A meeting of the Federal Prison Industries, Inc. (FPI) Board of Directors was held on August 17, 2022, via teleconference.

IN ATTENDANCE:

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

QUORUM: A quorum was present.

ALSO IN ATTENDANCE:

Colette S. Peters, 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
Edward Porras, Chief Financial Officer, FPI
Valery Logan, Executive Assistant, FPI

Chairman Spears welcomed Director Peters, the new Director of the Federal Bureau of Prisons (BOP or Bureau). The Board members introduced themselves.

I. BOP Director Comments

Director Peters introduced herself. She also expressed strong support for FPI and correctional industries, stating that FPI is a strong part of our mission and what we do here at the Bureau. FPI's operations create safe prisons, and the dual part our mission is that FPI creates good neighbors and teaches inmates skills that many of them never had prior to their stay with us. FPI is pushing them out into the community better prepared to be successful. Director Peters expressed gratitude for the work FPI does and promised that she will be a great supporter of FPI.

Chairman Spears thanked the Director for her enthusiasm about FPI.

II. Action Items/Legal Updates

The Board unanimously approved the draft meeting minutes for the June 15, 2022 Board meeting.

The next two meetings are scheduled for October 19, 2022 and December 21, 2022.

The Board received a copy of FPI's Six Months Sales Report, which covers the first six months of fiscal year (FY) 2022.

III. Chief Executive Officer Update

Mr. O'Connor provided the Board with an update on some of the challenges FPI is currently facing. Most of our factories are in institutions that are currently at Level 3/red for modified operations due to COVID levels. Approximately 10% of factories are closed on any given day and we are running at approximately 71% capacity. We need to make changes to the business model moving forward. Our waitlists have evaporated and inmates do not want to come to work. The continued shutdowns and low inmate numbers are driving low volumes and threatening the business model. Also, with increased shipping costs, especially with diesel prices, we have spent more than $4 million more than what we budgeted.

Mr. O'Connor provided an update on his travel since the last Board meeting. He presented at the Principles of Leadership II course at the Management and Specialty Training Center (MSTC) in Denver, Colorado and at the FPI Financial Management Branch (FMB) conference in Lexington, Kentucky. He also attended the American Correctional Association (ACA) conference in New Orleans, Louisiana and the SelectUSA Investment Summit in National Harbor, Maryland.

Mr. O'Connor provided an update on staffing and cost savings efforts. FPI has continued to control hiring and is currently staffed at 733, which is a gain of two since the last Board meeting. They were both overhires to be trained for impending staff retirements. Efforts are under way in all business groups to root out savings. Examples include stock transfers between factories, implementing second shifts to reduce overtime, purchase versus rent decisions on Conex boxes and trailers, competing office supplies, and competing office furniture installs.

Mr. O'Connor provided new business updates. We have a new repatriation agreement with an American corporation to produce N-95 and Level III surgical masks at FMC Lexington. The customer will install $500,000 in production equipment. Projections call for a requirement of one million masks per month, employing 12 inmates.

An Italian-based corporation has engaged FPI to package caps and closures for the food industry. The production will begin with 10 inmates with the expectation to grow to 20 inmates at FCC Hazelton.

The Clothing and Textiles Group (CTG) received three contracts from DLA, each as a five year contract for brown towels, white towels, and brown microfiber washcloths. If DLA buys the maximum towels and washcloths during the five years of the three contracts, the increased revenue will be $11,595,600 versus the current contracts that are expiring. The majority of this work will be performed at FCC Terre Haute.

Allenwood Recycling has created a new testing center in the FCI factory to include diagnostic testing for reuse of network servers and switches. Fifteen testing stations have been created to process the new commodities effectively adding 40 new inmate jobs. It has also added $20,000-40,000 in revenue per month in the program's infancy, with projections to hit $100,000 per month by FY23.

The Electronics Business Group (EBG) has added a 12,500 unit cable and kitting project at FCI Phoenix, foreign military sales (FMS) to Israeli for cable work/kitting at FCI Phoenix, FMS FOB barrier at USP Marion, electric car chargers at FCI Phoenix for a Taiwanese company, and a new contract manufacturing agreement to make MR24 clips assemblies at USP Marion.

Overall, the order bookings are looking good. The problem is staying in operation in enough hours to get products out.

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

KPI 1.0, Mission: For full-time inmate positions, FPI is slightly above last year's actuals but below our FY22 target by approximately 500. We lost a lot of inmates to residential reentry centers (RRCs) and home confinement. On total inmates employed we are ahead of where we wanted to be. Like last year, we are having a greater turnover than we have seen in the past. One metric we have particular trouble meeting recently is the percentage of inmates who are releasing within three years. We released a lot of those inmates and this figure has been dropping each month despite our hiring.

KPI 2.0, Financial Perspective: For sales, we are about $12 million behind where we were at this time last year. Our loss at this point is $15.8 million. We have a lot of finished goods that could get us in the positive.

KPI 3.0, Customer Perspective: When you aren't making product, it is hard to ship product. Deliveries are down. Backlog is down, but not as much as we would like it to be. Delinquencies are up. Diligent cost control has increased. We have interdependencies between our factories that people do not understand. FCC Coleman has three factories. All three have been down for at least two weeks, with one of them being down three to four weeks.

KPI 4.0, Internal Perspective: We continue to drive down the defect rate. Inventory turns, while they are not as good as we would like, are better than they were last year. For lost hours, we expected to finish the year around the 20,000 mark, but we will likely be a little higher than that. We are not getting hit at the stand alone factories; we are getting hit on the ones that have big cost items and interdependencies with other factories.

KPI 5.0, Learning and Growth Perspective: Staff vacancies are 87, which is by design. We will not be hiring anyone before end of year that is not absolutely critical. All staff have gone through at least one training class. We have run over 2,700 training classes, most of them virtual courses through our ULearn system. Our recordable injury rate is less than one half of one percent, so we have one of the safest factories to work at in the country.

Mr. Elliott asked if the current negative $15 million net income is due to timing or is losses. Mr. O'Connor responded that we are down due to both. We are incurring overhead costs greater than what our volume can support. But we have a sizeable chunk of finished goods inventory that if we could move that into this year and get it out, we would probably break even plus or minus three million. As it stands, we may be looking at a double digit loss.

Chairman Spears stated that the Board will help FPI however they can and encouraged Mr. O'Connor to let them know what they can do.

Mr. Lofthus commented that with only six weeks to go, it will be a miracle to move a lot of that inventory. If we are operating at a level that we cannot even cover our cost, then we will be in the red at the end of the year. He asked Mr. O'Connor if the number of staff and inmates getting sick over the summer really spiked with Omicron and what Mr. O'Connor's experience has been with the shutting down of factories. Mr. O'Connor responded that the majority of shutdowns are for COVID. There is an occasional shut down due to security. When an institution is Level 3/red on COVID metrics, they have to shut everything down. We currently have 85% of our operations in institutions that are the red, only two or three in yellow, and none in the green.

Mrs. Reardon stated that overhead expenses are really high and asked about looking at each individual factory production capability versus the cost to run it. That would allow FPI to assess whether or not we should consider combinations of factories or shutting down any that are costing too much money to stay in business. Mr. O'Connor responded that we are looking at that on an overall basis and he will go into more detail during the Executive Session.

Mr. Spears left the meeting and passed the meeting to Mr. Elliott to chair.

IV. Chief Financial Officer's Report

FPI's year-to-date (YTD) sales through July were below plan by 22% at $340.6 million. This is due to lower than expected sales by the Fleet Business Group (FBG) and CTG. Some factories are still affected by COVID restrictions, and we continue to face materials shortages due to shipment delays from vendors and supply chain issues in the acquisition of some materials. YTD sales are also below prior year sales of $352.3 million. The forecast for August and September sales is $79.8 million, which will result in FY22 sales of approximately $420 million. The original FY22 Operating Plan predicted sales of $533.7 million. We are expecting shipments to increase as we continue to come out of the pandemic and different locations start to resume normal operations and work to eliminate customer backlog (the delinquencies).

YTD group earnings before general and administrative expenses (G&A) were below plan by 58% at $17.2 million. G&A was below plan by 15% at $46 million. Other income is above plan by 9% at $11.3 million, which is related to the fee arrangements established for the year. Investment income is above plan at $1.9 million, also exceeding the prior YTD result. As interest rates are increased, we expect to be over the plan. We have a total net loss of $15.7 million. This loss is higher than our planned loss of $1.6 million. This increase in loss is primarily due to COVID restrictions through the third quarter of the fiscal year, inflation, and several vendors not able to provide materials on time due to COVID limitations, which resulted in delays in production especially in FBG and CTG.

The majority of YTD business group earnings before G&A were made by FBG, CTG, and the Recycling Business Group (RBG). Some of the earnings are due to delaying planned expenses related to non-capitalized purchases of machinery and equipment and roof repairs. There are three business groups with losses prior to G&A: the Agribusiness Group (ABG), EBG and the Office Furniture Group (OFG).

FPI's cash levels dropped from $238 million at the end of FY21 to $205 million as of July 2022, a decrease of $33 million. This decrease is primarily attributable to the following: (1) a $37 million decrease in deferred revenue (advance payable) that is attributable to customer advance payables on hand primarily for the retrofitting of vehicles for the Department of Homeland Security; (2) $15.7 million YTD net loss; and (3) disbursements are on trend to continue exceeding receipts. We are monitoring our expenses and the way we disburse our funds to ensure we manage cash based on our risk tolerance.

Inventory continues to trend downward and has decreased by $25 million since March. CTG has inventory well over the plan, specifically the operation at Yazoo City has $16.8 million of finished product in outer tactical vests (OTV) pending testing and approval for shipment. The other groups having inventories near planned levels. The backlog for manufactured orders is $312 million and is mostly for FBG and CTG.

Accounts receivable hit a high of $52.5 million on May 31 and decreased $16.1 million to $36.4 million as of July 31.

The meeting adjourned.

/s/
____
Patrick T. O’Connor, Chief Executive Officer