Annual Report 2005

MINNCOR
industries

MINNCOR St. Paul
1450 Energy Park Drive Suite 110 ▪ St. Paul, MN 55108
(651) 603-0118 ▪ Fax (651) 603-0119 ▪ 800-MINNCOR (646-6267) ▪ TTY (651) 643-3589 ▪ www.minncor.com

Overview

Table of Contents

Our Mission:
To be a customer driven business, operating a program that contributes to a safer Minnesota.

We will achieve our mission by providing:

- Sound management that ensures financial self-sufficiency
- Quality products on time to build a loyal customer base
- Efficient reduction of inmate idleness that contributes to a secure prison environment
- Work skills training that prepare the offender for release

MINNCOR industries

.....with purpose

Dear Stakeholders,

First and foremost, I would like to thank you for your interest in MINNCOR Industries. Fiscal 2005 was a year for opportunity, change and continuing to build on past successes. It was also a year for making decisions with regard to organizational change and investments to suit our mission. Profitable business growth remains a focal point. MINNCOR Industries' successes continue to support another key focus, that of increasing offender assignments and funding initiatives having a social impact in Minnesota.

The Customer

MINNCOR is privileged to serve two distinct groups 1) customers we transact with through our business activities 2) the State of Minnesota by providing opportunities for offenders to learn valuable work skills. We are proud to be able to provide offenders with tools needed to become productive and responsible citizens. We continued to increase the number of assigned offenders, employing more than 14.5%, the highest in the nation. Throughout the fiscal year, the assigned offenders worked more than 1,335,500 hours. We will focus on continuing to increase this number.

Changing With Our Industry

We have completed company-wide business planning in fiscal 2005. Working diligently to improve our facilities, we have created better response times, decreased the number of mistakes and implemented manufacturing modules at all of our facilities. We have evaluated not only each facility, but moreover, each and every business unit. Our strategic plan will enable us to operate an organization that can accomplish our goals and missions in the long term, through increased challenges of economic pressure and inmate population growth.

Opportunity

With our purposeful commitment to success, MINNCOR's future looks bright. We are working very hard to build upon our strengths and improve our weaknesses. We are dedicated to making any necessary improvements to ensure the success of MINNCOR Industries and contribute to a safer Minnesota.

Sincerely,

Chris Pizinger
Chief Executive Officer
MINNCOR Industries

Fiscal Year Highlights

Administrative Highlights

NCIA Conference

In April 2005, MINNCOR was the proud host of the annual National Correctional Industry Association (NCIA) National Conference. More than 500 correctional staff attended the event at the Minneapolis Hyatt. The central region provided a training track for canteen centralization. Presenters from Minnesota, Colorado, Iowa and Indiana provided details of their centralized canteens.

Placement Program:

Definitions and objectives were developed for a new employment coordinator position. Techniques to track released offenders employed and the employers willing to hire released offenders were implemented. MINNCOR received written confirmation from the Printing Industry of Minnesota (PIM) of their willingness to develop a placement program with private sector offenders that complete the Education/Industry Printing Program.

Performance Management

A new performance management system has been implemented throughout MINNCOR. Based on the management-by-objective (MBO) system, the annual organizational objectives cascade throughout MINNCOR to each staff member. Supervisors and staff develop measurable objectives together and continue to meet quarterly to review progress.

Staffing

All MINNCOR job descriptions were reviewed and revised where necessary. As a part of ongoing strategic planning, position duties now more accurately reflect the developing nature of the organization. Several staff were added following the strategic planning efforts. The MINNCOR St. Paul office new hires include an engineer, sales support, a project manager and a transition to employment position. Factory new hires include a new Faribault industry director and a Stillwater factory manager. In addition to new factory hires, several personnel have moved to different facilities. Most importantly, new and existing employees have been encouraged to participate in ongoing skills and development training.

Technology

The programming and installation of a "paperless" office solution was started. The first phase was related to purchasing. Efforts to incorporate the paperless solution into billing, receiving, shipping accounts payable and sales will begin next fiscal year. Managing virtually every type of paper content will enable more efficiency. In addition to paperless solutions, manufacturing software was installed at each of the facilities. This software will allow for planning and material control related to custom work. Training and more in-depth use of the software will continue next fiscal year. Efficiency was also a major component to the upgrade made in OnContact customer management software. The software is now better utilized through the direct converting capabilities of sales quotes. Now, sales quotes are directly converted into live orders in Traverse accounting software. The use of the program is now more widespread; the Moose Lake facility now has the capability to use OnContact for order entry. This not only speeds up the process of the print facility, but also reduces errors and provides the print industry with better access to detailed customer information.

Fiscal Year Highlights

Operational Highlights

Canteen

The Canteen is one of the most successful business units for MINNCOR. At the end of the fiscal year, MINNCOR Industries supported seven officers at Oak Park Heights relating to Canteen. This translated into a more than $300,000 payment to the DOC to help fund positions. Many issues and concerns were identified and remedied in the Canteen. Fulfillment errors were maintained at 3% or less due to new software installed in the third quarter. Feedback from staff and inmates has been very positive.

Factories in Motion

As part of the strategic planning process, facilities were reviewed. Results consisted of the decision to close the Automotive Refurbishing Facility. The remaining equipment was liquidated or sent to Surplus Services. This effort was made to ensure all of the facilities are as productive as possible. In addition, the two separate wood manufacturing shops were merged into a more efficient, single facility. This meant closing the furniture shop located at the Stillwater facility and moving all furniture efforts to the Faribault facility. This consolidation not only meant opening the doors to more opportunities, but a more efficient wood production due to all aspects of the business unit operating out of one facility. Finally, the operations at the Lino Lakes facility have been moved to Stillwater without sacrificing quality or timeline issues.

Partnerships

With the closing of the Automotive Refurbishing Facility at the Faribault facility, Anagram International took the opportunity to grow with MINNCOR. Anagram International continues to be valuable contributor to MINNCOR's success. In addition to Anagram International many other organizations began to build a partnership with MINNCOR to meet labor and manufacturing capacity needs. Northern Tool & Equipment renewed their contract, resulting in significant increased offender assignments. Other partnerships developed in Fiscal Year 2005 included Bridgewater Tech (Stillwater), Robinson Rubber (Shakopee), Savoie Supply, Jacobs Trading (Moose Lake) and Weyerhaeuser (Rush City). Partnerships continue to be one of MINNCOR's best opportunities for offender employment and business growth.

Looking Forward

Six Sigma
The future is bright for MINNCOR. The planning, restructuring and changes have not ended with this fiscal year. The Six Sigma process continues. Committees will be formed in order to identify more specific needs and desired directions. Ongoing Six Sigma training will allow for improvements in our weaker areas. The resources Six Sigma will make available should prove to be instrumental for MINNCOR to focus on continuous improvement.

Upgrading Technology and Software Implementation
In addition to Six Sigma, upgrading technology and current processes will be ongoing. An internal discovery process will be implemented for the manufacturing software. This will track custom work and enable job costings on manufacturing modules in addition to contributing to planning efforts. In the customer relationship management software, queries will be developed to enable better tracking of products, customers and orders.

Product Line Review
Continued review of all MINNCOR product lines will be conducted. Specifically, Seating and Upholstery will be among the first lines to be reviewed. All aspects of individual business units will be reviewed according to the number of hours of inmate labor and profitability.

Management by Objectives (MBO)
A new Performance Management system will be implemented. This method of performance review will be based on the management-by-objective system (MBO). Management by objectives (MBO) is a systematic and organized approach that allows management to focus on achievable goals and to attain the best possible results from available resources. It aims to increase organizational performance by aligning goals and subordinate objectives throughout the organization.

Department of Human Services Project
MINNCOR will continue to be a part of the planning and implementation for the multi-million dollar Department of Human Services project scheduled to begin this fall. MINNCOR is proud to have been selected to be a part of this impressive project. This project will push the factories to operate as efficiently as possible.

MINNCOR's Future Impact
MINNCOR has proven to be a nimble adapter to change and growth in Fiscal 2005. Key objectives in Fiscal 2006 will build on the past year's successful implementation of strategic planning, organizational restructuring, customer service benchmarks, quality initiatives and technological advancements. MINNCOR is well positioned to continue to succeed, continue to grow, and continue to make a difference for the State of Minnesota.

Financial Overview

Product Groups

Seating ▪ Library Furniture ▪ Residential Furniture ▪ Office Furniture ▪ Signage ▪ Printing Correctional Products ▪ Cleaning Products ▪ Outdoor Recreational Products ▪ Transportation Products ▪ Contract Services ▪ Partnerships.

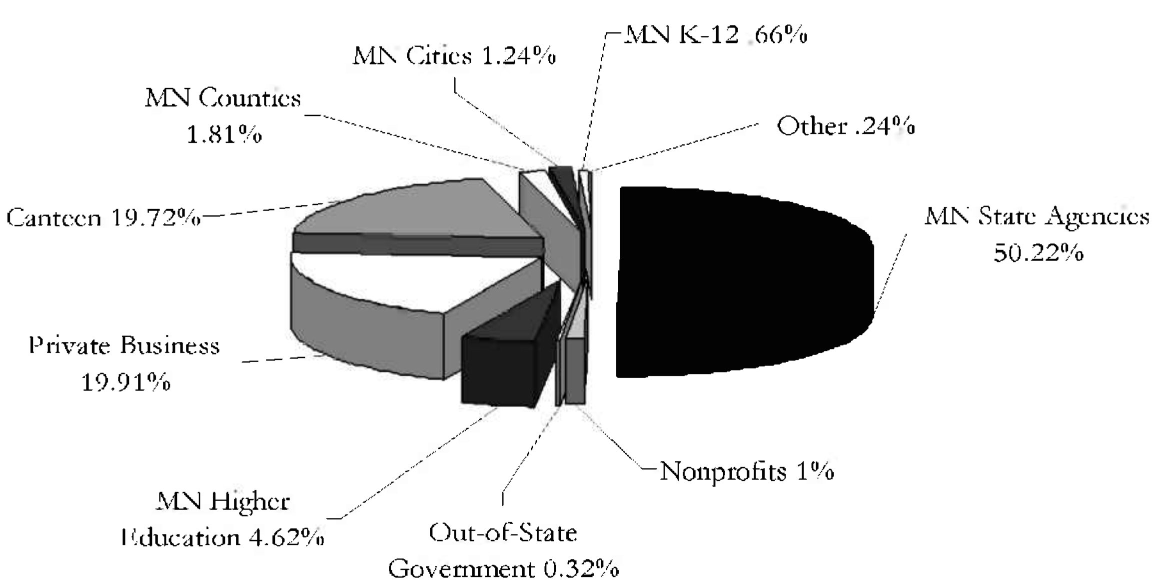
Fiscal Year 2005 marks the third year in a row that MINNCOR has operated without subsidy from the state of Minnesota. MINNCOR achieved $32,326,875 in sales – an increase of nearly nine percent over the previous fiscal year.

Fiscal year 2005 was also a year for change. The Cost of Goods (COG) was revised to reflect the true cost to manufacture a product. Also, new software has been installed that enables the capturing of costs in greater detail. This allowed for greater planning capabilities and better customer service.

This fiscal year brought the restructuring of many business units located at the Stillwater, Faribault and Lino Lakes Facilities. These and many other changes have allowed for the expansion of other business units to better reflect our mission statement.

Growth was evident in many business units including the Canteen, Wood Products, Laundry and Printing Services. Anticipated growth is expected for many other business units to follow with the strategic planning efforts already in place.

MINNCOR Market Segments



Comparative Income Statement

Year-to-Date Ending June 30th, 2005

	FY 2005	FY 2004
Total Sales	$ 32,326,875	$ 29,906,078
Total Cost of Goods Sold	$ 16,591,775	$ 14,606,788
Gross Margin	$ 15,735,100	$ 15,299,289
Total Facility Manufacturing Costs	$ 8,884,064	$ 9,269,866
Facility Operating Income	$ 6,851,037	$ 6,029,424
Total General and Administrative Costs	$ 5,526,536	$ 3,555,198
Net Income	$ 1,324,500	$ 2,474,266

Balance Sheet

Year-to-Date Ending June 30th, 2005

Assets

	FY 2005	FY 2004
Cash	$ 7,568,451	$ 8,051,947
Impress Cash	$ 6,000	$ 5,949
Total Other Current Assets	$ 12,263,594	$ 10,998,820
Total Current Assets	$ 19,832,045	$ 19,056,716
Total Other Assets	$ 3,956,133	$ 3,197,297
Total Assets	$ 23,788,178	$ 22,253,995

Liabilities and Equity

	FY 2005	FY 2004
Total Current Liabilities	$ 2,023,759	$ 1,509,041
Total Other Liabilities	$ 514,796	$ 829,652
Total Liabilities	$ 2,538,555	$ 2,338,692
Contributed Capital	$ 6,587,559	$ 6,577,739
Retained Earnings	$ 13,337,564	$ 13,337,564
Current Year Earnings	$ 1,324,500	$ N/A
Total Retained Earnings	$ 14,662,064	$ 13,337,564
Total Equity	$ 21,249,623	$ 19,915,303
Total Liabilities and Equity	$ 23,788,178	$ 22,253,995

Notes to the Financial Statements

NOTE 1 ▪ NATURE OF THE BUSINESS

MINNCOR as a division of the Minnesota Department of Corrections develops and markets premium products and services to various markets and industries. In addition, MINNCOR will provide contract manufacturing services to companies to fulfill their manufacturing needs. MINNCOR is a customer driven business, operating a program that contributes to a safer Minnesota. MINNCOR provides work skills to offenders as well as preparing them for release. MINNCOR operates through an enterprise fund, which is a set of self-balancing accounts comprised of assets, liabilities, equities, revenues and expenses. Beginning with Fiscal Year 2003, MINNCOR has continued to be self-sufficient receiving no grants or subsidies from the State of Minnesota.

NOTE 2 ▪ SUMMARIES OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation
The consolidated financial statements include the accounts of all the individual business units. All intercompany transactions and profits are eliminated in the consolidation.

Cash and Cash Equivalents
Cash and Cash equivalents are invested by the Minnesota Department of Finance and State Board of Investments.

Allowance for Doubtful Accounts
MINNCOR estimates the balance of allowance for doubtful accounts by analyzing accounts receivable balances by age and applying historical write-off trend rates to the most recent 12 months' sales, less actual write-offs to date. Account balances are charged off against the allowance when it is probable the receivable will not be recovered.

Inventory Valuations
Inventories are valued at the Weighted Average or Lower of Cost or Market. Predominately raw materials are priced at Weighted Average and finished goods are Lower of Cost or Market. Merchandise placed in service to support laundry rental operations is amortized over the estimated useful lives of the underlying inventory items, primarily on a straight-line basis, which results in a matching of the cost of the merchandise with the revenue generated by the merchandise. Estimated lives of this merchandise are in a service range of three years. In establishing estimated lives for merchandise in service, management considers historical experience and the intended use of the merchandise.

Property, Plant and Equipment
Property, plant and equipment are stated at cost. Depreciation is charged to operations using the straight-line method over the assets estimated useful lives ranging from 20 years for buildings to 4 to 10 years for machinery and equipment. Merchandising equipment consists principally of various systems that dispense MINNCOR's cleaning and sanitizing products. Merchandising equipment is capitalized and depreciated using the straight-line method over the assets estimated life of five years. Expenditures for repairs and maintenance are charged to expense as incurred. Expenditures for major renewals and betterments, which significantly extend the useful lives of existing plant and equipment, are capitalized and depreciated. Upon retirement or disposition of plant and equipment, the cost and related depreciation are removed from the accounts and any resulting gain or loss is recognized in income.

Capitalized Software
Purchased software applications in excess of $25,000 are capitalized and reported according to the Generally Accepted Accounting Principals (GAAP). These assets will appear on the balance sheet and be amortized using the straight-line method over an estimated useful life of five years.

Revenue Recognition
MINNCOR recognizes revenue as services are performed or on product sales at the time title transfers to the customer. MINNCOR records estimated reductions to revenue for customer programs and incentive offerings, including pricing arrangements, promotions and other volume based incentives at the time of the sale.

Inter-fund Transactions
In accordance with Statement 2 – Grant, Entitlement and Shared Revenue Accounting and Reporting by State and Local Governments by the national Council on Governmental Accounting, these transactions are reflected in the financial statements as follows:

1. Funds provided for capital expenditures and fixed assets are recorded and reported in the financial statements as Contributed Capital.
2. Funds provided for payment of operating expenses are recorded and reported in the financial statements as expenses and Operating Grant Revenue.

NOTE 3 ▪ COMPENSATING ABSENCES

The liability of the employee's rights to receive compensation for future absences when certain conditions are met has been accrued and recognized in the financial statements according to the Governmental Accounting Standards Board (GASB) Statement Number 16. Compensated absences are classified as current and non-current. Actuarial determined percentages determine what portion of the liability is current. For Fiscal Year 2005, 78.0% of vacation leave and 16.0% of vested severance is classified as current. 100% of compensatory time is classified as current. The remainder as well as 54% of non-eligible severance pay is classified as non-current. This resulted in an adjustment to record additional compensated balances for Fiscal Year 2005 of approximately $66,000.

NOTE 4 ■ REALIGNMENT OF OPERATIONS

During Fiscal Year 2005, management approved plans to undertake restructuring and cost saving actions. These actions included the consolidation of all the operations at the Lino Lakes facility to the Stillwater facility. In addition, the Stillwater Wood operation was consolidated to the Faribault facility under the Faribault Wood business unit. As a result, MINNCOR incurred restructuring costs of approximately $195,000.

NOTE 5 ■ PRIOR PERIOD ADJUSTMENTS

During Fiscal Year 2005, a complete internal audit of all balance sheet and income statement accounts was undertaken. This included a complete accounting and reconciliation of all fixed assets. Prior period adjustments were identified in the cash balance reconciliations for the past three years. These adjustments were related to the failure to properly account for reconcilable items between the Traverse (MINNCOR ERP system) and MAPs (State Accounting and Procurement system). These adjustments resulted in an increase in the prior year cash balance recorded in Traverse of $13,715. Daily versus yearly account reconciliations were established during Fiscal Year 2005 to prevent this from happening again. A complete physical audit was completed at each facility and compared to assets recorded on the Fixed Asset detail and Traverse general ledger. Assets were discovered that were recorded on the Fixed Asset detail ledger but the cost was expensed in prior year income statements. This resulted in the recording of higher expenses (both cost and depreciation) in those years. To adjust the general ledger to equal the fixed asset detail ledger an adjustment was recorded to the FY'05 income statement. The resulting adjustment was a gain of $34,776 on the income statement with the offset to the fixed assets. Due to the small materiality of this adjustment related to all the fixed assets, this adjustment was taken entirely in FY'05 and not retroactively applied to the prior years. New procedures related to yearly asset physicals and paper audits have been put in place to ensure that the fixed asset ledger is reconciled to general ledger each year.

NOTE 6 ■ DISCONTINUED OPERATIONS

In Fiscal Year 2005, MINNCOR terminated its Turned Edge and Vehicle operations at the Rush City facility and Faribault facility, respectively. The combined loss of approximately $58,000 reflects the final liquidation of assets associated with these business units.

Facility Locations

Moose Lake

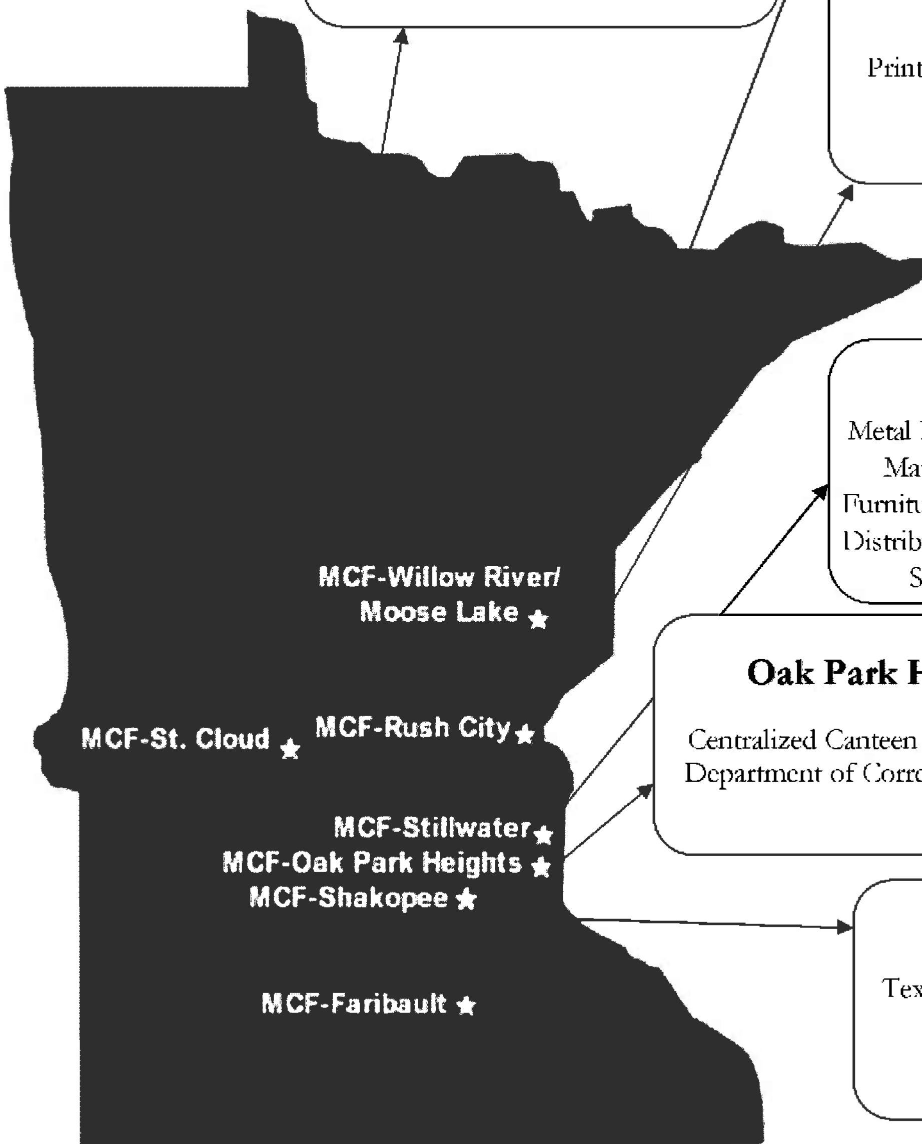
Textiles ■ Printing ■ Signs ■ Subcontract Labor Services

St. Cloud

License Plates ■ Validation Stickers

Rush City

Print Bindery ■ Subcontract Labor Services



Stillwater

Metal Products ■ Systems Furniture ■ Mattresses ■ Farm Machinery ■ Furniture Upholstery ■ Warehousing ■ Distribution and Installation Services ■ Subcontract Labor Services

Oak Park Heights

Centralized Canteen servicing other Department of Corrections facilities

Shakopee

Textiles ■ Data Processing ■ Market Research ■ Safety Products ■ Subcontract Labor Services

Faribault

Wood Furniture ■ Laundry Services ■ Plastics Thermoforming ■ Cleaning Products ■ Subcontract Labor Services