

MINNCOR INDUSTRIES ANNUAL REPORT FY 2009



15 YEARS AND BEYOND

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MINNCOR Industries strives to provide a safe working environment within the prison system and successfully transition offenders into the community at no cost to taxpayers. MINNCOR's mission is to be a customer-driven business that contributes to a safer Minnesota by providing:

- » **Sound management that ensures financial self-sufficiency;**
- » **Delivery of quality products on time to build a loyal customer base;**
- » **Efficient reduction of inmate idleness that contributes to a secure prison environment; and**
- » **Work skills' training that prepares the offender for release.**

QUALITY – DELIVERY - CUSTOMER SERVICE

To Our Stakeholders and Customers,

As depicted on our front cover, MINNCOR has been in existence for 15 years. Although correctional industries in Minnesota have been around for over 100 years, in 1994, MINNCOR, the Minnesota Department of Correction's prison industry program, was formed to integrate and centralize administration and sales functions of the department's various industry operations. Prior to our first year of financial self-sufficiency in 2003, MINNCOR received up to \$6 million in taxpayer funds annually.

We can be proud of our progress and, in spite of a tough economic year, tight customer budgets, and a decrease in sales prospects, we ended fiscal year 2009 on a high note. Our year-end consolidated net income was \$978,000, which exceeded budgeted expectations by \$489,000. This can be attributed to cost-saving initiatives and the hard work of staff. Because of our success this year, we were able to provide the department with \$1.4 million for purchases (consistent with Minnesota Statute 241.27) and an additional \$433,000 for offender education and reentry programming.

On June 30, 2009, MINNCOR offender assignments equated to 19.3 percent of the population in facilities with an industry operation. Average offender employment increased at three of the facilities during FY09.

Fiscal Year 2010 will be challenging. We have a budget that is very thin as it includes \$1 million for the state's general fund mandated by the legislature. We will need to be continually diligent and aware of manufacturing cost variances and sales variances from budget. MINNCOR's FY10 objectives will address these areas through cost-reduction measures, marketing plans, evaluation of current cost methods, and product development initiatives.

The goal is to be proactive in the analysis of current and future business conditions to ensure MINNCOR's self-sufficiency in FY10 and the years that follow.

I want to thank our more than 125 staff for their tremendous contributions. Our people continue to bring the deep, differentiated skills that set us apart in the marketplace.

Guy Piras
Chief Executive Officer
MINNCOR Industries

history of the organization . . .

Prison industries have a long history within Minnesota, dating back to the production of twine in the 1870s, soon followed by the Minnesota Line of farm machinery. For more than 100 years, emphasis was placed on training and employing as many inmates as possible in these programs.

MINNCOR Industries was created in 1994 by the Minnesota Department of Corrections (DOC) to consolidate and centralize its individual facility programs into a single statewide business, as well as to increase efficiency and decrease reliance on the state's general fund. MINNCOR exists for the primary purpose of providing offender job skill training, meaningful employment, and teaching proper work habits - not as a competitive business venture. Correctional industries provide a means to minimize offender idleness and reduce costly disruptive behavior, thereby significantly contributing to the maintenance of a safe and secure environment for both staff and offenders.

Financially self-sufficient since FY03, MINNCOR has demonstrated its ability to coordinate and maintain prison industries that are efficient, productive, and safe. Receiving no state subsidies, taxpayer dollars, or grants, MINNCOR offers premium products and services to various markets and industries. MINNCOR is located in six facilities throughout the state, utilizing up to 1,250 offenders as its main workforce.

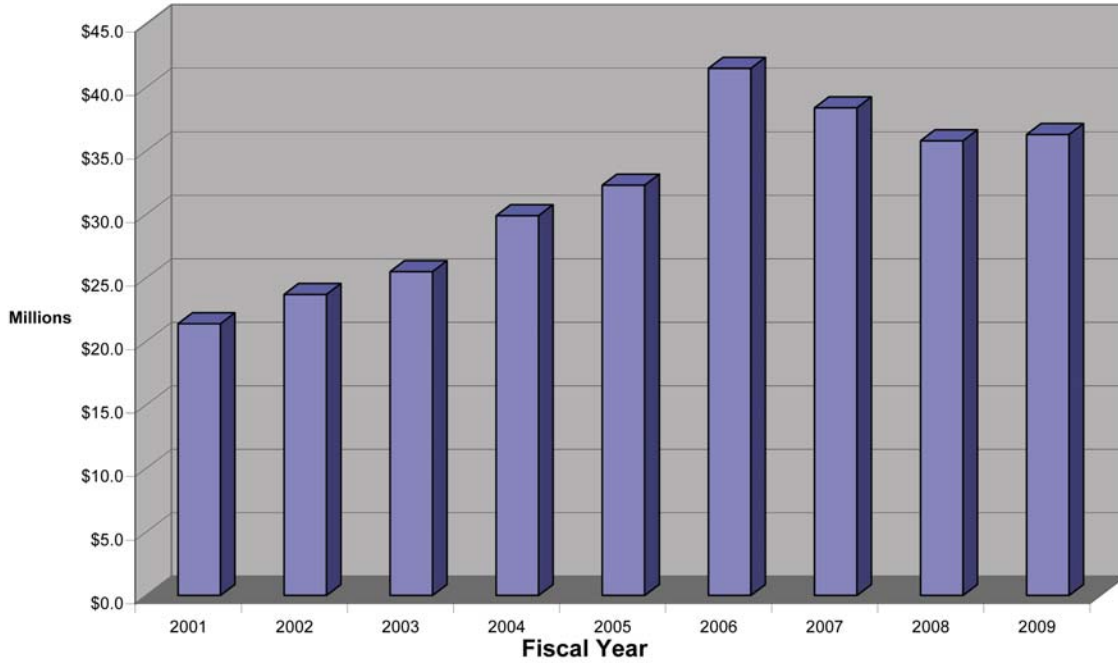
Today, MINNCOR runs a contemporary, cohesive, self-sufficient business operation featuring 18 diverse product lines. Strategically, MINNCOR endeavors to maintain diversification and avoid investing too heavily in any one area. It does not intend to become a dominate competitor in any particular segment. MINNCOR offers state and other government agencies an option for purchasing products through an easier and more efficient process.

MINNCOR serves as a subcontract manufacturer to many different companies located throughout Minnesota - a primary business segment. By partnering with MINNCOR, companies have benefited from a flexible/skilled workforce, broad capabilities, quality products and services, timely delivery, and competitive pricing. MINNCOR provides these subcontract services to Minnesota businesses to open new opportunities for them by broadening their capabilities and increasing their workforce and physical space as needed. MINNCOR views this service as a key asset to Minnesota industries that choose to utilize our resources.

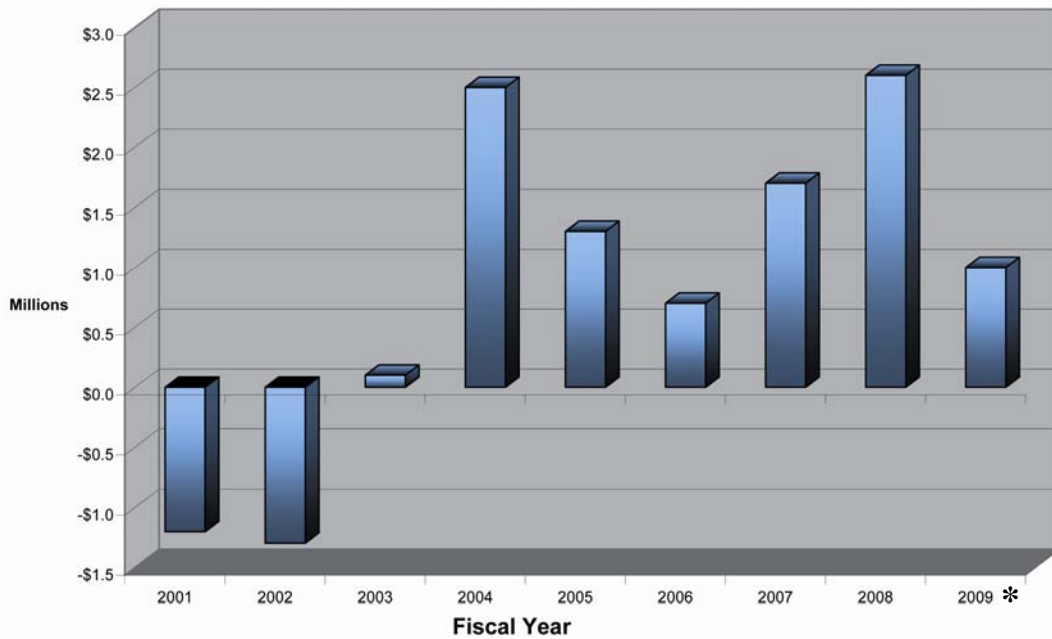
The EMPLOY Program, MINNCOR's post-release employment service, seeks to teach offenders to capitalize on vocational training, job skills, and skills learned while incarcerated and apply them to employment opportunities once released. EMPLOY staff provides employment readiness training and viable job leads to released participants.

over the years . . .

MINNCOR Sales History



MINNCOR Net Income History



*Net Income after \$1.8 million distribution to DOC

Through MINNCOR Industries, benefits are provided to all who are involved in its operations...

The State of Minnesota benefits from a program that:

- » Is provided at no cost to taxpayers.
- » Fuels the economy through materials purchased and employee wages.
- » Provides contributions/deduction from inmate wages for taxes, a portion of the cost of incarceration and special inmate programs, financial assistance to their dependents, and contributions to a victim compensation fund and/or restitution.
- » Returns productive, law-abiding citizens to the community. Over 95 percent of inmates will return to the community upon completion of court-ordered prison time. Employment is a significant factor in the success of released offenders. MINNCOR contributes to a lower recidivism rate by teaching offenders work skills during incarceration.

Correctional facilities are provided:

- » A means to minimize inmate idleness in a growing inmate population.
- » Reduction of costly disruptive behavior, contributing to the maintenance of a safe and secure environment for both staff and inmates.

Customers receive:

- » Quality products and services.
- » Real value for their purchasing dollars.
- » Full-service operation from design to delivery of product.
- » A reliable labor and space resource for business relationship activities.



Pictured Above: Offenders at the MCF-Faribault working on cabinetry.

significant achievements . . .

EMPLOY

EMPLOY staff refined their approach to contacting employers. Specific employers in the area of a participant's release are contacted 1-2 weeks prior to the offender's release. This year, 872 employers were contacted and 255 companies were added to our database as prospective employers. In FY09, 345 participants were added to the program through recruitment efforts. EMPLOY expanded to include graduates of vocational programs.

License Plates

In March, 2009, Rush City produced the one millionth pair of license plates since the plant opened 11 months ago. In addition, waste was reduced from a high of 15 percent down to 3.25 percent. Over 1.5 million registration and 12 million validation stickers have been produced while maintaining less than 1 percent waste.

Cost Reduction

MINNCOR surpassed the \$800,000 total cost savings goal in FY09, ending the year with a total cost savings of over \$1 million. A major contributor was Rush City, delivering just over half a million dollars of cost savings this past year through aggressive contract negotiations and purchasing strategies of raw materials. Rebate agreements with a canteen supplier also contributed to the savings.

Minneapolis Public Housing

A two-year contract worth \$1.2 million was secured with the Minneapolis Public Housing Authority for the Faribault wood shop. This project will allow the wood division to more efficiently utilize the CNC based equipment which will result in an increased throughput and capacity.

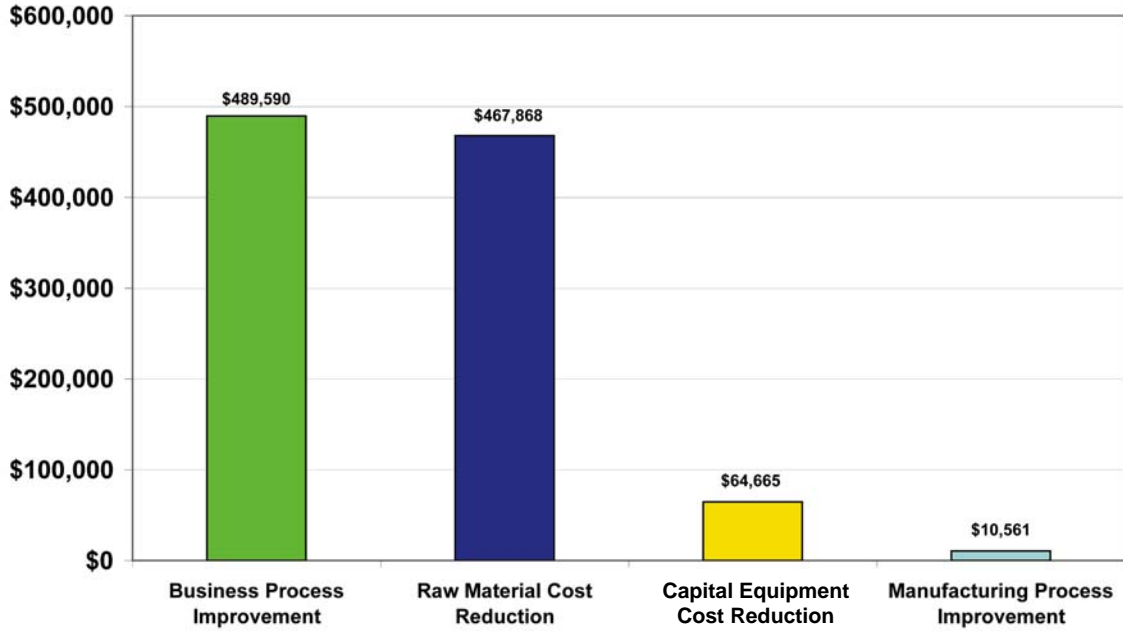
Physical Inventories

Annual physical inventories were completed at all facilities with a 98.1 percent overall accuracy. Staff's dedication to accurate material recording in FY09 is evident in the overall accuracy rating. The total value of the inventory counted was \$4,742,493.

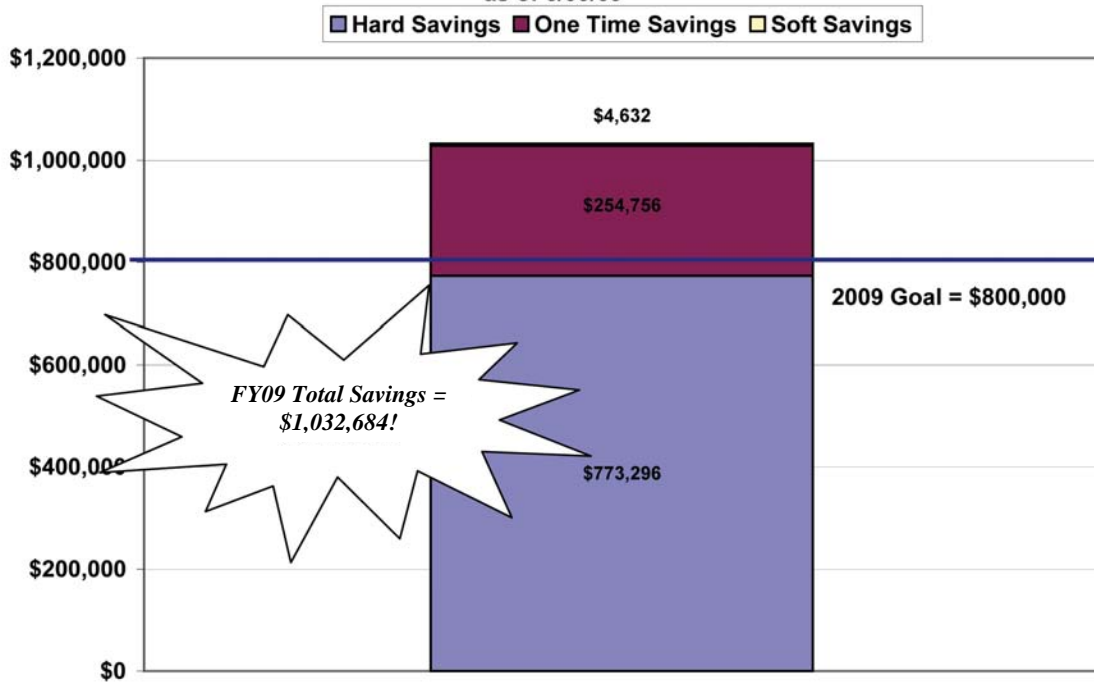
MINNCOR Funding for the DOC

MINNCOR's year-end consolidated net income was \$978,000, which exceeded budgeted expectations by \$489,000. Because of its success this year, MINNCOR was able to provide the DOC with \$1.4 million for legislative-approved purchases and an additional \$433,000 for offender education and reentry.

MINNCOR FY09 Savings by Source Type
as of 6/30/09



MINNCOR 2009 Cost Reduction Results
as of 6/30/09



Minnesota Legislative Audit

The Minnesota Office of the Legislative Auditor (OLA) conducted a program evaluation to determine the degree to which MINNCOR was accomplishing goals and objectives and whether resources were being utilized efficiently.

The legislative audit, finalized after about an eight month analysis, was released in January 2009. It stated that, overall, MINNCOR does a good job in a difficult environment. MINNCOR has been successful in maintaining high levels of inmate employment and generating enough revenue to cover costs. Based on a customer survey the auditors conducted, most state agency staff who do business with MINNCOR are satisfied. However, the auditors recommended some changes. The recommendations included development of a formal marketing plan, reporting the cost of confinement separately, the use of contracts rather than purchase orders when allowing private businesses to use inmate labor, and better evaluation of labor arrangements with private businesses. MINNCOR is reviewing new Enterprise Resource Planning (ERP) systems that will allow better evaluation of labor arrangements. The other recommendations have all been implemented.

Viper Next-Day

MINNCOR introduced the Viper Next-Day Shipping program in May to better accommodate the needs of customers and improve service. The Viper is an ergonomic chair featuring a contoured mesh back that allows for ventilation and an upholstered soft seat for longer hours of comfortable seating. Customers of MINNCOR no longer have to wait the standard eight weeks to receive a Viper chair. Instead, the chair is shipped within 24 hours of purchase. Because the Viper comes standard in a black frame and fabric, the Stillwater facility has chairs already assembled and packaged for shipping. Customers are limited to five chairs per order.

MINNCOR sold a total of 27 chairs during the two and a half months the chair was available during the fiscal year. This program is still running strong and will continue to grow throughout FY10.



EMPLOY was started in 2006 and is completely funded by MINNCOR Industries. It was designed to help inmates capitalize on work experiences and skills acquired during their incarceration and to aid them in employment readiness for post-incarceration. It also offers support for one year following an inmate's release. The ultimate goal of EMPLOY is to help offenders locate, gain, and retain employment at a livable wage.

In order to become a participant in EMPLOY, inmates must be within the last five years of their sentence and have either a minimum of six months work experience at MINNCOR Industries *or* have completed a vocational education program; OnTrack students are also eligible. Participants are held accountable for their actions and are expected to have a clean discipline record while enrolled. Remaining discipline-free reflects a willingness on the part of the individual to establish trust and shows that he or she is thinking about the future.

Shortly before release, participants meet with a job training specialist for two eight-hour sessions. During these meetings, the group discusses skills assessments, resumes, job-searching techniques, interviewing skills, and more. The week before a participant's supervised release date, a job development specialist begins searching for job leads in the offender's field of skill and location of release.

Within the first week of release, an appointment is scheduled with an EMPLOY retention specialist. At this meeting, participants receive an individualized portfolio that contains copies of their resume, any certifications submitted to EMPLOY, job leads, and various other resources and tools to assist them with their job search. The retention specialist maintains contact with and provides continuous support to each participant in the form of career advice and resume maintenance. Follow-up meetings are conducted one, three, and six months after release. The final meeting is held at 12 months upon program completion.

The EMPLOY program has enjoyed many successes this year. The program has continued to grow in size, and by the end of FY09, EMPLOY had 507 participants enrolled. Since inception, 117 participants have successfully completed the program. EMPLOY has retained an average of 70 percent employed participants for FY09.

“Jenny”

“Jenny” was an offender at the Minnesota Correctional Facility (MCF)-Shakopee and worked for MINNCOR Industries conducting market research for a subcontract company for six years. She was very skilled at conducting surveys on consumer purchasing habits, opinions, and marketing strategies and was able to assist clients with pre-planning for future purchasing needs. Within the six years, Jenny took the initiative to follow-up with clients and potential clients. Due to her high success rate, the subcontracting employer pursued her for future employment upon release; Jenny was later employed by the company.

Since her release in March 2008, Jenny has been working for the same company and is responsible for calling customers to present sales opportunities. She feels the best part of her job is the ability to network and build a loyal customer base. Thirteen months prior to her release date, Jenny joined EMPLOY and completed multiple worksheets, attended job search skills training sessions, and created a functional and presentable resume. She credits MINNCOR staff at Shakopee and EMPLOY for her success in the program.

Jenny currently has her own one-bedroom apartment. In her spare time she enjoys painting, sewing, and writing letters to 30 Shakopee inmates every other month.

“Anthony”

“Anthony” began his most recent sentence at the beginning of 2007 and was released on supervision in the summer of 2009. This was his fourth time serving a sentence inside a Minnesota correctional facility. He had a lengthy criminal background and expressed concern to EMPLOY staff during his employability skills training class that he would have a difficult time finding an employer who was willing to give him a chance. Anthony was adamant about finding a job and not going back to prison because he had a family he missed and a mother who was ill. It was important to him that they spend as much time together as they could and for him to make her proud.

Finding work would be more difficult than expected for Anthony because he was required to attend group sessions at his halfway house during the day when he wanted to be out looking for jobs. At his first retention visit with the EMPLOY program, Anthony updated staff on his situation. He was stressed but still committed to not returning to prison. The EMPLOY team kept in close contact with him over the next few weeks and offered suggestions and support. About a month later, Anthony landed two part-time jobs! During the week, he works as a mechanic and on the weekends he found a job at a restaurant.

Over the next month, Anthony was able to leave the halfway house and found full-time work in production in a nearby city. He carools with a co-worker, attends evening support groups for his addictions, and has his weekends free to catch up with family. Anthony is thankful for the extra support the EMPLOY team gave him when he thought all odds were against him. This experience has helped him to learn the importance of not giving up when times are tough.

MCF-FARIBAULT

FY09 saw many improvements at the Faribault division. The site of wood furniture, plastics, chemicals and subcontract operations, the number of assigned offenders jumped to 390 – a 33.1 percent increase. With the addition of three new products, the Green Seal certified line of chemicals finished at \$62,000 for the fiscal year, signifying the first substantial growth since adding chemicals to MINNCOR’s product line. The total Faribault sales revenue for FY09 ended at \$5.9 million.

MCF-MOOSE LAKE

Moose Lake experienced challenges in both the printing and subcontracting business units throughout the year with less than forecasted business activities. Although the number of assigned offenders decreased from 175 to 137, a realignment of subcontract business opportunities promises to deliver an increase in assignments in FY10. The OnTrack printing program continues to provide post-incarceration trade skills to offenders. The garment shop increased its production performance by \$400,000 over the year, resulting in a 27 percent increase in throughput and a 2.8 percent increase in business unit operating income. The total sales revenue for FY09 at Moose Lake ended at \$6.5 million.

MCF-OAK PARK HEIGHTS

Canteen growth within DOC and the Department of Human Services has driven to need to develop strategies for a canteen expansion at Stillwater. This expansion, scheduled for FY10 will increase capacity and allow MINNCOR to meet a forecasted increase in customer demand. Security systems were enhanced with a conversion to digital recording throughout industry. The number of assigned offenders was 95. The year-end sales revenue at Oak Park Heights for FY09 came to \$7.4 million.

MCF-RUSH CITY

Over the fiscal year, Rush City has had 218 assigned offenders. The Minnesota Department of Natural Resources (DNR) introduced four new critical habitat license plates and because of the new license plate system, MINNCOR was able to produce 5,000 of each style and ship them to Department of Public Safety deputy registrars. Since the plant opened over a year ago, Rush City has produced over one million pairs of license plates. In addition, waste has been reduced from a high of 15 percent down to 3.25 percent. Over 1.5 million registrations and 12 million validation stickers have been produced while maintaining less than 1 percent waste. The total sales revenue at Rush City for FY09 ended at \$9.3 million.

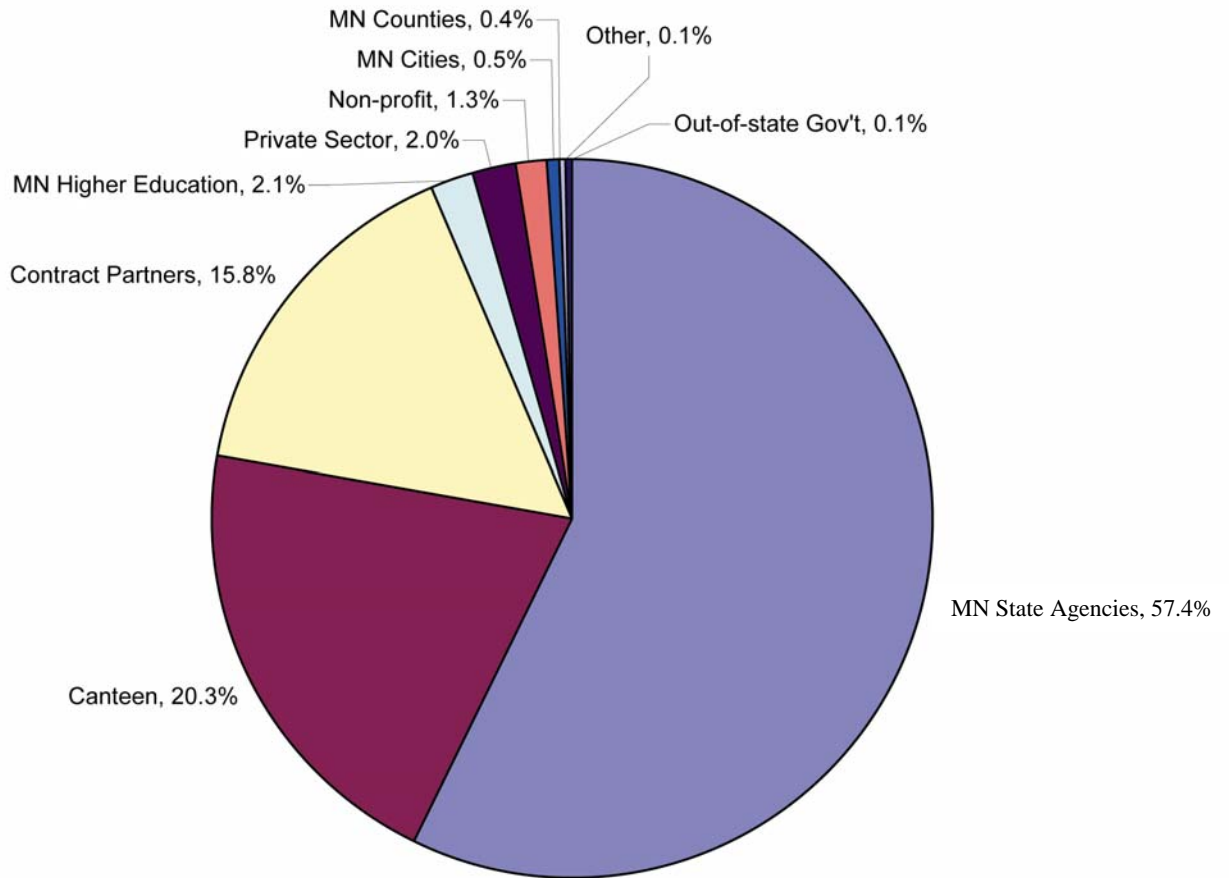
MCF-SHAKOPEE

Shakopee had 114 assigned offenders over the fiscal year. Sewn sales finished the year with production output at 38 percent over budget expectations. New opportunities introduced this year included a garment alternations program, which will add to the sewn shop activities. Shakopee continues to be strong in subcontract. Despite a slight drop in offender assignments, Shakopee's FY09 end sales revenue came to \$918,000.

MCF-STILLWATER

Stillwater's industry division has partnered with education to develop a computer training program for industry clerks. Training will focus on general computer skills with an emphasis on Word and Excel software programs. As part of MINNCOR's import solutions initiative, Stillwater's metal division has entered into a relationship with a Minnesota company that retrieved work targeted for off-shore production. MINNCOR's engineering department successfully worked with the customer to finalize a design that met function and value goals for both parties. A new plasma cutter and jib crane have been installed and will become a cornerstone in a major lean reorganization planned for FY10 that will improve production workflow and staff coverage of machining and fabricating units in metal. Stillwater totaled 250 assigned offenders in metal, upholstery, warehouse, and subcontract. The total sales revenue at Stillwater for FY09 resulted in \$6.6 million.

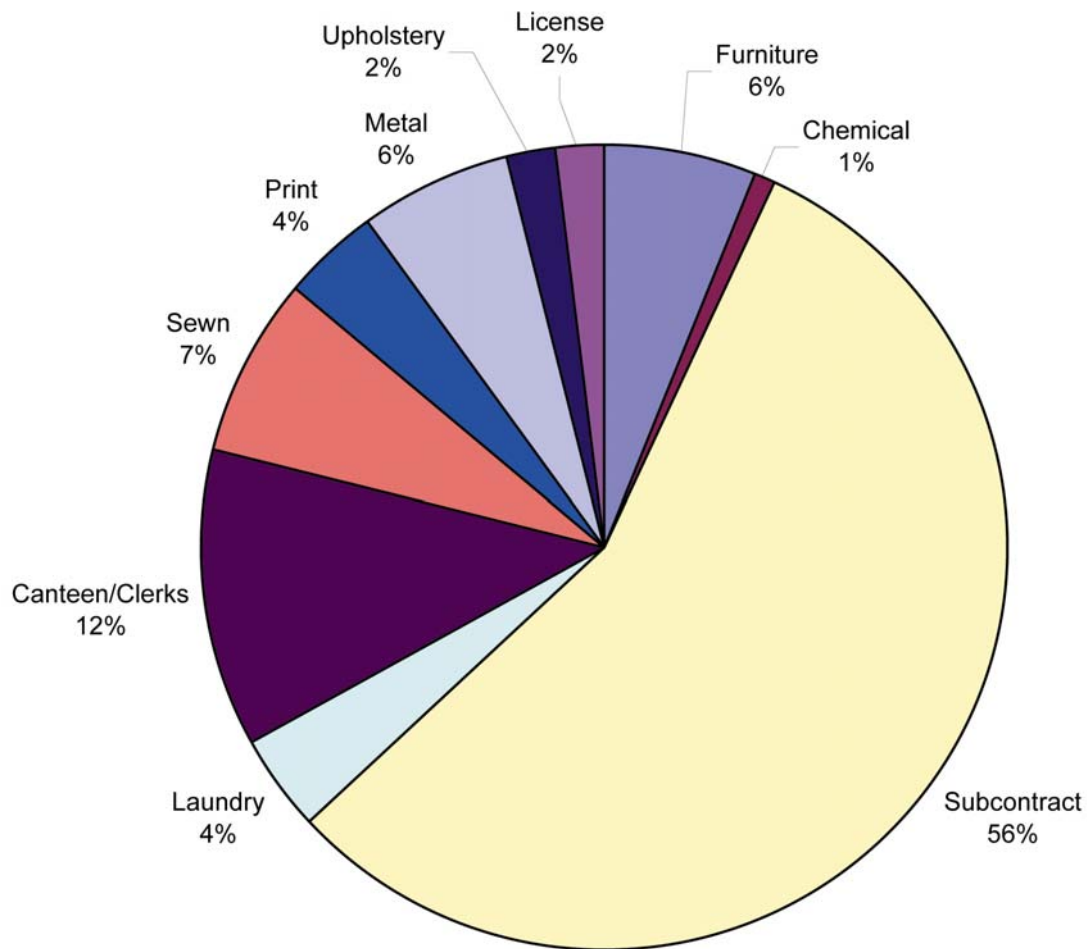
total sales . . .



Sales by Market Segment, as a Percentage of Total Sales FY09

offender employment . . .

June 30, 2009, Offender Employment by Industry
as a Percentage of the Total Employed



1,204 Total Offenders Employed

Balance Sheet

Assets

	FY2009	FY2008
Cash	\$15,451,592	\$14,272,356
Total Other Current Assets	9,562,383	9,633,355
Total Other Assets	4,441,576	4,806,145
Total Assets	\$29,455,551	\$28,711,856

Liabilities and Equity

	FY2009	FY2008
Total Current Liabilities	\$1,304,571	\$1,504,852
Total Other Liabilities	791,308	750,163
Total Liabilities	\$2,095,879	\$2,255,015
Contributed Capital	\$6,552,957	\$6,552,957
Retained Earnings	19,828,736	17,272,948
Current Year Earnings	977,979	2,630,936
Total Equity	\$27,359,672	\$26,456,841
Total Liabilities and Equity	\$29,455,551	\$28,711,856

Comparative Income Statement

	FY2009	FY2008
Total Sales	\$36,330,951	\$35,779,445
Total Cost of Goods Sold	(17,080,920)	(17,021,348)
Gross Margin	\$19,250,031	\$18,758,097
Total Facility		
Manufacturing Costs	\$10,651,583	\$10,771,203
Cost of Confinement	<u>(1,036,055)</u>	<u>(1,200,234)</u>
Net Manufacturing Costs	\$ 9,615,528	\$ 9,570,969
Total General and Administrative Costs	**\$8,656,524	*\$6,556,192
Net Income	\$977,979	\$2,630,936

*includes EMPLOY expenses

**see note 5

Cash Flow Statement

	FY2009	FY2008
Cash Flow from Operating Activities		
Income From		
Continuing Operations	\$977,979	\$2,630,936
Adjustments to Reconcile Income		
From Continuing Operations to		
Cash Provided by Operating Activities	\$47,551	(\$362,765)
Cash Provided from		
Financing Activities	\$1,025,530	\$2,268,171
Cash Flow from		
Financing Activities	\$153,704	(\$905,631)
Increase/(Decrease) in Cash and		
Cash Equivalents	\$1,179,234	\$1,362,540
Cash, Beginning of Year	\$14,272,356	\$12,909,816
Cash, End of Year	\$15,451,590	\$14,272,356

NOTE 1: NATURE OF THE BUSINESS

MINNCOR, a program of the Minnesota DOC, develops and market 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 Industries provides services that benefit the community by operating a dynamic and profitable business. MINNCOR provides work skills to offenders and prepares them for release. MINNCOR operates through an enterprise fund, which is set of self-balancing accounts comprised of assets, liabilities, equities, revenues, and expenses. Since FY03, MINNCOR has been self-sufficient - receiving no appropriations, grants, or subsidies from the State of Minnesota.

NOTE 2: SUMMARIES OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

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 Management and Budget Office and the State Board of Investments.

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 4-10 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 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 sale.

Interfund Transactions

In accordance with the National Council of Governmental Accounting's Statement 2 – *Grant, Entitlement and Shared Revenue Accounting and Reporting by State and Local Governments*, 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 FY09, 6.0 percent of vacation leave and 13.5 percent of vested severance is classified as current. One-hundred percent of compensatory time is classified as current. The remainder, as well as 53 percent of non-eligible severance pay, is classified as non-current. This resulted in a positive adjustment on the balance sheet to record compensated balances for FY09 of approximately \$19,088.

NOTE 4: SPECIAL CHARGES – PRIOR PERIOD ADJUSTMENTS

The accounting software created unit of measure inconsistencies; this resulted in transactions that affected inventory. Resulting adjustments for \$50,503 to correct this were made, and the impact was recorded to the balance sheet versus the income statement as these errors occurred in past years.

NOTE 5: SIGNIFICANT ACCOUNT VARIANCES

The Income Statement account entitled “DOC Expenses” incurred \$1.4 million in expenses in FY09. The expenses incurred include reentry programming and education costs for offenders and MINNCOR-related costs for manufacturing locations (per Minnesota Statute 241.27).