FPI BOARD OF DIRECTORS MEETING
October 20, 2021

A meeting of the Federal Prison Industries, Inc. (FPI) Board of Directors was held on October 20, 2021, via teleconference.

IN ATTENDANCE:

David Spears, Chairman
Lee Lofthus, Member
Audrey Roberts, Member
Dee Reardon, Member

QUORUM: A quorum was present.

ALSO IN ATTENDANCE:

Michael Carvajal, Director, Federal Bureau of Prisons; Commissioner, FPI
Patrick T. O'Connor, Chief Executive Officer, FPI
Greg Burke, Senior Deputy Assistant Director, FPI
Sean Marler, Deputy Assistant Director, FPI
Marianne Cantwell, General Counsel, FPI
Stephanie Gatz, Acting Controller, FPI
Valery Logan, Executive Assistant, FPI
Huba Papp, Project Manager, NTT DATA, Inc. (attended during discussion of SAP S4/HANA)

Chairman Spears opened up the meeting.

Director Carvajal provided an update on the Bureau of Prisons (BOP or Bureau). The situation with COVID-19 remains fluid. There are 450 BOP staff positive today and there have been seven staff deaths to date. There are 210 BOP inmates positive today and there have been 264 inmate deaths. A total of 233,000 doses of vaccines have been administered in the BOP. The vaccine mandate increased the total staff percentage by approximately one percent. We anticipate seeing some issues. Approximately 67% of inmates are vaccinated. Between vaccination and herd immunity, we are seeing more institutions operational. We instituted an operational matrix with three levels. Eighteen BOP institutions are currently in yellow (Level 2) and two are in green (Level 1).

Director Carvajal mentioned that he has been visiting many factories and they are very well maintained and clean. He stresses to the Regional Directors the importance of keeping factories operational.

Chairman Spears asked what the vaccination rate was for staff. Director Carvajal provided an update of the BOP's vaccination requirements and status. Chairman Spears expressed concern that we will lose enough employees that it will significantly impact operations. Director Carvajal noted that we will likely see impacts geographically as an institution's vaccination rate tends to reflect the local rate.

I. Chief Executive Officer Update

Staffing levels have plateaued. For institutions at the Bureau's Level 3 operating status, we appear capped at 77-82% inmate staffing. Plant start-ups have been offset by factory closings and low staffing.

Our expansions are on track. On-line facilities include Aliceville with growth from 106 to 168 inmates since last meeting, Marianna, which has gone from 92 to130 inmates, and Williamsburg, which has increased from 75 to 148 inmates. Williamsburg has absorbed some of the work from the Atlanta shut down. Activating facilities include Bennettsville for the Fleet Business Group (FBG) and Hazelton, which is shared by the Electronics Business Group (EBG) and the Office Furniture Group (OFG).

Mr. O'Connor attended the VisionExpo in Las Vegas. He also attended NCIA in Indianapolis and NEOCON in Chicago.

Edward Porras will start as our new Chief Financial Officer next week. He is coming to us from the Defense Logistics Agency (DLA); therefore, he is familiar with running SAP. He has also worked at KPMG as an auditor.

As part of the U.S. Government Accountability Office (GAO) audit conducted to satisfy a provision in the First Step Act, the GAO pointed out that the BOP should have conducted a recidivism study. Mr. O'C,onnor provided an update of the BOP's efforts.

Mr. O'Connor provided the Board with a review of FPI's key performance indicators (KPIs):

KPI 1.0, Mission: The number of full-time inmate workers was lower than FPI's fiscal year (FY) 2021 target. However, we exceeded our target for total inmates employed in FY21.

KPI 2.0, Financial Perspective: With the adjustment made as part of the adoption of the revenue recognition policies contained in Accounting Standards Codification (ASC) No. 606, FPI exceeded the FY21 sales target. Even without the adjustment, we exceeded the midyear forecast.

KPI 3.0, Customer Perspective: On-time delivery rates were lower than our FY21 target. We reduced our backlog, but we did not reach our FY21 goal. Delinquencies went down by a little over 3% from FY20 levels.

KPI 4.0, Internal Perspective: We performed better than our FY21 target defect rate. Staff are enthusiastic and that is translating into good product. Inventory turns remain low, but it is good right now because inventory is gold, so it has helped us. We came very close to meeting our lost hours goal.

KPI 5.0, Learning and Growth Perspective: We have more vacancies than we hoped to have. Time to fill and staff training have been very good. With SAP/HANA coming, it added a lot of training. Our injury rate remains extremely low.

All of the SAP/HANA training has been taken care of and put on video using the ULearn portal.

I am very proud of the work everyone has done. Nobody gave up. What is holding us back at this point is the community spread. As the community spread decreases, we should be able to have more people working.

II. Chief Financial Officer's Report

Ms. Gatz provided an update on FPI's financials.

September sales were below the forecast by 7% at $39.3 million. However, these sales were well above the FY20 September sales of $26 million, as well as the pre-pandemic sales in September 2019 of $25.8 million.

The earnings for September were $4.9 million before general and administrative expenses (G&A). September earnings were lower than forecasted due to the lower sales results. The Recycling Business Group (RBG), FBG, and the Services Business Group (SBG) were the groups with the highest earnings.

Due to a reduction in accounting for Federal Employees' Compensation Act (FECA) benefits, $1.1 million of G&A was credited back to the business groups in September. Other income is in line with the plan and forecast. Investment income is half of what it was in September FY20, and this category will likely continue to be low given the interest rates. The total net income for September was $6.4 million.

FY21 year-to-date (YTD) sales are $543 million, which includes revenue of $111.6 million recognized under the ASC 606 revenue standard implementation and $431.2 million from invoiced shipments and services rendered. The FY21 YTD business group revenue of $431.2 million is well above the FY20 results of $363 million.

Chairman Spears asked Ms. Gatz to provide a more detailed explanation of ASC 606. Ms. Gatz explained that the main change resulting from the new accounting standard (ASC 606) is going from recognizing revenue at a "point in time" to recognizing revenue "over time". For example, FBG performs upfit on vehicles sold to the U.S. Customs and Border Protection (CBP). Historically we would wait until the delivery of the completed vehicles to the customer to recognize the revenue at that "point in time". When the requirements of ASC 606 apply, revenue is now recognized "over time". Under the new standard we would recognize revenue based on the costs incurred (inventory) at the cut off for year-end. A policy memo has been finalized for the implementation. Chairman Spears asked if the auditors advised us to take this approach. Ms. Gatz responded in the affirmative.

Business group earnings of nearly $54 million exceed the forecast as well as the FY20 results. G&A was under the plan but exceeded the most recent forecast due primarily to expenditures related to the implementation of S4 HANA. Other income exceeded the plan and forecast with services continuing to catch up as COVID restrictions have been relaxed, as well the change in recognition timing for services related to furniture, racking, and sign installations. Overall, there would have been a near breakeven for the fiscal year after the FECA expense reduction. However, the implementation of ASC 606 increased recognized revenue to a net income $13.4 million.

FY21 YTD business group earnings before G&A are $53.7 million, which does not include the revenue now recognized under ASC 606. These earnings exceed the forecast and FY20 results. FBG, RBG, and SBG exceeded their planned and forecasted earnings. The Clothing and Textiles Group (CTG) has activations with expenses resulting in $1.9 million in start-up losses at Aliceville and Williamsburg. EBG's sales and earnings were lower than planned.

We continue to see cash recover as inventory is reduced. The total inventories are still above pre-pandemic levels. There was a small bump in accounts receivable for unbilled receivables in connection with the ASC 606 on top entry.

III. SAP/HANA Update

We completed Mock 3 of the stabilization phase. There were a high number of defects found during Mock 3. We resolved exception records and refined load programs. We had an extremely high load success rate which exceeded expected thresholds for this phase at over 99%. We spent extra time on defect resolution in Mock 3 to lower risks for the dress rehearsal and Go Live. The team determined that the overall schedule risk was very low. Completion was delayed by one week.

We completed Mock 4 on time on September 24, 2021. Mock 4 was conducted on the production environment. It provided real-world performance metrics so production-specific defects could be found. Overall, it went smoothly. We overcame some issues with slow load times for bills of materials (BOMs) and routings. We updated configuration settings and load scripts to improve load times.

The dress rehearsal started on time on October 1, 2021. It performed on time with only minor defects and was considered a success. The team worked around the clock to simulate Go Live. The dress rehearsal was completed on time on October 15, 2021.

The Mock 4 and dress rehearsal activities significantly lowers our Go Live risk. With a successful dress rehearsal, we do not need to plan for a roll-back to ECC, which would incur large delays and costs.

We are still on track for the scheduled Go Live in November 2021. The cutover will start on October 31, 2021. There will be downtime from November 5-15, 2021. FMB and business groups involved with validating the live HANA system are ready. Go Live will begin November 15, 2021.

The project costs are still within budget.

Mr. Davis, the Program Manager, will be going on reserve duty for the next year. The Board thanked Mr. Davis for his leadership and thanked the team for all the work they have put into this project.

Mr. Lofthus asked Mr. Papp to talk about how field staff have been prepared for the transition to HANA. Mr. Papp responded that the field has been undergoing training since August, and there are additional trainings scheduled as we approach Go Live. Field staff have been involved and we have regular calls with representatives from the field.

IV. FY22 Operating Plan

Mr. O'Connor presented the FY22 Operating Plan and explained possible future effects of existing events and conditions, the continuing impact of COVID-19 on FPI operations, the plan for growth, the upgrade to the SAP S/4 Enterprise Resource Planning (ERP) system, and inmate employment.

This year, we were more conservative in our predictions. The Operating Plan does not take into account the revenue recognition changes due to ASC 606. We expect net income to be close to break even. If COVID conditions improve, we can exceed this easily; if we have another COVID wave, it could impact this. We view these plans as what is minimally acceptable and always try to push to exceed the Plan.

Chairman Spears asked Mr. O'Connor whether we have any idea what the ASC 606 adjustment may be on an ongoing basis when it is reversed next year. Ms. Gatz responded that the entry is based on the inventory at that time. So if that inventory is much lower than it is now, the net entry will be smaller and reduce the revenue, if the inventory is higher, we will get a boost. Ms. Gatz indicated that she anticipates it being lower.

Chairman Spears asked what our depreciation is on an annual basis. Ms. Gatz stated that she does not have that broken out, but noted that depreciation on SAP/HANA is going to run around $2 million per year.

The Board agreed that they concur with the FY22 Operating Plan.

V. Action Items/Legal Updates

The next meeting is scheduled for December 15, 2021.

The Board unanimously approved the meeting minutes draft from August 2021.

Ms. Cantwell provided a legal/legislative update.

The meeting adjourned.

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Patrick T. O'Connor, Chief Executive Officer