of the lease.

Prize Reserve Account

This account is established in accordance with the requirements of the Rules governing the conduct and operation of NZ Lotteries games. Transfers into this account comprise amounts set aside from the prize pools for games, together with prizes unclaimed after 12 months from the date of the relevant draw or game closure. Funds accumulated in this account are used exclusively for augmenting the prize pools for various draws and games.

Revenue and Expense Recognition

Revenues and corresponding direct expenses for Lotto (including Lotto Strike and Lotto Powerball) and Keno are recognised when each lottery is drawn. Instant Kiwi revenue and corresponding direct expenses are recognised when retailers activate ticket stock prior to sale to players, thus making those tickets part of a game.

Taxation

NZ Lotteries is exempt from income tax by virtue of section 264 of the Gambling Act 2003.

NZ Lotteries pays the following taxes:

- Lottery duty of 5.5 cents in the dollar on GST-inclusive sales.
- Goods and services tax.
- Fringe benefit tax.
- Problem gambling levy.

International Financial Reporting Standards

It is intended that these new accounting standards will be adopted by NZ Lotteries in or before the financial year ending 30 June 2008.

Changes in accounting policies

These accounting policies are consistent with those used in the most recent annual financial statements.

Directory

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Marketing and Sales

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IT

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Facsimile 09-368 5609

Wellington Office

Communications, Corporate Services and Finance

54-56 Cambridge Terrace
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Wellington
Telephone 04-802 7000
Facsimile 04-385 2787

Christchurch Office

93 Manchester Street
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Shirley
Christchurch
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Website: www.nzlotteries.co.nz

Board Members:

John Goulter DCNZM, JP

Presiding Member

Dr Paddy Austin

Deputy Presiding Member

Dr Sally Jo Cunningham

Guy Herbert

Kay McKelvie

Senior Management:

Trevor Hall

Chief Executive
Auckland

Warren Salisbury

Deputy Chief Executive
Wellington

Quinton Hall

Chief Technology Officer
Auckland

Evan Lawrey

Head of Marketing
Auckland

Chris Lyman

General Manager Retail Sales
Auckland

Helen Morgan-Banda

Head of Communications and Government Relations
Wellington