

CORPORATE ANNUAL REPORT

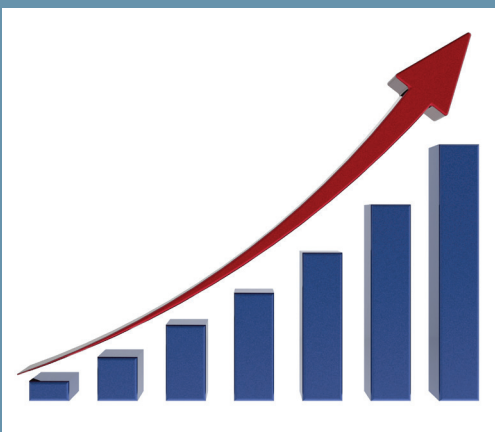
FY 12

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MINNCOR Industries



The success of FY12 can be attributed to all hard working MINNCOR staff as well as the support of DOC management and staff. MINNCOR experienced a year of positive growth not only in sales volume but in offender employment.



73.46 %

average annual net income growth over a four-year period



1,394

average number of offenders employed



5.1 %

growth in sales compared to FY-2011

About MINNCOR Industries

Improving the community and State of Minnesota by providing a safe working environment within the prison system and successfully transition offenders into the community at no cost to taxpayers.

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 20 lines of premium products and a variety of subcontract manufacturing services to various markets and industries.

a dominant 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 Industries is committed to benefiting the State of Minnesota's economy and safety by requiring no state funding and reducing recidivism.

***Today, MINNCOR runs a
contemporary, cohesive,
self-sufficient business operation
featuring 20 diverse product lines.***

MINNCOR is located in six facilities throughout the state, utilizing approximately 1300 offenders as its main workforce. Strategically, MINNCOR endeavors to maintain diversification and avoid investing too heavily in any one area. It does not intend to become

Maintaining a balance of offender employment and financial self-sufficiency through diverse business units, MINNCOR benefits the Minnesota correctional facilities, offenders, businesses, and communities.

To our shareholders, associates and customers

If this last year has taught us anything, it's that business is fundamentally erratic. It's constantly changing - either by chance or design - and we are faced with new challenges every day. We must attempt to stay competitive amidst constant disruption. Some of the challenges we encounter are similar to those faced by private industry and some are unique to correctional industry. Fiscal Year 2012 proved to be a pivotal year for MINNCOR as we met those difficulties head-on.

We started our FY12 with a state-wide shutdown, resulting in MINNCOR losing roughly 20 percent of its workforce. But despite the shutdown, our sales in the first quarter were \$66,000 over budget along with our net income coming in at close to \$400,000 over budget. When all was said and done, MINNCOR experienced a truly great year. Our total revenue for the year was \$40,334,716, up 5.1 percent over the previous year. Our average annual net income grew by 73.46 percent over a four-year period. And we were able to provide employment for an average of 1394 offenders, up from 1332 in FY11.

In 2012 we launched our new customer friendly website. This has been a big hit with customers and a very effective element of our marketing program due to the search engine optimization (SEO). Although the site was professionally designed, much of the work was then done in house. Changes can also be made in house, allowing greater flexibility for the website.

Last but certainly not least, MINNCOR made the cutover from Traverse to Microsoft AX this year. This conversion was the largest project ever undertaken by our organization. We made a surprisingly seamless cutover in March and have not looked back. This project involved staff from every facility and division as well as IT staff. The commitment of time and effort was extraordinary, the success that resulted, very unusual for these conversions. I can't say enough about the tremendous work the men and women of MINNCOR did on this project.

I would like to thank our customers, our partners, the Minnesota Department of Corrections, our offenders, and our talented and committed staff for their support this past year.

Thank you!



***MINNCOR continues to
be strong in spite of a
rough economic outlook.***

Guy Piras,
CEO

MINNCOR Executives (pictured left to right) Brenda Chandler, Mark Thompson, Guy Piras, Joe Bjelland, and Jeff Lonsky

Our Key Success Factors in FY12



3M Racks and Cores

MINNCOR has been manufacturing racks and cores for 3M for several years. The relationship has developed into a partnership valued by both parties. This past year MINNCOR's engineering department designed a method to rework used cores providing cost savings for 3M and additional work for offenders.

A longstanding, appreciated customer, 3M supports MINNCOR's mission of providing work skills to offenders and giving them the opportunity to succeed and live a better life.



Cedar Riverside Kitchen Cabinets and Sinks

MINNCOR teamed up with Sherman Associates (owners of Cedar Riverside) to renovate surrounding apartments and buildings in the Riverside Plaza. The renovation called for new p-lam kitchen cabinets and sink pans to be built and installed in many of the 1300 units.

The contract was valued at \$785,000 and awarded to MINNCOR. While most of the cabinets were installed in FY12, the final installation was done in early FY13. Overall, general feedback was very good and MINNCOR has another bid out for kitchen cabinets with Sherman Associates.



MSOP Casework and Seating

Minnesota Sex Offender Program (MSOP) Moose Lake, completed its Phase 2 Expansion in FY12. This expansion was a major improvement to MSOP-Moose Lake's infrastructure, including treatment and programming rooms, kitchen and dining areas, educational and vocational work space, and a loading dock. These improvements provided needed space for clinical services and improved overall operation and efficiencies at the Moose Lake campus.

MINNCOR was selected to provide \$175,000 in cabinetry and casework along with \$360,000 in seating and tables.



Salvation Army Steel Furniture

On any given night, 130 homeless adult men make sleeping arrangements (usually consisting of using mats on the floor) in the emergency shelter known as Safe Bay. As a redesign project was underway, Salvation Army contacted MINNCOR to design and construct a steel bunk bed with personal storage units.

An order for \$56,000 was placed by the Salvation Army and delivered during the end of the second quarter. MINNCOR continues to be a key partner with Salvation Army.

Our Key Success Factors in FY12



Minnesota State University, Mankato

Wood and Steel Furniture

After a successful partnership was established in FY11, MINNCOR continued to provide Minnesota State Mankato with furniture for the campus. When the need arose for furniture to be placed in an Adult Apartment complex on campus, MINNCOR was called upon for the job.

MINNCOR produced a series of furniture consisting of a writing desk, coffee tables, end tables, and a bed. Each item was constructed with a mixture of steel and wood components making them highly durable, while still stylish, functional and cost effective for the University.

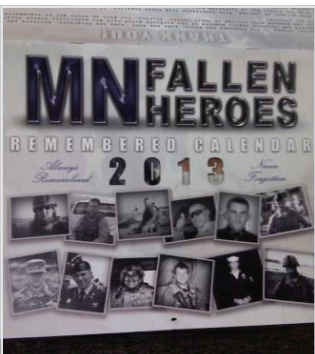


Pneumadyne

Successful Plant Relocation

Due to diminishing offender resources at MCF-Shakopee, MINNCOR's ability to meet the customer demand from Pneumadyne was limited. In an effort to maintain this relationship, MINNCOR offered the business unit to be moved to MCF-Rush City.

After a site visit to Rush City and many conversations with the customer, the move was agreed on and successfully occurred in the third quarter. This relationship continues to be successful as MINNCOR is able to meet customer demand by 100%.



Military Heroes Foundation

Bryan McDonough Calendar

The Bryan McDonough Military Heroes Foundation is a non-profit organization that supports Minnesota servicemen and women returning from deployment. Established as an organization to support soldiers adjusting to life, all donations are given to those heroes that serve our country.

Starting with the 2011 calendar, MINNCOR has partnered with the Foundation by providing its services and printing the calendars. This relationship has been a very successful one all thanks to the staff and offenders who helped make it possible year after year.



Department of Vehicle Services

Minnesota License and Stickers

MINNCOR has had a working relationship with the Minnesota Department of Public Safety/ Driver and Vehicle Services for many years and recently started working on the development and implementation of a new one-part registration form replacing a current three-part form.

This new project had concerns with the amount of staff time required to process the form as well as the possibility of not being able to separate personal information from registration stickers. After many meetings occurred, both teams are satisfied with the project and have



EMPLOY

The EMPLOY Program helps once-incarcerated individuals succeed on the 'outside' with the main goal of reducing recidivism by focusing on industry skills gained and on the cultivation of soft skills such as work values, ethics, responsibility and communication.

Minnesota prisons have provided inmates with employment opportunities since the late nineteenth century. In 1994, the state's prison industry program, MINNCOR, was formed to integrate and centralize administration and sales functions of the DOC's various industry operations. To help inmates capitalize on the work experiences and skills acquired as MINNCOR employees, the EMPLOY program was implemented in 2006.

Designed to help offenders locate, gain, and retain employment at a liveable wage, EMPLOY provides incarcerated participants with assistance to enhance their readiness for post-release employment and offers them community support for one full year following release from prison. The program is entirely voluntary and offenders must be qualified before submitting an application for consideration.

EMPLOY Program participants are experienced, skilled workers trained in one or more of 38 different trade areas. The employment skills gained while incarcerated give the

participants a distinct advantage in finding quality employment in today's competitive job market.

***On average, 70% of
EMPLOY participants
become gainfully
employed after release.***

The program is broken down into three critical stages: (1) Pre-Release Job Search Training Sessions, including resume completion and interview skills, (2) Transitional Period, providing job leads that best match the participants skills, employment portfolio and job coaching, and (3) Retention Services, occurring post-release, offer follow up support and services (bus cards, tools, work clothes, etc).



Makin' It Work

EMPLOY staff became certified in and administered the "Makin' It Work" curriculum, a soft-skills based, cognitive behavioral training program. The ten-lesson program is designated to help offenders in transition from corrections to community adjust more successfully to the world of work.

NCIA Conference

EMPLOY was selected to present a training session at the NCIA national conference. The training track featured correctional industry programs that could offer golden opportunities of evidence-based, offender workforce-focused reentry programs that other states could implement.

EMPLOY Videos

During the year, two new videos were created for EMPLOY. The first one featured a success story of a participant that was employed within a few weeks of his release while the second was made to increase awareness and participant enrolment within the facilities.

Workforce Development (OWDS) Training

In October of 2011, Brenda Chandler, Denise Ehlenz and Michael Hreha attended a 3 day Workforce Development Regional Training sponsored by NCIA. The training focused on the most critical portions of the full 2 week Offender Workforce Development class and covered topics such as Assessments, Understanding Diverse Offender Populations, Job Placement and Designing Training. The final portion of the training gave staff the opportunity to make a mock plan to take back and implement in each state.

MINNCOR staff used this time to help fine tune some of the elements of a transitional job program which is a future goal of the EMPLOY Program.

Overall the training was very insightful and gave staff a better understanding of what is needed to help assist our participants in their job search.

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Key Figures

Consolidated financial statements, include the balance sheet, income statement, and cash flows statement.

Balance Sheet

ASSETS	6/30/2012	6/30/2011
Cash	\$17,065,622	\$14,981,664
Receivables (net)	6,644,711	4,752,025
Inventory	5,306,281	5,763,136
Prepays	221,759	200,748
Other Current Assets	182,395	196,668
Fixed Assets	12,435,407	12,160,131
Accumulated Depreciation	(7,585,509)	(6,929,566)
TOTAL ASSETS	\$34,270,666	\$31,124,806
LIABILITIES	6/30/2012	6/30/2011
Accounts Payable	344,547	170,349
Accrued Liabilities	1,219,806	469,629
Accrued Payroll	382,968	951,537
TOTAL SHORT TERM LIABILITIES	1,947,321	1,591,512
TOTAL LONG TERM LIABILITIES	868,038	902,178
TOTAL LIABILITIES	\$2,815,359	\$2,493,690
EQUITY	6/30/2012	6/30/2011
Contributed Capital	6,552,957	6,552,957
Retained Earnings	20,070,272	19,185,926
Current Year Net Income	4,832,078	2,892,233
TOTAL EQUITY	\$31,455,306	\$28,631,116
TOTAL LIABILITIES & EQUITY	\$34,270,666	\$31,124,806

Income Statement

	6/30/2012	6/30/2011
Sales		
Customer Sales	40,334,716	38,253,711
MINNCOR Sales	509,863	565,937
Sales Returns	(571,553)	(513,483)
Sales Discounts	(25,105)	(20,880)
Sales Write Off	(393)	0
TOTAL SALES	<u>40,247,527</u>	<u>38,285,285</u>
Cost of Goods Sold		
CGS	18,821,565	19,247,286
CGS-Non Inventory	548,647	642,581
Intra Industry CGS	(363)	0
Obsolete, Scrap	42,442	38,687
Variances	(2,423,049)	(3,372,781)
TOTAL COST OF GOODS SOLD	<u>16,989,243</u>	<u>16,555,773</u>
GROSS MARGIN	<u>23,258,285</u>	<u>21,729,513</u>
TOTAL MANUFACTURING COSTS	<u>11,019,839</u>	<u>10,462,602</u>
FACILITY INCOME	<u>12,238,445</u>	<u>11,266,911</u>
TOTAL G & A COSTS	<u>7,406,368</u>	<u>8,374,678</u>
NET INCOME	\$4,832,077	\$2,892,233

Statement of Cash Flows

	6/30/2012	6/30/2011
Cash Flows from Operating Activities		
Receipts from Customers	40,247,527	38,285,285
Payments (Employees, FC, Mfg Costs & Suppliers)	35,613,660	35,370,414
Other Income	106,072	76,380
Gain on Sale of Fixed Assets	10,970	(188,701)
Investment Earnings	81,168	89,683
NET INCOME	<u>\$4,832,077</u>	<u>\$2,892,233</u>
Decreases (Increases) in:		
Accounts Receivable	(1,892,686)	1,572,430
Inventory	456,855	1,146,107
Other Current Assets	(6,737)	56,313
Increases (Decreases) in:		
Accumulated Depreciation	655,943	77,908
Accounts Payable	874,631	150,864
Accrued Expenses	(552,962)	338,753
Net Cash Provided by (used for) Oper. Exp.	<u>4,367,121</u>	<u>684,909</u>
Cash Flows from Capital & Related Fin. Act.		
Purchases of Fixed Assets	<u>(275,277)</u>	<u>(717,842)</u>
Net Cash Provided by (used for) Capital Activities	<u>(275,277)</u>	<u>(717,842)</u>
Cash Flows from General Fund & DOC Activities		
General Fund Distributions & DOC Initiatives	<u>(2,007,887)</u>	<u>(2,170,000)</u>
Net Cash to General Fund & DOC Activities	<u>(2,007,887)</u>	<u>(2,170,000)</u>
Net Increase (Decrease) in Cash & Cash Equivalents	<u>\$2,083,958</u>	<u>(\$2,202,933)</u>

Notes on the Financial Statements

Notes support the consolidated 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 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 vision is a customer-driven business model that contributes to a safer Minnesota by providing sound management, quality products, reduction of inmate idleness, offender transition services, and work skills' training that prepare offenders for release into the community. MINNCOR operates through a State 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 appropriations, grants or subsidies from the State of Minnesota, or the Department of Corrections.

NOTE 2 SUMMARIES OF SIGNIFICANT ACCOUNTING PRINCIPLES

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 Minnesota Management and Budget and State Board of Investments.

Inventory Valuations

Inventories are valued at a Weighted Average Cost. MINNCOR produced merchandise placed in service to support laundry rental operations is amortized over the estimated useful lives of the inventory items on a straight-line depreciation 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 11 months to 36 months. 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 3 – 10 years for machinery and equipment and computers. 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 Principles (GAAP). These assets will appear on the balance sheet and be amortized using the straight-line method over an estimated useful life of 5 years.

Revenue Recognition

MINNCOR recognizes revenue as services are performed, or on product sales at the time of shipping.

The remaining balance, as well as 54% of non-eligible severance pay is classified as non-current. This resulted in positive adjustments on the balance sheet and income statement to record compensated balances for Fiscal Year 2012 of approximately \$33,500.

NOTE 4 SIGNIFICANT ACCOUNT VARIANCES

In FY 2012 MINNCOR paid \$1,407,887 in DOC Expenses not related to Minncor activities. These DOC expenses incurred include re-entry/transition programs, education costs for offenders, DOC staff salaries and benefits, and miscellaneous DOC expenses approved by the Minncor Advisory Board.

Mandated by Minnesota Laws of 2011, 1st Special Session, Chapter 1, Article 1, Sec. 15, Subd. 5(a), MINNCOR transferred \$600,000 to the State General Fund in Fiscal Year 2012, which affected retained earnings on the Fiscal Year 2012 financial statements.

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 2012, 6.87% of vacation leaves, and 15.74% of vested severance is classified as current. 100% of compensatory time is also classified as current.



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