A meeting of the Federal Prison Industries, Inc. (FPI) Board of Directors was held on October 19, 2022.

**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:**

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

Chairman Spears chaired the meeting.

## I. Chief Executive Officer Update

Mr. O'Connor provided the Board with an update. One of the positive outcomes of the pandemic is that it has accelerated institutions' move to FPI-specific housing units. Wardens have provided feedback that FPI units are calmer than non-FPI units. Augmentation continues to reduce productivity. We have an approximately 16 percent of staff augmentation rate. The First Step Act (FSA) and Cares Act have lowered the availability of low security (camp) inmates. Supply chain issues, inflation, and the chip shortage continue to affect our operations.

Mr. O'Connor shared that FPI had a booth at the 2023 AUSA (Association of the United States Army) Annual Meeting & Exposition in Washington, DC in October. It was a very good and busy show for the full three days and we got some good lead. Mr. O'Connor is in the process of developing a slate of Board candidates. He has some candidates lined up for the retailers and consumers, industry, labor, and agriculture seats.

Chairman Spears shared that during his meeting with the Director yesterday, he shared the history of the Board and advised that upcoming Board members should have a history of business. Board members should have continuity. He also commented that it should be about two seats replaced at a time.

Mr. Elliott asked about the process for replacing Board members. Mr. O'Connor stated he will give the memo to the Director. She will elevate it to the Deputy Attorney General's office. Mr. Lofthus noted that he had reviewed the process and that as of May, the Department of Justice had some names that were generated.

Mr. O'Connor addressed FPI's financial challenges. We have continued to control hiring. Current staffing is at 729, which is four down from the last Board meeting. For Defense Logistics Agency shipments, FPI is working with Aberdeen; they have nearly doubled the pace of testing. Dairy operations at FCC Lompoc and FCI El Reno were closed the first week of October. Beef herds will be expanded as well as cultivation of vegetable crops. The dairy operations were consistently losing money. We had to displace three staff.

Mr. Elliott asked what we are doing with equipment and cows. Mr. O'Connor stated that a lot of the equipment is at the end of its life but the cows went to auction.

Mr. O'Connor stated we are realigning operations at FCI Beckley. We are changing the factory's mission from the Office Furniture Group (OFG) to the Clothing and Textiles Group (CTG). OFG was making chairs at FCI Beckley; this seating production is being moved to FCC Allenwood. In one year, this change will save OFG approximately $1.2 million. CTG will use the factory to expand Molle 4000 rucksack production.

Mr. O'Connor discussed managed services. We have had discussions with the Justice Management Division IT and the Marshalls to discuss best practices and possible contracting vehicles. In terms of strategic planning, as part of the Deloitte engagement we have strategic planning workshops scheduled in the next couple weeks. In working better with the U.S. General Services Administration (GSA), we find that people are breaking their purchases down into smaller orders or buying off of GSA Advantage. We are trying to put as many of our products on GSA as possible as we have very little right now. Our Fleet Solutions Group (FSG) is working with GSA to get them designated as a sales center, which would allow Fleet to rebuild vehicles when they are old and recondition them. On October 25, I'm meeting with Assistant Commissioner Eric Koehler to discuss building a better relationship between GSA and FPI. This is to be first in a series of regularly scheduled meetings.

The Federal Bureau of Prisons (BOP) continues to be a challenge. The BOP is our third largest customer. BOP sales have dropped 28%. They have a new deputy coming in from outside the BOP. The administration looks to be moving to centralize purchasing, which would be helpful to FPI.

Mr. Elliott asked if we were going to start manufacturing chip boards. Mr. O'Connor replied that we are getting into the chip business. Our Recycling Business Group (RBG) will be slicing boards to take chips out. Before, we were just recycling for copper. Our general manager is currently looking for the equipment to do so.

Mr. Lofthus asked Mr. O'Connor to provide information at the next meeting about why BOP sales are low - is it due to declining population or are they purchasing elsewhere? This will help us know the reasoning for the 28% reduced BOP sales. Mr. O'Connor said it is a little of both but we will have a report for the next board meeting with a comparison for multiple years. Mr. Burke added that when we lock down in certain situations, the BOP complains that we cannot get them product in time, but if they didn't lock us down, we would be able to produce.

Our incoming orders are getting back to pre-COVID levels.

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

KPI 1.0: We finished the fiscal year (FY) a couple hundred inmates below target, but we surpassed our FY21 total. Total inmates employed during the course of the year was high but we had a high turnover rate which affects production. The percentage of inmates within three years of release is at 25.4%. Between FSA and COVID-related releases to residential reentry centers and home confinement, our percentage of inmates within three years of release has been significantly reduced.

KPI 2.0, Financial Perspective: We are up about $20 million over last year as far as top line sales, but our net loss was larger. Part of that was from the 606 adjustment last year. Our gross margin exceeded our target.

KPI 3.0, Customer Perspective: On ontime delivery, we never recovered at FCC Coleman from the COVID outbreak in the fall, which then went into the national lockdown. This caused our backlog to back up. We went up about $80 million and delinquencies went up as well.

KPI 4.0, Internal Perspective: We have managed to keep our defect rate low, especially in light of complex products, such as the Molle 4000 rucksack. Inventory turns remain the same as last year, which is in large part because of OFG and FSG having delays. The Services Business Group (SBG) and Electronics Business Group (EBG) have inventory turns in the 4.7 range.

KPI 5.0, Learning and Growth Perspective: We have not hired to the original target. Our time to fill is good. Every staff member has been trained at least once. Our recordable injury rate is excellent.

## II. Chief Financial Officer's Report

Mr. Porras provided an update on FPI's financials. FPI's sales for FY22 ended below plan by 28% at $382 million. This is due primarily to lower than expected sales by FSG and CTG. FY22 was affected by a series of economic and environmental issues that negatively affected our sales and operations. These issues include COVID-19, the Omicron variant, inflation, and more. These issues had a negative impact on material shortages due to shipment delays from vendors, and supply chain issues in the acquisition of some materials. FY22 sales were also below FY21 sales of $431 million.

Business group earnings ended below plan by 64% at $18.6 million. General and Administrative expenses (G&A) ended below plan by 18% at $53 million. Other income is above the amount forecasted by 48% at $18.5 million, which is related to the fee arrangements established for the year. Investment income is above plan at $2.9 million, also exceeding the prior year result. We ended the fiscal year over plan due to rate increases in FEDINVEST.

FY22 is projected to end with a total net loss of $13.1 million. This loss is higher than our expected revenue of $390,000. This increase in loss is due to COVID restrictions during the fiscal year, inflation, and several vendors not able to provide materials on time due to COVID-19 limitations, which resulted in delays in production especially in the fleet and textiles business groups. Mr. Porras gave a caveat to his comments, noting that FPI is still completing some additional journal entries, including the FECA actuarial liability account and its respective adjustments. After this entry we will have to wait on the auditors to sample entries of the different accounts. There is the possibility that as a result of this testing we will need to make adjustments.

The FY22 business group earnings before G&A were $33 million. This represent lower than planned earnings due to lower sales results. RBG had the highest earnings, followed by CTG, FSG, and SBG. The other groups had losses prior to G&A: the Agribusiness Group (AGB) (expected), EBG, and OFG.

FPI's cash levels have dropped from $238 million at the end of FY21 to $215 million as of September 2022, a decrease of $23 million. This decrease in cash is primarily attributable to: $10 million decrease in Deferred Revenue (Advance Payable), which is due to customer advance payables on hand primarily for the retrofitting of vehicles for the Department of Homeland Security; $13.1 million net loss; and disbursements are on trend to continue exceeding receipts.

Inventory continues to trend downward and has decreased by $31 million since October 2021. CTG has inventory well over planned levels, specifically FCC Yazoo City has $16.8 million of finished product in outer tactical vests 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 in FSG and CTG. Accounts Receivable (AR) hit a high of $53 million at the end of May and has decreased by $15 million to $38 million as of September.

Mr. Lofthus asked if we have seen an increase in the price of raw materials. Mr. Burke responded that we have increased our raw material prices in new solicitations, but it seems like we are continually behind because raw material prices keep going higher. Mr. Burke said one of our big challenges is the private sector can go overseas, but we generally do not have that option. We need to try to work with DLA to build that in with inflation to have a clause to help us moving forward. Part of the problem is that our staff have never had to do that before. Our Procurement department is working on that.

Chairman Spears stated that he understands the challenges FPI has been facing, but we also know that changes need to be made so that FPI is sustainable.

Chairman Spears asked if there was any gainsharing this year. Mr. Porras responded that there was not because there is only gainsharing when FPI makes a profit.

**III. FY23 Operating Plan**

For FY23, FPI expects to end the year with a net revenue of $6 million. This plan is the result of numerous budget discussions with all business and support groups. These discussions helped us reduce our overhead costs by $8 million and our G&A by $8 million, for an overall cost reduction of $16M.

We expect to sell $456 million worth of manufactured and service products. The majority of sales will come from CTG with a plan of $167 million, followed by FSG with $111 million and OFG with a sales plan of $90 million. These sales will produce negative earnings of $5 million. Four out of seven of our business groups are anticipating having negative earnings: ABG with a loss of $824,000, EBG with a loss of $5 million, FSG with a loss of $189,000, and OFG with a loss of $7.3 million. CTG is anticipating positive earnings of $2 million, RBG is expecting to earn $6 million, and SBG forecasts earnings of $159,000.

Our investment strategy will have FPI bringing a net revenue of $7 million and our rental income will bring net revenues of $4 million. These revenues will help offset losses from our manufacturing and services lines.

We expect to spend $62 million on G&A in FY23, a decrease of $3 million compared to FY22's forecasted plan ($65M). FY22 actual G&A ended at $53 million, $12 million lower than planned and 14% of sales.

FPI is requesting 818 personnel for the first quarter, 814 in the second quarter and 815 in the third and fourth quarters. This is a reduction of 38 personnel compared to FY22 from 853 to 815. Corporate personnel is reduced by six from FY22 (190) and business groups reduced their personnel by 32 from 663.

Mr. Lofthus asked why we would plan on a $5M and $7M loss for EBG and OFG. Mr. Elliott added that there has to be a strategic reason to approve that. Mr. O'Connor stated that this operating plan is for a preliminary review and he will send another for the board to review. Chairman Spears asked for a one hour virtual meeting to be set for some time in November to go over a revised operating plan.

Ms. Reardon stated that she does not understand the issue in regards to uniforms. Small businesses can't provide what the Department of Defense needs. There is an essential market for uniforms and we should take a closer look at it. Mr. Burke requested some contacts.

## IV. Action Items/Legal Updates

The Board unanimously approved the draft meeting minutes for the August 17, 2022 Board meeting. The Board approved a resolution for funding to purchase sewing equipment for CTG's expansion of its Molle 4000 rucksack production.

The next meeting is scheduled for December 14, 2022, by teleconference, to start at 9:30 am EST. A tentative schedule for 2023 will be sent out.

## V. Executive Session

The meeting adjourned.

## VI. Follow-Up Meeting

A follow up meeting was conducted on Wednesday, November 16.

Mr. O'Connor updated the board on the South Korea meeting and tour conducted at FCI Dublin and FCC Lompoc.

Mr. O'Connor discussed strategic planning with Deloitte. We have had four sessions so far. We decided to go in depth in the profit and cost centers, which took some time especially in light of the audit. We completed the audit and are getting an unmodified opinion.

We looked at how to reduce costs. The biggest thing we identified was changes in staffing. We are taking a look at the positions that we added in anticipation of growth and looking at eliminating 21 positions. We took eight positions out of profit centers at the factory level and at the business group level. We took 13 positions out of the cost center level. We are also reducing costs through factory realignments that we can do quickly, such as Beckley. We had the opportunity to double our production of the Molle 4000 rucksack. If we had opened a new factory to do this it would have taken 6-12 months, but instead we moved it into Beckley. We plan to be up and running by the first of the year. We also did load balancing between FCI Forrest City and FCI Ashland. By the end of the exercise, all the business groups are profitable at the factory level. They are not all profitable when we throw in G&A but we have plans for that.

Mr. Elliott stated that one of the challenges we have is that we have not had enough staff. What impact does the identified staffing reductions have? Mr. O'Connor responded that it has not impacted us. FPI doesn't have a staffing problem, the BOP does. We are tracking staffing on a weekly basis. Mr. Burke added that we are the ones that set our staffing levels for a controlled growth. Anytime you grow staff, you are looking at sales in the next year. We haven't hit that growth. We were not anticipating COVID and supply chain issues. We need to put people in the right positions. We are repurposing people and putting together a priority list.

Mr. Porras presented the revised budget and 2023 Operating Plan. The Board provided their concurrence, but reserved the right to revisit. The Board asked FPI to continue to review their business lines, operating expenses and overall G&A. The Board also asked to receive financial summaries on a monthly basis.

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Patrick T. O'Connor, Chief Executive Officer