STATEMENT OF DR. JESSE PHILLIPS

Good morning, my name is Dr. Jesse Phillips, and I am the Assistant Director of Research and Development at Xcaliber International. I would like to begin by thanking you for your time and attention to this matter. This morning, I would like to provide an overview of some of the physical characteristics of 4th Tier cigarettes and to also provide an overview of the manufacturing process.

By way of background, I hold a bachelor's degree in Chemistry from the University of Florida and a Ph.D. in Materials Chemistry from the University of Tulsa. During my Tenure at the University of Tulsa, I had the privilege to work at NASA's Jet Propulsion Lab, as well as Argonne National Lab in collaborative efforts with researchers focusing on surface modification and early earth biochemical pathways. More recently, I have brought my knowledge and expertise in both chemistry and R&D to Xcaliber International and perform a variety of functions within the company.

My role within the company can be split into two major responsibilities: ensuring that all products currently produced by Xcaliber International comply with requirements set forth by FDA, as well as analyzing and addressing the R&D needs as they arise. My work on FDA compliance has many facets and involves testing of our products using instrumentation in house, communicating with our vendors regarding third party components and their respective specifications, as well as working with external labs for further independent analysis. Although typically viewed as a single product, a cigarette is comprised of multiple components such as the filter, plug wrap, tipping paper, cigarette wrapper, various adhesives, and of course, tobacco. When working to ensure compliance with FDA, each individual component must be accounted for and its effects on the overall cigarette understood. My work regarding Xcaliber International's R&D needs will be discussed at the end of my statement.

First, it is important to note that 4th tier cigarettes are a distinct type of cigarette product with distinct physical characteristics. Specifically, our 4th tier cigarettes are made with a tobacco blend that includes more than 10% tobacco stems. While many of the issues connected with tobacco blend "recipes" are proprietary in nature, it is my understanding that non-4th Tier cigarettes typically have less than 10% stems in their tobacco, and I'm aware of no information that would contradict that.

Similarly, there are differences in the types of filters used by 4th tier, as compared to non-4th tier, manufacturers. At Xcaliber International we make our filters in-house. Again, while some of these details are proprietary, I can tell you that we use – what is called in the industry - single component filters. These filters are made from thin sheets of cellulose acetate, which resemble cotton in both color and texture, if seen by the lay person. We use a plasticizer on the cellulose acetate to form the filter, which hardens the compound. We then wrap the filters

in plug wrap (a type of paper surrounding the cellulose acetate) as it sets and hardens to become a usable filter.

While I do not have access to the proprietary information in regard to the specifics of the filters used in non-4th tier cigarettes, I do know that they can be more complex products, which can consist of multiple components, with additions such as activated carbon.

Similarly, 4th tier and non-4th tier can use different types of cigarette paper – basically a wood pulp versus a flax based paper.

In sum, when comparing 4th tier manufacturers, such as Xcaliber International, to non-4th tier manufacturers, 4th tier manufacturers are a different industry – both in regard to the scale of the industry and the production process. As to this production process, non-4th tier companies frequently have machines dedicated to one brand family. They can have entire rooms dedicated to running one SKU that may be a "best seller." They can split tobacco growth in a way that ensures the typical blends for their products are always available even under the

chaotic nature of agronomy. In addition, 4th tier manufacturers are not integrated producers in that they generally do not have "primary facilities." On the other hand, the non-4th tier producers own their own primaries, have contracts with the farmers who produce the tobacco, and can control the process from seed to sales. It allows them to streamline their process. For 4th tier manufacturers, tobacco blends are formulated and sold by a 3rd party with its own contracts with primaries as well as other cigarette manufacturers. Although both 4th tier and non-4th tier cigarette tobacco blends are constantly regulated by FDA, the integrated nature of the non-4th tier producers allows quicker turnaround times at all points in the manufacturing process. In essence, we buy boxes of cut and flavored tobacco blend and hope that its in stock next time we call. If we need to produce a different brand on a given day, machines need to be changed over, shutting down production for a given product during the interim. The majors may have four machines making one brand whereas we, and other 4th tier manufactures, may only have four machines total. We may both produce tubes of tobacco for the

consumer to smoke, but that is where the similarities in 4th tier and non-4th tier manufacturing ends.

I would now like to review the production process:

BEGIN POWER POINT PRESENTATION

I would like to add one more thought. As I mentioned near the beginning of my statement, I have been brought in to address Xcaliber International's growing need for R&D. Because we're a small, close-knit company, I hear on a regular basis how we are being negatively affected by lower priced Korean products. I also know that as our overall cash flow is decreasing, our ability to invest in R&D decreases. We are currently in the process of trying to build a new R&D facility. This facility will be instrumental in keeping Xcaliber International relevant in an ever changing landscape, heavily regulated by FDA, and in constant need of product analysis and development. Due to these constraints being caused by Korean products, we're holding off on larger purchases necessary for this facility because we don't have the budget from a year

ago. We are limiting ourselves to searching for used machines rather than new ones and holding off on new construction because our cash flow is being negatively affected by imports. And I know that a company that loses the ability to invest in itself, is a company that is threatened with ongoing harm.

Thank you again for your time and I'll be happy to answer any questions.