A meeting of the Federal Prison Industries, Inc. (FPI) Board of Directors was held on February 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:

William W. Lothrop, Acting Deputy Director, Federal Bureau of Prisons
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
Aurelio Rivera, Principal, Deloitte Consulting (for portion of meeting)
Robert Frazzini, Partner, Deloitte Consulting (for portion of meeting)

Chairman Spears opened the meeting.

I. Director's Update

Mr. Lothrop provided an update on the Bureau of Prisons (Bureau or BOP). The mission at USP Thompson is changing. The Special Management Unit is being removed but we do not know yet what it will change to. UNICOR does not have a factory at USP Thompson.

II. Chief Executive Officer's Report

Mr. O'Connor provided the Board with an update. Mr. O'Connor visited five institutions since the last Board meeting, which brings the total to ten institutions this fiscal year. He also attended the American Correctional Association conference as well as BOP strategic planning and executive staff meetings. In addition, Mr. O'Connor visited the Eastern Kentucky Advanced Manufacturing Institute (eKAMI) and provided them a tour of our facility at FMC Lexington.

Mr. O'Connor shared corrective actions that have been put in place to address the challenge of inflation, including: raising prices on more than 140,000 SKUs; the Office Furniture Group (OFG) raising prices twice in the last twelve months; reducing quote validity from 90 to 30 days; adding a fuel surcharge; changing the mission at Ashland and Beckley; holding off on new hiring; working on a new strategic plan; increasing execution reviews from quarterly to monthly; encouraging the Defense Logistics Agency (DLA) to not exercise option years on some

contracts; and investigating “managed services” for FPI’s Management Informations System branch (MISB).

Mr. Elliott asked about the process for price increases. Mr. O’Connor responded that FPI started with the most important ones but it will eventually be across the board. We are going institution to institution. We started at FCC Coleman, which has approximately 60% of OFG’s sales. This process was started last year. Mr. Elliott noted that it sounds like FPI is starting with the SKUs with the greatest volume. Mr. O’Connor affirmed that was correct.

Mr. O’Connor stated that another challenge FPI has had is with inmate and employment staffing. For inmate staffing, we have worked with institutions to establish housing units composed solely of FPI inmate workers, which has proven to work well. Another issue has been staff augmentation. In October 2022, Mr. O’Connor issued a memo to BOP Regional Directors with guidelines to reduce the effects of augmentation on production. A number of regions have had no augmentations since the memo was issued. When an institution augments, it is usually due to union time or training; routine augmentation is no longer an issue.

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

KPI 1.0, Mission: We have met the fiscal year (FY) 2023 goal for full-time inmates. We continue to be significantly below our goal on inmates within three years of release. Our numbers on this metric could be affected further because, over the weekend, the FSA credits were updated. We do not know how many of the inmates affected work for FPI.

Mr. Elliott asked if there was any way of identifying who would be eligible to be released so we can start planning in case they are. Mr. Burke stated that part of the problem is that whenever they make the change, we do not know until they make calculations, which makes it very difficult to predict. There is not a way to get ahead of it until they come up with a consistent way to meet the statute.

KPI 2.0, Financial Perspective: We missed our target on sales by approximately 9%. We missed our net income by significantly more than that. Our gross margin was also down. The main drivers are the rise in costs and goods sold mainly due to inflation and general and administrative expenses (G&A), which we are trying to reduce by attrition and monitoring expenses.

KPI 3.0, Customer Perspective: While we are still below our target for on-time deliveries, we have cut our backlog in half and reduced delinquencies.

KPI 4.0, Internal Perspective: The defect rate continues to drop. We need a new way of gathering information about inventory turns. We were higher than target on lost hours. However, if we continue at this rate, we will still be lower than we were last year.

KPI 5.0, Learning and Growth Perspective: Open staff vacancies were below our target, and we only plan to fill critical positions. Time to fill is below the U.S. Office of Personnel Management (OPM) average of 80 days. The number of staff trained is on target to meet our FY23 goal. The recordable injury rate continues to be very good. We are one of the safest small manufacturing places to work in the country.

II. Deloitte Report

Deloitte was brought on board approximately ten months ago to look at opportunities for FPI to utilize the new markets authorized by the First Step Act (FSA). We realized that was too narrow of a market focus, so we started looking at a broader marker. Mr. Rivera and Mr. Fazzini from Deloitte presented their findings and next step recommendations.

There is an opportunity to grow the current market by doing adjacent sales to customers already out there. In terms of FSA authorities, there is potential for growth in new market opportunities such as nonprofits, penal institutions, disaster relief agencies, and DC.

Deloitte talked to over 30 FPI leaders, 15 inmates, and visited four institutions. They looked at drivers for change from three perspectives: organizational needs, marketplace shifts, and executive prioritization.

Mr. Elliott asked if we have a culture to make the recommended changes happen and how we would we get people to buy into this change. Mr. Frazzini responded that the only way to change a culture is incrementally. You have to make small 90-day cycle efforts to push vision and gain, but that there would also be pains too.

Mr. Spears commented that he appreciated the passionate presentation and looks forward to working with management to implement recommended changes.

III. Financial Review

FPI ended with a Net Loss of $6.8M an increase in loss from 1st Qtr. of (900K) 5.9M. This represents a variance from our budget which was planned to have a Net Loss of $21K. The following are the factors of this variance:

- Our cost of sales was higher than our plan by $2.4M. This is an 85% cost based on our sales.
- Our total expenses, which include overhead, selling expenses, and general and administrative expenses (G&A) is higher than plan by $1.4M. Overhead is the major driver in our total expenses, at $3.5M higher than our plan.

Our other income, which includes rent and investments, had a gain of $800K which offsets our operating income resulting in our net loss mentioned above.

Sales:

Our total sales are 2% off of planned levels and 3% higher than last year. The major drivers are:

The Recycling Business Group (RBG) with a difference of $1.5 million due to a downturn in the market for recyclable goods. There was a 15 day shutdown in China due to COVID which slowed sales in the first quarter and the market for precious metals and electronics continues to fluctuate.

The Clothing and Textiles Group (CTG) with a difference of $8.5 million due to a delayed in shipping finished goods from FCC Yazoo in October, November, December and January. Finished goods are done; we are waiting on testing. As soon as that is complete this will get caught up. First quarter sales of $4.8 million are completed but will not post until the second quarter due to the delays at Aberdeen Testing Facility. Net services revenues are below plan by 51% this year and 63% lower than last year.

FBG is below plan by $4M due to vehicle and raw material shortages. If shortages don't improve it will affect our Victorville locations once current stock is depleted. Victorville has also struggled with downtime due to COVID and lockdowns for FY23 so far.

Net Services Revenues:

FPI Revenues for services provided to clients YTD were $800K lower than our plan of $2.1M. Service revenue represents 1% of our sales.

Cost of sales:

Higher than planned by $2.4M. Our plan was $114M and our actuals were $116.4M. The main drivers are:

- OFG ended with a higher cost than planned by $9.9M due to higher sales; therefore cost of sales is proportionately over plan due to older products manufactured during COVID, now being able to ship, as agencies are returning to their office buildings. Raw materials have increased in pricing. Activity Rates were reviewed and updated in November and cost rolls are currently being performed. They are also evaluating selling prices and increased them where possible to account for the increases in costs. They also have consolidated their cost centers and updated their BOMs and Routings.
- EBG ended with a higher cost of sales than planned by $2M. Plan was $6.4M, actual was $8.5M. Electronics is currently doing BOM and Routing reviews. They are also having renegotiating prices with customers to adjust for inflation of materials. They are looking into Bulk buys to reduce material costs as well to combat this overage. They are also deep diving into Standard Costs, Cost Rolls and Activity Rates. Their activity rates continue to be monitored and will be reevaluated during 2nd quarter.

Expenses:

FPI total expenses were higher than planned by $1.4M. The main driver of this difference is overhead.

G&A - General and Administrative Expenses – Our G&A was under plan by 6%, however it represents 13% of sales. As I mentioned previously, for the past 15 years we have incurred mores losses than earnings, specifically our G&A have skyrocketed from 8% in 2009 where sales were $900M to 13% in 2020 where our sales were $363M. Our G&A YTD is $18M which makes our net earnings turn to losses when we applied G&A. Salaries represents the majority of those expenses with about $12M. Operating expenses which includes maintenance agreements are about $3M, and other expenses which includes contracts $2M. Out of the 18M. MISB is the

highest cost with 6M, followed by FMB with $3, procurement with 2 and BD with 2. We are looking for ways to reduce G&A cost. Our monthly execution reviews are shining the light on issues such as manual processes that we need to automate, centralized procurement versus retail, excessive use of credit card and some inaccurate data, and also analyzing the # of contract support we have.

OH - FPI factories underapplied their overhead to their manufacturing products by $3.5M. 29 out of 74 factories underapplied overhead. The under applied overhead represents the difference between overhead costs applied to work in process and overhead costs actually incurred by the factories producing activities. This is an unfavorable variance because our plan to apply overhead was incorrect. We continue to address this issue in our corrective action plan. The goal is to have all overhead applied over the year. Some of the root causes of the under application of overhead is due to issues with cost rolls updates, activity rate changes, and not enough production hours. March 8 will be conducting training on activity rates, cost rolls and BOMs to train personnel in how these actions affect pricing.

Selling Expenses – Our selling expense were under plan by 25%

Other Income – Our Rent income has missed our plan by 1%, however our investment income with FEDINVEST had a 2% increase from our plan.

Cash Availability – FPI ended January with $253M in operating cash and $194M in available cash. Our accounts receivable are at $41 million and have risen kept steady since July. Our inventory is at $159 million.

Mr. Lofthus commented that lack of sales cannot be the source of blame and that it goes back to profitability. Five months into the year and we have not recovered, and it is getting worse. Mr. Burke noted the effect of delinquencies on selling price.

IV. Action Items/Legal Updates

The Board unanimously approved the draft meeting minutes for the December 2022 Board meeting minutes.

The Board approved a sales ceiling increase for Federal Supply Classification code 8465.

The next meeting is scheduled for April 19, 2023, by teleconference to start at 9:30 EST.

V. Executive Session

The meeting adjourned.

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Patrick T. O’Connor, Chief Executive Officer