FPI BOARD OF DIRECTORS MEETING
February 20, 2024

A meeting of the Federal Prison Industries, Inc. (FPI) Board of Directors was held on February 20, 2024, 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 Spears opened the meeting.

**I. Chief Executive Officer's Report**

Mr. O'Connor commenced his update by noting his recent travel activities, which were relatively light and included attending the ACA conference at National Harbor, participating in an executive staff meeting held at the Central Office, and attending the Principles of Leadership 2 training in Denver. Mr. O'Connor also highlighted the graduation ceremony for the leadership program with The George Washington University, which took place on January 18th, adding 13 graduates to a growing list of over 53 alumni.

Mr. O'Connor proudly noted the recognition received by the Office Furniture Group (OFG) from the Vandenberg Space Force Base, for their exceptional work in setting up new office facilities, which promises more collaborations in the future. He also mentioned the commencement of the fiscal year (FY) 2024 audit with KPMG on February 2nd.

Focusing on business performance, Mr. O'Connor shared encouraging financial results, with new order bookings running about 64% above the previous year, driven significantly by large orders for the Fleet Business Group (FBG) and a 24% increase in orders for OFG.

In terms of financial control, Mr. O'Connor described the company's revenues as steady with a slight upward trend and noted that the net profit and overhead expenses are well within expected ranges, despite some seasonal fluctuations.

Mr. O'Connor addressed costs, stating that the company had managed to control the cost of goods sold effectively despite inflationary pressures. He highlighted a significant reduction in selling expenses due to moderated fuel costs and a transition away from the trucking company Yellow, which has ceased operations.

Turning to staffing, Mr. O'Connor informed the Board that inmate staffing levels are improving, approaching pre-COVID levels with most factories operational and three out of four regions performing strongly.

Mr. O’Connor provided an update on FPI’s key performance indicators (KPIs):

KPI 1.0, Mission: The number of full-time incarcerated worker positions is slightly above target but below last years’ numbers. Challenges remain in increasing the percentage of incarcerated workers within three years of release.

KPI 2.0, Financial Perspective: Sales and net income figures are ahead of last year, with sales exceeding targets and net income well above the budgeted $2.7 million.

KPI 3.0, Customer Perspective: On-time delivery remains below target due to supply chain issues, though efforts are ongoing to improve these figures.

KPI 4.0, Internal Perspective: Defect rates have risen, mainly due to transitions in the Clothing and Textiles Group’s (CTG) factories, but lost hours and finished goods inventory turns are showing positive trends.

KPI 5.0, Learning and Growth Perspective: Staff vacancies and training are on target, with efforts to minimize the time to fill positions and maintain low recordable injury rates continuing effectively.

Mr. Elliott raised concerns about the causes behind the below-target on-time deliveries, to which Mr. O'Connor responded that supply chain disruptions, particularly in the Electronics Business Group (EBG), were partially to blame. He reassured the Board that these issues are being actively managed, despite some being beyond the company’s direct control.

Mr. Lofthus queried the paradoxical increase in furniture sales despite widespread downsizing of office spaces by the federal government. Mr. O'Connor attributed this increase to significant orders from military rather than civilian agencies, highlighting ongoing demand from sectors like the Air Force.

Mr. O’Connor concluded by expressing confidence in the company's strategic direction and its ability to navigate the challenges ahead, backed by robust planning and operational adjustments.

## II. FY24 Financial Review

Mr. Porras presented the FY24 year-to-date (YTD) financials, beginning with a positive note on the January figures, which showed a net gain of $3.3 million. He highlighted that sales were a major contributor to this success, being $8 million above the plan and $10 million above the previous year. The cost of sales was 79%, within FPI’s target of staying below 80%. January also saw gains in operational income and investment income, each contributing approximately $1.5 million.

Mr. Lofthus raised a question regarding the significant reduction in selling expenses from over $1 million each in November and December to $381,000 in January. He inquired whether this was an artifact of booking timings or another factor. Mr. Porras explained that fluctuations in selling expenses often relate to timing issues with invoice processing, assuring the Board that these are monitored and analyzed regularly.

Mr. O'Connor added that product mix also affects selling expenses, giving an example of how certain products have varying shipping charges based on their delivery locations, which contributes to expense variability.

Mr. Porras continued, sharing that the YTD net profit stood at $7.9 million, with cost of sales at 78%. Overhead and general and administrative expenses (G&A) were controlled below the set targets, contributing to a nearly break-even operational income of $500,000, bolstered by about $6 million in investment income.

Mr. Elliott questioned the sustainability of the lower G&A and selling expenses, which were $5 million below plan. Mr. Porras responded that while some variability is expected due to timing, efforts are ongoing to maintain G&A expenses around the budgeted levels, potentially capitalizing certain investments like SAP to manage costs effectively.

Chairman Spears summarized the financial outlook, pointing out that while the operation stands at break-even, the majority of earnings stemmed from non-operational income. He sought confirmation that the financial strategies in place aim to sustain this level of performance, to which Mr. O'Connor expressed optimism, especially with upcoming negotiations and sales in the clothing and textiles and office furniture sectors.

Mr. Lofthus reiterated concerns about the impact of timing on reported financials, suggesting that if selling expenses normalized, operational income might revert to a deficit. He emphasized the need for vigilance in financial management to avoid potential pitfalls if expenses rise to typical levels.

Ms. Reardon asked for clarification on whether recent high order volumes for office furniture were due to new organizations being set up, implying that such sales levels might not be sustained. Mr. O'Connor responded that most sales were indeed for new setups, indicating that repeat large-scale orders were unlikely unless similar new setups occurred.

Mr. Porras elaborated on the sales and cost of sales by product categories, noting significant contributions from CTG and OFG. He reviewed the overhead and G&A distribution across different business groups, highlighting efforts to manage overhead costs effectively below planned percentages.

Mr. Lofthus pointed out the absence of significant revenues in EBG and the Recycling Business Group (RBG), prompting a discussion on the financial contributions of different segments to the overall organization.

Further discussions covered the ongoing audits and financial adjustments, with Mr. Porras detailing the plans for finalizing current and restating previous fiscal years' financial statements. The Board engaged in a detailed discussion about the timing and implications of these audits, emphasizing the need for clear and timely communication of audit outcomes and financial adjustments.

## III. Action Items/Legal Updates

The Board unanimously approved the draft meeting minutes from the December 2023 and October 2023 Board meetings after adjusting some language to better reflect the Board's discussion.

The Board discussed potential dates for April and June Board meetings.

The Board discussed two proposed resolutions – one for purchase and installation of a contract writing system for Procurement, and one for implementation of SAP module Revenue and Reporting and a Lease accounting and reporting solution.

Mr. Lofthus inquired about the current systems in place for contract writing, highlighting concerns about moving to a new system. Mr. O'Connor explained the current reliance on manual processes like spreadsheets and the intention to automate through a system compatible with SAP but not using SAP's problematic procurement module.

Mr. Elliott questioned how the Board could ensure that the approved systems would enhance organizational efficiency and how their results would be tracked. Mr. O'Connor assured that the impact of the new systems, especially in smoothing out financial processes and reducing manpower in specific departments, would be measurable and monitored closely.

The Board approved both resolutions. Ms. Cantwell requested permission for Mr. O'Connor to sign the Board resolutions on behalf of Chairman Spears, which was granted.

The meeting adjourned.

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Patrick T. O'Connor, Chief Executive Officer