FPI BOARD OF DIRECTORS MEETING
December 15, 2023

A meeting of the Federal Prison Industries, Inc. (FPI) Board of Directors was held on December 15, 2023, via teleconference.

IN ATTENDANCE:

David Spears, Chairman
Donald R. Elliott, Vice Chairman
Lee Lofthus, Member
Dee Reardon, Member

QUORUM: A quorum was present.

ALSO IN ATTENDANCE:

Patrick T. O'Connor, Chief Executive Officer, FPI
Sean Marler, Deputy Assistant Director, FPI
Marianne Cantwell, General Counsel, FPI
Edward Porras, Chief Financial Officer, FPI
Valery Logan, Executive Assistant, FPI

Chairman David Spears opened the meeting.

I. Chief Executive Officer's Report

Mr. O'Connor discussed issues related to procurement. He next provided an update on business development efforts. He discussed expanding efforts on foreign military sales and provided an update on discussions and planning that are ongoing for a new optical lab at FCC Beaumont.

FPI is doing a project with a contractor to supercharge the business development process. We have been working on a proof of concept with them for the past five weeks, which has focused on metals and electronics. We have been looking for items we can bid on and have identified several dozen potential opportunities.

We have been working hard on marketing. We are running webinars for Procurement officers every Wednesday. We have also been working on developing processes to respond to inquiries from the webinars. This week, we put out an email campaign for recycling and we have it set up to track responses.

II. FY24 Financial Review

Mr. Porras reviewed FPI's November 2023 financial performance. For November, FPI had a net gain of $1.4 million. The major drivers are November's cost of sales was 74%, lower than last month's cost of sales of 84% and last November's cost of sales of 91%. Last November FPI had $40 million in sales, compared to $33 million in sales this November.

Year to date (YTD), FPI ended with a net gain of $1.1 million. The Agribusiness Group (ABG), Clothing and Textiles Group (CTG), Electronics Business Group (EBG), and Fleet Business Group (FBG) lost money at the operative income level. Last year at this time cost of sales was $59 million (85%), while fiscal year (FY) 2024 YTD cost of sales is 79%.

FPI's sales YTD are $67 million, which is lower than last year by $2 million. The major drivers are FBG sales were lower than prior year by $10 million due to the supply chain issues in the automotive industry. EBG had sales $1 million lower than last year. CTG ended with higher sales than last year by $6 million.

Our revenues from services we provide to clients are higher than last year by $1.3 million. The major drivers are FBG, the Office Furniture Group (OFG), and the Services Business Group (SBG).

FPI's cost of sales is lower than last year by $5 million. FBG ended with a lower cost of sales by $10 million due to lower sales. CTG ended with a higher cost of sales than last year by $5 million. EBG's cost of sales is lower than last year by $2 million, but cost rolls continue to be completed and contracts reviewed to help control costs.

Our general and administrative expenses (G&A) was higher than last year by $500,000; this represents 14% of sales compared to 16% last year.

Go control G&A, FPI has curtailed travel and is utilizing virtual capabilities whenever possible. We have implemented a "no new hiring" policy unless approved by the CEO. For the past 12 months, we have introduced 9 corrective actions to improve our operations. We have 33 factories under the cycle count program testing phase. We continue to update our bills of material, cost rolls, and standard routings to improve our costs accuracy in production. We are in phase 2 of our revenue recognition implementation. We are updating our warehouse procedures policy, which includes training implementation. Our goal is to have our composite cost of sales below 80% and our G&A under 13%.

The actual overhead cost at the factory level is $21 million. The applied overhead is under applied by $6 million. We take into consideration that not all locations applied overhead. The under applied overhead is adjusted each period using the Capitalization of Overhead entry, adjusting our inventory.

FPI ended November with $224 million in available cash. Accounts receivable are at $35 million. Our inventory is at $129 million, down from $137 million.

Mr. Lofthus stated that the bottom line is only there because of investment income. Every month FPI is losing $1 to $1.5 million, and by the end of the year it will be $12 to $15 million or more. FPI is running unprofitably, and the only reason numbers are showing in the black is due to investment income.

Mr. O'Connor responded that there are two issues: overhead and G&A. Total expenses have gone up considerably over the past five years. Part of that is as a percentage of sales because our sales have dropped over the last few years, and we are recovering after COVID. We must either radically reduce the expenses, which we are somewhat limited in how much we could reduce them, or we must drive that top line to get those expenses down. The 21% gross profit at the factory level is better than 2019 when we made $9 million. Over the last five years, we have grown the gross profit by several percentage points, but unfortunately expenses have grown at a faster rate. We must get control of those expenses, which we are working on, and grow the top line, which is why we are working on the business development side. We do recognize that and it is part of what we will discuss during the executive session.

III. FY24 Operating Plan

This budget represents our CEO's vision and the guidelines he provided to us. The first FY24 budget goal is to increase sales to $443 million. The second FY24 goal is to keep costs of sales between 76% to 79%. The third FY24 goal is to decrease G&A from 15% to 13% by investing in automation, centralizing major areas of procurement, and replacing major equipment to lower maintenance cost.

We reduced 27 positions which amounts to about $4 million. Business groups have reduced positions to be in line with the operational environment. Mr. Elliott asked if the reduced positions were vacancies or actual people. Mr. Porras responded that they were vacancies. We are trying to minimize the reduction of personnel. Mr. O'Connor added that we have not done a reduction in force on anyone. We have had attrition out. Mr. Elliott asked how long the positions have been vacant, on average. Mr. O'Connor responded that most have only been vacant approximately three months.

Mr. Elliott asked if FPI has looked at the cost of sales percentages and G&A before Covid, during Covid, and post Covid. If so, was there a lot of movement between those? Mr. O'Connor answered that for gross profit at the operating level: 2019 was 20%, 2020 was 22%, 2021 was 23%, 2022 was 24%, and 2023 was back to 21%. The biggest problem was our volume. Our expenses were: 18% in 2019, 25% in 2020, 24% in 2021, 28% in 2022, and 25% in 2023. When we shut things down in early 2020, our volumes dropped considerably. We couldn't cut the overhead and expenses and it jumped up as a percentage of sales. It stayed that way for most of the time here. One of our bigger hitters was FBG. We had been building FBG to be sort of our tent pole of the future. With us not being able to get vehicles, we are backlogged somewhere around 1,000 vehicles right now. We are just getting them in drips and drabs and that is knocking us down $5 to $10 million a month in revenues.

Mr. Spears asked what the bottom line is going to look like for the new operating plan? Mr. O'Connor responded that it basically breaks even at the operating level, which is a shift from $16 million last year. Mr. Spears asked what was presented in October. Mr. O'Connor answered that it was a loss of $8 million at the operating level.

Mr. Spears asked for a summary of the key bullet things that were changed to get to an $8 million difference. Mr. O'Connor said the biggest thing was controlling our costs of goods sold. We looked at what the product mixes were, what the trends had been because many of the older contracts were at higher prices that we couldn't get out of. So, we looked at where the trend was on our costs of goods sold and where we feel we can keep that cost of goods sold somewhere in the 76% range. The other was working on our expenses to try to get them down to the level necessary for $400 million in sales versus $500 million in sales.

Mr. Spears asked Mr. O'Connor what his confidence level is of seeing that number? Mr. O'Connor responded that his confidence level is in the 90% range. These numbers also include the first month or two of the year, so that loss you see of $2 million at the operating level is already baked into these numbers. Mr. Spears asked, so you are basically going to have a $10 million turnaround in the operating level for the last ten months of the fiscal year? Mr. O'Connor responded in the affirmative. Basically, we'll get up to a bit over break even at the operating level for every month for the rest of the year. There will be months where we make more and others where we make less.

Mr. Elliott asked what changed between our last meeting and this meeting in terms of assumptions other than the fact that we said come back with a break-even budget? What gives you that 90% degree of confidence that you are going to hit these numbers versus the previous numbers? Mr. O'Connor responded that one of the things he looked at is how people had calculated their costs of sales. He went back through them in detail and found that people were including the first two months of last year when we had the tremendous increase in costs of goods sold and we were working on changing the pricing. They kept those numbers in their calculations for the rest of the year versus taking what was done in the last half of the year and maintaining that level. Mr. O'Connor pushed the business groups to sustain or improve where they have been for the last four to six months. The other driver was just sitting down with people, looking at G&A, and saying that we must do better and be more efficient with what we are doing.

Mr. Elliott asked when he sat down with people and discussed being more efficient, what thoughts and ideas did they come up with? The challenges you are facing are operational. Mr. O'Connor responded that if we look at the numbers and the history, the problem is not in the factories per se. They are operating at a higher gross margin now than they were five years ago. They've been doing a pretty good job of it. What we haven't been doing a good of is getting them loaded. We haven't loaded them up with enough work to keep them operating. We are operating them with minimum staff at the factory level, but if we don't put the work in there, they will never cover the overhead. On the other level here, we have been looking at how we can shuffle the paper better. In procurement, we have an RSA to put in the current state of procurement module for SAP HANA, which is a procurement module that wouldn't work for us, but a piece of software that would help them reduce the paperwork they have to do manually and how much repeat work they must do so we can cut back and stay at the benchmarks. The same thing internally. We have a group working on order to cash to find out how we can streamline that process of moving orders through the factory. So, we have projects working on those and hope they come to fruition.

Mr. Elliott asked a year from now when we are having this conversation, are we talking about the same issues or are we talking about something different because we have projects going all the time. Mr. O'Connor responded that a year from now, we will be talking about something completely different. He stated that he believes we will be back on a growth curve, which will take care of most of these problems. We will have stabilized G&A and overhead, and we will have better loaded the factories. There are a few difficult decisions, some of which I have for the executive session, that we must look at.

Mr. Elliott asked what are your assumptions behind the statement that things will be better? What is going to change with the things you can control and the things you can't control? Mr. O'Connor responded that the thing he can control is the accelerated effort on the front-end sales to bump up those numbers and get us back up to where we're selling a lot more product. If we can get up to the $450 million range and above on sales, then we start generating large amounts of cash and that we can control easily. I think we can also control how we are handling the procurement side. I am getting that done. Because I am looking at changes on how we run some of the support groups to make them more efficient and cost effective.

Mr. Lofthus noted that some numbers seem off in relation to overhead, G&A, and investment income.

IV. Action Items/Legal Updates

Ms. Cantwell discussed the Board schedule for 2024. Mr. Spears asked that a teleconference be set up in January to further discuss the Operating Plan.

Ms. Cantwell provided the Board with a legislative update.

V. Follow Up Discussion Regarding the FY24 Budget

The Board met on January 26, 2024, to conduct a comprehensive review of the proposed budget for FY24. After a thorough discussion and consideration of the various components and projections outlined in the budget, the Board did not approve the budget, but agreed that FPI could proceed with the implementation of the proposed FY24 budget. They asked FPI to further review and provide the Board with updates on the Board's recommendations.

/S/

Patrick T. O'Connor, Chief Executive Officer