ALTRIA GROUP, INC.
Form DEF 14A
April 24, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the Securities

Exchange Act of 1934 (Amendment No.)

Filed by the Registrant x

Filed by a Party other than the Registrant ¨

Check the appropriate box:

¨ Preliminary Proxy Statement
¨ Confidential, For Use of the Commission Only(as permitted by Rule 14a-6(e)(2))
x Definitive Proxy Statement
¨ Definitive Additional Materials
¨ Soliciting Material Under Rule 14a-12

Altria Group, Inc.

(Name of Registrant as Specified in Its Charter)

(Name of Person(s) Filing Proxy Statement, if Other Than the Registrant)

Payment of Filing Fee (Check the appropriate box):

x No fee required.

¨ Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

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(2) Aggregate number of securities to which transaction applies:

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(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

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¨ Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the form or schedule and the date of its filing.

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(2) Form, Schedule or Registration Statement No.:

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(3) Filing Party:

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(4) Date Filed: April 24, 2008

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ALTRIA GROUP, INC.

MICHAEL E. SZYMANCZYK
CHAIRMAN OF THE BOARD

6601 WEST BROAD STREET
RICHMOND, VIRGINIA 23230

April 24, 2008

Dear Fellow Stockholder:

It is my pleasure to invite you to join us at the 2008 Annual Meeting of Stockholders of Altria Group, Inc. to be held on Wednesday, May 28, 2008 at 9:00 a.m., at the Greater Richmond Convention Center, 403 North 3rd Street, Richmond, Virginia 23219.

At this year s meeting, we will vote on the election of eight directors, the ratification of PricewaterhouseCoopers LLP s selection as the Company s independent auditors and, if properly presented, six proposals from stockholders. There will also be a report on the Company s business, and stockholders will have an opportunity to ask questions.

We anticipate that a large number of stockholders will attend the meeting. Because seating is limited, you may bring only one immediate family member as a guest. To attend the meeting, you must present an admission ticket and government-issued photographic identification. **Please note that you must submit a request for an admission ticket**. **To request an admission ticket, please follow the instructions set forth on page 2 in response to question 4**.

The meeting facilities will open at 7:30 a.m. We suggest you arrive early to facilitate your registration and security clearance. Those needing special assistance at the meeting are requested to write to the Company s Corporate Secretary at 6601 West Broad Street, Richmond, Virginia 23230. For your comfort and security, you will not be permitted to bring any packages, briefcases, large pocketbooks or bags into the meeting. Also, cellular and digital phones, audio tape recorders, laptops, video and still cameras, pagers and pets will not be permitted into the meeting. We thank you in advance for your patience and cooperation with these rules. While they may seem strict to some, they assist us in conducting a safe and orderly meeting and are in everyone s interest.

Attached you will find a notice of meeting and proxy statement that contains additional information about the meeting, including the methods that you can use to vote your proxy, such as the telephone or Internet.

Your vote is important. I encourage you to sign and return your proxy card, or use telephone or Internet voting prior to the meeting, so that your shares of common stock will be represented and voted at the meeting even if you cannot attend.

Sincerely,

For further information about the Annual Meeting,

please call 1-800-367-5415

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ALTRIA GROUP, INC.

6601 West Broad Street

Richmond, VA 23230

NOTICE OF 2008 ANNUAL MEETING OF

STOCKHOLDERS OF ALTRIA GROUP, INC.

TIME:	9:00 a.m. on Wednesday, May 28, 2008
PLACE:	The Greater Richmond Convention Center 403 North 3rd Street Richmond, Virginia
ITEMS OF BUSINESS:	1) To elect eight directors.
	2) To ratify the selection of PricewaterhouseCoopers LLP as independent auditors for the Company for the fiscal year ending December 31, 2008.
	3) To vote on six stockholder proposals, if properly presented at the meeting.
	4) To transact other business properly coming before the meeting.
WHO CAN VOTE:	Stockholders of record on April 4, 2008.
2007 ANNUAL REPORT:	A copy of our 2007 Annual Report is enclosed.
DATE OF MAILING:	This notice and the proxy statement are first being mailed to stockholders on or about April 24, 2008.
	Sean X. McKessy *Corporate Secretary*

April 24, 2008

WE URGE EACH STOCKHOLDER TO PROMPTLY SIGN AND RETURN THE ENCLOSED PROXY CARD OR TO USE TELEPHONE OR INTERNET VOTING. SEE OUR QUESTION AND ANSWER SECTION FOR INFORMATION ABOUT VOTING BY TELEPHONE OR INTERNET, HOW TO REVOKE A PROXY, AND HOW TO VOTE YOUR SHARES OF COMMON STOCK IN PERSON.

PLEASE NOTE THAT YOU MUST SUBMIT A REQUEST FOR AN ADMISSION TICKET. TO OBTAIN AN ADMISSION TICKET, PLEASE FOLLOW THE INSTRUCTIONS SET FORTH ON PAGE 2 IN RESPONSE TO QUESTION 4.

Important Notice Regarding the Availability of Proxy Materials

For the Stockholder Meeting to be Held on May 28, 2008

The Company s Proxy Statement and 2007 Annual Report to Shareholders are available at

http://www.altria.com/proxy.

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ALTRIA GROUP, INC.

6601 WEST BROAD STREET

RICHMOND, VIRGINIA 23230

April 24, 2008

PROXY STATEMENT

FOR ANNUAL MEETING OF STOCKHOLDERS

TO BE HELD ON MAY 28, 2008

Our Board of Directors is furnishing you with this proxy statement to solicit proxies on its behalf to be voted at the 2008 Annual Meeting of Stockholders of Altria Group, Inc. (the Company) at 9:00 a.m., at the Greater Richmond Convention Center, 403 North 3rd Street, Richmond, Virginia. The proxies also may be voted at any adjournments or postponements of the meeting.

We are first sending the proxy materials to stockholders on or about April 24, 2008.

All properly executed written proxies, and all properly completed proxies submitted by telephone or by the Internet, that are delivered pursuant to this solicitation will be voted at the meeting in accordance with the directions given in the proxy, unless the proxy is revoked before the meeting.

Only stockholders of record of shares of common stock at the close of business on April 4, 2008 are entitled to notice of and to vote at the meeting, or at adjournments or postponements of the meeting. Each stockholder of record on the record date is entitled to one vote for each share of common stock held. On April 4, 2008, there were 2,099,732,751 shares of common stock issued and outstanding.

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QUESTIONS AND ANSWERS ABOUT

THE MEETING AND VOTING

1. WHAT IS A PROXY?

It is your legal designation of another person to vote the stock you own. That other person is called a proxy. If you designate someone as your proxy in a written document, that document also is called a proxy or a proxy card. Michael E. Szymanczyk and Denise F. Keane have been designated as proxies for the 2008 Annual Meeting of Stockholders.

2. WHAT IS THE RECORD DATE AND WHAT DOES IT MEAN?

The record date for the 2008 Annual Meeting of Stockholders is April 4, 2008. The record date is established by the Board of Directors as required by Virginia law. Stockholders of record (registered stockholders and street name holders) at the close of business on the record date are entitled to:

(a) receive notice of the meeting; and

(b) vote at the meeting and any adjournments or postponements of the meeting.

3. WHAT IS THE DIFFERENCE BETWEEN A REGISTERED STOCKHOLDER AND A STOCKHOLDER WHO HOLDS STOCK IN STREET NAME?

If your shares of stock are registered in your name on the books and records of our transfer agent, you are a registered stockholder.

If your shares of stock are held for you in the name of your broker or bank, your shares are held in street name. The answer to Question 15 describes brokers discretionary voting authority and when your bank or broker is permitted to vote your shares of stock without instructions from you.

4. HOW DO I OBTAIN ADMISSION TO THE MEETING?

To obtain admission to the meeting, you must request an admission ticket. Because seating is limited, you may bring only one immediate family member as a guest. In addition, all meeting attendees must present government-issued photographic identification at the meeting. Please submit your request for an admission ticket by Monday, May 12, 2008, by mailing or faxing a request to the Company s Corporate Secretary at 6601 West Broad Street, Richmond, Virginia 23230, facsimile: 1-800-352-6172 (from within the United States) or 1-914-272-0985 (from outside the United States). Please include the following information:

- your name and mailing address;
- whether you need special assistance at the meeting;
- the name of your immediate family member, if one will accompany you; and
- if your shares are held for you in the name of your broker or bank, evidence of your stock ownership (such as a letter from your broker or bank or a photocopy of a current brokerage or other account statement) as of April 4, 2008.

5. WHAT ARE THE DIFFERENT METHODS THAT I CAN USE TO VOTE MY SHARES OF COMMON STOCK?

(a) *In Writing:* All stockholders of record can vote by mailing their completed and signed proxy card (in the case of registered stockholders) or their completed and signed vote instruction form (in the case of street name holders).

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(b) *By Telephone and Internet Proxy:* All registered stockholders of record also can vote their shares of common stock by touchtone telephone from the United States and Canada, using the toll-free telephone number on the proxy card, or by the Internet, using the procedures and instructions described on the proxy card and other enclosures. Street name holders of record may vote by telephone or the Internet if their banks or brokers make those methods available. If that is the case, each bank or broker will enclose instructions with the proxy statement. The telephone and Internet voting procedures, including the use of control numbers, are designed to authenticate stockholders identities, to allow stockholders to vote their shares, and to confirm that their instructions have been properly recorded.

(c) *In Person:* All stockholders may vote in person at the meeting (unless they are street name holders without a legal proxy).

6. HOW CAN I REVOKE A PROXY?

You can revoke a proxy prior to the completion of voting at the meeting by:

(a) giving written notice to the Corporate Secretary of the Company;

(b) delivering a later-dated proxy; or

(c) voting in person at the meeting.

7. ARE VOTES CONFIDENTIAL? WHO COUNTS THE VOTES?

We will continue our long-standing practice of holding the votes of each stockholder in confidence from directors, officers and employees except: (a) as necessary to meet applicable legal requirements and to assert or defend claims for or against the Company, (b) in case of a contested proxy solicitation, (c) if a stockholder makes a written comment on the proxy card or otherwise communicates his or her vote to management, or (d) to allow the independent inspectors of election to certify the results of the vote. We will also continue, as we have for many years, to retain an independent tabulator to receive and tabulate the proxies and independent inspectors of election to certify the results.

8. WHAT ARE THE VOTING CHOICES WHEN VOTING ON DIRECTOR NOMINEES, AND WHAT VOTE IS NEEDED TO ELECT DIRECTORS?

When voting on the election of director nominees to serve until the 2009 Annual Meeting of Stockholders, stockholders may:

(a) vote in favor of a nominee;

(b) vote against a nominee; or

(c) abstain from voting on a nominee.

Directors will be elected by a majority of the votes cast. A majority of the votes cast means that a number of votes FOR a director nominee must exceed the number of votes AGAINST that nominee. Any director who receives a greater number of votes AGAINST his or her election than votes FOR such election shall offer to tender his or her resignation to the Board. The Nominating, Corporate Governance and Social Responsibility Committee shall consider the offer and recommend to the Board whether to accept or reject the offer. The full Board will consider all factors it deems relevant to the best interests of the Company, make a determination and publicly disclose its decision and rationale within 90 days after confirmation of the election results.

The Board recommends a vote FOR all of the nominees.

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9. WHAT ARE THE VOTING CHOICES WHEN VOTING ON THE RATIFICATION OF THE SELECTION OF PRICEWATERHOUSECOOPERS LLP, AND WHAT VOTE IS NEEDED TO RATIFY THEIR SELECTION?

When voting on the ratification of the selection of PricewaterhouseCoopers LLP as independent auditors for the Company, stockholders may:

(a) vote in favor of the ratification;

(b) vote against the ratification; or

(c) abstain from voting on the ratification.

The selection of the independent auditors will be ratified if the votes cast FOR exceed the votes cast AGAINST.

The Board recommends a vote FOR this proposal.

10. WHAT ARE THE VOTING CHOICES WHEN VOTING ON EACH STOCKHOLDER PROPOSAL PROPERLY PRESENTED AT THE MEETING AND WHAT VOTE IS NEEDED TO APPROVE ANY OF THESE STOCKHOLDER PROPOSALS?

A separate vote will be held on each stockholder proposal that is properly presented at the meeting. When voting on each of the stockholder proposals, stockholders may:

(a) vote in favor of the proposal;

(b) vote against the proposal; or

(c) abstain from voting on the proposal.

A stockholder proposal will be approved if the votes cast FOR the proposal exceed the votes cast AGAINST.

The Board recommends a vote AGAINST each of the shareholder proposals.

11. WHAT IF A STOCKHOLDER DOES NOT SPECIFY A CHOICE FOR A MATTER WHEN RETURNING A PROXY?

Stockholders should specify their choice for each matter on the enclosed proxy. If no specific instructions are given, proxies that are signed and returned will be voted FOR the election of all director nominees, FOR the proposal to ratify the selection of PricewaterhouseCoopers LLP and AGAINST each of the stockholder proposals.

12. WHO IS ENTITLED TO VOTE?

You may vote if you owned stock as of the close of business on April 4, 2008. Each share of common stock is entitled to one vote. As of April 4, 2008, we had 2,099,732,751 shares of common stock outstanding.

13. HOW DO I VOTE IF I PARTICIPATE IN THE DIVIDEND REINVESTMENT PLAN?

The proxy card you have received includes your dividend reinvestment plan shares. You may vote your shares through the Internet, by telephone or by mail, all as described on the enclosed proxy card.

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14. WHAT DOES IT MEAN IF I RECEIVE MORE THAN ONE PROXY CARD?

It means that you have multiple accounts with brokers and/or our transfer agent. Please vote all of these shares. We recommend that you contact your broker and/or our transfer agent to consolidate as many accounts as possible under the same name and address. Our transfer agent is Computershare Trust Company, N.A., P.O. Box 43078, Providence, RI 02940-3078 or you can reach Computershare at 1-800-442-0077 (from within the United States or Canada) or 1-781-575-3572 (from outside the United States or Canada).

15. WILL MY SHARES BE VOTED IF I DO NOT PROVIDE MY PROXY?

Your shares may be voted if they are held in the name of a brokerage firm, even if you do not provide the brokerage firm with voting instructions. Brokerage firms have the authority under New York Stock Exchange rules to vote shares for which their customers do not provide voting instructions on certain routine matters.

The ratification of the selection of PricewaterhouseCoopers LLP as independent auditors of the Company is considered a routine matter for which brokerage firms may vote unvoted shares. The other proposals to be voted on at our meeting are not considered routine under New York Stock Exchange rules. When a proposal is not a routine matter and the brokerage firm has not received voting instructions from the beneficial owner of the shares with respect to that proposal, the brokerage firm cannot vote the shares on that proposal. This is called a broker non-vote.

16. ARE ABSTENTIONS AND BROKER NON-VOTES COUNTED?

Abstentions and broker non-votes will not be included in vote totals and will not affect the outcome of the vote.

17. MAY STOCKHOLDERS ASK QUESTIONS AT THE MEETING?

Yes. The Chairman will answer stockholders questions of general interest during a designated portion of the meeting. In order to provide an opportunity for everyone who wishes to speak, stockholders will be limited to two (2) minutes. Stockholders may speak a second time only after all others who wish to speak have had their turn. When speaking, stockholders must direct questions and comments to the Chairman and confine their remarks to matters that relate directly to the business of the meeting.

18. HOW MANY VOTES MUST BE PRESENT TO HOLD THE MEETING?

Your shares are counted as present at the meeting if you attend the meeting and vote in person or if you properly return a proxy by Internet, telephone or mail. In order for us to conduct our meeting, a majority of our outstanding shares of common stock as of

April 4, 2008, must be present in person or by proxy at the meeting. This is referred to as a quorum. Abstentions and shares of record held by a broker or its nominee (Broker Shares) that are voted on any matter are included in determining the number of votes present. Broker Shares that are not voted on any matter will not be included in determining whether a quorum is present.

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BOARD OF DIRECTORS

Board of Directors

The primary responsibility of the Board of Directors (the Board) is to foster the long-term success of the Company, consistent with its fiduciary duty to the stockholders. The Board has responsibility for establishing broad corporate policies, setting strategic direction, and overseeing management, which is responsible for the day-to-day operations of the Company. In fulfilling this role, each director must exercise his or her good faith business judgment of the best interests of the Company.

The Board holds regular meetings typically during the months of January, February, April, May, August, October and December, and special meetings are held when necessary. The organizational meeting follows immediately after the Annual Meeting of Stockholders. One of the meetings is held at an offsite location for several days each year to review the Company s strategic plan. The Board held seven meetings in 2007. The Board meets in executive session at every Board meeting. Directors are expected to attend Board meetings, the Annual Meeting of Stockholders and meetings of the Committees on which they serve, with the understanding that on occasion a director may be unable to attend a meeting. During 2007, all nominees for director who served in 2007 attended at least 75% of the aggregate number of meetings of the Board and all Committees on which they served. In addition, all directors who served in 2007 attended the 2007 Annual Meeting of Stockholders.

The Board has adopted Corporate Governance Guidelines. In addition, the Company has adopted the Altria Code of Conduct for Compliance and Integrity, which applies to all of its employees, including its principal executive officer, principal financial officer, principal accounting officer or controller, and persons performing similar functions, as well as a code of business conduct and ethics that applies to the members of the Company s Board. The Board has also adopted a policy with regard to reviewing certain transactions in which the Company is a participant and an officer, director or nominee for director has, had or may have a direct or indirect material interest. All of these documents are available free of charge on the Company s website, www.altria.com/governance, and will be provided free of charge to any stockholders requesting a copy by writing to: Corporate Secretary, Altria Group, Inc., 6601 West Broad Street, Richmond, Virginia 23230.

The information on the Company s website is not, and shall not be deemed to be, a part of this proxy statement or incorporated into any other filings the Company makes with the Securities and Exchange Commission.

Presiding Director

The non-management directors annually elect one independent director to be the Presiding Director. The Presiding Director s responsibilities are to:

- Preside over executive sessions of the non-management directors and at all meetings at which the Chairman is not present;
- Call meetings of the non-management directors as he or she deems necessary;
- Serve as liaison between the Chairman and the non-management directors;

Develop and coordinate agendas and schedules for Board meetings with the Chairman;

Advise the Chairman of the Board s informational needs;

Together with the Chairman of the Compensation Committee, communicate goals and objectives to the Chairman and Chief Executive Officer and the results of the evaluation of his performance; and

Be available for consultation and communication if requested by major stockholders.

The Presiding Director is invited to attend all meetings of Committees of the Board of which he or she is not a member.

Robert E. R. Huntley currently serves as the Presiding Director.

Communications with the Board

Stockholders and other interested parties who wish to communicate with the Board may do so by writing to the Presiding Director, Board of Directors of Altria Group, Inc., 6601 West Broad Street, Richmond, Virginia 23230. The non-management directors have established procedures for the handling of communications from stockholders and other interested parties and directed the Corporate Secretary to act as their agent in processing any communications received. All communications that relate to matters that are within the scope of the responsibilities of the Board and its Committees are to be forwarded to the Presiding Director. Communications that relate to matters that are within the responsibility of one of the Board Committees are also to be forwarded to the Chair of the appropriate Committee. Communications that relate to ordinary business matters that are not within the scope of the Board s responsibilities, such as customer complaints, are to be sent to the appropriate subsidiary. Solicitations, junk mail and obviously frivolous or inappropriate communications are not to be forwarded, but will be made available to any non-management director who wishes to review them.

Committees of the Board

The Board has established various separately-designated standing committees of the Board to assist it with the performance of its responsibilities. These Committees and their members are listed below. The Board designates the members of these Committees and the Committee Chairs annually at its organizational meeting following the Annual Meeting of Stockholders, based on the recommendations of the Nominating, Corporate Governance and Social Responsibility Committee. The Board has adopted written charters for each of these Committees and these charters are available on the Company s website at www.altria.com/governance. The Chair of each Committee develops the agenda for that Committee and determines the frequency and length of Committee meetings.

The **Audit Committee** consists entirely of non-management directors all of whom the Board has determined are independent within the meaning of the listing standards of the New York Stock Exchange and Rule 10A-3 of the Securities Exchange Act of 1934, as amended. Its responsibilities are set forth in the Audit Committee Charter, which is available on the Company s website at www.altria.com/governance. The Committee was established pursuant to Section 3(a)(58)(A) of the Securities Exchange Act of 1934. The Committee s responsibility is to assist the Board in its oversight of (i) the Company s financial statements and financial reporting processes and systems of internal control, (ii) the qualifications, independence and performance of the Company s independent auditors, (iii) the internal audit function and (iv) the Company s compliance with legal and regulatory requirements. The Committee is also responsible for preparing the Audit Committee Report that the rules of the Securities and Exchange Commission require the Company to include in the proxy statements. The Committee met nine times in 2007. During 2007, the members of the Committee were Lucio A. Noto (Chair); Elizabeth E. Bailey; J. Dudley Fishburn; Robert E. R. Huntley; George Muñoz; John S. Reed; and Stephen M. Wolf. The current members of the Committee are: George Muñoz (Chair); Elizabeth E. Bailey; Thomas F. Farrell II; Robert E. R. Huntley; and Thomas W. Jones. See pages 62 to 63 for further matters related to the Audit Committee, including its Report for the year 2007.

The Board has determined that all members of the Audit Committee are financially literate and that George Muñoz and at least one other member of the Committee are audit committee financial experts within the meaning set forth in the regulations of the Securities and Exchange Commission. No member of the Audit Committee received any payments in 2007 from Altria Group, Inc. or its subsidiaries other than compensation received as a director of Altria Group, Inc.

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The **Compensation Committee** consists entirely of non-management directors all of whom the Board has determined are independent within the meaning of the listing standards of the New York Stock Exchange. Its responsibilities are set forth in the Compensation Committee Charter, which is available on the Company s website at www.altria.com/governance. The Committee discharges the Board s responsibilities relating to executive compensation, produces an annual Compensation Committee report to be included in the Company s proxy statement and reviews the succession plans for the chief executive officer and other senior executives. In addition, the Committee reviews and makes recommendations regarding compensation disclosures to be provided in the Company s Securities and Exchange Commission filings, including the Compensation Discussion and Analysis and narrative descriptions in the Committee s disclosure of its procedures in determining executive compensation. This Committee met six times in 2007. During 2007, the members of the Committee were: John S. Reed (Chair); Elizabeth E. Bailey; Harold Brown; J. Dudley Fishburn; Robert E. R. Huntley; Lucio A. Noto; and Stephen M. Wolf. The current members of the Committee are: Robert E. R. Huntley (Chair); Elizabeth E. Bailey; Gerald L. Baliles; Thomas F. Farrell II; and Thomas W. Jones. See pages 18 through 20 for further matters related to the Compensation Committee, including a discussion of its procedures and its report on the Compensation Discussion and Analysis appearing on pages 21 through 61.

The **Executive Committee** has the responsibilities set forth in the Executive Committee Charter, which is available on the Company s website at www.altria.com/governance. The Committee has authority to act for the Board during intervals between Board meetings to the extent permitted by law. This Committee did not meet in 2007. During 2007, the members of the Committee were: Louis C. Camilleri (Chair); Elizabeth E. Bailey; Mathis Cabiallavetta; Robert E. R. Huntley; Lucio A. Noto; John S. Reed; and Stephen M. Wolf. The current members of the Committee are: Michael E. Szymanczyk (Chair); Elizabeth E. Bailey; Robert E. R. Huntley; Thomas W. Jones; and George Muñoz.

The **Finance Committee** has the responsibilities set forth in the Finance Committee Charter, which is available on the Company s website at www.altria.com/governance. The Committee monitors the Company s financial condition, oversees the sources and uses of cash flow and the investment of certain employee benefit plan assets and advises the Board with respect to financing needs, dividend policy, share repurchase programs and other financial matters. This Committee met four times in 2007. During 2007, the members of the Committee were: Mathis Cabiallavetta (Chair); Harold Brown; Louis C. Camilleri; J. Dudley Fishburn; Robert E. R. Huntley; Thomas W. Jones; Lucio A. Noto; and John S. Reed. The current members of the Committee are: Thomas W. Jones (Chair); Elizabeth E. Bailey; Gerald L. Baliles; Dinyar S. Devitre; Robert E. R. Huntley; and George Muñoz.

The **Nominating, Corporate Governance and Social Responsibility Committee** consists entirely of non-management directors all of whom the Board has determined are independent within the meaning of the listing standards of the New York Stock Exchange. This Committee has the responsibilities set forth in the Nominating, Corporate Governance and Social Responsibility Committee Charter, which is available on the Company s website at www.altria.com/governance. The Committee identifies individuals qualified to become Board members consistent with the criteria approved by the Board and recommends a slate of nominees for election at each annual meeting of stockholders; makes recommendations to the Board concerning the appropriate size, function, needs and composition of the Board and its committees; advises the Board on corporate governance matters, including developing and recommending to the Board the Company s corporate governance principles; oversees the self-evaluation process of the Board and its committees; and provides oversight of the Company s public affairs, corporate reputation and societal alignment strategies. This Committee met four times in 2007. During 2007, the members of the Committee were: Stephen M. Wolf (Chair); Elizabeth E. Bailey; J. Dudley Fishburn; Thomas W. Jones; and John S. Reed. The current members of the Committee are: Elizabeth E. Bailey (Chair); Gerald L. Baliles; Thomas F. Farrell II; Robert E. R. Huntley; and George Muñoz. See page 9 for a description of the process the Nominating, Corporate Governance and Social Responsibility Committee follows in nominating directors.

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ELECTION OF DIRECTORS

Process for Nominating Directors

The Nominating, Corporate Governance and Social Responsibility Committee is responsible for identifying and evaluating nominees for director and for recommending to the Board a slate of nominees for election at the Annual Meeting of Stockholders.

In evaluating the suitability of individuals for Board membership, the Committee takes into account many factors, including whether the individual meets requirements for independence; the individual s general understanding of the various disciplines relevant to the success of a large publicly-traded company in today s global business environment; the individual s understanding of the Company s businesses and markets; the individual s professional expertise and educational background; and other factors that promote diversity of views and experience. The Committee evaluates each individual in the context of the Board as a whole, with the objective of recommending a group of directors that can best perpetuate the success of the business and represent stockholder interests through the exercise of sound judgment, using its diversity of experience. In determining whether to recommend a director for re-election, the Committee also considers the director s past attendance at meetings and participation in and contributions to the activities of the Board. The Committee has not established any specific minimum qualification standards for nominees to the Board, although from time to time the Committee may identify certain skills or attributes (e.g., financial experience, global business experience) as being particularly desirable to help meet specific Board needs that have arisen. The Committee does not distinguish between nominees recommended by stockholders and other nominees.

In identifying potential candidates for Board membership, the Committee relies on suggestions and recommendations from the Board, stockholders, management and others. From time to time, the Committee also retains search firms to assist it in identifying potential candidates for director, gathering information about the background and experience of such candidates and acting as an intermediary with such candidates. Stockholders wishing to suggest candidates to the Committee for consideration as directors must submit a written notice to the Corporate Secretary, who will provide it to the Committee. The Company s By-Laws set forth the procedures a stockholder must follow to nominate directors. These procedures are summarized in this proxy statement under the caption 2009 Annual Meeting.

The Nominees

It is proposed that eight directors, six of whom are independent directors, be elected to hold office until the next Annual Meeting of Stockholders and until their successors have been elected. The Nominating, Corporate Governance and Social Responsibility Committee has recommended to the Board, and the Board has approved, the persons named and, unless otherwise marked, a proxy will be voted for such persons. Each of the nominees currently serves as a director and, with the exception of Messrs. Szymanczyk, Baliles, Devitre and Farrell, was elected by the stockholders at the 2007 Annual Meeting. The new nominees were identified and proposed as candidates for service on the Board by the Nominating, Corporate Governance and Social Responsibility Committee.

Independence of Nominees

The Board has determined that each of the following nominees for director is independent in that such nominee has no material relationship with the Company: Elizabeth E. Bailey, Gerald L. Baliles, Thomas F. Farrell II, Robert E. R. Huntley, Thomas W. Jones, and George Muñoz. To assist it in making these determinations, the Board has adopted categorical standards of director independence that are set forth in Annex A to the Corporate Governance Guidelines, which is available on the Company s website at www.altria.com/governance. Each of the above-named nominees qualifies as independent under these standards. In making its affirmative determination that these directors are independent, the

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Nominating, Corporate Governance and Social Responsibility Committee considered the fact that Mr. Farrell and immediate family members (as defined in the Policy on Related Persons Transactions, which is available on the Company s website at www.altria.com/governance) of Ms. Bailey and Mr. Baliles are employed by entities with which the Company or its subsidiaries do business in the ordinary course on terms comparable to those provided to unrelated third parties and that neither Mr. Farrell nor any immediate family member is involved in or directly benefits from such business. The Committee determined that none of these transactions created a direct or indirect material benefit to the directors.

Although it is not anticipated that any of the persons named below will be unable or unwilling to stand for election, a proxy, in the event of such an occurrence, may be voted for a substitute designated by the Board. However, in lieu of designating a substitute, the Board may amend the Company s By-Laws to reduce the number of directors.

Elizabeth E. Bailey John C. Hower Professor of Business and Public Policy, The Wharton School of the University of Pennsylvania, Philadelphia, PA Director since 1989 Age: 69	Dr. Bailey assumed her present position in July 1991, having served from July 1990 to June 1991 as a professor of industrial administration at Carnegie-Mellon University and as a visiting scholar at the Yale School of Organization and Management. From 1983 to 1990, she was Dean of the Graduate School of Industrial Administration of Carnegie-Mellon University. Dr. Bailey serves as a director of Teachers Insurance and Annuity Association and CSX Corporation, and as a trustee of The Brookings Institution and the National Bureau of Economic Research. Dr. Bailey is Chair of the Nominating, Corporate Governance and Social Responsibility Committee and a member of the Audit, Compensation, Executive, and Finance Committees.
Gerald L. Baliles Director, Miller Center of Public Affairs at the University of Virginia, Charlottesville, Virginia Director since 2008 Age: 67	Mr. Baliles is the director of the Miller Center of Public Affairs at the University of Virginia, a leading public policy institution; he has held this position since April 2006. From 1990 to April 2006, he served as a partner in the firm of Hunton & Williams LLP, headquartered in Richmond, Virginia. From 1986 through 1990, Mr. Baliles served as the 65th Governor of the Commonwealth of Virginia. Mr. Baliles serves on the boards of the Norfolk Southern Corporation and the Shenandoah Life Insurance Company, and has served on the boards of the Greater Richmond World Affairs Council, the Greater Richmond Transportation Advocacy Board, and the Richmond Symphony Council. Mr. Baliles is a member of the Compensation, Finance and Nominating, Corporate Governance and Social Responsibility Committees.

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Dinyar S. Devitre Retired Senior Vice President and Chief Financial Officer, Altria Group, Inc., New York, NY Director since 2008 Age: 61	Mr. Devitre retired from his position as Senior Vice President and Chief Financial Officer of Altria Group, Inc. in March 2008. Prior to Mr. Devitre s appointment to this position in April 2002, he held a number of senior management positions with the Company. He is a director of Western Union Company, SAB Miller plc and a Trustee of the Lincoln Center Inc., the Asia Society and the Brooklyn Academy of Music. Mr. Devitre is a member of the Finance Committee.
Thomas F. Farrell II Chairman, President and Chief Executive Officer, Dominion Resources, Inc., Richmond, VA Director since 2008 Age: 53	Mr. Farrell is the Chairman, President and Chief Executive Officer of Dominion Resources, Inc., one of the nation s largest producers of energy. He became President and Chief Executive Officer of Dominion effective January 1, 2006; he was elected Chairman in April 2007. From January 1, 2004 through December 31, 2006, he served as President and Chief Operating Officer of Dominion Resources, Inc. and prior to that as Executive Vice President. He is Chairman of the Board and Chief Executive Officer of Virginia Electric and Power Company and Chairman, President and Chief Executive Officer of CNG, both wholly-owned subsidiaries of Dominion. He is also a director of the Institute of Nuclear Power Operations (INPO). Mr. Farrell is a member of the Audit, Compensation and Nominating, Corporate Governance and Social Responsibility Committees.
Robert E. R. Huntley Retired lawyer, educator and businessman Director since 1976 Age: 78	Mr. Huntley retired as counsel to the law firm of Hunton & Williams LLP in December 1995, a position he had held since December 1988. Previously, Mr. Huntley had served as Chairman, President and Chief Executive Officer of Best Products Co., Inc., Professor of Law at Washington and Lee School of Law and President of Washington and Lee University. He is the Presiding Director, Chair of the Compensation Committee, and a member of the Audit, Executive, Finance and Nominating, Corporate Governance and Social Responsibility Committees.

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Thomas W. Jones Senior Partner, TWJ Capital LLC, Stamford, CT Director since 2002 Age: 58	Mr. Jones assumed his position as Senior Partner of TWJ Capital LLC, an investment company, in May 2005. From August 1999 to October 2004, he held the position of Chairman and Chief Executive Officer of Global Investment Management with Citigroup Inc. He joined Travelers Group as Vice Chairman in 1997 and served as Chairman and Chief Executive Officer of Smith Barney Asset Management until August 1999. Prior to joining Travelers Group, Mr. Jones served as Vice Chairman of TIAA-CREF, the largest pension system in the United States, from 1993 to 1997. Mr. Jones currently serves as a director of the following privately held companies: Game Trust, Kool Span, Inc., and Floor and Décor Outlets of America. He is also a trustee emeritus of Cornell University. Mr. Jones is Chair of the Finance Committee and a member of the Audit, Compensation and Executive Committees.
George Muñoz Principal, Muñoz Investment Banking Group, LLC, Washington, DC Partner, Tobin, Petkus & Muñoz, Chicago, IL Director since 2004 Age: 56	Mr. Muñoz is a principal of the Washington, D.C.-based firm of Muñoz Investment Banking Group, LLC. He is also a partner in the Chicago-based law firm of Tobin, Petkus & Muñoz. He served as President and Chief Executive Officer of the Overseas Private Investment Corporation from 1997 to January 2001. From 1993 to 1997, Mr. Muñoz was Chief Financial Officer and Assistant Secretary of the United States Treasury Department. He is a member of the Board of Directors of Marriott International, Inc., and Anixter International, Inc. He also serves on the Board of Trustees of the National Geographic Society. Mr. Muñoz is Chair of the Audit Committee and a member of the Nominating, Corporate Governance and Social Responsibility, Executive and Finance Committees.

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Michael E. Szymanczyk Chairman and Chief Executive Officer Altria Group, Inc., Richmond, VA Chairman, President and Chief Executive Officer Philip Morris USA, Richmond, VA Director since 2008 Age: 59	Mr. Szymanczyk was appointed Chairman and Chief Executive Officer of Altria Group, Inc. in March 2008. He is also Chairman, President and Chief Executive Officer of Philip Morris USA, positions he has held since August 2002. He serves on the board of trustees of the Virginia Foundation for Independent Colleges, the University of Richmond, the Virginia Commonwealth University School of Engineering Foundation, the United Negro College Fund and the Richmond Performing Arts Center. Mr. Szymanczyk is Chair of the Executive Committee.

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Compensation of Directors

Directors who are full-time employees of the Company receive no additional compensation for services as a director. With respect to non-employee directors, the Company s philosophy is to provide competitive compensation and benefits necessary to attract and retain high-quality non-employee directors. The Board believes that a substantial portion of director compensation should consist of equity-based compensation to assist in aligning directors interests with the interests of stockholders.

The Nominating, Corporate Governance and Social Responsibility Committee periodically reviews director compensation taking into account the Company s compensation survey group (described below), considers the appropriateness of the form and amount of director compensation and makes recommendations to the Board concerning such compensation with a view toward attracting and retaining qualified directors. Based on the latest available data, total compensation for the Company s non-employee directors ranked within the third quartile (i.e., between the 50th percentile and the 75th percentile) of the Company s Compensation Survey Group.

During 2007, non-employee directors received an annual cash retainer of $40,000 and fees of $2,000 for each Board and Committee meeting attended ($2,500 for committee chairs). Non-employee director committee chairs received annual retainers of $10,000 for additional services rendered in connection with committee chair responsibilities.

Pursuant to the 2005 Stock Compensation Plan for Non-Employee Directors, approved by stockholders at the 2005 Annual Meeting on April 28, 2005, each non-employee director received an annual share award on April 26, 2007 of that number of shares of common stock having an aggregate fair market value of $120,000 on the date of grant (1,715 shares of common stock with a fair market value of $70.01 per share).

The following table presents the compensation received by the non-employee directors for fiscal year 2007.

NON-EMPLOYEE DIRECTOR COMPENSATION TABLE

Name	Fees Earned or Paid in Cash ($)	Stock Awards ($) (1) (2)	Total
Elizabeth E. Bailey	$ 118,524.00	$ 120,000.00	$ 238,524.00
Harold Brown	91,024.00	120,000.00	211,024.00
Mathis Cabiallavetta	87,000.00	120,000.00	207,000.00
J. Dudley Fishburn	105,014.00	120,000.00	225,014.00
Robert E. R. Huntley	109,024.00	120,000.00	229,024.00
Thomas W. Jones	83,002.00	120,000.00	203,002.00
George Muñoz	99,000.00	120,000.00	219,000.00
Lucio A. Noto	117,500.00	120,000.00	237,500.00
John S. Reed	111,024.00	120,000.00	231,024.00
Stephen M. Wolf	123,024.00	120,000.00	243,024.00

(1) Pursuant to the 2005 Stock Compensation Plan for Non-Employee Directors, on April 26, 2007, each non-employee director received 1,715 shares of Common Stock with an aggregate fair market value of $120,000. The fair market value of the shares of $70.01 per share was based on the average of the high and low price of Altria Group, Inc. Common Stock on April 26, 2007. In addition, each director was paid dividends totaling $2,469.60 on this award during 2007.

(2) Options were awarded to directors in 2000, 2001 and 2002. No options have been awarded to directors since 2002. As of December 31, 2007, option awards were outstanding for the following directors in the following aggregate amounts: Dr. Bailey, 14,334; Dr. Brown, 14,334; Mr. Fishburn, 4,695; Mr. Huntley, 14,334; Mr. Jones, 2,295; Mr. Reed, 14,334; and Mr. Wolf, 14,334.

A non-employee director may elect to defer the award of shares of common stock, meeting fees and all or part of the annual retainer. Deferred fee amounts are credited to an unfunded account and may be invested in eight investment choices, including an Altria common stock equivalent account. These investment choices parallel the investment options offered to employees under the Altria Group, Inc. Deferred Profit-Sharing Plan and determine the earnings that are credited for bookkeeping purposes to a non-employee director s account. Subject to certain restrictions, a non-employee director is permitted to take cash distributions, in whole or in part, from his or her account either prior to or following termination of service.

Non-employee directors also are covered by business travel and accident insurance, which the Company maintains for their benefit when they travel on Company business, as well as group life insurance.

In February 2008, the Board of Directors approved the following recommendation of the Nominating, Corporate Governance and Social Responsibility Committee with respect to director compensation following the spin-off of Philip Morris International Inc. (PMI):

- $100,000 annual cash retainer;
- $20,000 annual cash retainer for the Presiding Director and the Chairs of the Audit and Compensation Committees;
- $10,000 retainer for Chairs of the Finance and Nominating, Corporate Governance and Social Responsibility Committees;
- $5,000 annual membership fee for each member of each Committee; and
- Increase of the stock award value from $120,000 to $140,000.

The Board also approved the elimination of the $2,000 per meeting fee. Based on the latest available data, when these changes to director compensation are implemented, the total compensation for the Company s non-employee directors will rank within the targeted fourth quartile (i.e., between the 75^{th} percentile and the 100^{th} percentile) of the Company s Compensation Survey Group.

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OWNERSHIP OF EQUITY SECURITIES

The following table shows the number of shares of common stock beneficially owned as of April 1, 2008, by each director, nominee for director, executive officer named in the Summary Compensation Table, our newly elected CFO and the directors and executive officers of the Company as a group. Unless otherwise indicated, each of the named individuals has sole voting and investment power with respect to the shares shown. The beneficial ownership of each director and executive officer is less than 1% of the outstanding shares.

Name	Amount and Nature of Beneficial Ownership (2) (3)
Elizabeth E. Bailey	44,913
Gerald L. Baliles	8
David R. Beran	481,635
André Calantzopoulos	123,658
Louis C. Camilleri	2,595,204
Dinyar S. Devitre	155,411
Thomas F. Farrell II	2,500
Robert E. R. Huntley	48,211
Thomas W. Jones	21,848
George Muñoz	6,672
Steven C. Parrish	1,288,439
Michael E. Szymanczyk	1,221,846
Charles R. Wall	1,374,802
Group (19 persons) (1)	3,395,984

(1) Group consists of Company s directors and officers following the March 28, 2008 spin-off of PMI.

(2) Includes maximum number of shares as to which these individuals can acquire beneficial ownership upon the exercise of stock options that are currently vested or that will vest before June 1, 2008 as follows: Dr. Bailey, 14,334; Mr. Beran, 164,578; Mr. Calantzopoulos, 63,326; Mr. Camilleri, 1,841,540; Mr. Jones, 2,295; Mr. Parrish, 772,635; Mr. Szymanczyk, 710,914; Mr. Wall, 987,539; and group, 1,525,256. Also includes shares of restricted common stock as follows: Mr. Beran, 17,860; Mr. Camilleri, 371,900; Mr. Szymanczyk, 90,650; Mr. Wall, 95,450; and group, 171,970.

(3) Includes shares as to which beneficial ownership is disclaimed by Mr. Parrish, 4,000 (shares held by children). Also includes 401,740 additional shares as to which voting and/or investment power is shared with or controlled by another person and as to which beneficial ownership is not disclaimed, as follows: Mr. Devitre, 50,485 (shares held in GRAT); Mr. Huntley, 3,600 (shares held in joint tenancy); and Mr. Parrish, 347,655 (shares held in family trust). Also includes shares of deferred stock as follows: Dr. Bailey, 14,662; Mr. Beran, 77,298; Mr. Calantzopoulos, 60,332; Mr. Camilleri, 152,527; Mr. Jones, 14,434; Mr. Muñoz, 5,672; Mr. Szymanczyk, 128,102; and Mr. Wall, 33,564; and group, 571,110. Mr. Camilleri s deferred stock total reflects the cancellation of his 2008 Altria deferred stock grant (330,280 shares, which were replaced by a grant of PMI deferred stock) following the March 28, 2008 spin-off of PMI.

In addition to the shares shown in the table above, as of April 1, 2008, those directors who participate in the Company s director deferred fee program had the following Altria share equivalents allocated to their accounts: Dr. Bailey, 19,868; Mr. Huntley, 14,308; and Mr. Muñoz, 2,198. See Compensation of Directors on pages 14 and 15 for a description of the deferred fee program for directors.

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Section 16(a) Beneficial Reporting Compliance

The Company believes that during 2007 all reports for the Company s executive officers and directors that were required to be filed under Section 16 of the Securities Exchange Act of 1934 were filed on a timely basis.

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COMPENSATION COMMITTEE MATTERS

Introduction

The **Compensation Committee** consists entirely of non-management directors all of whom our Board has determined are independent within the meaning of the listing standards of the New York Stock Exchange. Its responsibilities are described below and set forth in the Compensation Committee Charter, which is available on the Company s website at www.altria.com/governance. During 2007, the members of the Committee were: John S. Reed (Chair); Elizabeth E. Bailey; Harold Brown; J. Dudley Fishburn; Robert E. R. Huntley; Lucio A. Noto; and Stephen M. Wolf. The current members of the Committee are: Robert E. R. Huntley (Chair); Elizabeth E. Bailey; Gerald L. Baliles; Thomas F. Farrell II; and Thomas W. Jones.

Compensation Committee Interlocks and Insider Participation

No member of the Compensation Committee at any time during 2007 or at any other time had any relationship with us that would be required to be disclosed as a related person transaction. During 2007, none of our executive officers served on the board of directors or compensation committee of another entity one or more of whose executive officers served as a member of our Board of Directors or its Compensation Committee.

Compensation Committee Procedures

Scope of Authority

The responsibilities of the Compensation Committee are set forth in its charter and include, among other duties, the responsibility to:

- make recommendations to the Board with respect to incentive compensation plans and equity based plans, to administer and make awards under such plans and to review the cumulative effect of its actions;
- review and approve corporate goals and objectives relevant to the compensation of our chief executive officer, to evaluate the performance of our chief executive officer in light of these goals and objectives, and determine and approve the compensation of our chief executive officer based on this evaluation;
- review and approve the compensation of all executive officers;
- monitor compliance by executives with our stock ownership guidelines;

- review and assist with the development of executive succession plans, to evaluate and make recommendations to the Board regarding potential candidates to become chief executive officer, and to evaluate and approve candidates to fill other senior executive positions;

- review and discuss with management our Compensation Discussion and Analysis; and

- produce and approve the Compensation Committee s annual report for inclusion in our annual proxy statement.

In accordance with its charter, the Compensation Committee may delegate its authority to subcommittees or the chair of the Committee when it deems appropriate, unless prohibited by law, regulation or New York Stock Exchange listing standards.

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Processes and Procedures

The Compensation Committee s primary processes and procedures for establishing and overseeing executive compensation are described in the Compensation Discussion and Analysis on pages 21 through 61 of this proxy statement. These processes and procedures include:

Meetings. The Compensation Committee meets several times each year, including six times in 2007. The chair of the Committee, in consultation with the other members, sets meeting agendas. The Compensation Committee reports its actions and recommendations to the Board of Directors.

Role of Consultants. As part of our annual compensation process, we engage Hewitt Associates to conduct a survey of Compensation Survey Group Companies. See below for a description of the companies included in the Compensation Survey Group and the criteria and process for their selection. The survey collects both compensation and benefit data and competitive practices. The data is reviewed by the Committee to help it assess competitive levels of pay and the competitive mix of pay elements. In addition, we engage Towers Perrin to provide competitive compensation and benefit information primarily from public filings, including annual proxy filings, by companies within our Compensation Survey Group. This data, which focuses on chief executive officer pay, is reviewed by the Compensation Committee. Neither Hewitt Associates nor Towers Perrin makes recommendations with respect to decisions to be made by the Compensation Committee nor do they attend Committee meetings.

Role of Executive Officers. Each year, our chief executive officer presents to the Compensation Committee his compensation recommendations for our senior executive officers that report directly to him. The Compensation Committee reviews and discusses these recommendations with our chief executive officer and, exercising its discretion, makes the final decision with respect to the compensation of these individuals. The chief executive officer has no role in setting his own compensation.

Compensation Committee Report for the Year Ended December 31, 2007

To Our Stockholders:

The Compensation Committee has reviewed and discussed the Compensation Discussion and Analysis contained on pages 21 through 61 of this proxy statement with management. Based on its review and discussions with management, the Committee recommended to the Board of Directors that the Compensation Discussion and Analysis be included in this Proxy Statement. During 2007, the members of the Committee were: John S. Reed (Chair); Elizabeth E. Bailey; Harold Brown; J. Dudley Fishburn; Robert E. R. Huntley; Lucio A. Noto; and Stephen M. Wolf.

Compensation Committee:

John S. Reed, Chair

Elizabeth E. Bailey

Harold Brown

J. Dudley Fishburn

Robert E. R. Huntley

Lucio A. Noto

Stephen M. Wolf

The information contained in the report above shall not be deemed to be soliciting material or to be filed with the Securities and Exchange Commission, nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, except to the extent specifically incorporated by reference therein.

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Compensation Discussion and Analysis

Overview

The compensation discussion and analysis below reflects our compensation decisions and philosophies and takes into account the following events.

On March 30, 2007 (the Kraft Distribution Date), Altria distributed all of its remaining interest in Kraft Foods Inc. (Kraft) on a pro-rata basis to Altria s stockholders in a tax-free distribution. The distribution ratio was 0.692024 of a share of Kraft for each share of Altria common stock outstanding as of the record date. On March 28, 2008, (the PMI Distribution Date), Altria distributed 100% of outstanding shares of PMI owned by Altria to its stockholders in a tax-free distribution. Each Altria stockholder received one share of PMI for each share of Altria common stock held as of the record date.

As of March 28, 2008, as a result of the spin-off of PMI, Mr. Michael E. Szymanczyk assumed the role of Chairman and Chief Executive Officer of Altria Group, Inc., succeeding Mr. Louis C. Camilleri who resigned his position on that date to assume that role at PMI. In addition, Mr. Charles R. Wall resigned his position at Altria and assumed the role of Vice Chairman of PMI. Mr. Dinyar S. Devitre retired as an officer of Altria and became a member of our Board of Directors. Mr. Steven C. Parrish retired from Altria. These individuals were Altria s named executive officers in 2007. The information provided below reflects the compensation decisions for fiscal year 2007 and, where appropriate, any material decisions made in 2008. In addition, we also describe the manner in which outstanding equity compensation and certain other compensation elements have been adjusted to reflect the spin-offs of Kraft and PMI and the elements of our executive compensation and benefit programs that have been changed in 2008 in connection with the spin-off of PMI.

Our compensation programs are designed to support our business and financial objectives. The programs are set and periodically reviewed by the Compensation Committee of the Board of Directors. They are intended to achieve a number of objectives, including:

- to support our ability to attract, develop and retain world-class leaders;
- to align the interests of executives and stockholders;
- to reward performance;
- to support business growth, superior financial results, societal alignment and integrity of conduct; and
- to promote internal equity and a disciplined qualitative and quantitative assessment of performance.

These objectives provide the framework for the various components of compensation and benefits, and take into account the specific nature of our business. Each element of compensation is designed to achieve a specific purpose. Together, they form an aggregate package that is intended to be appropriately competitive and to provide the necessary flexibility and incentives to achieve our goals and objectives. The design of the overall package encompasses the following features:

- a mix of fixed and at-risk compensation. The higher the organizational level of the executive, the lower the fixed component of the overall compensation and benefits package;

- a mix of annual and long-term compensation and benefits to appropriately reward the achievement of annual goals and objectives and long-term performance aspirations; and

- a mix of cash and equity compensation that seeks to discourage actions that are solely driven by our stock price at any given time to the detriment of strategic goals, and to minimize the potential dilutive nature of equity compensation on stockholder value.

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In determining the precise levels of each element of compensation as well as the total compensation and benefit package awarded, the Compensation Committee:

- exercises its business judgment and discretion in setting the level of compensation within pre-established ranges;
- reviews actual historical delivery of compensation versus design to ensure that actual compensation is consistent with the intent of the programs; and
- reviews total compensation design to assure that the various ranges remain appropriately competitive and continue to meet the objectives described above.

Our executives are ranked by salary band reflecting the executive s level of responsibility and accountability. We expect to employ 14 senior executives in salary bands A through D.

Compensation and Benefits for 2007

The Compensation Committee establishes and periodically reviews a compensation and benefits mix for each salary band. The compensation and benefits mix for each U.S.-based salary band as of December 31, 2007 was as follows:

2007 Design Mix of Compensation and Benefits

Salary Band	Base Salary	Annual Incentives	Total Long-Term Incentives (1)	Benefits (2)	Perquisites
A (3)	9%	13%	73%	5%	<1%
B	17%	15%	59%	8%	1%
C	20%	16%	54%	9%	1%
D	24%	15%	48%	11%	2%

(1) Annual equity awards and the annual value of Long-Term Performance Incentive awards.

(2) The benefit percentages represent the average annual value of retirement, healthcare, disability and death benefits and are based on the methodology employed by Hewitt Associates in its Total Compensation Measurement Study (described below in Role of Consultants). The actual value for any given year will vary based on, among other things, each employee s age and years of covered service. These benefit percentages are not intended to represent the total value of benefits earned over a career and payable upon retirement.

(3) The mix of compensation and benefits for band A is based on actual equity awards in 2005, 2006 and 2007 for Mr. Camilleri (the only band A executive prior to the spin-off). The Compensation Committee followed a cumulative equity award strategy

and, based on its assessment of Mr. Camilleri s performance and a review of competitive data, has awarded Mr. Camilleri annual stock grants in the range of 100,000 to 200,000 shares. The Compensation Committee may follow a different award strategy for Mr. Szymanczyk and, as a result, his mix of compensation and benefits may be different.

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In 2007, our Chairman and Chief Executive Officer was in salary band A, and our Chief Financial Officer and other named executive officers were in salary band B. The table below compares Altria s mix of compensation and benefits for salary bands A and B with that of the Compensation Survey Group (see discussion of the Compensation Survey Group below):

Altria 2007 Design Mix of Compensation and Benefits

versus the Compensation Survey Group

			Long-Term Incentives			
	Base Salary	**Annual Incentives**	**Incentive Cash Awards**	**Equity Awards**	**Benefits (1)**	**Perquisites**
Salary Band A						
Altria	9%	13%	23%	50%	5%	<1%
Compensation Survey Group (2)	9%	21%	24%	41%	4%	1%
Salary Band B						
Altria	17%	15%	35%	24%	8%	1%
Compensation Survey Group (2)	20%	22%	18%	32%	7%	1%

(1) The benefit percentages represent the average annual value of retirement, healthcare, disability and death benefits and are based on the methodology employed by Hewitt Associates in its Total Compensation Measurement Study (described below in Role of Consultants). The actual value for any given year will vary based on, among other things, each employee s age and years of covered service. These benefit percentages are not intended to represent the total value of benefits earned over a career and payable upon retirement.

(2) 75th percentile of the Compensation Survey Group as shown in 2007 Hewitt Associates Total Compensation Measurement Study.

To maximize alignment with the interests of stockholders, we have provided a greater percentage of total compensation in the form of long-term incentive compensation than do the Compensation Survey Group companies, as follows: salary band A, 73% versus 65% and salary band B, 59% versus 50%.

Elements of Compensation and Benefits for 2007

Our compensation and benefit programs are designed to deliver total compensation upon attainment of targeted goals at levels between the 50th and the 75th percentiles of compensation paid to executives in the Compensation Survey Group, described below. This approach has been critical to attracting and retaining employees and has contributed to low employee turnover across all of our businesses. Actual awards can exceed the 75th percentile when business and individual performance exceed targeted goals.

A description of each element of the compensation and benefit program in 2007 follows.

Base Salary

Several factors are considered when setting base salaries, including each executive s individual performance rating, level of responsibility, prior experience, and the relationship between base salaries paid within our businesses. In addition, as appropriate, the Compensation Committee compares the base salaries paid to our executive officers to the base salaries paid to executive officers holding comparable positions at other companies in the Compensation Survey Group. Numerical weights are not assigned to any factor.

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The base salary ranges for salary band A through salary band D executives who were based, for purposes of pay, in the United States were as follows:

	2007 U.S.-Based Annual Base Salary Ranges		
Salary Band	**Minimum**	**Midpoint**	**Maximum**
A	$ 1,030,000	$ 1,700,000	$ 2,370,000
B	515,000	875,000	1,235,000
C	360,000	565,000	770,000
D	260,000	425,000	590,000

The base salary ranges for executives who were based, for purposes of pay, outside of the United States are determined based on local market competitive practices. Mr. Calantzopoulos, who was in salary band B, was the only named executive officer based outside of the United States in 2007 for purposes of pay, and he is located in Switzerland. The 2007 base salary range for salary band B in Switzerland is below:

	2007 Swiss-Based Annual Base Salary Ranges		
Salary Band	**Minimum**	**Midpoint** [(1)]	**Maximum**
B	CHF 847,800	1,441,200	2,034,600

(1) The midpoints of salary band B is equivalent to $1,202,302 based on the average conversion rate for 2007 of $1=1.1987 CHF. However, as noted above, this salary range is based on local market competitive practices and is not directly comparable to the U.S. dollar salary range used for those executives based for purposes of pay in the United States.

See Compensation and Benefit Changes for 2008 for the base salary ranges in effect for 2008.

Annual Incentives

The Annual Incentive Award program is a cash-based, pay-for-performance plan for management employees worldwide, including our named executive officers. We believe that the use of cash (as opposed to equity) for annual incentives is consistent with competitive practice among companies within the Compensation Survey Group. Each participant has an award target expressed as a percentage of base salary. The target award is paid when both business and individual results are achieved at planned levels of performance. Actual awards paid vary based on an assessment of actual business performance and individual performance.

In December of each year, the Compensation Committee assesses our overall corporate performance, as well as the performance of each of our businesses for that year. Based on its assessment, the Compensation Committee assigns business ratings that are used to determine the size of the incentive award pool. Businesses that perform at planned levels of performance received a rating of 100. The ratings reflecting the business performance assessment can range from 0 to 130. Business ratings determined for 2007 are discussed below under 2007 Executive Compensation Decisions.

Each participant is rated on a five-point scale with only the top three points (Good, Exceeds and Spectacular) generally eligible to receive an annual incentive award. Individuals who achieve their annual objectives receive a rating of Good. To assure a disciplined, fair and equitable assessment of individual performance, general guidelines have been set by the Compensation Committee whereby approximately 50% of the eligible population receives a rating of Good or less, 40% receives a rating of Exceeds and 10% receives a rating of Spectacular.

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Annual incentive target award ranges for salary bands A through D for 2007 were as follows:

2007 Annual Incentive Target Award Ranges (1)

	Award Ranges Associated with Individual Performance					
Band	**Good**		**Exceeds**		**Spectacular**	
A	128%	159%	159%	201%	217%	293%
B	77%	95%	95%	120%	130%	175%
C	68%	85%	85%	108%	117%	158%
D	51%	63%	63%	78%	85%	114%

(1) Annual incentive target award ranges are stated as a percentage of base salary and assume that business results are at planned levels of performance (*i.e.*, at a rating of 100). These are target ranges only. There is no guarantee that any amount will be paid.

Long-Term Incentives

We award long-term incentives to senior executives through a combination of cash-based long-term performance incentive awards and either restricted or deferred stock. The mix of cash-based incentives and equity awards varies based on salary band. Consistent with our compensation objectives, the mix has been intended primarily to focus executives on total stockholder return, or TSR, long-term operational performance and progress against strategic and societal objectives while remaining sensitive to stockholder dilution concerns. We believe that long-term incentives play a key role in attracting and retaining executives. The long-term incentives are based on the performance of Altria Group, Inc. in total as opposed to the performance of each operating company.

2007-2009 Long-Term Performance Incentive Awards. The Long-Term Performance Incentive Plan, or LTIP, for Altria executives in salary bands A through F, including our named executive officers, began its most recent performance cycle on January 1, 2007. Awards under this plan are based primarily on long-term growth in total stockholder return, an assessment of progress against our societal alignment objectives and, to a lesser extent, our strategic performance. We generally use three-year long-term performance cycles that are end-to-end and do not overlap. The three-year cycle is consistent with our planning cycle, and we have determined that utilizing cycles that do not overlap provides clarity for participants and stockholders. Awards are payable to executives in cash and are based on an assessment of overall corporate and individual performance. Each participant has an award target based on their salary band, normally expressed as a percentage of cumulative year-end base salaries over the three-year cycle. At the conclusion of each performance cycle, the Compensation Committee considers our TSR results over this time period and qualitatively assesses our performance against the strategic measures communicated to participants at the commencement of the performance cycle. Based on its assessment, the Compensation Committee assigns a rating used to determine the size of the LTIP award pool. The specific LTIP ratings can range from 0 to 130. As noted below, the 2007-2009 performance cycle was terminated on December 31, 2007. See Compensation and Benefit Changes for 2008 for modifications to the LTIP measures for 2008.

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LTIP award targets established for salary bands A through D for the 2007-2009 performance cycle were as follows:

2007 Long-Term Performance Incentive Award Ranges(1)

	Individual Performance		
Salary Band	**Below**	**Achieves**	**Above**
A	0% 225%	225% 275%	275% +
B	0% 180%	180% 220%	220% +
C	0% 113%	113% 138%	138% +
D	0% 68%	68% 83%	83% +

(1) LTIP award ranges are stated as a percentage of cumulative year-end base salaries over the three-year performance cycle, and assume that results of our businesses are at planned levels of performance reflected by an assigned performance rating of 100. These are target ranges only. There is no guarantee that any award will be granted.

Annual Equity Awards. Equity awards are intended to build stock ownership and enhance the retention and commitment of participants to increasing long-term stockholder value. Since 2003, equity awards have been made in shares of restricted or deferred stock rather than stock options because they:

establish a relationship between our cost and the value ultimately delivered to executives that is both more direct and more visible than is the case with stock options; and

require the use of substantially fewer shares than stock options to deliver equivalent value, resulting in an annual company run rate (number of stock options, restricted and deferred shares granted in the calendar year as a percentage of all shares outstanding) in 2007 of 0.1% and a total 2007 year-end overhang (number of unexercised stock options and unvested deferred stock as a percentage of all shares outstanding) of 1.6%.

Equity award recommendations are approved annually at the Compensation Committee s January meeting, and are granted on the date of approval. The number of shares awarded is based on the fair market value of our stock on the date of grant. The value of shares awarded is based on an evaluation of each participant s performance and potential to advance within the organization.

Equity awards generally vest three or more years after the date of the award, subject to earlier vesting on death, disability or normal retirement. The three-year vesting period provides us with a means of both retaining and motivating executives. Recipients receive cash dividends or dividend equivalents on unvested shares of restricted or deferred stock in order to more fully align the interests of participants with stockholders. Dividends and dividend equivalents paid prior to vesting are ordinary income for individual tax purposes and, for awards granted after 2006, are generally deductible by us.

The annual equity award ranges for salary bands B through D for 2007 were as follows:

2007 Equity Award Ranges

	Individual Performance					
Salary Band	**Good**		**Exceeds**		**Spectacular**	
B	$ 885,000	$1,475,000	$ 1,475,000	$1,843,800	$ 1,843,800	$2,212,500
C	531,000	885,000	885,000	1,106,300	1,106,300	1,327,500
D	303,000	505,000	505,000	631,300	631,300	757,500

The Compensation Committee has exercised discretion in making equity awards for salary band A based on a cumulative equity award strategy and its assessment of competitive data. With respect to Mr. Camilleri, the Compensation Committee reviewed an analysis of various equity award scenarios, reflecting its past practices as well as those of companies within the Compensation Survey Group, in order to establish both an appropriate range of awards as well as an appropriate cumulative equity award size over a ten-year period as chief executive officer. The Compensation Committee also took into account Mr. Camilleri s individual performance. In recent years, the Compensation Committee awarded Mr. Camilleri annual stock grants in the range of 100,000 to 200,000 shares. The Compensation Committee may employ a different award strategy for Mr. Szymanczyk.

In addition, all of our most senior executives are subject to stock ownership guidelines that require them to hold our stock in an amount equal to a multiple of their base salary, as described in Stock Ownership Guidelines and Restriction on Hedging. As of December 31, 2007, all of our named executive officers had satisfied their ownership guidelines.

Stock Options. Consistent with the Compensation Committee s practice of making equity awards in shares of restricted or deferred stock, the Compensation Committee has not made any new stock option grants since 2002. Adjustment of outstanding stock options granted in 2002 and prior years as well as other equity-based awards in connection with the spin-off of PMI are described in Treatment of Compensation and Benefit Programs At Completion of the Spin-Off of PMI.

Retirement Benefits

Almost all of our U.S.-based employees are covered by funded tax-qualified pension and profit-sharing plans. We also maintain supplemental retirement plans and arrangements which compensate employees for the difference between the full pensions or full profit-sharing contributions they would receive under our tax-qualified plans, if those plans were not subject to tax law limitations, and the benefits that in fact can be provided after taking those limits into account. In limited instances, these plans provide additional benefits. See Plans Maintained by Altria below. These arrangements are generally intended to provide our U.S.-based salaried employees with pension benefits, or their equivalent, in an amount equal to 1.75% of the employee s highest average annual compensation (annual salary plus annual incentive) during a period of five consecutive years, minus 0.30% of such compensation up to the applicable Social Security covered compensation amount, times years of credited service (up to a maximum of 35). For an employee who completes 30 years of service, this translates into providing payments equivalent to a pension of approximately 52.5% of five years annual average salary and incentive compensation. For an employee with the maximum credited service of 35 years, this replacement ratio is approximately 61.25%.

After termination of employment, pension benefits can commence at age 55, though generally with a reduction in benefits for commencement before age 65. For employees who work until age 55, the annual reduction factors for early commencement decrease significantly. For employees who retire at or above age 55 with 30 years of service or at or above age 60 with five years of service, there is no reduction for early commencement. The retirement benefits we provide are described in greater detail in the discussions following the Pension Benefits table and the Non-Qualified Deferred Compensation table.

Prior to the spin-off, our employees based outside of the U.S., including Mr. Calantzopoulos, participated in various retirement plans that were substantially similar to the ones described above. Employees located in Switzerland, for example, were generally covered by the Pension Fund of Philip Morris in Switzerland, or the Swiss Pension Fund, a broad-based, contributory, funded pension plan established in accordance with the Swiss Federal Law on Occupational Retirement, Survivors and Disability Pension Plans that provided retirement, death and disability benefits for employees and their

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beneficiaries. Retirement benefits are determined under a formula similar to the formula in Altria s tax-qualified U.S. pension plan. As is the case under our tax-qualified U.S. plans, benefits under the Swiss Pension Fund were subject to tax regulatory limits on the amount of compensation that can be taken into account in determining benefits. Our former employees covered by the Swiss Pension Fund, but whose benefits were affected by these limits, were also covered by additional Swiss plans designed to provide benefits equivalent to the incremental benefits that would be provided if the Swiss Pension Fund were not subject to these limits. Where an employee was also entitled to benefits under a pension plan in another country, benefits were coordinated through offsets in order to assure that the employee received full career benefits while avoiding duplication in benefits.

During 2006, the Compensation Committee decided to limit compensation for purposes of pension determinations for U.S.-based executives in salary bands A and B. This decision limited annual incentive compensation considered for purposes of pension determinations to the lesser of either (i) actual annual incentive or (ii) annual incentive at a business rating of 100 and individual performance rating of Exceeds. This limitation does not apply to any executive who was age 55 or older at December 31, 2006, or to any executive who is not a participant in our U.S.-based pension plan. Mr. Camilleri was the only executive who was subject to this limitation in 2007. Mr. Camilleri was awarded an annual incentive award of $4,750,000 for 2007. Of this amount, $2,887,500, which reflects the above ceiling, was recognized as pensionable earnings for the purposes of his pension calculation.

Perquisites

Any perquisites received by our named executive officers are described in footnotes to the All Other Compensation heading of the Summary Compensation Table. Other than these perquisites, our named executive officers received the same benefits that were provided to our employees generally. For reasons of security and personal safety, we required Messrs. Camilleri and Szymanczyk to use company aircraft for all travel, and we provided Mr. Camilleri with a driver.

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2007 Executive Compensation Decisions

The assessment of the performance of our named executive officers is discussed below. The compensation paid or awarded to our named executive officers under our compensation programs is included in the compensation tables and, in the case of each executive, was within the ranges specified for each element of compensation discussed above.

Base Salary Increases

The Compensation Committee did not increase Mr. Camilleri s base salary in 2007. Mr. Camilleri s base salary was within the 4th quartile of the Compensation Survey Group at approximately the midpoint of his salary range.

The following were the 2007 increases in base salary for our other named executive officers:

Mr. Calantzopoulos: CHF 1,200,000 to CHF 1,250,080, an increase of 4.2%, effective April 1, 2007

Mr. Devitre: $780,000 to $900,000, an increase of 15.4%, effective May 1, 2007

Mr. Parrish: $980,000 to $1,000,000, an increase of 2.0%, effective May 1, 2007

Mr. Szymanczyk: $1,170,000 to $1,200,000, an increase of 2.6%, effective May 1, 2007

Mr. Wall: $1,025,000 to $1,080,000, an increase of 5.4%, effective May 1, 2007

These increases took into account Mr. Camilleri s recommendations, and the factors enumerated in the Overview above, and were part of a merit increase program that applied to all employees. Mr. Devitre s base salary increase also reflected an adjustment to assure both internal and external pay equity.

Annual Incentives

As previously discussed, annual incentive awards are based on a comprehensive assessment of both business and individual performance. Numerical weights and specific objectives are not assigned to the factors used in assessing either individual or business performance. For 2007, the financial performance factors considered by the Compensation Committee included operating company income, discretionary cash flow (defined as net cash provided by operating activities less capital expenditures), net revenue as well as volume and market share. At the corporate level, the performance factors also included net earnings, earnings per share, or EPS, and TSR. The Compensation Committee also evaluated our performance relative to numerous strategic and qualitative factors such as portfolio management, innovation, progress on societal alignment, management of regulatory and legal challenges, compliance and integrity and leadership development.

In 2007, we recorded strong consolidated adjusted earnings growth and took a number of strategic actions to further strengthen our businesses for long-term growth. Operating companies income, net earnings and EPS all exceeded the annual budget. Full-year adjusted diluted EPS from continuing operations rose 8.1% to $4.38 versus $4.05 in 2006. Income growth was predominantly attributable to pricing, currency and overhead cost reductions. TSR at 22.2% exceeded that of the Compensation Survey Group (10.6%), the Altria Peer Group (20.9%) and the S&P 500 (5.5%).

Beyond our financial performance, we took numerous actions to enhance stockholder value and accelerate income growth. These included the spin-off of Kraft in March 2007, the spin-off of PMI in March 2008, the acquisition of John Middleton, Inc., acquisitions in Pakistan and Mexico, the

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implementation of a global cigarette manufacturing reconfiguration plan including the closure of the Cabarrus cigarette manufacturing facility, the sale of the New York headquarters building and the successful launch of several innovative tobacco products in both the smokeless and cigarette categories.

In a year that was marked by a step-up in Master Settlement Agreement payments and an above-trend erosion in cigarette consumption affecting the U.S. domestic market, PM USA achieved a record market share of 50.6%, driven by the continued strong performance of *Marlboro*. Operating companies income increased by 1.9% on an adjusted basis versus 2006, but fell marginally short of the annual budget. PM USA introduced several successful innovative products in both the smoking and smokeless categories. A number of cost reduction initiatives were pursued with vigor and PM USA delivered savings of more than $300 million in 2007, resulting in a unit margin gain of 6%.

PMI also generated strong financial results and contributed significantly to our increase in consolidated adjusted earnings. Adjusted operating companies income rose 12.5% attributable primarily to pricing and favorable currency. Excluding currency and other items that affected comparability, operating companies income rose 6.8%. This performance exceeded the annual budget and was at the high end of the guidance provided to the investment community of like-for-like growth of between 5% and 7%. Market share performance was mixed, with share growth in some markets lagging expectations.

Taking these factors into account, the Compensation Committee assigned the following Annual Incentive ratings for 2007:

Altria Group, Inc.	115
Philip Morris USA	107
Philip Morris International	102

These ratings were used to determine the size of the annual incentive award pool.

Long-Term Performance Incentive Awards

The 2007 to 2009 performance cycle of the long-term incentive plan, or LTIP, is predominantly designed to reward growth in TSR, performance relative to the Altria Peer Group, the Compensation Survey Group and the S&P 500. The secondary measures emphasize progress against societal alignment objectives, and key strategic performance factors such as market share, portfolio management and leadership development. These measures were selected as they are intended to focus executives on achieving results that contribute to continued long-term growth in stockholder value.

As the three-year cycle LTIP began on January 1, 2007, no payments would ordinarily have been made for the 2007 fiscal year. However, as a result of the spin-off of PMI, the 2007-2009 LTIP was terminated on December 31, 2007 and participants received a cash payment for the 2007 plan year assuming individual performance of Achieves using base salaries in effect on December 31, 2007 and an LTIP business rating of 115. The Compensation Committee awarded an LTIP business rating of 115 as a result of our strong stockholder return as noted above and the attainment of secondary long-term objectives described above. 2007 marked the sixth consecutive year of strong TSR.

Compensation of the Chairman and Chief Executive Officer

Louis C. Camilleri: Mr. Camilleri s awards for 2007 reflected his responsibility for and major contribution to our overall results, including a marked increase in stockholder value. In determining his awards, the Compensation Committee also took into consideration Mr. Camilleri s leadership role in the

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restructuring of Altria, the sustained positive evolution of the litigation environment, progress on societal alignment initiatives, product innovation, our solid financial results including the strength of our balance sheet, leadership development and progress against our longer term plan.

For 2007, Mr. Camilleri was awarded an annual incentive of $4,750,000, or 271% of his annual base salary. This award is at the high end of his award range reflecting the Compensation Committee s assessment of his performance. In addition, he received an LTIP award of $5,031,250 reflecting his target award at the LTIP business rating of 115. Mr. Camilleri also received an annual equity award of 130,280 shares of deferred stock.

In addition, the Compensation Committee awarded Mr. Camilleri a special deferred stock award of 200,000 shares in recognition of his successful efforts during his tenure as our Chief Executive Officer to execute against the strategy, first announced in 2004, to separate Altria into three component parts to significantly enhance stockholder value and growth. This award further recognized that the Compensation Committee and the Board of Directors asked Mr. Camilleri to assume the role of Chairman and Chief Executive Officer of PMI, while accepting a reduction in his compensation at PMI. On January 30, 2008, the Compensation Committee decreased Mr. Camilleri s base salary from $1,750,000 to $1,500,000 effective upon his transfer to PMI.

Compensation of Other Named Executives Officers

André Calantzopoulos. Mr. Calantzopoulos served as President and Chief Executive Officer of PMI and, following the PMI spin-off, now serves as Chief Operating Officer of PMI. Mr. Calantzopoulos s 2007 awards were all within pre-established ranges and reflected his significant contributions to PMI s strong operating results and strategic initiatives. Particularly noteworthy were Mr. Calantzopoulos s contributions to PMI s product innovation strategy including the launch of *Marlboro Filter Plus, Marlboro Ice Mint* and other menthol line extensions, *Parliament Platinum* and *Virginia Slims Uno,* his relentless pursuit of cost reduction opportunities that exceeded PMI s productivity targets and contributed to PMI s strong financial results, management development, societal alignment, 2007 acquisitions and business development initiatives. His awards also reflected his instrumental role in restructuring PMI to accelerate decision-making and speed-to-market and recognized his critical role in developing PMI s strategic partnership with the China National Tobacco Company.

Dinyar S. Devitre. Mr. Devitre served as our Senior Vice President and Chief Financial Officer. He elected to retire upon completion of the PMI spin-off, after more than 33 years of exemplary service to our company and its subsidiaries, and now serves on our Board of Directors. Mr. Devitre s awards for 2007 reflected his contributions to our overall financial results, our strategic initiatives and shareholder value performance. These notably included the strong results achieved by Philip Morris Capital Corporation, his significant contributions to the Kraft spin-off and reaching executional readiness for the PMI spin-off, effective tax planning and a strong internal control environment, as well as the effective management of our strong balance sheet. Furthermore, the awards were granted in recognition of his key role in assuring clear, effective and comprehensive communications of our strategies and results to the investment community.

Steven C. Parrish. Mr. Parrish served as our Senior Vice President, Corporate Affairs. He elected to retire upon the completion of the PMI spin-off, after an exemplary and successful 18 year career with us and our subsidiaries. Mr. Parrish s awards for 2007 reflected his contributions to our comprehensive societal alignment initiatives, his leadership role in pursuing strong and fair worldwide regulation of tobacco and numerous successful initiatives on the legislative and regulatory front, including fair and equitable excise tax reform. They also recognized his role in ensuring a flawless transition of his responsibilities to his functional successors at both Altria and PMI.

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Michael E. Szymanczyk. Mr. Szymanczyk served as Chairman and Chief Executive Officer of Philip Morris USA Inc., and began serving as our Chairman and Chief Executive Officer on March 28, 2008, the date of the spin-off of PMI. Mr. Szymanczyk s 2007 awards recognize his successful leadership of PM USA and his significant contribution to its overall results, including a relentless pursuit of several major cost reduction initiatives, the successful launch of *Marlboro Smooth* and *Marlboro Virginia Blend,* as well as the introduction of *Marlboro Snus* and *Marlboro Moist Smokeless Tobacco* in furtherance of PM USA s adjacency strategy. The awards also recognize the instrumental role that Mr. Szymanczyk personally played in the acquisition of John Middleton, Inc. and his significant contributions to reaching executional and organizational readiness for the corporate restructuring.

Charles R. Wall. Mr. Wall served as our Senior Vice President and General Counsel and, following the spin-off, assumed the position of Vice Chairman of PMI. His 2007 awards, which were all within pre-established ranges, recognized his invaluable contributions to total stockholder value through the critical role he played in successfully managing the complex litigation challenges faced by us and our subsidiaries. They also reflected his role in assuring the successful execution of the Kraft and PMI spin-offs.

Role of Altria s Chief Executive Officer

Each year, Mr. Camilleri, as our Chairman and Chief Executive Officer, presented to the Compensation Committee compensation recommendations for each of our executive officers. The Compensation Committee reviewed and discussed these recommendations with him, taking into account the factors noted elsewhere in this discussion and, exercising its discretion, made final compensation decisions with respect to the compensation of those executive officers. Mr. Camilleri did not make recommendations or otherwise have any role in the setting of his own compensation and has never attended the Compensation Committee meetings when his compensation was discussed. The Compensation Committee met in executive session when discussing and deciding on Mr. Camilleri s compensation. We anticipate that Mr. Szymanczyk will have a similar role.

Altria Compensation Survey Group for 2007

Management periodically reviews and presents to the Compensation Committee its recommendations of companies to include in the Compensation Survey Group. For 2007, companies were selected based on the following criteria:

- are of a similar size and have executive positions similar in breadth, complexity and scope of responsibility;
- have global businesses; and
- compete with us for executive talent.

For 2007, the following 22 companies were selected by the Compensation Committee and included in the Compensation Survey Group, based upon the above criteria: 3M Company, Anheuser-Busch Companies, Inc., Bristol-Myers Squibb Company, Campbell Soup Company, Citigroup Inc., The Coca-Cola Company, Colgate-Palmolive Company, ConAgra Foods, Inc., Exxon Mobil Corporation, Ford Motor Company, General Electric Company, General Mills, Inc., General Motors Corporation, H.J. Heinz Company, International Business Machines Corporation, Johnson & Johnson, Kellogg Company, Merck & Co., Inc., PepsiCo, Inc., Pfizer Inc., The Procter & Gamble Company and Reynolds American Inc. See Our New Compensation Survey Group below for the

Compensation Survey Group that is in effect following the spin-off of PMI.

While there is substantial overlap between these companies and the companies in the Altria Peer Group included in Altria s Annual Report, there are some differences. These differences result from the

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fact that the Compensation Survey Group has been designed primarily to include companies with whom we competed for executive talent and whose approach to compensation did not differ greatly from those of U.S.-based multinationals, while the Altria Peer Group was a broader group that included our international business competitors. The companies in the Altria Peer Group in 2007 were Anheuser-Busch Companies, Inc., British American Tobacco plc, Campbell Soup Company, The Coca-Cola Company, ConAgra Foods, Inc., General Mills, Inc., H.J. Heinz Company, The Hershey Company, Kellogg Company, Nestlé S.A., PepsiCo, Inc., The Procter & Gamble Company, Reynolds American Inc., Sara Lee Corporation, Unilever N.V. and UST Inc.

Role of Consultants

As part of the Compensation Committee s review of the compensation of executive officers, we engage Hewitt Associates to conduct a survey of the companies within the Compensation Survey Group. This survey, called the Total Compensation Measurement Study, collects both compensation and benefits data and summarizes competitive practices. The data is reviewed by the Compensation Committee to help it assess competitive levels of pay and competitive mix of pay elements. In addition, we engage Towers Perrin to provide competitive compensation and benefit information, primarily from public filings, including annual proxy filings, by companies within the Compensation Survey Group. This data, which focuses on chief executive officer pay, is also reviewed by the Compensation Committee.

Neither Hewitt Associates nor Towers Perrin makes any recommendations with respect to the decisions to be made by the Compensation Committee nor do they attend the Compensation Committee meetings.

Stock Ownership Guidelines and Restriction on Hedging

We have established stock ownership guidelines under which executives are expected to hold common stock in an amount equal to a multiple of their base salary as determined by their position. These guidelines are expressed as a number of shares and a dollar value. Executives multiples can be satisfied by meeting the lesser of the required number of shares or dollar value. The guidelines were based on the applicable multiple of the salary in effect as of the beginning of the year in which the executive became subject to the guidelines and are set at 12 times base salary for the Chief Executive Officer and at 6, 5 and 4 times base salary for salary bands B, C and D executives, respectively. The required number of shares were based on the multiple times salary divided by the value of shares as of that date, and satisfying the required dollar amount is based on the current value of stock owned. For the purpose of these guidelines, stock ownership includes shares over which the executive has direct or indirect ownership or control, including restricted and deferred stock, but does not include unexercised stock options. Executives have been expected to meet their ownership guidelines within five years of becoming subject to the guidelines. As of December 31, 2007, all of our named executive officers had satisfied their ownership guidelines. Our executive officers are not permitted to engage in hedging activities with respect to our stock.

Policy with Respect to Qualifying Compensation for Deductibility

Our ability to deduct compensation paid to individual officers who are covered by Section 162(m) of the Internal Revenue Code is generally limited to $1.0 million annually. However, this limitation does not apply to performance-based compensation, provided certain conditions are satisfied. The annual and long-term performance incentives and the deferred stock that the Compensation Committee awarded to our covered officers in 2007 were subject to, and made in accordance with, performance-based compensation arrangements previously implemented by us. See Compensation and Benefits Changes for 2008 below for the maximum amounts that can be paid to officers covered by the compensation formula under our plans in 2008.

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Annual Incentives

For those executives whose compensation was subject to the deductibility limitations of Section 162(m), annual incentive awards were contingent upon a compensation formula based on adjusted net earnings that was established by the Compensation Committee at the beginning of the year. Under the formula used to establish the award pool, the maximum amount that could be paid to officers covered by the compensation formula as a group was 0.25% of adjusted net earnings. The maximum award for Mr. Camilleri, as our Chief Executive Officer, was equal to one-third of this pool, and the maximum amount that could be paid for each of the remaining officers covered by the compensation formula was equal to one-sixth of the pool. In addition, individual award amounts were limited to the stockholder-approved maximum of $10 million as provided in the 2005 Performance Incentive Plan. These limits established the maximum annual incentive awards that could be paid; the Compensation Committee retained complete discretion to pay any lesser amounts. All annual incentive awards presented in the Summary Compensation Table and related tables were below these limits. Actual awards to officers covered by the compensation formula were based on the Compensation Committee s assessment of individual, overall corporate performance, as well as the performance of our businesses, utilizing the negative discretion permitted by Section 162(m).

Long-Term Performance Incentives

Maximum long-term performance incentive awards payable to the officers covered by Section 162(m) were limited by a formula similar to that previously described for annual incentive awards, based on the achievement of cumulative adjusted net earnings during the period as well as by the limits described in the 2005 Performance Incentive Plan approved by stockholders. Under the formula, maximum award amounts that could be paid to the officers covered by the compensation formula as a group were 0.25% of the three-year cumulative adjusted net earnings. The maximum award for Mr. Camilleri, as our Chief Executive Officer, was equal to one-third of this pool, and the maximum amount that could be paid for each of the remaining officers covered by the compensation formula was equal to one-sixth of the pool. In addition, individual awards for the three-year period were limited to the stockholder-approved maximum of $8 million per year as provided in the 2005 Performance Incentive Plan. These limits establish the maximum long-term incentive awards that could be paid; the Compensation Committee retained complete discretion to pay any lesser amounts. We based actual awards paid to our officers on the Compensation Committee s assessment of overall corporate performance, utilizing the negative discretion permitted by Section 162(m).

Annual Equity Awards

Coincident with the adoption of Financial Accounting Standards No. 123(R) Share-Based Payments, or FAS 123R, the Compensation Committee approved the use of a performance pool from which restricted or deferred stock awards may be granted, in amounts up to individually specified proportions of the pool, to those executives whose compensation is subject to the deductibility limitations of Section 162(m). Pursuant to this approval, 2007 and 2008 equity award grants were contingent upon formulas based on adjusted net earnings established by the Compensation Committee at the beginning of 2006 and 2007. The specific limits, as in effect for those years, are as follows:

Each year, a maximum grant value was established based on a performance pool equal to 0.50 percent of adjusted net earnings. This formula was approved by the Compensation Committee at the beginning of the year prior to the year in which the equity award was made; for example, the formula was approved in January 2007 for the equity awards that were granted in January 2008.

At the conclusion of the performance year, the performance pool was calculated and divided among the officers covered by the compensation formula. As an example, for adjusted net earnings of $9.6 billion, the above formula would yield total potential awards of $48 million. Our Chairman and Chief Executive Officer s maximum award would be equal to one-third (or $16 million) of the pool and the remaining officers covered by the compensation formula would each be eligible for a maximum award equal to one-sixth (or $8 million) of the pool. Each award is subject to the lesser of the results of this calculation or the maximum share award (1.0 million shares) as provided under the 2005 Performance Incentive Plan approved by stockholders.

These limits established the maximum awards that could be granted; the Compensation Committee has retained complete discretion to pay any lesser amounts. The awards made to our named executive officers for the periods covered in the Summary Compensation Table and related tables were well within these limits. Awards have been granted out of the share pool and accounted for as fixed awards over the restriction period.

We have taken appropriate actions, to the extent feasible, to preserve the deductibility of annual and long-term incentives and equity awards. However, notwithstanding this general policy, the Compensation Committee has authorized, and continues to retain the discretion to authorize, other payments that may not be deductible, if it believes that they are in both our best interests and those of our stockholders. Such determinations include, for example, payment of base salaries to some officers that exceed $1.0 million, with the result that a portion of such officers base salaries exceed the deductibility limit. In addition, our covered officers compensation has exceeded the $1.0 million deductibility limit because of other elements of their annual compensation, such as vesting of restricted or deferred stock granted before 2007 and dividends or dividend equivalents paid on certain restricted or deferred stock, payments related to the funding of retirement benefits or Target Payments (as defined below) made in lieu of coverage under retirement plans, tax reimbursements, income resulting from payments made pursuant to plans that do not discriminate in favor of executive officers, and perquisites.

Policy Regarding the Adjustment or Recovery of Compensation

We have adopted a policy providing for the adjustment or recovery of compensation in certain circumstances. If the Board of Directors or an appropriate Committee of the Board determines that, as a result of a restatement of our financial statements, an executive has received more compensation than would have been paid absent the incorrect financial statements, the Board or its Committee, in its discretion, shall take such action as it deems necessary or appropriate to address the events that gave rise to the restatement and to prevent its recurrence. Such action may include, to the extent permitted by applicable law, in appropriate cases, requiring partial or full reimbursement of any bonus or other incentive compensation paid to the executive, causing the partial or full cancellation of restricted stock or deferred stock awards and outstanding stock options, adjusting the future compensation of such executive, and dismissing or taking legal action against the executive, in each case as the Board or its Committee determines to be in the best interests of us and our stockholders. The Board has designated the Compensation Committee to implement this policy.

Treatment of Compensation and Benefit Programs At Completion of the Spin-Off of PMI

At completion of the spin-off of PMI, we entered into an Employee Matters Agreement with PMI addressing a number of compensation and benefits matters relating to our and PMI s employees. In general, prior to the spin-off, PMI s U.S.-based employees participated in our retirement, health and welfare, and other employee benefit plans. Employees in other jurisdictions were covered by plans that PMI maintained either independently or jointly with us. Following the spin-off, PMI s U.S.-based employees generally participate in similar plans and arrangements that PMI has established and will maintain. Generally, liabilities for benefits under our retirement plans in which PMI employees participated were assumed by PMI, to the extent such benefits were not already liabilities of PMI. Effective as of the date of the spin-off, we and PMI each retain responsibility for our respective employees and compensation plans. In addition, pursuant to the Employee Matters Agreement, we

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and PMI generally protect employees transferring between us and PMI before the end of 2008 from any adverse economic impact of such transfer on their benefits.

Following the spin-off, the holder of each outstanding option to purchase our stock received the following stock options with an aggregate intrinsic value (the difference between the exercise price of the options and the fair market value of the underlying stock) equal to the intrinsic value of the stock option immediately prior to the spin-off:

- a new PMI stock option (issued by PMI) to acquire a number of shares of PMI common stock; and
- an adjusted Altria stock option (issued by us) for the same number of shares of Altria common stock at a reduced exercise price.

Holders of our restricted or deferred stock awarded prior to January 30, 2008 retained their existing awards and received an equal amount of PMI restricted or deferred stock. The PMI restricted or deferred stock received in the spin-off is subject to the same forfeiture conditions and terms and conditions as the underlying Altria restricted or deferred stock. Recipients of our deferred stock awarded on January 30, 2008, who continue to be employed by us after the spin-off, received additional shares of our deferred stock to preserve the value of their award. Recipients of our deferred stock awarded on January 30, 2008, who were employed by PMI after the spin-off, received substitute shares of PMI deferred stock to preserve the value of their award.

We and PMI cross-reimbursed each other following the PMI spin-off for the fair value of options issued to employees of the other party, for the expected value of deferred stock granted to employees of the other party, and for certain other anticipated costs related to equity compensation as well as retirement plans and payments in lieu of retirement plan coverage. Fair value with regard to stock options was determined using Black-Scholes calculations.

Treatment of Compensation and Benefit Programs At Completion of the Spin-Off of Kraft

At the completion of the spin-off of Kraft, we and Kraft entered into an Employee Matters Agreement, pursuant to which, each retained responsibility for our respective employees and compensation plans.

As of the date of the spin-off, the holder of each outstanding option to purchase our stock received the following stock options with an aggregate intrinsic value (the difference between the exercise price of the options and the fair market value of the underlying stock) equal to the intrinsic value of the original stock option:

- a new Kraft stock option (issued by Kraft under its plan) to acquire a number of shares of Kraft Class A common stock based on the spin-off ratio; and
- an adjusted Altria stock option (issued by Altria) for the same number of shares of Altria common stock at a reduced exercise price.

The exercise price for the new Kraft option and the adjusted Altria option was determined based on the closing market prices of Altria and Kraft on the Kraft Distribution Date. We and Kraft cross-reimbursed each other following the spin-off for the fair value of options issued to employees of the other party. Fair value was determined using Black-Scholes calculations.

Altria employees who held our restricted or deferred stock awarded prior to January 31, 2007 received restricted or deferred shares of Kraft Class A common stock in accordance with the spin-off ratio. The Kraft shares distributed were subject to the same terms and restrictions as the underlying Altria restricted or deferred stock. Any such Kraft shares that were subsequently forfeited by holders of restricted stock were returned to Kraft. Accordingly, shortly after the spin-off, Kraft made a one-time payment to us based on the present rate of anticipated forfeitures. As with stock options, we and Kraft cross-reimbursed each other for the estimated value of deferred stock and certain other securities

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issued or to be issued to employees of the other party. Each holder of deferred stock awarded on January 31, 2007 received additional shares of Altria deferred stock based on the ratio of the pre-adjustment fair market value of Altria stock to the post-adjustment fair market value of Altria stock on the Kraft Distribution Date. Any Kraft employees who held Altria deferred stock awarded on January 31, 2007 received deferred shares of Kraft Class A common stock in accordance with the spin-off ratio.

Our New Compensation Survey Group

In connection with the spin-off of PMI and the resulting decrease in the size and scope of our business, a review was conducted with the assistance of Hewitt Associates and Towers Perrin to determine an appropriate Compensation Survey Group for us. The review focused on companies that compete with us for talent and:

- are direct competitors; or
- have similar market capitalization; or
- are primarily focused on consumer products (excluding high technology and financial services); and
- have business generally focused within the U.S.

Using these characteristics as our guide, the Compensation Committee has selected the following 19 companies as our new Compensation Survey Group following the spin-off:

3M Company, Abbott Laboratories, Anheuser-Busch Companies, Inc., Bristol-Myers Squibb Company, Colgate-Palmolive Company, ConAgra Foods, Inc., Eli Lilly and Company, Fortune Brands, Inc., General Mills, Inc., The Hershey Company, Kellogg Company, Kimberley-Clark Corporation, Kraft Foods Inc., Loews Corporation, McDonald s Corporation, Merck & Co., Inc., Reynolds American Inc., Sara Lee Corporation and UST Inc.

This survey group is comprised of companies that are based in the U.S. and, as a group, have median revenue that is 30% smaller than our previous Compensation Survey Group. As a result, we expect that the data we use to review our programs better reflects our size and scope after the spin-off of PMI.

Compensation and Benefit Changes for 2008

Taking into account our compensation objectives described above, our performance metrics and our new Compensation Survey Group, we have established the following salary ranges for 2008 for our band B through D executives which are lower than the 2007 salary ranges (we no longer have any Swiss-based executives following the spin-off of PMI):

	2008 Annual Base Salary Ranges		
Salary Band(1)	Minimum	Midpoint	Maximum
B	$ 480,000	$ 790,000	$ 1,100,000
C	325,000	532,500	740,000
D	250,000	407,500	565,000

(1) A new salary range has not been established for salary band A.

Annual incentive, equity and long-term incentive target award ranges have not been modified for 2008. The LTIP will continue to include TSR performance versus the Compensation Survey Group, Altria Peer Group and the S&P 500 as a key measure. However, the measures will be expanded to include diluted EPS relative to the Compensation Survey Group, Altria Peer Group and the S&P 500 and multi-year strategic objectives that we believe will contribute to TSR. This change in measures will ensure that the compensation of our senior executives is fully aligned with our most critical business objectives.

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The resulting design mix of pay of compensation and benefits relative to the Compensation Survey Group for salary bands B through D is as follows:

Altria 2008 Design Mix of Compensation and Benefits versus the Compensation Survey Group

			Long-Term Incentives			
	Base Salary	**Annual Incentives**	**Incentive Cash Awards**	**Equity Awards**	**Benefits [1]**	**Perquisites**
Salary Band B						
Altria	19%	17%	25%	31%	8%	<1%
Compensation Survey Group [2]	21%	26%	12%	31%	9%	1%
Salary Band C						
Altria	21%	17%	17%	31%	13%	1%
Compensation Survey Group [2]	34%	21%	10%	23%	11%	1%
Salary Band D						
Altria	26%	16%	12%	29%	15%	2%
Compensation Survey Group [2]	34%	21%	8%	22%	13%	2%

(1) The benefit percentages represent the average annual value of retirement, healthcare, disability and death benefits and are based on the methodology employed by Hewitt Associates in its Total Compensation Measurement Study. The actual value for any given year will vary based on, among other things, each employee s age and years of covered service. These benefit percentages are not intended to represent the total value of benefits earned over a career and payable upon retirement.

(2) 75th percentile of the Compensation Survey Group as provided by Hewitt Associates.

To maximize alignment with the interests of stockholders, we generally provide a greater percentage of total compensation in the form of long-term incentive compensation than do the new Compensation Survey Group companies, as follows: salary band B, 56% versus 43%; salary band C, 48% versus 33% and salary band D, 41% versus 30%.

The Compensation Committee has not established a target equity award for Mr. Szymanczyk; consequently no design mix is shown for salary band A.

In addition, the compensation formula established by the Compensation Committee to determine the award pool used to establish the maximum amount that could be paid to officers under Section 162(m) has been modified as a result of the spin-off and the resulting reduction in adjusted net earnings for 2008. The percentages of adjusted net earnings used for the annual incentive, long-term incentive and annual equity award programs have been increased to 0.7%, 0.5% and 1.0% of adjusted net earnings, respectively. Otherwise, the formula is unchanged.

Finally, the Compensation Committee has limited retirement benefits for Mr. Szymanczyk beginning in 2008. The present value of Mr. Szymanczyk s pension, calculated as if he had continued to participate in the Benefit Equalization Plan, or BEP, and the

Supplemental Management Employee s Retirement Plan, or SERP, cannot exceed $30,000,000.

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Summary Compensation Table

The following table sets forth information concerning the cash and non-cash compensation awarded to our named executive officers for 2007 and 2006. The compensation of Mr. Calantzopoulos is not shown as of December 31, 2006 because he was not a named executive officer for that year.

Summary Compensation Table

Name and Principal Position	Year	Salary (1)	Stock Awards (2)	Option Awards (2)	Non-Equity Incentive Plans: Annual Incentive Plan	Non-Equity Incentive Plans: Long-Term Incentive Plan (3)	Change in Pension Value (4)	All Other Compen-sation(5)	Total Compen-sation
		$	$	$	$	$	$	$	$
Louis C. Camilleri,	2007	1,750,000	10,226,119		4,750,000	5,031,250	1,818,775	469,165	24,045,309
Chairman of the Board and Chief Executive Officer, Altria Group, Inc.	2006	1,750,000	9,291,095		4,500,000	15,000,000	3,041,262	409,987	33,992,344
André Calantzopoulos,	2007	1,035,867	2,064,864		1,354,810	2,554,150	0	30,026	7,039,717
President and Chief Executive Officer, Philip Morris International, Inc.									
Dinyar S. Devitre,	2007	858,000	1,957,192		1,200,000	2,070,000	1,603,215	262,403	7,950,810
Senior Vice President and Chief Financial Officer, Altria Group, Inc.	2006	769,615	1,840,962		1,050,000	5,175,000	2,408,087	150,312	11,393,976
Steven C. Parrish,	2007	993,000	2,148,957	4,899,052	1,250,000	2,300,000	958,679	245,310	12,794,998
Senior Vice President, Corporate Affairs, Altria Group, Inc.	2006	969,615	2,172,958		1,250,000	6,520,000	943,715	191,440	12,047,728
Michael E. Szymanczyk,	2007	1,190,000	2,439,914	976,726	2,150,000	2,760,000	2,272,209	716,367	12,505,216
Chairman and Chief Executive Officer, Philip Morris USA, Inc.	2006	1,152,000	2,404,649	3,672,254	2,000,000	7,675,000	3,597,500	529,478	21,030,881
Charles R. Wall,	2007	1,060,750	2,458,979	446,456	2,100,000	2,484,000	1,332,895	263,260	10,146,340
Senior Vice President and General Counsel, Altria Group, Inc.	2006	1,010,808	2,415,375	2,232,281	2,000,000	7,400,000	1,862,371	196,720	17,117,555

(1) Base salaries earned in Swiss francs are converted to U.S. dollars using the average conversion rate for 2007 of $1.00 = 1.1987 CHF. Annual and long-term incentive awards are converted to U.S. dollars using the exchange rate on December 31, 2007 of $1.00 = 1.1256 CHF. Included in base salary for Mr. Calantzopoulos is a compulsory, annual, service-based payment (maximum CHF 3,000). The Compensation Committee did not increase Mr. Szymanczyk s base salary following the spin-off of PMI.

(2)

The amounts shown in these columns represent the annual expense associated with all unvested restricted and deferred stock and stock option awards based on the FAS 123R valuation methodology used in the preparation of Altria audited financial statements, with the exception that the valuation shown in the Summary Compensation Table assumes no forfeitures. See our 2007 Annual Report, Note 2 Summary of Significant Accounting Polices Stock Based Compensation for a description of this methodology. The number of shares awarded and securities underlying options grants received in 2007 together with their grant date values are disclosed in the Grants of Plan-Based Awards During 2007 Table below.

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(3) For 2007, reflects amounts paid upon termination of the 2007-2009 performance cycle of the LTIP on December 31, 2007 as a result of the spin-off of PMI. See 2007 Executive Compensation Decisions Long-Term Performance Incentive Awards above.

(4) Reflects the change in the present value of benefits under defined benefit plans listed in the Pension Benefits table plus the Target Payments, also reported in that table, made in lieu of accruals under nonqualified defined benefit plans for service during the applicable year. As a result of increases in the discount rates used to value the retirement benefits, the change in value for Mr. Calantzopoulos which appears as $0 in the table is, in fact, a decrease of $387,292. As a result of the spin-off of Kraft, the changes in pension value reported for Messrs. Camilleri and Szymanczyk for 2007 no longer include their benefits in plans maintained by Kraft.

(5) Details of All Other Compensation for each of the named executives appear on the following page.

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All Other Compensation

	Year	Camilleri	Calantzopoulos	Devitre	Parrish	Szymanczyk	Wall
Target Payments in lieu of Defined Contribution Plan Participation [(a)]	2007	$ 228,206		$ 97,819	$ 126,366	$ 153,269	$ 133,938
	2006	$ 234,134		$ 84,096	$ 118,756	$ 143,787	$ 125,052
Allocation to Defined Contribution Plans [(b)]	2007	$ 29,500		$ 33,750	$ 29,500	$ 29,500	$ 29,500
	2006	$ 29,000		$ 33,000	$ 29,000	$ 29,000	$ 29,000
Reimbursement for Taxes on Assets Held for Retirement [(c)]	2007	$ 64,374		$ 96,486	$ 39,460	$ 164,925	$ 81,385
	2006	$ 4,093			$ 2,687		$ 7,457
Personal Use of Company Aircraft [(d)]	2007	$ 94,339				$ 359,579	
	2006	$ 103,521				$ 317,964	
Car Expenses [(e)]	2007	$ 22,825	$ 22,929	$ 24,348	$ 33,236		$ 10,757
	2006	$ 33,778		$ 23,216	$ 28,089	$ 28,727	$ 26,013
Financial Counseling Services	2007		$ 7,097	$ 10,000	$ 10,000		$ 7,680
	2006			$ 10,000	$ 10,000	$ 10,000	$ 9,198
Security [(f)]	2007	$ 29,921			$ 6,748	$ 9,094	
	2006	$ 5,461			$ 2,908		
TOTALS	2007	$ 469,165	$ 30,026	$ 262,403	$ 245,310	$ 716,367	$ 263,260
	2006	$ 409,987		$ 150,312	$ 191,440	$ 529,478	$ 196,720

(a) The amounts shown are Target Payment amounts paid in early 2008 and 2007 in lieu of continued participation during 2007 and 2006, respectively, in our supplemental defined contribution plans.

(b) The amounts shown are for allocations to tax-qualified defined contribution plans.

(c) The amounts shown are reimbursements during 2007 and 2006 for taxes on a portion of prior year earnings on assets held in trusts of individual officers. These assets and payments offset amounts otherwise payable by us or our operating subsidiaries, for vested pre-2005 benefits under supplemental retirement plans and are not intended to increase total promised benefits.

(d) For reasons of security and personal safety, we require Messrs. Camilleri and Szymanczyk to use company aircraft for all travel. The amounts shown are the incremental cost of personal use of company aircraft and include the cost of trip-related crew hotels and meals, in-flight food and beverages, landing and ground handling fees, hourly maintenance contract costs, hangar or aircraft parking costs, fuel costs based on the average annual cost of fuel per hour flown, and other smaller variable costs. Fixed costs that would be incurred in any event to operate company aircraft (e.g., aircraft purchase costs, depreciation, maintenance not related to personal trips, and flight crew salaries) are not included. Executives are responsible for their own taxes on the imputed taxable income resulting from personal use of the company aircraft.

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(e) Amounts shown for Mr. Camilleri include the incremental cost of personal use of a driver that we provided for reasons of security and personal safety. With respect to Messrs. Devitre, Parrish and Wall, amounts include the annual cost of providing a leased vehicle and operating expenses, including insurance, maintenance and repairs. With respect to Mr. Calantzopoulos, amounts include the cost, amortized over a 5-year period, of a vehicle, including insurance, maintenance and repairs and taxes. Executives are responsible for their own taxes on the imputed taxable income resulting from personal use of company car and car expenses.

(f) Includes the costs associated with company-provided home security systems. A new system was installed in Mr. Camilleri s residence in 2007.

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Grants of Plan-Based Awards during 2007

Name and Principal Position	Grant Date	Estimated Possible Payouts Under Non-Equity Annual Incentive Plan (1) Threshold ($)	Target ($)	Maximum ($)	Estimated Possible Payouts Under Non-Equity Long-Term Incentive Plan (1) Threshold ($)	Target ($)	Maximum ($)	All Other Stock Awards: Number of Shares of Stock or Units (#) (2)	Grant Date Fair Value of Stock Awards ($)
Louis C. Camilleri, Chairman of the Board and Chief Executive Officer, Altria Group, Inc.	2007		2,625,000	10,000,000		4,375,000	8,000,000		
	1/31/2007							114,470	10,000,099
André Calantzopoulos, President and Chief Executive Officer, Philip Morris International, Inc.	2007		999,514	10,000,000		2,221,142	8,000,000		
	1/31/2007							24,040	2,100,134
Dinyar S. Devitre, Senior Vice President and Chief Financial Officer, Altria Group, Inc.	2007		810,000	10,000,000		1,800,000	8,000,000		
	1/31/2007							24,040	2,100,134
Steven C. Parrish, Senior Vice President, Corporate Affairs, Altria Group, Inc.	2007		900,000	10,000,000		2,000,000	8,000,000		
	1/31/2007							22,900	2,000,544
Michael E. Szymanczyk, Chairman and Chief Executive Officer, Philip Morris USA Inc.	2007		1,080,000	10,000,000		2,400,000	8,000,000		
	1/31/2007							25,190	2,200,598
Charles R. Wall, Senior Vice President and General Counsel, Altria Group, Inc.	2007		972,000	10,000,000		2,160,000	8,000,000		
	1/31/2007							25,190	2,200,598

(1) The numbers in these columns represent the range of potential awards as of the time of the grant. Actual awards payable under these plans for 2007 are found in the Annual Incentive Plan and Long-Term Incentive Plan columns of the Summary Compensation Table. See the above discussion of annual and long-term incentive plan awards generally and annual and long-term incentive awards made for 2007. The 2007-2009 LTIP performance cycle commenced on January 1, 2007 and, as discussed above, concluded on December 31, 2007.

(2) These Altria deferred stock awards vest on February 12, 2010. Dividend equivalents are payable on a quarterly basis throughout the restriction period. The grant date fair value was determined by using the average of the high and the low trading prices of our stock on the grant date. On January 31, 2007, the average of the high and low trading prices of our stock was $87.36. The grant date closing market price of our stock on that day was $87.39. In addition, on January 30, 2008, each of our named executives received Altria deferred stock awards, with a value at such date as follows: Mr. Camilleri, 330,280 shares, $25,352,293; Mr. Calantzopoulos, 27,360 shares, $2,100,154; Mr. Szymanczyk, 28,670 shares, $2,200,709; and Mr. Wall, 27,360 shares, $2,100,154. Mr. Devitre and Mr. Parrish did not receive a stock award as they retired in connection with the spin-off of PMI. See Treatment of Compensation and Benefit Programs At Completion of the Spin-Off of PMI and Treatment of Compensation and Benefit Programs At Completion of the Spin-Off of Kraft for how each named executive officer s deferred stock award has been adjusted to reflect the spin-off of PMI and Kraft, respectively.

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Outstanding Equity Awards (Altria) as of December 31, 2007

	Option Awards			Stock Awards		
Name and Principal Position	Number of Securities Underlying Unexercised Options (#) Exercisable	Option Exercise Price ($)	Option Expiration Date	Stock Award Grant Date	Number of Shares or Units of Stock That Have Not Vested (#) (1) (2) (3)	Market Value of Shares or Units Of Stock That Have Not Vested ($) (4)
Louis C. Camilleri,	171,100	29.809	6/23/2008	1/31/2007	152,527	11,527,991
Chairman of the Board and	387,500	30.020	6/29/2009	1/25/2006	135,000	10,203,300
Chief Executive Officer,	200,000	16.018	1/26/2010	1/26/2005	125,000	9,447,500
Altria Group, Inc.	253,530	33.303	1/31/2011	1/29/2003	175,000	13,226,500
	229,410	36.804	6/12/2011	6/23/1998	61,900	4,678,402
	300,000	39.498	2/27/2012			
	300,000	48.782	2/27/2012			
André Calantzopoulos,	11,018	39.172	6/23/2008	1/31/2007	32,032	2,420,979
President and Chief Executive Officer,	5,169	39.172	6/29/2009	1/25/2006	28,300	2,138,914
Philip Morris International Inc.	26,383	43.525	1/31/2011	1/26/2005	32,270	2,438,967
	20,756	49.810	6/12/2011			
Dinyar S. Devitre,				1/31/2007	32,032	2,420,979
Senior Vice President and Chief				1/25/2006	26,960	2,037,637
Financial Officer,				1/26/2005	29,040	2,194,843
Altria Group, Inc.						
Steven C. Parrish,	96,973	56.821	6/23/2008	1/31/2007	30,513	2,306,173
Senior Vice President,	77,220	65.180	6/29/2009	1/25/2006	25,610	1,935,604
Corporate Affairs,	139,796	56.821	6/29/2009	1/26/2005	29,040	2,194,843
Altria Group, Inc.	12,117	34.609	1/26/2010	6/23/1998	61,900	4,678,402
	164,909	49.964	1/26/2010			
	32,426	56.821	1/26/2010			
	134,820	65.180	1/31/2011			
	114,374	65.180	6/12/2011			
Michael E. Szymanczyk,	80,671	41.067	6/23/2008	1/31/2007	33,564	2,536,767
Chairman and	39,452	36.860	6/29/2009	1/25/2006	29,650	2,240,947
Chief Executive Officer,	127,543	49.045	6/29/2009	1/26/2005	35,500	2,683,090
Philip Morris USA Inc.	68,337	55.743	6/29/2009	6/23/1998	61,000	4,610,380
	6,757	38.875	1/26/2010			
	23,982	35.772	1/26/2010			
	42,930	40.984	1/26/2010			
	38,373	55.743	1/31/2011			
	138,166	53.300	1/31/2011			
	54,837	53.300	6/12/2011			
	40,844	60.748	6/12/2011			
	49,022	63.837	6/12/2011			
Charles R. Wall,	131,600	29.809	6/23/2008	1/31/2007	33,564	2,536,767
Senior Vice President and	300,000	30.020	6/29/2009	1/25/2006	29,650	2,240,947
General Counsel,	22,939	16.018	1/26/2010	1/26/2005	35,500	2,683,090
Altria Group, Inc.	19,997	34.181	1/26/2010	6/23/1998	65,800	4,973,164
	175,663	60.748	1/26/2010			
	185,920	33.303	1/31/2011			
	151,420	36.804	6/12/2011			

(1) These awards vest according to the following schedule:

Grant Date	Vesting Schedule
1/31/07	100% of award vests on 2/12/10.
1/25/06	100% of award vests on 2/11/09.
1/26/05	100% of award vested on 2/4/08.
1/29/03	100% of award vests on 2/3/11.
6/23/98	100% of award vests on 6/23/08.

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(2) Unlike deferred stock awards granted prior to 2007, deferred stock awards granted on January 31, 2007 to Altria employees were not split into both Altria and Kraft awards. Instead, the number of Altria deferred shares awarded was increased to preserve the intrinsic value of the award as follows: Mr. Camilleri s award increased from 114,470 shares to 152,527 shares; Messrs. Calantzopoulos and Devitre s awards increased from 24,040 shares to 32,032 shares; Mr. Parrish s award increased from 22,900 shares to 30,513 shares and Messrs. Szymanczyk and Wall s awards increased from 25,190 shares to 33,564 shares. See Treatment of Compensation and Benefit Programs At Completion of the Spin-Off of Kraft for how options and stock awards have been adjusted to reflect the spin-off of Kraft.

(3) Dividends and dividend equivalents paid in 2007 on outstanding Altria restricted and deferred stock awards for each of our named executive officers were as follows: Mr. Camilleri, $2,028,553; Mr. Calantzopoulos, $289,712; Mr. Devitre, $270,919; Mr. Parrish, $464,525; Mr. Szymanczyk, $501,224; and Mr. Wall, $516,392.

(4) Based on closing market price of Altria on 12/31/07 of $75.58.

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Outstanding Equity Awards (Kraft) as of December 31, 2007

(Altria equity awards granted before 2007 were split into Altria and Kraft Equity awards on the 2007 spin-off of Kraft by Altria)

	Option Awards			Stock Awards		
Name and Principal Position	**Number of Securities Underlying Unexercised Options (#) Exercisable**	**Option Exercise Price ($)**	**Option Expiration Date**	**Stock Award Grant Date**	**Number of Shares or Units of Stock That Have Not Vested (#) (1)(2)**	**Market Value of Shares or Units of Stock That Have Not Vested ($) (3)**
Louis C. Camilleri,	118,405	14.321	6/23/2008	1/25/2006	93,423	3,048,392
Chairman of the Board and	268,158	14.422	6/29/2009	1/26/2005	86,503	2,822,593
Chief Executive Officer	138,404	7.696	1/26/2010	1/29/2003	121,104	3,951,624
Altria Group, Inc.	175,448	16.000	1/31/2011	6/23/1998	42,836	1,397,739
	158,757	17.681	6/12/2011			
	207,606	18.976	2/27/2012			
	207,606	23.436	2/27/2012			
André Calantzopoulos,	7,624	18.819	6/23/2008	1/25/2006	19,584	639,026
President and Chief Executive Officer,	3,577	18.819	6/29/2009	1/26/2005	22,331	728,661
Philip Morris International Inc.	18,257	20.910	1/31/2011			
	4,940(4)	31.000	6/12/2011			
	14,363	23.930	6/12/2011			
Dinyar S. Devitre,				1/25/2006	18,656	608,745
Senior Vice President and				1/26/2005	20,096	655,732
Chief Financial Officer,						
Altria Group, Inc.						
Steven C. Parrish,	96,741	27.298	6/29/2009	1/25/2006	17,722	578,269
Senior Vice President,	53,435	31.314	6/29/2009	1/26/2005	20,096	655,732
Corporate Affairs,	22,439	27.298	1/26/2010	6/23/1998	42,836	1,397,739
Altria Group, Inc.	114,120	24.004	1/26/2010			
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Substantially all our operating lease obligations are building leases.

Off-Balance Sheet Arrangements

At June 30, 2003, we did not have any relationship with unconsolidated entities or financial partnerships, which other companies have established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes as defined in Item 303(a)(4)(ii) of SEC Regulation S-K. Therefore, we are not materially exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in such relationships.

Business Outlook

Our business outlook has not changed since we completed our Form 10-K for fiscal 2002, filed with the SEC April 16, 2004.

Following the takeover of the Board of Directors of the Company on June 29, 2001, new management of the Company began a thorough review of all aspects of the business operations of the Company and its subsidiaries. Since the takeover, we have engaged in numerous transactions to restructure and refocus our business.

Since the takeover, our primary strategy for business operations has been to restructure our unprofitable businesses, acquire undervalued companies (such as GoVideo) and focus on profitable growth. We aggressively sold, restructured or shutdown our businesses which were either not consistently generating cash from operations or which could have required future significant cash investments to become consistently cashflow positive. As a result of this effort, we currently have one subsidiary with operations (GoVideo) and one subsidiary with no operations (Correlant) but with significant cash and other assets. We seek to identify market opportunities that complement current operations, create and accelerate the growth and success of GoVideo and to implement new business plans to improve the returns on these businesses.

We plan to further improve the efficiencies of our consolidated operations and accelerate growth by utilizing our competitive advantages. We believe our competitive advantages include, but are not limited to, the following:

Significant experience of current management in the consumer electronics and communications industry;

Business opportunities in China and Asia through the strength of our relationships with significant shareholders, including TCL. TCL is an affiliated company of TCL International (HKSE: 1070), a leading multimedia consumer electronics product manufacturer, with a strong brand presence in China and Asia. TCL International s core products include televisions, mobile handsets, personal computers, audio-visual equipment as well as information technology services. Under its highly recognized and well-established TCL brand, it is one of the strongest players in the TV and mobile handset marketplace in China. Headquartered in China, it operates a number of highly efficient manufacturing bases in Asia.

On November 3, 2003, TCL International and Thomson (Euronext Paris: 18453; NYSE: TMS) signed a memorandum of understanding to form a joint venture company named TCL-Thomson Electronics for the development, manufacturing and distribution of television sets and related products and services. The joint venture s operations commenced August 1, 2004. Its objectives are to consolidate its global TV leader position, offer a complete and high-quality product range from basic to high-end innovative products, address all key markets competitively by leveraging an efficient cost structure, and seize development opportunities in the fast-growing Chinese market.

GoVideo brand recognition; and

The ability to increase market share by introducing TCL products into the US using GoVideo s existing distribution channels.

As we look to the future, we are planning for growth in annual revenues as a result of revenues generated from GoVideo. And although consumer electronics historically have slightly lower gross margins than our past gross margins realized from MAC+software and cable modem-related products, we expect gross margin dollars to increase as a result of increased revenue. Our strategy will remain within our core competency of consumer electronics and telecommunications as we attempt to gain strength, momentum and market share in the US and abroad.

Our future results of operations and the other forward-looking statements contained in this filing, including this MD&A, involve a number of risks and uncertainties in particular, the statements regarding plans to cultivate new businesses that complement existing consumer electronics business, revenue and gross margin. In addition to various factors discussed above, a number of other factors could cause actual results to differ materially from our expectations.

Critical Accounting Policies

The discussion and analysis of our financial condition and results of operations are based on the consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the US. The preparation of these financial statements requires estimates and assumptions that affect the reported amounts and disclosures.

We believe the following, among others, to be critical accounting policies. That is, they are both important to the portrayal of our financial condition and results of operations, and they require critical management judgments and estimates about matters that are inherently uncertain. Although we believe our judgments and estimates are appropriate and correct, actual future results may differ from our estimates.

Revenue recognition. We recognize revenue upon passage of title of our product in accordance with SEC Staff Accounting Bulletin 101, *Revenue Recognition in Financial Statements* (SAB 101), as amended by SAB 101A and 101B. At the time revenue is recognized, GoVideo records an allowance for estimated sales returns based on estimates derived from historical trends. Sales returns are recorded with net revenues. GoVideo also establishes an allowance for estimated payment term discounts expected to be taken by customers based on analysis of historical trends. Payment term discounts granted are recorded in other expense.

Warranty Reserves. Go Video provides limited labor and parts warranties on certain of its products for a maximum of one year. Go Video records a warranty reserve based upon historical experience and an estimate of total exposure associated with products sold to consumers through retail outlets. Correlant did not provide a product warranty. The warranty liability for defective cable modems was the responsibility of the third-party manufacturer.

Bad debt reserves. We conduct business and extend credit based on an evaluation of our customers financial condition generally without requiring collateral. Exposure to losses on trade receivables is expected to vary by customer due to the financial condition of each customer. We monitor exposure to credit losses and maintain allowances for anticipated losses considered necessary under the circumstances. Delinquent notes and trade accounts receivable are charged against the allowance for doubtful accounts once uncollectibility has been determined. The allowance is determined through an analysis of the aging of accounts receivable and assessments of risk based on historical trends and an evaluation of the impact of current and projected economic conditions. We evaluate the past-due status of our notes and related parties and trade receivables based on contractual terms of sale. If the financial condition of our customers were to deteriorate, resulting in an impairment of ability to make payments, additional allowances may be required.

Related party transactions. We have significant related party transactions and agreements; many of which are complex. We believe such transactions have been accounted for at fair value. We utilized our best estimate of the value of these transactions and agreements. Had alternative assumptions been used, the values obtained may have been different.

Inventories. GoVideo s inventory consists of finished goods, which are mostly in transit from its contract manufacturer. Correlant s inventory consisted primarily of integrated circuits and other components to be used in the manufacture of cable modems. Inventories are stated at the lower of cost or market with cost being determined on a first-in, first-out basis. We write down our inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of the inventory and the estimated market value based upon assumptions about future demand and market conditions. Due to the aforementioned change in Correlant s business model and the timing of Correlant s product life cycle, the inventory was fully reserved at June 30, 2003. It remained fully reserved until the shutdown of Correlant s historical operations in the cable modem and cable modem-related market.

Investments. Our investments consist primarily of debt securities. Investments are stated at fair value based on quoted market prices obtained from an independent banker. Investments are classified as available-for-sale based on management s intended use. As of June 30, 2003 short-term investments and any difference between the fair market value and the underlying cost of such investment is disclosed at **Item 8. Financial Statements and Supplementary Data Note 2 Significant Accounting Policies**. Currently we do not have any equity investments in publicly traded companies. During the period covered by this Annual Report, we held noncontrolling interests in private companies with no active market, which required fair values to be estimated. We recorded an investment impairment charge when we believe an investment has experienced a decline in value that is other than temporary.

Valuation of goodwill and other identifiable intangible assets. We actively pursued the acquisition of businesses, which resulted in significant goodwill and other identifiable intangible assets. We assess the impairment of goodwill and other identifiable intangible assets whenever events or changes in circumstances indicate the carrying value may not be recoverable. Factors which trigger an impairment review include, but are not limited to, the following: (1) significant negative industry or economic trends; (2) current, historical or projected losses that indicate continuing losses; and (3) a significant decline in our market capitalization relative to net book value. When we determine there is an indicator the carrying value of the goodwill or other identifiable intangible assets may not be recoverable, we measure impairment based on estimates of future cash flow. These estimates include assumptions about future conditions within the Company as well as the entire industry.

Impairment of other long-lived assets. Other long-lived assets, such as property and equipment, are amortized or depreciated over their estimated useful lives. These assets are reviewed for impairment whenever events or circumstances provide evidence that suggest that the carrying amount of the asset may not be recoverable, with impairment being based upon an evaluation of the identifiable undiscounted cash flows. If the asset has been impaired, the resulting charge reflects the excess of the asset s carrying cost over its fair value.

Income taxes. We record a valuation allowance to reduce the deferred tax assets to the amount that is more likely than not to be realized in the future. We considered future taxable income and ongoing tax planning strategies in assessing the need for the valuation allowance. If we determine that we will not realize all or part of our net deferred tax assets in the future, we will make an adjustment to the deferred tax assets, which will increase income tax expense in the period of such determination.

Recently Issued Accounting Standards

In June 2002, the FASB issued SFAS 146, *Accounting for Costs Associated with Exit or Disposal Activities* (SFAS 146), which addresses accounting for restructuring and similar costs. SFAS 146 supersedes previous accounting guidance, principally Emerging Issues Task Force (EITF) Issue 94-3, *Liability Recognition for*

Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring) (EITF 94-3). SFAS 146 requires the liability for costs associated with an exit or disposal activity be recognized when the liability is incurred. Under EITF 94-3, a liability for an exit cost was recognized at the date of the Company s commitment to an exit plan. SFAS 146 also states the liability should initially be measured and recorded at fair value. Accordingly, SFAS 146 may affect the timing of recognizing future restructuring costs as well as the amounts recognized. We adopted SFAS 146 during fiscal 2003. The adoption did not have a material effect on our financial position, results of operations, or cash flows as of or for the year ended June 30, 2003.

In November 2002, the FASB issued FASB Interpretation (FIN) 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (FIN 45). FIN 45 requires that upon issuance of a guarantee, the guarantor must recognize a liability for the fair value of the obligation it assumes under that guarantee. The provisions for initial recognition and measurement are effective on a prospective basis for guarantees issued or modified after December 31, 2002, irrespective of a guarantor s year-end. The disclosure requirements of FIN 45 are applicable to the Company s product warranty liability and other guarantees. We adopted FIN 45 during fiscal 2003. The adoption did not have a material effect on our financial position, results of operations, or cash flows as of or for the year ended June 30, 2003.

In December 2002, the FASB issued SFAS 148, *Accounting for Stock-Based Compensation Transition and Disclosure* (SFAS 148), which amends SFAS 123. SFAS 148 provides alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation. It also amends the disclosure provisions of SFAS 123 to require prominent disclosure about the effects an entity s accounting policy decisions with respect to stock-based employee compensation have on reported net income in both annual and interim periods. We adopted SFAS 148 during fiscal 2003. The adoption did not have a material effect on our financial position, results of operations, or cash flows as of or for the year ended June 30, 2003.

In January 2003, the FASB issued FIN 46, *Consolidation of Variable Interest Entities* (FIN 46). FIN 46 was revised in December 2003. FIN 46 establishes accounting guidance for consolidation of a variable interest entity (VIE), formerly referred to as special purpose entities. FIN 46 applies to any business enterprise, both public and private, that has a controlling interest, contractual relationship or other business relationship with a VIE. FIN 46 provides guidance for determining when an entity (Primary Beneficiary) should consolidate a VIE that functions to support the activities of the Primary Beneficiary. The application of FIN 46 is required for periods ending after December 15, 2003. The Company has no contractual relationship or other business relationship with a VIE, and therefore the adoption of FIN46 will have no effect on our financial position, results of operations, or cash flows.

In January 2003, the EITF published EITF Issue 00-21, *Revenue Arrangements with Multiple Deliverables* (EITF 00-21), which requires companies to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting. In applying EITF 00-21, revenue arrangements with multiple deliverables should be divided into separate units of accounting, if the deliverables in the arrangement meet certain criteria. Arrangement consideration should be allocated among the separate units of accounting based on their relative fair values. This issue is effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003. The Company does not expect the adoption of EITF 00-21 to have a material impact on its financial position, results of operations, or cash flows.

In April 2003, the FASB issued SFAS 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities* (SFAS 149). SFAS 149 amends and clarifies financial accounting and reporting for derivative instruments and hedging activities. SFAS 149 is effective for contracts entered into or modified after June 30, 2003. The Company does not expect SFAS 149 to have a material impact on its financial position, results of operations, or cash flows.

In May 2003, the FASB issued SFAS 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity* (SFAS 150). SFAS 150 represents the first phase of the FASB s project to clarify the accounting treatment of certain instruments that possess characteristics of both liabilities and equity. SFAS 150 generally requires that freestanding financial instruments that obligate the issuer to redeem the holders shares, or are indexed to such an obligation, and are settled in cash or settled with shares meeting certain conditions be treated as liabilities. The provisions of SFAS 150 are effective immediately for instruments entered into or modified after May 31, 2003 and to all other instruments that exist as of the beginning of the first interim financial reporting period beginning after June 15, 2003, with the exception of mandatorily redeemable instruments of non-public companies, which become subject to SFAS 150 for fiscal periods beginning after December 15, 2003. The Company does not expect SFAS 150 to impact the classification of its outstanding preferred stock instruments upon the Company s adoption effective July 1, 2003.

Certain Factors That May Affect Future Results

Forward Looking Statements. This Annual Report on Form 10-K contains certain statements that are forward looking within the meaning of Section 27A of the Securities and Exchange Act of 1933, as amended, and Section 21E of the Securities and Exchange Act of 1934, as amended, that involve risks and uncertainties. Any statements contained herein (including, without limitation, statements to the effect that the Company or management estimates, expects, anticipates, plans, believes, projects, continues, may, or will or statements concerning potential or opp variations thereof or comparable terminology or the negative thereof), that are not statements of historical fact should be construed as forward looking statements. All statements that address operating performance, events or developments that our management expects or anticipates to incur in the future, including statements relating to sales and earnings growth or statements expressing general optimism about future operating results, are forward-looking statements. These forward-looking statements are based on our management s current views and assumptions regarding future events and operating performance. Many factors could cause actual results to differ materially from estimates contained in our management s forward-looking statements including the factors listed at pages 30-32. The differences may be caused by a variety of factors, including but not limited to adverse economic conditions, competitive pressures, inadequate capital, unexpected costs, lower revenues, net income and forecasts, the possibility of fluctuation and volatility of our operating results and financial condition, inability to carry out marketing and sales plans and loss of key executives, among other things. Because of these and other factors that may affect our operating results, past performance should not be considered an indicator of future performance and investors should not use historical results to anticipate results or trends in future periods.

The restatement and reaudit of our financial statements and the potential for review of our financial disclosure could materially impact our business and results of operations. Following the replacement of prior management, the new management began reviewing various transactions undertaken by old management prior to June 29, 2001. During its preliminary investigation, new management identified certain material transactions undertaken by prior management that impact reported financial and operating results with respect to its consolidated financial statements for the fiscal years ended June 30, 2001, 2000 and 1999. Due to the preliminary results, the Company dismissed the then existing independent accountants, hired new independent accountants and re-audited all periods under investigation. The Company completed the restatement of previously reported financial statement in its Form 10-K for fiscal 2002 filed with the SEC April 16, 2004.

As a result of the restatement and reaudit of our financial statements for fiscal 2001, 2000 and 1999 and the resulting delay in filing SEC reports, the SEC or other governmental authorities may choose to review our SEC filings. If we are required to respond to the SEC or other governmental authorities or otherwise take actions in response to, arising out of, or relating to the restatement and reaudit of our financial statements, such actions may require significant attention and resources of management and, regardless of the outcome, could materially impact our business and results of operations.

If we become subject to such heightened scrutiny, this could adversely affect investor confidence, our ability to access the capital markets and cause the trading price for our securities to decline. In addition, we cannot assure you that we will not have to further restate earnings or further revise our reports for prior periods as a result of any SEC review. Any such restatement could further impact investor confidence, our ability to access the capital markets and the trading price of our securities.

The Company faces tough competition. The Company s current subsidiary GoVideo plays a unique niche in a highly competitive industry: consumer electronics. GoVideo competes against many well established companies including many original equipment manufacturers (OEM) who have substantially greater financial and other resources than the Company. Additionally, the consumer electronics industry is empirically facing a trend of declining gross margin resulted from emerging global market and competition. While GoVideo was profitable in fiscal 2003, the competitive nature of the industry may negatively affect the Company s earnings if GoVideo is unable to quickly adapt to the technological and market changes of the industry.

GoVideo utilizes contract manufacturers and a combination of technologies from its own intellectual property as well as third parties. Hence, there are no assurances GoVideo can continue to obtain new consumer electronic products that will be competitive in today s constantly changing marketplace.

We may not be able to produce sufficient quantities of our products as we obtain components from, and depend on, a limited number of key suppliers. All our TV and DVD player products contain one or more components that are available from a single supply source and other components that are available from limited sources. We depend on these sources to meet our production requirements. We do not have any long term supply contracts. Although we do not presently anticipate a disruption in this source of supply, if it is necessary for us to obtain these key components from an alternative supplier, it could take several months before receiving adequate supplies, and during this time we would be unable to satisfy our customers demands. In such event, prolonged delays could result in the cancellation of orders and the loss of customers.

GoVideo purchases products from countries in Asia, including China, South Korea and Taiwan, where there are risks associated with the potential change in social, political and regulatory and economic conditions. Significant changes in the social, political and regulatory and economic conditions could adversely affect GoVideo through increased costs, unavailability of goods or increased tariffs. As a result of trade disputes, the US has occasionally imposed tariffs, regulatory procedures and importation bans on certain products. Trade sanctions or regulatory procedures involving a country in which we conduct a substantial amount of business could have a material adverse effect on our operations.

GoVideo is responsible for product warranties and defects. Although GoVideo outsources all product manufacturing, it provides limited labor and parts warranties on certain of its products for a maximum of one year. Therefore, GoVideo is highly dependent upon the quality of its suppliers.

Our new products may not be well accepted. Our future success depends on GoVideo s ability to continue to design and develop and win acceptance of its products and services, which are offered in highly competitive markets characterized by continual product introductions, rapid development in technology, and subjective and changing consumer preferences.

The introduction or expected introduction of new products or technologies may depress sales of existing products and technologies. This may result in declining prices and inventory obsolescence. As GoVideo maintains a substantial investment in product inventory, declining prices and inventory obsolescence could have a material adverse effect on our business and financial results.

We are exposed to the risks associated with the recent decision to cease cable modem-related business by Correlant, our subsidiary. The Company is actively seeking a viable business model for Correlant to maximize our shareholders interest. Even if a viable business model is found that will correspond with Correlant s available cash size, there is still no guarantee the model will succeed.

Our stock price may not come back. The Company s stock was removed from OTC Bulletin Board as a result of the Company s failure to timely submit the Form 10-K for fiscal 2002. Although Lotus filed its Form 10-K for fiscal 2002 on April 16, 2004, Lotus is not eligible to trade on the OTC Bulletin Board until Lotus becomes current in all its required filings or files a Form 10 and clears all comments with the SEC. The current trading of the Company s stock is sporadic and minimal and there is no established public trading market for our common stock. In addition, the stock market has experienced extreme price and volume fluctuations that have affected the market price of many technology companies, in particular, and that have often been unrelated to the operating performance of these companies. These factors, as well as general economic and political conditions, may materially adversely affect the market price of our common stock in the future. Additionally, volatility or a lack of positive performance in our stock price may adversely affect our ability to retain key employees.

Our executive officers and key personnel are critical to our business and the loss of their services could disrupt our operations and our customer relationships. Our success depends to a significant degree upon the continuing contributions of our key management, technical, marketing and sales employees. There can be no assurance that we will be successful in retaining our key employees or that we can attract and retain additional skilled personnel as required. The loss of the services of key personnel could significantly harm our results of operations and business.

GoVideo may need additional capital resources. We believe GoVideo s cash flow from operations and borrowings under its credit facility are sufficient to fund existing operations for the foreseeable future. See **Liquidity and Capital Resources.** However, GoVideo may need additional capital to operate if:

Market conditions change;

Business plans or assumptions change;

Acquisitions are pursued;

Material increases in capital expenditures or working capital become necessary; or

GoVideo s lender calls or accelerates the repayment of its line of credit due to noncompliance with debt covenants as previously discussed.

Because of these and other factors affecting our operating results, past financial performance should not be considered an indicator of future performance, and investors should not use historical trends to anticipate results or trends in future periods.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

Interest Risk. Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio. We do not use derivative financial instruments in our investment portfolio. We place our investments with high credit quality issuers and, by policy, limit the amount of credit exposure to any one issuer. We are averse to principal loss and ensure the safety and preservation of invested funds by limiting default risk, market risk, and reinvestment risk. We minimize our risk by investing in only the safest and highest credit quality securities and by constantly positioning our portfolio to respond appropriately to a significant reduction in a credit rating of any investment issuer or guarantor. Our portfolio includes only corporate debt securities and municipal bonds.

Foreign Currency Risk. Until January 31, 2002 a large portion of Correlant s business was transacted in Taiwan. However, the functional currency of our Taiwan branch was the US dollar. Only a small number of transactions were denominated in the Taiwan dollar and exposed to foreign currency exchange rate risk. Subsequent to January 31, 2002, as part of the change in Correlant s business model, we closed our Taiwan branch. All transactions, with the exception of Beijing Lotus, which has no material independent operations, are now denominated in the US dollar. Therefore, we do not have any hedging or similar foreign currency contracts. To date, we have not experienced any material foreign currency exchange rate gains or losses associated with transactions denominated in the Taiwan dollar or the Chinese RMB and do not expect any significant changes in foreign currency exposure in the near future.

Item 8. Financial Statements

The information required by Item 8 is included at pages F-1 to F-35.

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

(a) There were no changes in or disagreements with accountants on accounting and financial disclosure during fiscal 2003.

(b) The Company previously reported the dismissal of Larson, Allen, Weishair & Co. as its independent accountants and the appointment of Hein & Associates LLP (Hein) as its new independent accountants in current reports on Form 8-K and 8-K/A as filed with the Commission on March 26, March 27 and April 12, 2002.

The Company previously reported the dismissal of Ernst & Young LLP as the independent accountant of Correlant, a significant subsidiary (as defined in Rule 1-02 of Regulation S-X) of the Company, and the engagement of Hein as the new independent accountant of Correlant on April 23, 2002, in the Company s current reports on Form 8-K and 8-K/A as filed with the Commission on April 25 and June 4, 2002.

(c) In connection with the change in accountants referenced above, there were no disagreements with the former accountants on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of the former accountants, would have caused them to make reference to the subject matter of the disagreement in connection with their reports. In connection with the change in accountants referenced above, there were no reportable events of the type described in Item 304(a)(1)(v).

Item 9A. Controls and Procedures

Evaluation of disclosure controls and procedures

The Company carried out an evaluation, under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-14 of the Securities Exchange Act of 1934 (the Exchange Act). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that as of June 30, 2003, the end of the period covered by this report, the Company s disclosure controls and procedures were effective at the reasonable assurance level in timely alerting them to material information relating to the Company (including its consolidated subsidiaries) required to be included in our Exchange Act filings.

Changes in internal control over financial reporting

During fiscal 2003 there were no significant changes in our internal control over financial reporting that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Except as set forth below, during fiscal 2002, there were no significant changes in our internal control over financial reporting that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

As previously reported, following the replacement of prior management on June 29, 2001, new management began an extensive undertaking to review various transactions undertaken by and involving old management prior to June 29, 2001. As a consequence of its preliminary review, effective March 25, 2002, the Company terminated its audit relationship with its then existing independent accountants and replaced such firm with new independent accountants. As previously reported, during its preliminary investigation, new management of the Company identified various transactions involving a former subsidiary and other transactions undertaken by prior management which impacted reported financial and operating results with respect to its consolidated financial statements for the fiscal years ended June 30, 2001, 2000 and 1999 and ultimately concluded that a reaudit of the financial statements for the fiscal years ended June 30, 2001, 2000 and 1999 was required. Effective July 24, 2002, the Company engaged its new independent accountants, to perform such reaudit and the Company concluded that it must restate these prior periods. During the course of its review and investigation of various transactions undertaken by and involving old management, and its completion of such restatement and reaudit, new management of the Company has established its own systems of internal controls over financial reporting.

PART III

Item 10. Directors and Executive Officers of the Registrant

(A) Lotus Pacific Directors

The Company has five Directors elected in three separate classes. One Director serves as a Class I Director, and will serve for a term which was scheduled to expire at the 2002 Annual Meeting of stockholders, or until their successors are duly elected and qualified or until their death, resignation or removal. One director serves as a Class II Director, and will serve for a term which was scheduled to expire at the 2003 Annual Meeting of stockholders, or until their successors are duly elected and qualified or until their death, resignation or removal. Three Directors serve as Class III Directors, and each will serve for a term which was scheduled to expire at the 2004 Annual Meeting of stockholders, or until their successors are duly elected and qualified or until their death, resignation or removal. The following table sets forth certain information with respect to the directors and executive officers of the Company as of August 15, 2004.

Name	Age	Office
LI, Dongsheng	47	Chairman of the Board and Class III Director
YAN, Vincent Yong	41	President, Chief Executive Officer, Class II Director
LIU, James Jian	48	Class III Director
LIN, Zuoquan	41	Class I Director
LIN, Jih-Ming	52	Class III Director

Mr. Dongsheng Li was elected as a Class III Director of the Company on June 29, 2001. Mr. Li also has served as Chairman of the board of directors of the Company s subsidiary, Correlant, since February 2003. Mr. Li has been Chairman of the board of directors and President of TCL Corporation (formerly TCL Holdings Co., Ltd.), a People s Republic of China company (and TCL s parent company), since 1996. Mr. Li is also the Chairman of the board of directors of TCL International Holdings, Ltd. Mr. Li has 20 years of experience in the telecommunication equipment and consumer electronics industry. Mr. Li holds a Bachelor degree in Engineering from South China University of Technology.

Mr. Vincent Yong Yan was elected as a Class II Director of the Company on June 29, 2001. Mr. Yan has been the President, CEO and Secretary of the Company since June 29, 2001. Mr. Yan was the CFO of the Company from June 29, 2001 until November 2002. Mr. Yan also has served as a Vice President, director and member of the Executive Committee of the board of directors of Correlant since February 2003. Mr. Yan has been Executive Director and Chief Financial Officer of TCL International Holdings, Ltd., a publicly traded consumer electronics and information technology company since 1999. Prior to joining TCL, Mr. Yan served as PRC Country Manager of Tulip Computers (Asia) Ltd., a subsidiary of a European computer manufacturer. Mr. Yan has over ten years of experience in the computer and consumer goods industries. Mr. Yan holds an MBA from Stanford University and a Masters degree in Computer Science from Peking University.

Mr. James Jian Liu was appointed as a Class III Director of the Company on August 6, 2001. Mr. Liu also has served as a director of Correlant since February 2003. Mr. Liu served as President of JBL International Inc., an apparel agent in New York, New York, from January 1996 to the present. He earned his BA degree from Nanjing University, China.

Professor Zuoquan Lin was appointed as a Class I Director on March 25, 2002. Professor Lin also has served as a director of Correlant since February 2003. He is currently the Dean of the Department of Information Science, a position he has held since 1998, and is the Director of the Networking Research and Development Center at Peking University, China, having held the position since 1999. His main areas of research include computer software, artificial intelligence, network economy and management information system. Professor Lin also is currently an independent consultant in enterprise strategy and information technology. From 1995 to 1997, he was the Director of the Institute of Computer Sciences at Shantou University, China. Professor Lin holds a Ph.D. in computer science from Bei Hang University in Beijing, China.

Mr. Jih-Ming Lin was elected a Class III Director of the Company on June 29, 2001. Mr. Lin has been Vice President of Techlab Tech Inc., a Taiwanese semiconductor manufacturer, since 1998. From 1992 to 1998, Mr. Lin served as Vice President of National Advantages Computer, Inc., a computer products manufacturer. Mr. Lin has 16 years of experience in the semiconductor industry. Mr. Lin is a graduate of Defense Medical Industry in Taiwan.

(B) Lotus Pacific Executive Officers

Name	Age	Office
YAN, Vincent Yong	41	President, Chief Executive Officer, Class II Director
DAVIS, Steve	35	Chief Financial Officer

WANG, Sean Shaojian	40	Chief Operating Officer

See discussion related to Mr. Yan above.

Mr. Davis was appointed as the Company s Chief Financial Officer in March 2004 and will serve until his successor is appointed and approved. Mr. Davis previously served as the Company s Controller since October 2002. Mr. Davis also has served as Vice President of Correlant since March 2003 and Chief Financial Officer of the Company s subsidiary Opta Systems, LLC, dba GoVideo, since July 2003. Prior to joining the Company, Mr. Davis served as Controller and Chief Financial Officer for a number of start-up or financially distressed companies including BuyGolf.com, iWear Corp and Aviation Distributors, Inc. from July 1998 until October 2002. Prior to this Mr. Davis was with Ernst & Young LLP for eight years, from September 1990 to July 1998, most recently as Senior Manager.

Sean Shaojian Wang was appointed as the Company s Chief Operating Officer in June 2004. Mr. Wang served as the Chief Financial Officer, from 2002 to 2004, of PacificNet, Inc., a company in Minneapolis, Minnesota whose shares are traded on NASDAQ (Symbol: PACT). PacificNet, Inc., through its subsidiaries, invests, operates and provides value-added telecom services (VAS) and products solutions in China. From 1993 to 2002, Mr. Wang served as a managing director of Thian Bing Investments PTE, Ltd. in Singapore, an investment company in oil seeds planting, edible oil processing, packing materials and the other related industries. Mr. Wang graduated from Hamline University in St. Paul, Minnesota with a Bachelor of Science in 1986 and from the University of Minnesota with a Masters of Business Administration in 1989.

None of the members of the Board of Directors or executive officers of the Company are related to one another.

(C) *Section 16(a) Beneficial Ownership Reporting Compliance*

During fiscal 2002, the following directors had delayed filings of Form 3: Li Dongsheng and Vincent Yan (10 days), and James Jian Liu (20 days). The delay was due to the fact that when the current management took over the Company in June 2001, it needed time to contract a professional agent to do the filing for the Company.

The following four directors did not tender their Form 4 when their association with the Company was terminated: Robert Lo, Chris Ching, Chung-I Chiang, and William Hu.

(D) *Code of Ethics*

The Company has adopted a code of ethics that applies to all employees, executive officers and all members of our finance department, including the principal accounting officer. The Company will provide a copy of our code of ethics to any person, free of charge, upon written request sent to our principal executive office.

(E) *Audit Committee*

The Company has a separately designated standing Audit Committee of the Company s Board of Directors established in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934, as amended. Jian Liu and Zuoquan Lin are the members of our Audit Committee. The Audit Committee shall represent the Board of Directors in discharging its responsibility relating to the accounting, reporting and financial practices of the Company and its subsidiaries and shall have general responsibility for surveillance of the systems of internal controls, which management and the Board of Directors have established, the performance and selection of independent auditors, and our audit and financial reporting processes.

Item 11. Executive Compensation

The following table sets forth for the periods presented the compensation for services in all capacities to the Company of the persons who were the (i) the chief executive officer of the Company, and (ii) the four most highly compensated executive officers, other than the chief executive officer, who received over $100,000 in compensation during the fiscal year (collectively, the Named Officers).

Summary Compensation Table

		Annual Compensation				Long Term Compensation		
Name and Principal Position	**Year**	**Salary**	**Bonus**	**Other Annual Compensation**	**Restricted Stock Awards**	**Securities Underlying Options**	**LTIP Payouts**	**All Other Compensation**
Vincent Y Yan (1)	2004	$ 180,000	$ 150,000					
President, Chief								
Executive	2003	120,000						
Officer	2002	120,000						
CFO								
Steve Davis (2)	2004	$ 124,000	$ 34,000					
CFO	2003	120,000						
	2002	N/A						
Sean Wang (3)	2004	$ 160,000						
COO	2003	N/A						
	2002	N/A						

(1) Mr. Yan has an employment contract with the Company signed on June 29, 2001. The contract was automatically extended for a year on June 30, 2004.

(2) Mr. Davis s salary is paid by both Lotus and GoVideo. During fiscal 2003, GoVideo paid $80,000 and Lotus paid $40,000. During fiscal 2004, GoVideo paid $84,000 and Lotus paid $40,000. Lotus paid Mr. Davis a bonus of $10,000 and GoVideo paid Mr. Davis a $24,000 bonus in fiscal 2004.

(3) Reflects Mr. Wang s salary at the time he was appointed Chief Operating Officer in June 2004.

Stock Options

No current executive officer or director of the Company holds any stock options. No stock option grants were made during fiscal 2003. No stock appreciation rights were granted during fiscal 2003.

Option Exercises and Holdings

No current executive officer or director of the Company holds any option, and no options were exercised during fiscal 2003.

Director Compensation

For fiscal 2003, non-employee directors of the Company were each paid $1,000 for each regular meeting of the Board of Directors which they attended and $800 for each special or committee meeting of the Board of Directors which they attended, plus, in each case, actual out-of-pocket expenses for attendance. Non-employee directors were eligible to receive an option to purchase 5,000 shares of the Company s common stock for each fiscal year that they serve as Directors. For fiscal 2003, no directors received cash payments or stock options for their service on the Board of the Directors.

Directors who are also employees of the Company do not receive cash payments or stock options for their service on the Board of the Directors.

Employment Contracts, Termination of Employment, and Change in Control Agreements

None of the other employees besides Mr. Yan has any employment or severance agreement with the Company and their employment may be terminated at any time at the discretion of the Board of Directors.

On June 29, 2001, the Company entered into a one-year employment agreement with Mr. Yan for the positions of President, Chief Executive Officer, Chief Financial Officer and Secretary of the Company. This agreement may be extended for successive one-year periods by the Company and Mr. Yan. For his services, Mr. Yan is paid an annual salary of $180,000 as of January 1, 2004 and an annual bonus to be determined in the discretion of the Special Committee of the Board of Directors of the Company. A copy of the employment contract with Vincent Yan was attached in the Company s Form 10-K filed on October 12, 2001. During fiscal 2003, the employment agreement entered into between the Company and Vincent Yan, CEO and President of the Company, was extended for one year without any changes.

Compensation Committee Interlocks and Insider Participation

The compensation for executive officers of the Company is reviewed and determined on an annual basis by the Compensation Committee of the Company s Board; the Compensation Committee was approved by the Board in March 2004. The members of the Compensation Committee, Jian Liu and Zuoquan Lin, are independent directors and are not employees of the Company. Neither of them are or were officers or employees of Lotus Pacific or any of its subsidiaries.

Before the Compensation Committee was created, compensation was determined by three members of the Board of Directors, Jian Liu and Zuoquan Lin who are independent directors and are not employees of the Company, and Li Dongsheng, Chairman of the Board.

Stock Price Performance Graph

The line graph below compares the cumulative total shareholder return on our Lotus Pacific common stock with the cumulative total return for the Standard & Poor s SmallCap 600 Index from June 30, 1999 through June 30, 2003. The graph assumes the value of the investment in our Lotus Pacific common stock and the SmallCap 600 Index was $100 at June 30, 1999. It also assumes that all dividends paid by those companies included in the indexes were reinvested. No cash dividends have been declared on our Lotus Pacific common stock.

Comparison of 5 Year Cumulative Total Return*
Lotus Pacific, Inc and Standard & Poor s SmallCap 600 Index

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* $100 invested on June 30, 1998 in stock or index including reinvestment of dividends. Fiscal year ending June 30.

	June 30,				
	1999	**2000**	**2001**	**2002**	**2003**
Lotus Pacific	$ 100.00	$ 94.05	$ 9.05	$ 0.57	$ 0.38

S&P SmallCap 600	100.00	390.89	429.78	429.22	409.98

Due to the dramatic shift in business focus from cable modems and cable-modem related equipment to consumer electronics during fiscal 2003, we are unable to present any meaningful comparisons to peers. Therefore, the above graph and table include the S&P SmallCap 600 index only. Stockholder returns over the indicated period should not be considered indicative of future stockholder returns.

Item 12. Security Ownership of Certain Beneficial Owners and Management

The following table sets forth information with respect to the number of shares of Common Stock beneficially owned as of June 30, 2004 by (i) all persons who are beneficial owners of five percent or more of the Company s Common Stock, (ii) the Company s executive officers named in the Summary Compensation Table above, (iii) each director and nominee for director of the Company, and (iv) all current executive officers and directors as a group as of August 15, 2004:

	Shares of Stock Beneficially Owned (1)	Percentage of Class (1)
Lotus International Holdings Ltd.(2) Suite 13 First Fl., Oliaji Trade Center Francis Rachel Street Victoria, Mahe Republic Of Seychelle	12,000,000	23.7%
TCL Industries Holdings (HK) Ltd.(3) 13/F TCL Tower 8 Tai Chung Road Tsuen Wan, Hong Kong	9,606,671	18.9%
LI, Dongsheng		
YAN, Vincent Yong		
LIU, James Jiam		
LIN, Zuoquan		
LIN, Jih-Ming		
DAVIS, Steve		
WANG, Sean		
All directors and executive officers as a group (consisting of 7 persons)		

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(1) All information is as of August 15, 2004 and determined in accordance with Rule 13d-3 under the Securities Exchange Act of 1934, as amended, based solely upon information furnished by the persons listed or contained in filings made by them with the Securities and Exchange Commission.

(2) Lotus International Holdings Ltd. is controlled by TCL Industries Holdings (HK) Ltd.

(3) TCL Industries Holdings (HK) Ltd. is an affiliate of TCL Holdings Group.

In May 1997, Lotus Pacific granted 1,090,000 options to certain officers and key employees with an exercise price of $6.00 per share, which was the market price of Lotus Pacific s common stock at the time of grant. Options were 100% vested when granted and expired five years from grant date. All options expired during fiscal 2002 and as such there were no options outstanding as of June 30, 2003.

The shareholders approved the 2000 Equity Incentive Plan (Incentive Plan) on April 28, 2000. The Board of Directors administers the Incentive Plan. Employees, directors, and consultants of the Company and its affiliates, who in the judgment of the Board render significant service to the Company, are eligible to participate. The Incentive Plan provides for the award of a broad variety of stock-based compensation alternatives such as nonstatutory stock options, incentive stock options, restricted stock, performance awards and stock appreciation rights. The Incentive Plan provided 11,355,000 shares of common stock to be offered. The vesting provisions of individual options may vary. The exercise price shall not be less than 100% of the fair market value of a common stock on the grant date. No options have been granted since the Incentive Plan s adoption.

As part of the 1999 acquisitions of Correlant and Arescom, Lotus Pacific entered into share exchange agreements with both Correlant and Arescom. As stipulated by the agreements, Lotus Pacific set aside a total of 1,708,000 of contingently issuable shares of Lotus Pacific common stock. The contingent shares were to be issued as Correlant and Arescom stock options, specified in the purchase agreements, were exercised. For each option exercised by a Correlant stock option holder, 81% of such shares were to be transferred to Lotus Pacific in exchange for 0.5364 shares of Lotus Pacific common stock for each share of Correlant stock transferred. For each option exercised by an Arescom stock option holder, 81% of such shares were to be transferred to Lotus Pacific in exchange for 0.02915 shares of Lotus Pacific common stock for each share of Arescom stock transferred. There were a total of 1,017,000, 1,134,000 and 1,550,000 Lotus Pacific shares contingently issuable in connection with both share exchange agreements as of June 30, 2003, 2002 and 2001, respectively. Due to the sale of Arescom, there have been no contingently issuable shares with respect to Arescom options since the date of the sale in December 2001. Due to the wind down of Correlant s historical operations, there were 3,000 Lotus Pacific shares contingently issuable with respect to the Correlant shares as of June 30, 2004.

Item 13. Certain Relationships and Related Transactions

In addition to employment agreements discussed in Item 11, Lotus Pacific entered into the following transactions during fiscal 2003 required to be reported under Item 404 of Regulation S-K:

Effective January 30, 2003, Lotus Pacific and TCL, a Lotus Pacific stockholder with holdings of greater than 10% of Lotus Pacific s outstanding shares, settled all disputes with prior independent accountants of the Company concerning their audits of the Company for fiscal 2001 and prior. The prior auditors deny that they are liable for any damages to Lotus Pacific, but consented to the settlement to avoid the costs of litigation. Pursuant to an agreement dated March 24, 2003 between Lotus Pacific and TCL, Lotus Pacific and TCL agreed on the allocation of the settlement funds, whereby TCL Industries received $6,500,000 in cash, Lotus Pacific received $3,500,000 in cash and Lotus Pacific will be entitled to receive up to an additional $3,500,000 in cash held in an escrow account, plus interest accrued therein. In connection with the agreement, Lotus Pacific and TCL agreed to forbear from bringing claims against each other with respect to the allocation of funds or otherwise.

Subsequent to fiscal 2003, Lotus Pacific entered into the following transactions required to be reported under Item 404 of Regulation S-K:

On September 30, 2003, Lotus Pacific sold its entire equity interest in TCL Digital to TCL Information for a cash price of approximately $5,600,000 US dollars. The Company invested $5,280,000 US dollars to acquire the sold equity in TCL Digital. TCL Information is an affiliate of TCL, a stockholder of the Company. Li Dongsheng and Vincent Yan, directors of the Company, are directors and officers of TCL International, a publicly traded company on the Hong Kong Stock Exchange (HKSE: 1070.HK), an affiliate of TCL.

On February 17, 2004, the Lotus Pacific Board of Directors approved the repurchase of approximately 623,000 shares of Lotus Pacific common stock at $0.30 per share from Gordon Lum. Mr. Lum was appointed as a Class II Director of the Company on August 6, 2001. In connection with the stock repurchase, Mr. Lum resigned from the Board of Directors.

On July 7, 2004, the Company s Board of Directors approved the commencement of a new wholly-owned subsidiary, GoVideo DigiTech (Huizhou) Co., Ltd. (DigiTech), which will be located in Guangdong, China. DigiTech will market GoVideo s MP3 players. The Company plans to invest approximately $500,000 in the new subsidiary. TCL Multimedia Electronics R&D Center (TCL Multimedia), an affiliate company of TCL, is currently expending some resources during the start up phase of DigiTech.

Item 14 Principal Accounting Fees and Services

The following table is a summary of the fees that Lotus paid or accrued for the audit and other services provided by Hein from the date Hein was engaged through the date of this filing. Hein was engaged March 25, 2002 to audit the year ended June 30, 2002 and July 24, 2002 for the reaudit of the years ended June 30, 2001, 2000 and 1999. As a result, fees included in fiscal 2002 include the fees to reaudit the years ended June 30, 2001, 2000 and 1999.

Fee Category		Year ended June 30, 2004		Year ended June 30, 2003		Year ended June 30, 2002
Audit fees	$		$	175,000	$	682,000
Audit-related fees		7,000		15,000		7,000
Tax fees		125,000		93,000		

Audit Fees. Consists of fees billed for professional services rendered for the audit and restatement of our consolidated financial statements and review of our interim consolidated financial statements included in quarterly reports and services that are normally provided by Hein in connection with statutory and regulatory filings or engagements. Because the fiscal 2004 audit has not commenced as of the date of this filing, there are no related fees included in the above table. All fees associated with the fiscal 2004 audit will be included in the Company s fiscal 2004 Form 10-K, which will be filed upon completion.

Audit-Related Fees. Consists of fees billed for assurance and related services that are reasonably related to the performance of the audit or review of our consolidated financial statements and are not reported under Audit fees. These services include employee benefit plan audits, accounting consultations in connection with acquisitions, attest services that are not required by statute or regulation, and consultations concerning financial accounting and reporting standards.

Tax Fees. Consists of fees billed for professional services for tax compliance, tax advice, and tax planning. These services include assistance regarding federal, state and international tax compliance, tax audit defense, mergers and acquisitions, and international tax planning.

Policy Related to Audit Committee Pre-Approval of Audit and Permissible Non-Audit Services of Independent Auditors. Our Audit Committee s has a policy of pre-approving all audit and permissible non-audit services provided by the independent auditors. These services may include audit services, audit-related services, tax services, and other services. Pre-approval is generally provided for up to one year and any pre-approval is detailed as to the particular service or category of services and is generally subject to a specific budget. The independent auditors and management are required to periodically report to the Audit Committee regarding the extent of services provided by the independent auditors in accordance with this pre-approval, and the fees for the services performed to date. The Audit Committee may also pre-approve particular services on a case-by-case basis.

PART IV

Item 15. Exhibits, Financial Statement Schedules and Reports on Form 8-K

(a) Documents filed as part of this report.

1. Financial Statements

(i) Report of Hein & Associates LLP, Independent Auditors

(ii) Consolidated Balance Sheets

(iii) Consolidated Statements of Operations

(iv) Consolidated Statements of Stockholders Equity

(v) Consolidated Statements of Cash Flows

(vi) Notes to Consolidated Financial Statements

2. Financial Statement Schedules

All schedules are omitted because they are not applicable or the required information is shown in the financial statements or related notes.

3. Exhibits

Exhibit Number	Description of Exhibit	Method of Filing
3.1	Certificate of Amendment of Certificate of Incorporation dated as May 25, 1999	Incorporated by reference to Exhibit 3.1 to Form 10/A, filed June 17, 1999
3.2	Certificate of Amendment of Certificate of Incorporation dated as June 15, 1998	Incorporated by reference to Exhibit 3.1 to Form 10, filed October 27, 1998
3.3	Certificate of Incorporation, as amended	Incorporated by reference to Exhibit 3.2 to Form 10, filed October 27, 1998
3.4	Amended and Restated Bylaws	Incorporated by reference to Exhibit 3.3 to Form 10 K, filed October 13, 2000
3.5	Amendment to Bylaws	Incorporated by reference to Exhibit 99.1 to Form 8K, filed July 2, 2001
10.1	2000 Equity Incentive Plan	Incorporated by reference to Exhibit A to Proxy Statement on Schedule 14A filed April 4, 2000
10.2	Agreement dated September 30, 2000, between the registrant and TurboNet Communications (now Correlant Communications, Inc.)	Incorporated by reference to Exhibit 10.10 to Form 10 K, filed October 13, 2000
10.3	Lotus Pacific Inc., Executive Employment Agreement	Incorporated by reference to Exhibit 10.11 to Form 10 K, filed October 15, 2001
10.4	Opta Systems, LLC dba GoVideo Executive Employment Agreement	Incorporated by reference to Exhibit 10.4 to Form 10 K, filed April 16, 2004
10.5	Exchange Agreement between Registrant and ARESCOM Inc. dated December 11, 2001	Incorporated by reference to Exhibit 10.5 to Form 10 K, filed April 16, 2004
10.6	Stock Purchase Agreement between Registrant and Solomon Extreme International Ltd. dated December 11, 2001	Incorporated by reference to Exhibit 10.6 to Form 10 K, filed April 16, 2004

10.7	Acquisition Agreement of TCL Digital dated January 18, 2003	Incorporated by reference to Exhibit 10.7 to Form 10 K, filed April 16, 2004
10.8	Opta LLC Interest Purchase Agreement between Registrant and Carmco Investment, LLC, dated April 17, 2003	Incorporated by reference to Exhibit 10.8 to Form 10 K, filed April 16, 2004
10.9	Sale agreement of TCL Digital dated December 20, 2003	Incorporated by reference to Exhibit 10.9 to Form 10 K, filed April 16, 2004
10.10	Current Lease GoVideo Office Lease	Incorporated by reference to Exhibit 10.10 to Form 10 K, filed April 16, 2004
10.11	Current Lease Go Video Lease for Commercial Space	Incorporated by reference to Exhibit 10.11 to Form 10 K, filed April 16, 2004
16.1	Letter re Change in Certifying Accountant	Incorporated by reference to Exhibit 16.1 to Form 8 K, filed April 12, 2002
16.2	Letter re Change in Certifying Accountant	Incorporated by reference to Exhibit 16.2 to Form 8 K, filed June 4, 2002
21	List of Subsidiaries	Filed herewith
31.1	Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed herewith
31.2	Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed herewith
32.1	Certification of Chief Executive Officer Pursuant to Section 1350 Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed herewith
32.2	Certification of Chief Financial Officer Pursuant to Section 1350 Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed herewith

(b) Reports on Form 8-K.

During the fourth quarter ended June 30, 2003, the registrant filed the following reports on Form 8-K:

Date Filed	**Item Number**	**Description**
April 1, 2003	Items 5 and 9	The Company announced that a Special Meeting of the Stockholders of Correlant was held on March 28, 2003. At the meeting, Hein & Associates LLP was selected as independent accountants and auditors of Correlant for the fiscal year ending June 30, 2003. The Company also announced that members of Correlant s management made a presentation at the meeting regarding Correlant s past operations and future prospects.
April 25, 2003	Item 5	The Company announced that it purchased 100% of the outstanding membership interests of Opta Systems, LLC, a Delaware limited liability company.

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Signatures

Pursuant to the requirements of Section 13 and 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Signature	Title	Date
/s/ Vincent Yong YAN Vincent Yong YAN	President, Chief Executive Officer, Director	August 24, 2004
/s/ Steve DAVIS Steve DAVIS	Chief Financial Officer (Principal Accounting Officer)	August 24, 2004

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Dongsheng LI Dongsheng LI	Chairman of the Board	August 24, 2004
/s/ Vincent Yong YAN Vincent Yong YAN	President, Chief Executive Officer, Director	August 24, 2004
/s/ Jian LIU Jian LIU	Director	August 24, 2004
/s/ Zouquan LIN Zouquan LIN	Director	August 24, 2004

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Index to Consolidated Financial Statements

Financial Statements:

Financial Statement Schedules:

All schedules are omitted because they are not required or the required information is included in the consolidated financial statements or notes thereto.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of

Lotus Pacific, Inc.

We have audited the accompanying consolidated balance sheets of Lotus Pacific, Inc. and subsidiaries as of June 30, 2003 and 2002, and the related consolidated statements of operations, stockholders equity and comprehensive income, and cash flows for the years ended June 30, 2003, 2002 and 2001. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

Except as explained in the following paragraph, we conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

We were unable to audit the financial information of one of the Company s significant subsidiaries that is consolidated in the June 30, 2001 financial statements as discontinued operations because the subsidiary would not provide the necessary information to allow us to complete the audit. Due to the subsidiary s lack of cooperation, we were unable to satisfy ourselves about the subsidiary s account balances by means of other auditing procedures.

Because of the matter discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the consolidated financial statements for the year ended June 30, 2001.

In our opinion, the June 30, 2003 and 2002 consolidated financial statements present fairly, in all material respects, the financial position of Lotus Pacific, Inc. and subsidiaries as of June 30, 2003 and 2002, and the results of its operations and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

HEIN & ASSOCIATES LLP

Orange County, California

June 15, 2004

LOTUS PACIFIC, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands)

	June 30, 2003		June 30, 2002	
ASSETS				
Current assets:				
Cash and cash equivalents	**$**	**12,044**	$	32,647
Short-term investments		**13,964**		4,959
Accounts receivable, net		**6,847**		281
Accounts receivable from related parties, net		**39**		7,075
Inventories, net		**6,438**		
Notes and interest receivable from related parties, net		**1,592**		3,522
Income tax receivable		**2,475**		3,201
Prepaid expenses and other current assets		**876**		283
Total current assets		**44,275**		51,968
Property and equipment, net		**1,068**		1,323
Tradename		**2,420**		
Goodwill		**1,795**		
Investment in joint venture		**3,378**		
Other assets		**51**		51
	$	**52,987**	$	53,342
LIABILITIES AND STOCKHOLDERS EQUITY				
Current liabilities:				
Notes payable to related parties	**$**	**6,283**	$	
Accounts payable		**2,903**		4,045
Accounts payable to related parties		**73**		247
Accrued expenses		**2,792**		714
Warranty reserve		**688**		
Income tax payable		**91**		
Total current liabilities		**12,830**		5,006
Commitments and contingencies (Note 14)				
Non-controlling interest in subsidiaries		**9,592**		11,776
Stockholders equity:				
Preferred stock Series A, $.001 par value: 100 shares authorized, 4 shares issued and outstanding at June 30, 2003 and 2002; $10 per share liquidation preference and June 30, 2002				
Common stock, $.001 par value: 100,000 shares authorized; 64,236 shares issued and 61,233 outstanding at June 30, 2003 and 64,233 shared issued and outstanding at June 30, 2002		**64**		64
Additional paid-in capital		**128,469**		128,019
Less: treasury stock at cost, 3,003 shares at June 30, 2003		**(150)**		
Accumulated deficit		**(97,889)**		(91,523)
Accumulated other comprehensive income		**71**		

Total stockholders equity		**30,565**		36,560
	$	**52,987**	$	53,342

The accompanying notes are an integral part of these consolidated financial statements.

LOTUS PACIFIC, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

	Year Ended June 30, 2003	2002	2001
Net revenues:			
Products	**$ 10,049**	$ 5,090	$ 78,121
Products related party	**9,454**	50,416	183,845
Other related party		374	1,226
Total net revenues	**19,503**	55,880	263,192
Cost of net revenues:			
Products	**7,936**	5,395	62,695
Products related party	**7,258**	44,546	164,013
Write down of inventory to lower of cost or market	**238**		3,893
Total cost of net revenues	**15,432**	49,941	230,601
Gross profit	**4,071**	5,939	32,591
Operating expenses:			
Selling, general and administrative (includes amounts to related parties of $0, $46 and $3, respectively)	**9,097**	6,019	14,072
Depreciation and amortization	**486**	12,048	12,020
Research and development	**6,906**	9,392	16,214
Impairment of assets	**498**	20,071	
Total operating expenses	**16,987**	47,530	42,306
Loss from operations	**(12,916)**	(41,591)	(9,715)
Other income (expense):			
Gain on sale of investments			3,560
Interest income	**545**	851	920
Interest expense		(65)	(24)
Equity in earnings of joint venture	**(62)**		
Other	**3,585**	(148)	(7,393)
Total other income (expense), net	**4,068**	638	(2,937)
Income (loss) from continuing operations before income taxes and non-controlling interest	**(8,848)**	(40,953)	(12,652)
Provision (benefit) for income taxes	**(109)**	(3,181)	(6,434)
Loss from continuing operations before non-controlling interest	**(8,739)**	(37,772)	(6,218)
Non-controlling interest in (income) loss of consolidated subsidiaries	**2,373**	1,243	(1,215)
Loss from continuing operations	**(6,366)**	(36,529)	(7,433)
Discontinued operations, net of tax:			
Gain from sale of discontinued operations, including applicable tax benefit of $1,802		16,765	
Gain (loss) from discontinued operations, less applicable tax		789	(28,973)
Total gain (loss) from discontinued operations, net of tax		17,554	(28,973)

Net loss	**$**	**(6,366)**	$	(18,975)	$	(36,406)
Net loss per common share basic and diluted:						
Loss from continuing operations	**$**	**(0.10)**	$	(0.57)	$	(0.12)
Gain (loss) on discontinued operations				0.27		(0.45)
Net loss	**$**	**(0.10)**	$	(0.30)	$	(0.57)
Weighted average common shares outstanding basic and diluted		**63,144**		64,233		64,232

The accompanying notes are an integral part of these consolidated financial statements.

LOTUS PACIFIC, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY AND COMPREHENSIVE INCOME

FOR THE YEARS ENDED JUNE 30, 2003, 2002 AND 2001

(in thousands)

	Comprehensive Income	Preferred Stock Shares	Preferred Stock Amount	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Stock Warrants	Treasury Stock	Accumulated Deficit	Accumulated Other Comprehensive Income	Total Stockholders Equity
Balances at July 1, 2000	$	4	$	64,231	$ 64	$ 119,728	$ 80	$	$ (36,142)	$	$ 83,730
Issuance of Common Stock upon conversion of subsidiary stock				2		18					18
Issuance of stock by subsidiary						41					41
Compensation expense recognized by subsidiaries upon issuance of options and warrants						6,945					6,945
Net loss									(36,406)		(36,406)
Balances at June 30, 2001		4		64,233	64	126,732	80		(72,548)		54,328
Issuance of stock by subsidiary						4					4
Compensation expense recognized by subsidiaries upon issuance of options and warrants						1,203					1,203
Expiration of stock warrants						80	(80)				
Net loss									(18,975)		(18,975)
Balances at June 30, 2002		4		64,233	64	128,019			(91,523)		36,560
Issuance of Common Stock upon conversion of subsidiary stock				3		21					21
Compensation expense recognized by subsidiaries upon issuance of options and warrants						429					429
Acquisition of treasury stock								(150)			(150)
Unrealized gain on securities	71									71	71
Net loss	(6,366)								(6,366)		(6,366)
Balances at June 30, 2003	$ (6,295)	4	$	64,236	$ 64	$ 128,469	$	$ (150)	$ (97,889)	$ 71	$ 30,565

The accompanying notes are an integral part of these consolidated financial statements.

LOTUS PACIFIC, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Year Ended June 30, 2003	2002	2001
Operating activities			
Loss from continuing operations	**$ (6,366)**	$ (36,529)	$ (7,433)
Income (loss) from discontinued operations		17,554	(28,973)
Adjustments to reconcile net loss to cash used in operating activities			
Depreciation and amortization continuing operations	**656**	12,782	12,460
Depreciation and amortization discontinued operations		2,702	5,404
Reserve for uncollectible receivables	**1,979**	44	4,477
Reserve for obsolete and excess inventories	**238**		3,893
Stock compensation recorded by subsidiary-continuing operations	**592**	1,657	9,189
Stock compensation recorded by subsidiary-discontinued operations			47
Loss (gain) on sale of property and equipment			(10)
Gain on sale of investments		(14,963)	(3,560)
Gain on acquisition of treasury stock	**(150)**		
Equity in earnings of unconsolidated entity	**62**		
Impairment of assets	**498**	20,071	
Non-controlling interest in income (loss) of subsidiaries	**(2,373)**	(1,243)	1,215
Change in deferred tax assets		1,997	(1,997)
Changes in operating assets and liabilities:			
Accounts receivable	**(3,641)**	5,180	727
Accounts receivable from related parties	**5,090**	7,747	(9,169)
Inventories	**(7,672)**	6,483	(9,739)
Notes and interest receivable from related parties			(79)
Notes receivable		2,784	
Income tax receivable	**726**	(1,520)	(1,681)
Prepaid expenses and other assets	**(593)**	(117)	1,032
Assets of discontinued operations		3,307	574
Other non current assets		(51)	367
Accounts payable to related parties	**(174)**	(25,825)	8,089
Accounts payable	**(1,142)**	1,145	1,888
Accrued expenses	**1,626**	(1,847)	1,994
Income tax payable	**91**	(366)	(12,504)
Warranty reserve	**(44)**		
Liabilities of discontinued operations		(6,791)	7,772
Cash used by operating activities	**(10,597)**	(5,799)	(16,017)
Investing activities			
Advances to related parties		(10)	
Payments received on advances to related parties			2,981
Issuance of notes receivable from related parties			(300)
Payments received on notes receivable from related parties	**1,930**	1,980	7,560
Purchase of property and equipment	**(64)**	(502)	(1,486)
Proceeds from sale of property and equipment			80
Cash forfeited with subsidiary sale			(484)
Investment in joint venture	**(3,440)**		
Purchase of subsidiary	**(5,808)**		
Proceeds from sale of investments		10,000	2,858

Payment of non-controlling interest on dissolution of subsidiary				(11)		
Purchase of short-term investments		**(16,552)**		(26,723)		(9,437)
Proceeds from sale of short-term investments		**7,645**		31,483		
Cash provided (used) by investing activities		**(16,289)**		16,217		1,772
Financing activities						
Proceeds from advances from related parties		**6,283**				
Proceeds from issuance of stock by subsidiaries				9		13,241
Cash provided by financing activities		**6,283**		9		13,241
Increase (decrease) in cash and cash equivalents		**(20,603)**		10,427		(1,004)
Cash and cash equivalents at beginning of year		**32,647**		22,220		23,224
Cash and cash equivalents at end of year	**$**	**12,044**	$	32,647	$	22,220
Supplemental disclosures of cash flow information						
Cash paid during the year for:						
Interest	$		$	89	$	
Income taxes	$		$	614	$	7,416
Non-cash investing and financing activities						
Acquisition of subsidiary stock with issuance of stock	$	21	$		$	18
Conversion of trade receivable to note receivable	$		$		$	2,784
Transfer of restricted cash to short-term investment	$		$	5,500	$	
Unrealized gain on short term investments	$	98	$		$	

The accompanying notes are an integral part of these consolidated financial statements.

LOTUS PACIFIC, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 Business and Background

Description of Business

Lotus Pacific, Inc. (LPFC , Lotus or Company), a Delaware corporation, is a holding company whose operations are conducted through its subsidiaries. Lotus develops, manages, and operates emerging consumer electronics and communications companies, focusing on developing next generation consumer electronics and communication products. Lotus provides its subsidiaries with capital and strategic infrastructure services.

In April and May 1997, the Company acquired 70% of the common stock of Regent Electronics Corporation (Regent). In June 1997, Regent acquired Amiga-based, multimedia technology related assets and rights from Rightiming Electronics Corporation (Rightiming). On June 26, 2001, the Company spun-off Regent to Regent s management. See Note 3.

In February 1999, the Company acquired 100% of Professional Market Brokerage, Inc. (PMB), a Chicago-based financial trading firm that provides online trading services and 100% of US Securities & Futures Corp. (USSF), a full service brokerage firm in New York, NY. In June 1999, the Company created USS Online, Inc., (USS Online) a wholly-owned subsidiary, and transferred all of its ownership interests in each of USSF and PMB to USS Online to run those two financial service subsidiaries. In February 2000, the Company sold 72% of its ownership in USS Online.

In March 1999, the Company acquired 94.5% of the issued and outstanding common shares of Correlant Communications, Inc. (formerly TurboNet Communications, Inc.) (Correlant), representing an 81% ownership interest in Correlant. Based in San Diego, California, Correlant designed, developed and marketed telecommunications products to cable operators, network service providers, and communications network users in the United States and Asian countries. See Note 3.

In March 1999, the Company acquired 77% of the issued and outstanding common shares of Arescom, Inc. (Arescom). See Note 4. Based in Fremont, California, Arescom designs, manufactures and markets a broad range of high quality remote access products, such as routers and remote managing software, and other inter-networking equipment for Internet Service Providers (ISP), resellers, and system integrators in the North America market. In December 2001, the Company sold approximately 92% of its investment in Arescom, representing 65% of the outstanding securities of Arescom to an unrelated third party. See Note 3.

On April 22, 1999, the Company organized Lotus World, Inc. (Lotus World) to offer Auction Live, an online auction service, to international clients. In May 2002, the Company dissolved Lotus World. See Note 3.

On November 13, 2000, the Company established a wholly-owned subsidiary, Acumen Technology, Inc. (Acumen), incorporated in the state of Delaware and in December 2000, the Company transferred all of the capital stock it held in Correlant and Arescom to Acumen. Other than it s holdings of the Correlant and Arescom stock, Acumen had no material independent operations. In December 2001, Acumen was merged into Lotus and all the assets and liabilities of Acumen were absorbed by the Company.

In June 2001, Acumen formed Lotus Pacific Communications Technology (Beijing) Co., Ltd. (Beijing Lotus), a wholly-owned subsidiary, to support business activity in Beijing. Beijing Lotus has no material independent operations. See Note 18.

On June 29, 2001, a majority of the Company s stockholders, led by T.C.L. Industries Holdings (H.K.) Limited (TCL Industries), were successful in their solicitation to gain control of the Company and to replace prior management and Board of Directors of the Company. On June 29, 2001, new directors and officers were appointed and the then existing directors and officers were immediately terminated.

Following the takeover of the Board of Directors of the Company on June 29, 2001, new management of the Company began a thorough review of all aspects of the business operations of the Company and its subsidiaries and has engaged in numerous transactions to reorganize the Company s business. Under new management, the

Company s primary strategy for business operations has been to reorganize its unprofitable businesses, acquire undervalued or underutilized companies and focus on profitable growth. The Company has moved aggressively to sell, reorganize or shutdown its businesses which were either not operating profitably or may have required significant future cash investment.

In February 2003, Lotus, as majority stockholder of Correlant, appointed four new members to the Board of Directors of Correlant, effectively taking control of Correlant s Board of Directors. Prior to this, Lotus Pacific had only one representative on Correlant s Board of Directors and did not control Correlant s Board or its operations. Immediately thereafter, the Board of Directors created a new Executive Committee of the Board, comprised of two members who are also Lotus Pacific employees, to act on behalf of the Board of Directors and oversee Correlant s management and operations. In July 2003, Correlant s President, Chief Executive Officer and co-founder resigned as a director of Correlant. From that date forward he no longer served as President and CEO of Correlant. In July 2003 the Vice President of Engineering, Secretary, and co-founder of Correlant resigned as director and secretary of Correlant. From that date forward, he no longer served as VP of Engineering. In connection with their resignations, the Company entered into Employment Separation and Consulting Agreements with both former employees. See Note 18. Upon recommendation of its consultants, following the two co-founder s resignations, Correlant began a substantial reduction in its workforce and operations to reduce operating expenses, reducing the number of Correlant employees from 34 as of August 1, 2003 to 18 employees as of December 23, 2003. As a result of declining margins and demand for its products, Correlant s Board of Directors approved the wind down and cessation of Correlant s historical operations in the cable modem business effective December 23, 2003. As part of the wind down, Correlant licensed part of its technology, and could potentially license other technology. Correlant s wind down was substantially completed by March 31, 2004. As of June 30, 2004, Correlant has one employee to maintain corporate records and to comply with statutory reporting requirements. Correlant, together with Lotus, will continue to explore either acquiring or investing in other businesses to utilize its assets.

In April 2003, the Company formed a wholly-owned subsidiary Opta Systems, LLC dba GoVideo (GoVideo or Opta), which purchased 100% of the outstanding membership interests of Opta Systems from Carmco Investments, LLC (Carmco), a Connecticut limited liability company, which had acquired substantially all assets and assumption of certain liabilities of a product line known as GoVideo See Note 3. GoVideo, established in 1984, designs and manufactures product lines in the consumer electronics industry, including digital video disc (DVD) players, portable DVDs, DVD-Video Cassette Recorder (VCR) Combos, Dual-Deck VCRs, DVD Recorders, DVD Recorder + VCRs, and LCD TVs. GoVideo holds various patents covering Dual-Deck technology as well as other electronics products and systems. GoVideo was purchased as part of the Company s strategic direction of investing in companies which will benefit from the Company s strategic relationships with Asian consumer electronic manufacturers. GoVideo s potential for growth under the Company s ownership and established brand name were the primary reasons for the purchase of GoVideo at a price resulting in goodwill being recognized. As of December 31, 2003, GoVideo is the sole operating subsidiary of the Company. See Note 3.

As of June 30, 2003, the only significant subsidiaries were GoVideo and Correlant.

The Company will continue to identify market opportunities that will create and accelerate the growth and success of its subsidiary companies and to implement new business plans to improve the returns on these businesses.

Unless the context indicates otherwise, reference to the Company shall include all of its wholly-owned and majority-owned subsidiaries.

Delays in Reporting

Following the replacement of prior management discussed above, the new management began reviewing various transactions undertaken by old management prior to June 29, 2001. During its preliminary investigation, new management of the Company identified certain material transactions undertaken by prior management that impact reported financial and operating results with respect to its consolidated financial statements for the fiscal years ended June 30, 2001, 2000 and 1999. Due to the preliminary results, the Company dismissed its then existing independent accountants, engaged new independent accountants and re-audited all periods under investigation. Accordingly, Lotus was unable to file its Form 10-K for the period ending June 30, 2002 until April 16, 2004.

On January 30, 2003, the Company and TCL Industries, a stockholder of the Company with holdings of greater than 10% of the Company s outstanding shares, settled all disputes with the prior auditors concerning their audits of the Company for fiscal 2001 and prior. The prior auditors deny that they are liable for any damages to Lotus, but consented to the settlement to avoid the costs of litigation. Pursuant to an agreement dated March 24, 2003 between the Company and TCL Industries, the Company and TCL Industries agreed on the allocation of the settlement funds, whereby TCL Industries received $6,500,000 in cash, the Company received $3,500,000 cash, which is included in Other income (expense) on the consolidated statement of operations. Additionally, the Company may be entitled to receive up to $3,500,000 in cash held in an escrow account, plus interest accrued therein. In connection with the agreement, Lotus and TCL agreed to forbear from bringing claims against each other with respect to the allocation of funds or otherwise.

Note 2 Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of Lotus and its subsidiaries. All significant intercompany transactions and balances have been eliminated. Subsidiaries in which Lotus owns at least 50% are consolidated, except for investments in which control is deemed to be temporary, in which case the equity method of accounting is used. Equity investments in which Lotus owns at least 20% of the voting securities are accounted for using the equity method, except for investments in which the Company is not able to exercise significant influence over the investee, in which case, the cost method of accounting is used. The cost method of accounting is used for all investments in which Lotus owns less than 20%.

Estimates and Assumptions

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates are required as part of inventory valuation, product warranty reserve, allowance for doubtful accounts, goodwill and long-lived asset impairments, valuation allowances on deferred income taxes, the potential outcome of future tax consequences of events recognized in our financial statements or tax returns, and determining when investment impairments are other-than-temporary. Actual results and outcomes may differ from management s estimates and assumptions.

Foreign Operations

The functional currency of the Company is the U.S. dollar. Any accounts denominated in a currency other than the U.S. dollar, mainly the Taiwan dollar and the Chinese RMB, are re-measured and resultant gains and losses are recorded in the Company s consolidated statement of operations. Foreign currency transaction gains (losses) are also included in the Company s consolidated statement of operations. Transaction gains (losses) were not material in fiscal 2003. In fiscal 2002 and 2001, the Company recorded transaction gains (losses) of $(161,000) and $147,000, respectively, which are included with other income (expense) on the consolidated statement of operations.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash and highly liquid investments, which include debt securities with remaining maturities when acquired of three months or less and are stated at cost, which approximates market value.

Short-Term Investments

The Company accounts for short-term investments in accordance with Statement of Financial Accounting Standards (SFAS) SFAS 115, *Accounting for Certain Investments in Debt and Equity Securities* (SFAS 115), and classifies investments as available-for-sale in accordance with that standard. Available-for-sale securities are carried at fair market value. Unrealized gains and losses, net of tax, are reported in stockholders equity. Realized gains and losses and declines in value judged to be other-than-temporary, if any, on available-for-sale securities are included in investment income. The cost of securities sold is based on the specific-identification method. As of June 30, 2003 short-term investments, and any difference between the fair market value and the underlying cost of such investments, consisted of the following (*in thousands*):

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Market Value
Government Securities	$ 9,751	$ 39	$ (1)	$ 9,789
Corporate Bonds	4,115	60		4,175
	$ 13,866	$ 99	$ (1)	$ 13,964

The above unrealized gain relates to Correlant. Therefore, only Lotus s portion of the unrealized gain, $71,000, is included as Other comprehensive income and the remaining $27,000 is included as non-controlling interest in subsidiaries on the balance sheet.

As of June 30, 2002, unrealized holding gains and losses on securities classified as available-for-sale were not material.

As of June 30, 2003 and 2002, short-term investments consisted of government and corporate debt securities with the following maturities (*in thousands*):

	Market value as of June 30, 2003	2002
One year or less	$	$ 4,959
Between one and three years	13,412	
Greater than three years	552	
	$ 13,964	$ 4,959

Fair Value of Financial Instruments

The estimated fair values of all financial instruments on the Company s balance sheets were determined by using available market information and appropriate valuation methodologies. Fair value is described as the amount at which the instrument could be exchanged in a current transaction between informed willing parties, other than a forced liquidation. However, considerable judgment is required in interpreting market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts. The Company does not have any off balance sheet financial instruments.

Cash and cash equivalents, trade accounts receivable, notes receivable, trade accounts payable and certain other current liabilities are reported on the balance sheet at carrying value which approximates fair value due to the short-term maturities of these instruments.

Concentration of Credit Risk

Credit risk represents the accounting loss that would be recognized at the reporting date if counterparties failed completely to perform as contracted. Concentrations of credit risk (whether on or off balance sheet) that arise from financial instruments exist for groups of customers or counterparties when they have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions described below.

Financial instruments that subject the Company to credit risk are cash balances maintained in excess of federal depository insurance limits and accounts receivable with no collateral or security. As of June 30, 2003 and 2002, the Company had combined balances of $11,263,000 and $31,504,000, respectively, which were not guaranteed by Federal Deposit Insurance Corporation (FDIC). The Company has not experienced any losses in such accounts and believes the exposure is minimal. As of June 30, 2003 and 2002, all the Company s receivables were unsecured.

A relatively small number of customers account for a significant percentage of the Company s revenues. The percentage of revenues derived from significant customers is detailed as follows:

	Year ended June 30,		
	2003	**2002**	**2001**
Costco	31%	%	%
Toshiba (Related party, see Note 11)		54	67
TurboComm (Related party, see Note 11)	48	37	3
Terayon		8	13
COM21			11

Gross accounts receivable from these customers totaled $8,944,000 and $7,335,000 at June 30, 2003 and 2002, respectively.

Allowance for Doubtful Accounts

The following are recorded at net realizable value:

Accounts receivable, net;

Accounts receivable from related parties, net; and

Notes and interest receivable from related parties, net.

The Company does business and extends credit based on an evaluation of the customers financial condition generally without requiring collateral. Exposure to losses on trade receivables is expected to vary by customer due to the financial condition of each customer. The Company monitors exposure to credit losses and maintains allowances for anticipated losses considered necessary under the circumstances.

The Company records interest income from interest-bearing loans using an appropriate rate of interest over the life of the loan. Related fees and/or costs are deferred and amortized over the life of the loan using the effective interest method. Interest income recognition is suspended for interest-bearing loans in default and deemed uncollectible. Any payments received subsequently are first applied against the accrued interest balance. Interest income recognition does not resume until the note is deemed collectible.

Delinquent notes and trade accounts receivable are charged against the allowance for doubtful accounts once uncollectibility has been determined. The allowance is determined through an analysis of the aging of accounts receivable and assessments of risk that are based on historical trends and an evaluation of the impact of current and projected economic conditions. The Company evaluates the past-due status of its receivables based on contractual terms of sale. If the financial condition of the Company s customers were to deteriorate, resulting in an impairment of ability to make payments, additional allowances may be required. There was no activity in the allowance for doubtful accounts except during those fiscal years shown below (*in thousands*):

Year ended June 30,		Beginning Balance		Expense/ (Recovery)		Write off and other		Ending Balance
Allowance Accounts receivable:								
2003	**$**	**44**	**$**	**33**	**$**	**(38)**	**$**	**39**
2002				44				44
Allowance Accounts receivable from related party:								
2003	**$**		**$**	**1,946**	**$**		**$**	**1,946**
Allowance Notes and interest receivable from related party:								
2003	**$**	**1,734**	**$**		**$**	**(1,734)**	**$**	
2002		1,734						1,734
2001		1,355		4,477		(4,098)		1,734

Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market value. As of June 30, 2003, inventories are mostly comprised of consumer electronics in transit from the manufacturer, which are generally purchased FOB shipping point. When Correlant had inventory, it was comprised of raw materials, primarily integrated circuits and other electronic components, to be used in the manufacture of cable modems and CMTS units. Correlant had no inventory as of June 30, 2003 and it was completely reserved at June 30, 2002. The Company provides inventory reserves for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated realizable value based upon assumptions about future demand and market conditions. The activity in the allowance for obsolete and excess inventory is shown below (*in thousands*):

Year ended June 30,		Beginning Balance		Expense/ (Recovery)		Write off and other		Ending Balance
2003	$	600	$	238	$	(838)	$	
2002		3,811				3,211		600
2001				3,893		(82)		3,811

Shipping and Handling Charges

The Company includes costs of shipping and handling billed to customers in revenue and the related expense of shipping and handling costs is included in cost of sales.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation. Depreciation and amortization expense is provided using the straight-line method over the estimated useful lives of the assets, which range from 18 months to eight years. Leasehold improvements are amortized using the straight-line method over the shorter of their estimated useful lives or the lease period.

Total depreciation and amortization expense was $656,000, $1,329,000 and $871,000 for fiscal 2003, 2002, and 2001, respectively. Included in this total was amortization of purchased software, a component of cost of sales, of $170,000, $734,000 and $440,000 for fiscal 2003, 2002 and 2001, respectively.

Impairment of Long-Lived Assets

The Company accounts for any impairment of long-lived assets in accordance with SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS 144). SFAS 144 supersedes SFAS 121, *Accounting for the Impairment of Long-Lived Assets and for Assets to Be Disposed Of* (SFAS 121), and the accounting and reporting provisions of the Accounting Principles Board (APB) Opinion 30, *Reporting the Results of Operations Reporting* *the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions* (APB 30), for the disposal of a segment of a business (as previously defined in that opinion). SFAS 144 provides a single accounting model for disposal of long-lived assets. SFAS 144 also changed the criteria for classifying an asset as held for sale and broadens the scope of businesses to be disposed of that qualify for reporting as discontinued operations and changes the timing of recognizing losses on such operations. The broadened definition of discontinued operations with SFAS 144 affected the presentation and disclosure of the Company s results of operations for the year ended 2002 and prior years presented for comparison. In accordance with SFAS 144, long-lived assets, such as property, plant, and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposal group classified as held for sale would be presented separately in the appropriate asset and liability sections of the balance sheet.

During fiscal 2003, the Company recorded a charge of $477,000 relating to the impairment of Correlant s property and equipment resulting from the wind down and cessation of Correlant s historical operations (see Note 1) in the cable modem industry.

Tradename

The Company s Tradename relates to the acquisition cost of the GoVideo Tradename used to market GoVideo products. ***The GoVideo Tradename is not amortized in accordance with*** SFAS 142, *Goodwill and Other Intangible Assets* (SFAS 142) as its life is deemed indefinite**.**

Goodwill

The Company accounts for goodwill in accordance with SFAS 141*, Business Combinations* (SFAS 141), and SFAS 142. As part of its annual review of financial results, the Company noted indicators that the carrying value of its goodwill may not be recoverable. The impairment review was performed due to the prolonged economic downturn affecting Correlant s operations and revenue forecasts. As the Company determined the continued decline in market conditions within Correlant s industry was significant and prolonged, the Company evaluated the recoverability of its goodwill associated with Correlant. Based on the annual testing performed, the Company recorded a goodwill impairment charge of $21,000 and $20,071,000 in fiscal 2003 and 2002, respectively.

The following table summarizes the activity in the Company s goodwill account associated with all acquisitions and dispositions (*in thousands*):

	Correlant	Arescom	GoVideo	Total
Balance at July 1, 2000	$ 44,996	$ 20,497	$	$ 65,493
Acquisition of additional stock of subsidiary	18			18
Sale of investment	(1,901)	(231)		(2,132)
	(11,589)	(5,404)		(16,993)

Amortization expense, year ended June 30, 2001				
Balance at June 30, 2001	31,524	14,862		46,386
Sale of investment		(11,180)		(11,180)
Amortization fiscal 2002	(11,453)	(2,702)		(14,155)
Impairment charge	(20,071)	(980)		(21,051)
Balance at June 30, 2002				
Acquisition of additional stock of subsidiary	21			21
Acquisition of subsidiary			1,795	1,795
Impairment charge	(21)			(21)
Balance at June 30, 2003	$	$	$ 1,795	$ 1,795

Correlant amortization and impairment charge is included in loss from continuing operations. Arescom amortization and impairment charge is included with gain (loss) on discontinued operations and gain on sale of discontinued operations, respectively.

Treasury Stock

Treasury stock is recorded at cost. In the event of subsequent reissue, the treasury stock account will be reduced by the cost of such stock on the average cost basis with any excess proceeds credited to additional paid-in capital.

Comprehensive Income (Loss)

Comprehensive income consists of net income and other gains (losses) affecting shareholders equity that, under generally accepted accounting principles are excluded from net income in accordance with SFAS 130, *Reporting Comprehensive Income* (SFAS 130). Other comprehensive income includes unrealized gains (losses) on marketable securities and foreign currency translation adjustments. During fiscal 2003, the Company s other comprehensive income was comprised of Lotus s portion, $71,000, of the unrealized gains on Correlant s short term investments categorized as available-for-sale. The Company did not have any other comprehensive income during fiscal 2002 or 2001.

Revenue Recognition

GoVideo sells consumer electronics. Revenue is recognized when persuasive evidence of an arrangement exists, product has been shipped, fees are fixed and determinable, collectibility is probable and when all other significant obligations have been fulfilled. At the time of the sale, the Company records an allowance for estimated sales returns based on estimates derived from historical trends. The Company also establishes an allowance for estimated payment term discounts expected to be taken by customers based on analysis of historical trends. Payment term discounts granted are recorded in other expense.

GoVideo provides limited labor and parts warranties on certain of its products for a maximum of one year. GoVideo records a warranty reserve based upon historical experience and an estimate of total exposure associated with products sold to consumers through retail outlets. Correlant, while in the cable modem and cable modem termination system (CMTS) business, did not provide a warranty for its products, primarily the cable modem and CMTS. The warranty liability for defective products was the responsibility of the third-party manufacturer.

Correlant sold cable modems, CMTS and, in certain instances, the Media Access Controller (MAC), a key component of the cable modem. The Company developed and owns the proprietary technology used in the MAC. However, the manufacturing of both the MAC and the cable modem is outsourced to manufacturers. Cable modem and CMTS revenue is recognized upon shipment of the completed unit to the customer. In addition to supplying the MAC to the cable modem manufacturer for use in Correlant cable modems, the Company also sells the MAC for use by the cable modem manufacturer in non-Correlant products. MAC revenue is recognized upon passage of title of the MAC for use by the cable modem manufacturer in its own product.

During fiscal 2002 and 2001, Correlant licensed its proprietary software. Software license revenue wass recognized over the life of the license.

Stock-Based Compensation

SFAS 123, *Accounting for Stock-Based Compensation* (SFAS 123) encourages, but does not require, companies to record compensation cost for stock-based employee compensation plans at fair value. The Company elected to continue to account for stock-based compensation using the intrinsic value method prescribed in APB 25, *Accounting for Stock Issued to Employees* (APB 25) and related Interpretations. Under APB 25 and the intrinsic value method, the exercise price of the Company s employee stock options equals the market price of the underlying stock on the date of grant or, in the case of the Company s employee stock purchase plans since the plans are non-compensatory, no compensation expense is recognized.

The following table illustrates the effect on the Company s net loss and loss per share as if the Company had applied the fair value recognition provisions of SFAS 123 to its stock-based employee compensation awards, and recognized expense over the applicable award vesting period (*in thousands, except per share amounts*):

	Year Ended June 30, 2003	2002	2001
Net loss, as reported	**$ (6,366)**	$ (18,975)	$ (36,406)
Add: Stock-based employee compensation expense included in reported net loss	**429**	1,203	6,898
Less: Stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	**(1,169)**	(2,519)	(7,932)
Pro-forma net loss	**$ (7,106)**	$ (20,291)	$ (37,440)
Basic and diluted net loss per share, as reported	**$ (0.10)**	$ (0.30)	$ (0.57)
Pro-forma basic and diluted net loss per share	**$ (0.11)**	$ (0.32)	$ (0.58)

These numbers do not include Arescom as this detail was unavailable. The pro-forma effect for the years presented is not likely to be representative of the pro-forma effect on reported net income or loss in future years because these amounts reflect less than four years of vesting.

The Company s assumptions made for purposes of estimating the fair value of its stock options, as well as a summary of the activity under the Company s stock option plan are included in Note 12.

Research and Development Costs

Research and development costs are charged to operations as incurred.

Advertising Costs

Advertising costs include payroll, employee benefits, and other headcount-related costs as well as expenses related to advertising, promotions and tradeshows, and are expensed as incurred. Advertising expense included in continuing operations was $87,000, $9,000 and $38,000, in fiscal 2003, 2002 and 2001, respectively.

Income Taxes

Current income tax expense or benefit is the amount of income taxes expected to be payable or refundable for the current year. A deferred income tax asset or liability is computed for the expected future impact of differences between the financial reporting and tax basis of assets and liabilities and for the expected future tax benefit to be derived from tax credits and loss carryforwards. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

Net Income (Loss) per Share

Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of shares of common stock outstanding during the period. Diluted net income (loss) per share is computed by dividing net income (loss) by the weighted average number of shares of common stock and common stock equivalents outstanding during the period. There were no employee stock options or common stock warrants outstanding as of June 30, 2003 or 2002. There were 9,090,000 employee stock options and common stock warrants outstanding as of June 30, 2001 and 1,017,000, 1,134,000 and 1,551,000 shares contingently issuable in connection with share exchange agreements (See Note 3), as of June 30, 2003, 2002 and 2001, respectively, which were not considered in calculating diluted net loss per common share as their effect would be anti-dilutive. As a result, for all periods presented, the Company s basic and diluted net loss per share are the same.

The following table computes basic and diluted net loss per share (*in thousands, except per share amounts*):

	Year Ended June 30,		
	2003	**2002**	**2001**
Numerator:			
Loss from continuing operations	$ (6,366)	$ (36,529)	$ (7,433)
Total gain (loss) from discontinued operations		17,554	(28,973)
Net loss	$ (6,366)	$ (18,975)	$ (36,406)
Net loss per common share basic and diluted:			
Loss from continuing operations	$ (0.10)	$ (0.57)	$ (0.12)
Gain (loss) on discontinued operations		0.27	(0.45)
Net loss	$ (0.10)	$ (0.30)	$ (0.57)
Denominator:			
Common shares outstanding basic and diluted	63,144	64,233	64,232

Reclassifications and Adjustments

Certain prior period amounts have been reclassified to conform to the current period presentation. Such reclassifications had no effect on net loss.

Recently Issued Accounting Standards

In June 2002, the Financial Accounting Standards Board (FASB) issued SFAS 146, *Accounting for Costs Associated with Exit or Disposal Activities* (SFAS 146), which addresses accounting for restructuring and similar costs. SFAS 146 supersedes previous accounting guidance, principally Emerging Issues Task Force (EITF) Issue 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity* (including Certain Costs Incurred in a Restructuring) (EITF 94-3). SFAS 146 requires the liability for costs associated with an exit or disposal activity be recognized when the liability is incurred. Under EITF 94-3, a liability for an exit cost was recognized at the date of the Company s commitment to an exit plan. SFAS 146 also states the liability should initially be measured and recorded at fair value. Accordingly, SFAS 146 may affect the timing of recognizing future restructuring costs as well as the amounts recognized. The Company adopted SFAS 146 during fiscal 2003. The adoption did not have a material effect on the Company s financial position, results of operations, or cash flows as of or for the year ended June 30, 2003.

In November 2002, the FASB issued FASB Interpretation (FIN) 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (FIN 45). FIN 45 requires that upon issuance of a guarantee, the guarantor must recognize a liability for the fair value of the obligation it assumes under that guarantee. The provisions for initial recognition and measurement are effective on a prospective basis for guarantees issued or modified after December 31, 2002, irrespective of a guarantor s year-end. The disclosure requirements of FIN 45 are applicable to the Company s product warranty liability and other guarantees. The Company adopted FIN 45 during fiscal 2003. The adoption did not have a material effect on the Company s financial position, results of operations, or cash flows as of or for the year ended June 30, 2003.

In December 2002, the FASB issued SFAS 148, *Accounting for Stock-Based Compensation Transition and Disclosure* (SFAS 148), which amends SFAS 123. SFAS 148 provides alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation. It also amends the disclosure provisions of SFAS 123 to require prominent disclosure about the effects an entity s accounting policy decisions with respect to stock-based employee compensation have on reported net income in both annual and interim periods. The Company adopted SFAS 148 during fiscal 2003. The adoption did not have a material effect on the Company s financial position, results of operations, or cash flows as of or for the year ended June 30, 2003.

In January 2003, the FASB issued FIN 46, *Consolidation of Variable Interest Entities* (FIN 46). FIN 46 was revised in December 2003. FIN 46 establishes accounting guidance for consolidation of a variable interest entity (VIE), formerly referred to as special purpose entities. FIN 46 applies to any business enterprise, both public and private, that has a controlling interest, contractual relationship or other business relationship with a VIE. FIN 46 provides guidance for determining when an entity (Primary Beneficiary) should consolidate a VIE that functions to support the activities of the Primary Beneficiary. The application of FIN 46 is required for periods ending after December 15, 2003. The Company has no contractual relationship or other business relationship with a VIE, and therefore the adoption of FIN46 will have no effect on the financial position, results of operations, or cash flows.

In January 2003, the EITF published EITF Issue 00-21, *Revenue Arrangements with Multiple Deliverables* (EITF 00-21), which requires companies to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting. In applying EITF 00-21, revenue arrangements with multiple deliverables should be divided into separate units of accounting, if the deliverables in the arrangement meet certain criteria. Arrangement consideration should be allocated among the separate units of accounting based on their relative fair values. This issue is effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003. The Company does not expect the adoption of EITF 00-21 to have a material impact on its financial position, results of operations, or cash flows.

In April 2003, the FASB issued SFAS 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities* (SFAS 149). SFAS 149 amends and clarifies financial accounting and reporting for derivative instruments and hedging activities. SFAS 149 is effective for contracts entered into or modified after June 30, 2003. The Company does not expect SFAS 149 to have a material impact on its financial position, results of operations, or cash flows.

In May 2003, the FASB issued SFAS 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity* (SFAS 150). SFAS 150 represents the first phase of the FASB s project to clarify the accounting treatment of certain instruments that possess characteristics of both liabilities and equity. SFAS 150 generally requires that freestanding financial instruments that obligate the issuer to redeem the holders shares, or are indexed to such an obligation, and are settled in cash or settled with shares meeting certain conditions be treated as liabilities. The provisions of SFAS 150 are effective immediately for instruments entered into or modified after May 31, 2003 and to all other instruments that exist as of the beginning of the first interim financial reporting period beginning after June 15, 2003, with the exception of mandatorily redeemable instruments of non-public companies, which become subject to SFAS 150 for fiscal periods beginning after December 15, 2003. The Company does not expect SFAS 150 to impact the classification of its outstanding preferred stock instruments upon the Company s adoption effective July 1, 2003.

Note 3 Acquisitions and Dispositions Majority Owned Subsidiaries

Correlant Communications, Inc.

On March 31, 1999, the Company entered into a share exchange agreement which provided for the acquisition of 94.5% of the issued and outstanding common shares of Correlant, representing an 81% ownership interest in Correlant. Consideration paid for the purchase was 9,657,000 Lotus common shares valued at $7.21 per share plus contingently issuable shares of up to 1,435,000. The contingent shares were issuable as Correlant options specified in the agreement were exercised. For each option exercised, 81% of such shares were to be transferred to Lotus in exchange for 0.5364 shares of Lotus common stock for each share of Correlant stock transferred. Due to the nature of the contingent consideration, the Company could not at the time reasonably determine whether the additional shares would be issued. Accordingly, pursuant to the provisions of APB 16, *Business Combinations* (APB 16), the contingent consideration is not recorded until such determination can be reasonably made. At the acquisition date, the excess of the purchase price and related costs over the value assigned to the net tangible assets acquired was

$74,545,000 and was assigned to goodwill. The Company recorded $21,000 during fiscal 2003 and $18,000 during fiscal 2001 as additional goodwill as a result issuing 3,000 and 2,000 of the contingently issuable shares in fiscal years 2003 and 2001, respectively.

In April 2000, as part of the Correlant acquisition agreement, Lotus provided Correlant with $10,000,000 of non-interest bearing convertible debt financing. The debt was converted into 10,000 shares of Series D preferred stock on September 30, 2000. Correlant has Series A, B, C and D convertible preferred stock with total liquidation preferences over the common stockholders of $3,450,000, $1,000,000, $4,000,000 and $10,000,000, respectively. In the event the proceeds available for distribution are insufficient to pay all Correlant preferred shareholders the full amount of the liquidation preference, the available proceeds shall be distributed ratably among Correlant s preferred shareholders.

From December 1999 through March 2000, the Company sold 3,657,000 of its shares in Correlant to various third parties, for total proceeds of $73,135,000. In connection with the sale of the Correlant shares, the Company paid commissions totaling $10,970,000 or 15% of the proceeds received to Hywin Investments Limited (Hywin) and related entities, which were related parties. The Company recorded a gain of $50,512,000 on the disposition. This sale reduced the Company s ownership in Correlant to 76% of the outstanding common stock, representing a 65% ownership interest.

During October 2000, the Company sold 656,000 shares of Correlant common stock to various unrelated parties. Although the Correlant shares were transferred to the parties, the Company did not receive any of the proceeds. The Company investigated the transaction and was unable to recover the funds, and as a result the Company recorded a loss of $2,266,000 during fiscal 2001. The sale reduced the Company s ownership in Correlant to 73% of the outstanding common stock representing a 62% ownership interest.

In January 2001, the Company agreed to refund $7,100,000 to several investors that purchased a total of 355,000 shares of Correlant common stock during fiscal 2000. The Company refunded the $7,100,000 to Hywin, who was to return the funds to the individual investors. In connection with the refund, Hywin refunded $1,065,000 of commissions relating to the shares to be returned. However, the shares were never returned to the Company. The Company investigated the transaction and was unable to recover the funds, and as a result, the $6,035,000 was expensed by the Company and is included in Other income (expense) in the consolidated statement of operations.

Arescom, Inc.

On March 31, 1999, the Company entered into a share exchange agreement which provided for the acquisition of 81% of the issued and outstanding common shares of Arescom. Consideration for the purchase was 3,886,000 Lotus common shares valued at $7.25 per share plus contingently issuable shares of up to 273,000. The contingent shares will be issued as Arescom options specified in the agreement are exercised. For each option exercised, 81% of such shares were to be transferred to Lotus in exchange for 0.02915 shares of Lotus common stock for each share of Arescom stock transferred. Due to the nature of the contingent consideration, the Company cannot reasonably determine that the additional shares will be issued. Accordingly, pursuant to the provisions of APB 16, the contingent consideration is not recorded until such determination can be reasonably made. At the acquisition date, the excess of the purchase price and related costs over the value assigned to the net tangible assets acquired was $27,330,000 and was assigned to goodwill. The Company has not issued any contingently issuable shares.

During July 2000, Lotus sold, to unrelated parties, 300,000 shares of Arescom stock for total proceeds of $1,500,000. Pursuant to the terms of the agreement, the number of Arescom shares purchased would be adjusted based on the occurrence of an initial public offering of Arescom. In connection with the sale, Lotus recorded a gain of $1,269,000 during fiscal 2001. On January 31, 2002, the agreements were amended to delete the section related to the adjustment to the number of shares purchased. As consideration for this, the Company issued an additional 150,000 shares of Arescom stock to the parties. Since the investment had no value at the time the shares were issued, there was no gain or loss recorded for the issuance of the additional shares.

In December 2000, the Company agreed to refund the $1,500,000 received in connection with the sale of Arescom stock. The amount refunded to the Company s attorney was to be returned to the individual investors. However, the funds were not returned to the investors and the shares were never returned to the Company. The Company investigated the transaction and as a result, filed a claim against the individual. However, as the Company was unable to recover the funds, the $1,500,000 was expensed in fiscal 2001 and is included in Other income (expense) in the consolidated statement of operations.

Effective December 18, 2001, Lotus sold, to an unrelated party approximately 92% of its investment in Arescom, representing 65% of the outstanding securities of Arescom for $10,000,000. In connection with this agreement, the Share Exchange and related Agreements from March 1999 were terminated thus eliminating the restrictions on the Company s common stock issued to Arescom shareholders and the Company was released from all liability as a guarantor of Arescom s indebtedness to an unrelated third party. In addition, the Company and Arescom entered into an exchange agreement, whereby the Company forgave $13,235,000 due from Arescom in exchange for a new promissory note for the principal sum of $2,192,000 (See Note 8) and 11,000 shares of subordinated preferred stock of Arescom. The Company determined that there was no value associated with the 11,000 shares of subordinated preferred stock of Arescom. Immediately following the sale of its majority interest in Arescom, the Company determined that the value of its remaining 6% interest in Arescom was impaired. The Company recognized a net gain of $16,765,000, which includes a tax benefit of $1,802,000, on the sale, exchange of the debt and impairment of the remaining value of its investment. The sale of Arescom and its related operating results have been excluded from the results from continuing operations and classified as a discontinued operation for all periods presented in accordance with the requirements of SFAS 144.

The Company s auditors were unable to audit the financial statements of Arescom, a significant subsidiary, for fiscal 2001 as the subsidiary would not provide the necessary information to allow the auditors to complete the audit. Due to the subsidiary s lack of cooperation, the Company s auditors were unable to attain satisfaction about the subsidiary s account balances by means of other auditing procedures. As a result, the Company s auditors did not express an opinion on the consolidated financial statements for fiscal 2001.

The following is a summary of the results of discontinued operations relating to Arescom for the years ended June 30, 2002 and 2001 (*in thousands*).

	Year Ended June 30,	
	2002	**2001**
	(Unaudited)	**(Unaudited)**
Net revenues	$ 38,200	$ 31,086
Cost of net revenues	27,295	39,503
Gross profit	10,905	(8,417)
Operating expenses		
General and administrative	7,342	14,999
Amortization	2,702	5,404
Loss from operations	861	(28,820)
Other income (expense)	(72)	(153)
Gain (loss) from discontinued operations	$ 789	$ (28,973)

In September 2003, the Company sold its remaining 6% interest in Arescom. See Note 8. On the sale date, the 6% ownership interest in Arescom had no value.

Lotus World

On April 22, 1999, Lotus organized Lotus World, Inc (Lotus World) and invested $1,000,000. On March 12, 2002, the Company and Lotus World entered into an Asset Purchase and Assignment and Assumption Agreement with Avtech Technology, whereby the Company assigned its rights to certain contracts and related intangible assets to Avtech in exchange for Avtech s assumption of all of the Lotus World s obligations under the contracts assigned. There was no gain or loss associated with the transaction with Avtech. Subsequent to the completion of the transaction, the Company dissolved Lotus World.

Regent Electronics Corporation

In June 2001, the Company entered into an Acquisition Agreement with the management of Regent Electronics Corporation (Regent) providing for the transfer by the Company of its 93% ownership of the outstanding shares of capital stock of Regent to the Management of Regent. As consideration for the transfer of these shares to Regent s management, Regent management agreed to pay the Company $1 and 50% of the earnings generated by Regent starting from the date of the agreement until the aggregated payment totals $15,000,000. To date the Company has not received anything from Regent as Regent has had no earnings. In connection with the spin-off of Regent, the Company forgave amounts due from Regent in the amount of $4,098,000. During fiscal 2001, the Company recorded a net loss of $213,000 from the spin-off of Regent and forgiveness of the debt.

Opta Systems, LLC dba GoVideo

In April 2003, the Company loaned $5,986,000 to Opta, which was used, in addition to a deposit of $250,000 paid by Opta, to complete its purchase of substantially all assets and assumption of certain liabilities of a product line known as GoVideo from SONICblue Incorporated, a Delaware corporation (NASDAQ: SBLU), and Sensory Science Corporation, a Delaware corporation and wholly-owned subsidiary of SONICblue. The purchase was pursuant to a purchase agreement and an order issued by the United States Bankruptcy Court, Northern District of California, San Jose Division overseeing SONICblue s bankruptcy case.

Immediately subsequent to Opta s purchase of the GoVideo product line, the Company purchased 100% of the outstanding membership interests of Opta from Carmco Investments, LLC (Carmco), a Connecticut limited liability company for $420,000, representing the return of the $250,000 deposit used in the acquisition of the GoVideo product line and $170,000 for related transaction fees and expenses. In addition, Lotus agreed to pay up to an additional $200,000 for legal fees incurred by Carmco and an additional $100,000 if certain significant vendors continued their relationship with Opta through October 2003. Subsequent to the closing, the Company paid an additional $294,000 in connection with these items. In connection with this agreement, the $5,986,000 originally loaned to Opta was converted to a capital contribution, resulting in a total purchase price, including actual out-of-pocket expenses of approximately $6,770,000. In October 2003, the purchase price was reduced by $962,000 based on a settlement with SONICblue concerning the purchase price of certain assets acquired, resulting in an adjusted purchase price of $5,808,000. The $962,000 was refunded to GoVideo and is recorded as a note payable to Lotus Pacific. The following is a condensed balance sheet showing the fair values of the assets acquired and the liabilities assumed on the date of acquisition (*in thousands*):

Accounts receivable	$	2,959
Inventory		1,361
Equipment		814
Intangibles not subject to amortization		4,215
Current liabilities		(3,541)

Purchase price of net assets acquired	$	5,808

The amount allocated to intangibles includes $2,420,000 allocated to the GoVideo Tradename, for the acquisition cost of the tradename used to market the GoVideo products and goodwill of $1,795,000, ***representing the excess of the cost of the acquired company over the fair value of the net assets at the date of acquisition. The GoVideo Tradename and goodwill are not amortized in accordance with*** SFAS 142, as the lives are deemed indefinite***. For income tax purposes, the entire amount of the goodwill is deductible.***

Note 4 Acquisitions and Dispositions Equity Method Investess

In January 2003, the Company entered into an agreement to form a joint venture with Beijing Youbang Online Electronics Technology Co., Ltd. (Youbang), TCL Computer Technology Co., Ltd. (TCL Computer), an affiliate of TCL Industries and all the equity holders of Youbang, pursuant to which the Company acquired a 50% interest in a new joint venture to own substantially all of Youbang s operations. Pursuant to the agreement, all of Youbang s assets, other than real estate, were transferred to a newly formed Beijing, China joint venture named TCL Digital Technologies, Ltd., and operates as a computer notebook manufacturing company in China. The Company contributed 50% of the total investment amount or approximately $5,240,000, payable in three installments. At the time, the investment was part of the Company s business strategy to seek businesses to maximize the Company s growth potential based on its assets. However, shortly after completing its investment, the Company deemed the joint venture s business model did not fit with the Company s long-term business strategy, and diverted management resources from the operations of other subsidiaries, notably GoVideo, as discussed above. See Note 18.

Note 5 Acquisitions and Dispositions Cost Method Investees

TurboComm Technology

During fiscal 2000, the Company purchased shares of stock of TurboComm Technology, (TurboComm) Correlant s supplier and related party (See Note 11), for a total of $686,000 from an existing shareholder of TurboComm. The number of shares acquired represented a small percentage of TurboComm, and thus the investment was carried at cost. This investment was disposed of in fiscal 2001 through the sale to another shareholder of TurboComm for total proceeds of $1,358,000, resulting in a gain of $672,000.

Note 6 Accounts Receivable and Accounts Receivable from Related Parties

The following summarizes components of accounts receivable, net (*in thousands*):

	June 30,			
	2003		2002	
Accounts receivable	**$**	**6,886**	$	325
Allowance for doubtful accounts		**(39)**		(44)
	$	**6,847**	$	281

The following summarizes components of accounts receivable from related parties, net (*in thousands*):

June 30,

	2003	2002
Accounts receivable from related parties	**$ 1,985**	$ 7,075
Allowance for doubtful accounts	**(1,946)**	
	$ 39	$ 7,075

Note 7 Inventories

The following summarizes components of inventories (*in thousands*):

	June 30, 2003		June 30, 2002	
Raw materials	**$**		$	600
Service replacement parts		**2,558**		
Finished goods		**3,880**		
		6,438		600
Allowance for obsolete inventory				(600)
	$	**6,438**	$	

Note 8 Notes and Interest Receivable from Related Parties

The following summarizes components of notes and interest receivable from related party (*in thousands*):

	June 30, 2003		June 30, 2002	
Notes and interest receivable from related parties	**$**	**1,592**	$	5,256
Allowance for doubtful accounts				(1,734)
	$	**1,592**	$	3,522

On April 7, 2000, the Company loaned $10,000,000 to TurboComm. Originally the promissory note was due one year from effective date with interest at the rate of 6% per year. TurboComm was unable to make payments in accordance with the terms of the agreement and became delinquent on the note. As a result, the Company suspended interest income accruals and all payments received were applied to the principal balance. The principal balance due on the note was $0 and $1,320,000 as of June 30, 2003 and 2002, respectively.

In fiscal 2000, Lotus loaned USS Online $1,300,000. The loan was originally due on demand, with interest at the rate of 8% per year. As of June 30, 2000, the Company deemed the note and the accrued interest of $55,000 uncollectible and fully reserved against the principal and interest due. In March 2001, the note was refinanced and interest accrued during fiscal 2001 and 2000 totaling $134,000 was added to the note. Subsequent to the refinancing, the Company suspended interest income accruals. In fiscal 2001, the Company advanced $300,000 to PMB. There was no interest and no due date associated with the advance. As of June 30, 2001, Lotus deemed the advance uncollectible and fully reserved against the amount owed by PMB. To date, the amounts have not been collected and Lotus entered into litigation to obtain the total amount due to them. On February 18, 2003, the Company entered into a settlement agreement to settle all the disputes with USS Online and subsidiaries. See Note 14.

As discussed in Note 3, in December 2001, the Company sold, to an unrelated party approximately 92% of its investment in Arescom for $10,000,000. In connection with this agreement, the Company and Arescom entered into an exchange agreement, whereby the Company forgave $13,235,000 due from Arescom in exchange for a new promissory note (New Note) for the principal sum of $2,192,000 and 11,000 shares of subordinated preferred stock of Arescom. The New Note, due November 3, 2002 accrued interest at a rate of 4% per annum. Accrued and unpaid interest became due and payable on November 3, 2002. The payment of principal under the New Note and interest thereon, was secured by the grants to Lotus Pacific of a security interest in all of the Company s right, title and interest in all amounts owing to the Company from Microsoft Corporation under the Modem Purchase Agreement, dated February 7, 2000 among Arescom and Microsoft Corporation pursuant to the Loan and Security Agreement. Arescom was unable to make payments in accordance with the terms of the agreement and became delinquent on the note. In May 2003, the Company filed an action against Arescom seeking to recover from

Arescom $1,704,000, representing amounts previously due on the promissory note and damages resulting from Arescom s failure to cooperate with the Company in its efforts to restate and reaudit the Company s consolidated financial statements for prior periods. In September 2003, the Company settled all claims against Arescom, including all amounts previously due on the promissory note dated December 14, 2001 that were paid in installments through December 15, 2003. The balance due on note at June 30, 2003 and 2003 was $1,592,000 and $2,192,000, respectively. As part of the settlement, the Company also exchanged with certain shareholders of Arescom all of the shares of Arescom common stock and Series B Preferred Stock held by the Company for all of the shares of the Company s common stock held by such shareholders. Pursuant to the stock swap agreement, the Company was to acquire up to 3,886,000 shares of its stock. To date, the Company has received 3,578,000 shares of its stock. Arescom agreed to hold in escrow all of the Arescom shares previously held by Lotus for a period of one year. At the end of such period, if any additional shareholders have not then tendered their Lotus shares and as a result, Arescom has not distributed the escrowed Arescom shares, Arescom will retain the escrowed Arescom shares and indemnify Lotus for any claims by shareholders who have not then tendered their Lotus shares. There was no value on the Company s books for the Arescom shares at the date of the transactions.

Note 9 Property and Equipment

The following summarizes components of property and equipment (*in thousands*):

	June 30,	
	2003	**2002**
Computer hardware and purchased software	**$ 2,086**	$ 2,007
Office furniture and lab equipment	**2,483**	2,136
Leasehold improvements	**628**	176
	5,197	4,319
Accumulated depreciation and amortization	**(4,129)**	(2,996)
	$ 1,068	$ 1,323

Note 10 Notes Payable

In June 2003, GoVideo borrowed $6,283,000 from TCL Industries and Asia Focus Industrial Ltd., entities affiliated with TCL Industries, to fund inventory purchases and operating expenses. These advances, which accrue interest at annual rates of approximately 4% and are guaranteed by Lotus, are due at various dates during 2004. The advances have not been repaid, and GoVideo and TCL Industries are currently negotiating an extension on the due dates for those notes that have matured. Neither the TCL Industries nor the Asia Focus advance is collateralized. Both advances are subordinate to GoVideo s bank line of credit. See note 18.

Note 11 Related Party Transactions

During fiscal 2002, the Company incurred consulting expense in the amount of $46,000 to entities related to a significant shareholder of the Company. Additionally, during fiscal 2002 the Company leased a portion of the building to a significant shareholder and shared employees with the significant shareholder. Amounts due from the shareholder for such services as of June 30, 2002 were $5,000. There were no such amounts due from this shareholder as of June 30, 2003. See Note 14

Correlant

Cooperative Research and Development Agreement. During the periods presented in this report, Correlant had significant transactions with two related party stockholders. In 1997, the Company established a relationship with Toshiba Corporation (Toshiba), whereby Correlant and Toshiba entered into a cooperative research and development agreement. As part of this arrangement, the Company agreed to pay Toshiba a percentage of the selling price of each developed product sold to customers, other than Toshiba, which utilized the technology developed under the agreement. Royalty expense to Toshiba was $0, $52,000 and $819,000 for fiscal 2003, 2002 and 2001, respectively. Accounts payable to Toshiba for unpaid royalties as of June 30, 2003 and 2002 was $0 and $9,000, respectively, and is included in accounts payable to related parties.

Toshiba accounted for 54% and 67% of the Company s consolidated revenues for fiscal 2002 and 2001, respectively. Effective February 1, 2002, Correlant ceased selling completed cable modems directly to Toshiba. As a result, there was no revenue attributed to Toshiba during fiscal 2003.

Manufacturing and Sales. During the periods presented in this report, Correlant also had an established relationship with TurboComm, a company located in Taiwan that manufactures high-speed data over cable technology products. Correlant purchased the completed cable modems and CMTS units from TurboComm. For fiscal 2003, 2002 and 2001, purchases from TurboComm were $271,000, $20,439,000 and $221,997,000, respectively. Accounts payable to TurboComm was $73,000 and $238,000 as of June 30, 2003 and 2002, respectively, and is included in accounts payable to related parties in the consolidated balance sheet.

Additionally, during fiscal 2001, Correlant began selling the MAC to TurboComm for use by them in their own products. For fiscal 2003, 2002 and 2001, MAC sales to TurboComm accounted for 42%, 35% and 3% of total net revenues, respectively. As a result of the above transactions, accounts receivable from TurboComm amounted to $1,985,000 as of June 30, 2003. Of this receivable, $1,946,000 was deemed uncollectible and reserved. See Note 18. Accounts receivable from TurboComm as of June 30, 2002 was $7,070,000 and is included in accounts receivable, related parties in the consolidated balance sheet.

Note 12 Stockholders Equity

Preferred Stock

Lotus has one class of preferred stock, which is designated Series A preferred stock. The par value is $0.001 per share and 100,000 shares are authorized. Series A preferred stock has the same voting rights as common stock, a liquidation preference of $10 per share, is entitled to the right to receive dividends on the same per share basis as common shareholders and is redeemable by the Company, at its sole option in whole or in part, at any time at $10 per share. There are 4,000 shares issued and outstanding at June 30, 2003, 2002, and 2001.

Common Stock Transactions

During fiscal 2003 and 2001, the Company issued 3,000 and 2,000 shares of common stock valued at $21,000 and $18,000, respectively, to Correlant shareholders in connection with the Share Exchange Agreement. See Note 3. There were no shares issued during fiscal 2002.

Subsidiary Stock Transactions

During fiscal 2001, Arescom issued 31,000 shares upon the exercise of options for proceeds of $39,000, which has been recorded in the Company s consolidated equity. This transaction did not have a material effect on the Company s ownership of Arescom.

During fiscal 2001, Arescom granted warrants to an affiliate of a bank in connection with the receipt of a waiver for non-compliance with required covenants under their line of credit. The estimated fair value of the warrant is $47,000, which was determined using the Black-Scholes valuation model. The value of the warrants has been recorded in the Company s consolidated equity.

During fiscal 2003, 2002 and 2001, Correlant issued 7,000, 6,000, and 6,000 shares upon the exercise of options for proceeds of $250, $9,000 and $3,000, respectively. For fiscal 2003, 2002 and 2001, the Company recorded $0, $4,000 and $2,000 in consolidated equity for the issuance of these shares. The remaining amount was recorded as non-controlling interest in subsidiaries on the consolidated balance sheet. These transactions did not materially affect the Company s ownership of Correlant.

During fiscal 2003, 2002, and 2001, Correlant recognized compensation expense of $592,000, $1,657,000 and $9,189,000, respectively for the difference between the exercise price and fair value of stock options issued to employees. For fiscal 2003, 2002 and 2001, the Company recorded $429,000, $1,203,000 and $6,898,000 in consolidated equity for the recognition of the compensation expense. The remaining amount was recorded as non-controlling interest in subsidiaries on the consolidated balance sheet.

At the date the Company acquired a majority interest in Correlant, Correlant had preferred stock outstanding that Lotus did not acquire. In addition, in April and May 1999, Correlant sold preferred stock to third parties for net proceeds of $1,463,000, which was recorded as non-controlling interest in subsidiaries on the consolidated balance sheet. The preferred stock held by third parties has a liquidation preference over the common shareholders of $8,425,000, which was included in non-controlling interest in subsidiaries on the consolidated balance sheets for fiscal 2003 and 2002.

Stock Warrants

In May 1997, the Company issued 8,000,000 common stock warrants for $80,000. Each warrant entitled the holder to purchase one share of the Company s common stock at $6 per share. All warrants expired May 5, 2002 and as such, the $80,000 proceeds received were reclassed from warrants to additional paid in capital at June 30, 2002.

Stock Option Plans

Lotus

In May 1997, Lotus granted 1,090,000 options to certain officers and key employees with an exercise price of $6.00 per share, which was the market price of Lotus s common stock at the time of grant. Options were 100% vested when granted and expire five years from grant date. As of June 30, 2001, 2000 and 1999, 1,090,000 options were outstanding. All options expired during the year ended June 30, 2002 and as such there were no options outstanding as of June 30, 2003 or June 30, 2002.

The shareholders approved the 2000 Equity Incentive Plan (Incentive Plan) on April 28, 2000. The Board of Directors administers the Incentive Plan. Employees, directors, and consultants of the Company and its affiliates, who in the judgment of the Board render significant service to the Company, are eligible to participate. The Incentive Plan provides for the award of a broad variety of stock-based compensation alternatives such as nonstatutory stock options, incentive stock options, restricted stock, performance awards and stock appreciation rights. The Incentive Plan provided 11,355,000 shares of common stock to be offered. The vesting provisions of individual options may vary. The exercise price shall not be less than 100% of the fair market value of a common stock on the grant date. No options have been granted since the Incentive Plan s adoption.

GoVideo

Currently, GoVideo has no approved stock option or stock issuance plan.

Correlant

In March 1998, Correlant s Board of Directors approved the 1998 Stock Option/Stock Issuance Plan (1998 Plan) under which 8,500,000 shares of common stock are authorized for issuance, and reserved for purchase upon exercise of options granted. The 1998 Plan provides for the grant of incentive and non-statutory options and issuance of common stock under the stock issuance program (as defined) to employees, directors, and consultants.

The exercise price of incentive stock options must equal at least the fair value on the date of grant and the exercise price of non-statutory stock options and the issuance price of common stock under the stock issuance program may be no less than 85% of the fair value on the date of grant or issuance. The options are exercisable for a period of up to ten years after the date of grant. Options granted prior to August 2001 vest over four years at the rate of 25% on each anniversary of the vesting start date. Options granted subsequent to August 2001 vest over three years at the rate of 33% after the first and second anniversaries and the remainder after the third anniversary.

Correlant reviewed its exercise prices and arrived at the fair value for accounting purposes for each option grant since July 1, 1999. With respect to the 597,000 options granted between July 1, 1999 and June 30, 2000, the Company recorded deferred stock compensation of $5,144,000 for the difference between the exercise price per share determined by Correlant s Board of Directors and the fair value per share for accounting purposes at the grant date. The approximate weighted average fair value per share for accounting purposes was $14.23. Deferred stock compensation is recognized and amortized on an accelerated basis in accordance with FIN 28 over the vesting period of the related options, generally four years.

In connection with Lotus s acquisition of Correlant in March 1999, Lotus obtained the right to acquire up to 2,674,000 additional Correlant shares upon acquisition of such shares by the option holders. All options granted by Correlant through December 21, 1999 are subject to an exchange agreement, whereby Lotus acquires 81% of the shares exercised in exchange for 0.5364 shares of Lotus stock for each Correlant share exchanged. The Lotus shares into which the acquired shares are exchangeable were restricted from sale until Correlant met certain financial milestones and the options were, at the time of grant, considered to be contingent. Effective August 31, 2000, the restrictions were removed and, accordingly, the Company recorded deferred stock compensation for 2,613,000 previously contingent options that were outstanding as of the date the restrictions were lifted. The deferred stock compensation recorded related to these shares is being amortized over the vesting periods of the related options on an accelerated basis in accordance with FASB Interpretation 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans* (FIN 28). The total deferred compensation relating to the previously contingent options is $9,034,000 based on the value of the options on the date the contingency was removed.

The following table summarizes stock option activity under the 1998 Stock Option Plan and related information through June 30, 2003 (*in thousands*):

	Options	**Weighted-Average Exercise Price**
Outstanding at June 30, 2000	3,277,000	1.54
Granted		
Exercised	(6,000)	0.48
Cancelled	(113,000)	0.79
Outstanding at June 30, 2001	3,158,000	1.57
Granted	1,616,000	1.50
Exercised	(6,000)	1.50
Cancelled	(685,000)	2.60
Outstanding at June 30, 2002	4,083,000	$ 1.37
Granted		
Exercised	**(7,000)**	**0.04**
Cancelled	**(376,000)**	**0.94**
Outstanding at June 30, 2002	**3,700,000**	**$ 1.41**

As of June 30, 2003, 2002 and 2001, there were 2,868,000, 2,080,000 and 1,108,000 options exercisable, respectively, at the weighted average prices of $1.31, $1.18 and $1.14 per share, respectively. There were no options granted prior to March 1998 and 4,558,000 shares are available for future grant at June 30, 2003.

The following table summarizes all options outstanding by price range as of June 30, 2003 (*in thousands*):

Range of Exercise Prices		Options Outstanding Number Outstanding	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price		Options Exercisable Number Exercisable	Weighted-Average Exercise Price	
$	0.038 to 0.095	825,000	5.15	$	0.07	824,000	$	0.07
	1.00 to 1.50	2,751,000	6.83		1.22	1,951,000		1.21
	12.00 to 15.00	124,000	6.83		14.65	93,000		14.65
$	0.038 to 15.00	3,700,000	6.45	$	1.41	2,868,000	$	1.31

As discussed in Note 2, the Company accounts for stock-based awards using the intrinsic value method in accordance with APB 25 and its related interpretations. SFAS 123 requires the disclosure of pro forma net income (loss) and earnings (loss) per share as if the Company had adopted the fair value method as of the beginning of 1996. There were no options granted during the year ended June 30, 2003. The weighted-average fair value of options granted during the year ended June 30, 2002 was $1.14. There were no options granted in 2001. The calculations were made using the Black-Scholes option-pricing model. The fair value of the Company s stock-based awards to employees was estimated assuming no expected dividend and the following weighted-average assumptions for 2002: expected volatility of 78%; risk-free interest rate of 5.5%; and a weighted-average expected life of the options of five years. For purposes of pro forma disclosures, the estimated fair value is amortized on an accelerated basis in accordance with FIN 28 over the vesting period.

Note 13 Income Taxes

The provision (benefit) for income taxes for fiscal 2003, 2002 and 2001 is comprised of the following (*in thousands*):

	Year Ended June 30, 2003		2002		2001	
Current:						
Federal	**$**	**(111)**	$	(5,016)	$	(4,691)
State		**2**		2		(1,260)
Foreign				(164)		1,514
		(109)		(5,178)		(4,437)
Deferred:						
Federal				1,564		(1,564)
State				433		(433)
Foreign						
				1,997		(1,997)
Total	**$**	**(109)**	$	(3,181)	$	(6,434)

The reported provision (benefit) for income taxes for the year ended June 30, 2003, 2002 and 2001 differ from the amount computed by applying the statutory federal income tax rate of 35 percent to the consolidated income (loss) before income taxes as follows (*in thousands*):

	Year Ended June 30,		
	2003	**2002**	**2001**
Provision (benefit) computed at statutory rates	**$ (2,266)**	$ (13,899)	$ (4,853)
Increase (reduction) resulting from:			
Non-deductible goodwill		11,979	4,056
Non-deductible expenses	**8**	7	50
State taxes, net of federal benefit	**2**	435	(1,534)
Utilization of NOLs	**(111)**	(4,425)	(10,325)
Utilization of tax credits			(2,278)
Valuation allowance	**2,258**	2,722	8,450
Total	**$ (109)**	$ (3,181)	$ (6,434)

The components of the Company s net deferred income tax asset is as follows (*in thousands*):

	As of June 30,	
	2003	**2002**
Current deferred tax assets:		
Accrued expenses	**$ 836**	$ 215
Deferred compensation	**5,486**	5,487
Deferred revenue	**45**	126
Inventory reserves	**2,054**	244
Allowance for bad debts	**3,170**	69
Total	**11,591**	6,141
Valuation allowance for deferred tax assets (liabilities)	**(11,591)**	(6,141)
Net deferred tax assets	**$**	$
Non-current deferred tax assets:		
Net operating loss carryforwards	**$ 4,247**	$ 949
Tax credit carryforwards	**1,539**	1,027
Basis difference in joint venture	**25**	
Other	**(32)**	
Total	**5,779**	1,976
Valuation allowance for deferred tax assets	**(5,779)**	(1,976)
Net deferred tax assets	**$**	$

The net change in the total valuation allowance for fiscal 2003 and 2002 was an increase of $9,253,000 and $1,258,000, respectively. In assessing the realizability of deferred tax assets, the Company considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. The Company considers the projected future taxable income and tax planning strategies in making this assessment. Based on the level of historical operating results and projections of taxable income for the future, the Company has determined that it is more likely than not that the deferred tax assets will not be realized through future taxable earnings. Accordingly, a valuation allowance was recorded to reduce deferred tax assets to the amount that is more likely than not to be realized. There can be no assurance that the Company will ever be able to realize the benefit of some or all of the federal and state loss carryforwards either due to ongoing operating losses or due to ownership changes, which limit the usefulness of the loss carryforwards.

At June 30, 2003, the Company had a California net operating loss carryforward of $10,343,000 which will begin to expire in 2013 unless previously utilized. At June 30, 2003, the Company had a Federal net operating loss carryforward of $9,522,000 which will begin to expire in 2023 unless previously utilized. The federal net operating losses generated in fiscal 2002 and 2001 were carried back to fiscal 2000 and are reflected as an income tax receivable in fiscal 2002.

The Company is currently under IRS audit for tax years ending June 30, 2001, 2000, and 1999. The IRS may propose certain adjustments, which could be material in amount, in connection with its audit of these periods. The Company believes that it has provided sufficiently for all audit exposures.

At June 30, 2003, Correlant has federal and state research and development credit carryforwards of $568,000 and $971,000 respectively, which will begin to expire in 2022 unless previously utilized.

Federal and state tax laws impose restrictions on the utilization of net operating loss and tax credit carryforwards in the event of an ownership change for tax purposes as defined under Section 382 of the Internal Revenue Code.

On September 11, 2002, the Governor of California signed into law new tax legislation that suspends the use of NOL carryforwards into tax years beginning on or after January 1, 2002 and 2003. Should the Company have taxable income for the year ending June 30, 2004, it may not look to California net operating losses generated in prior years to offset taxable income. This suspension will not apply to tax years beginning in 2005 and beyond.

Note 14 Commitments and Contingencies

Leases

The Company leases its facilities and certain equipment under non-cancelable operating leases, expiring at various dates through 2007. During fiscal 2003 and 2002, the Company leased a portion of the building to a significant shareholder of the Company. The sublease terminated August 1, 2003 when the Company moved to a new building. Sublease income totaled $1,000 and $8,000 during fiscal 2003 and 2002, respectively.

GoVideo, which was acquired in April 2003, has an operating lease for a 33,000 square foot facility that is used for both office space and warehousing. The remaining term of the lease is approximately two years. Monthly rentals are based on a fixed schedule that provides for periodic rental adjustments during the lease term.

GoVideo also leases a 13,000 square foot facility under another operating lease that is used for warehousing. The term of the lease is for five years and began on November 11, 1999. Monthly rentals are based on a fixed schedule that provides for periodic rental adjustments during the lease term. Upon expiration of the initial term of these leases, there is an option to extend the term for an additional five years.

Correlant leases approximately 26,000 square feet of office space in San Diego, California, which expires November 2007. Due to the shut down of operations, Correlant s interim management has attempted to either sublease the San Diego facility or negotiate a lease buy out with the landlord. Due to the weak commercial real estate market in San Diego, interim management has not been successful.

The following is a schedule by years of future minimum lease payments under operating leases and future non-cancelable sublease income *(in thousands):*

Years Ended June 30,		Future Minimum Lease Payments
2004	$	856
2005		874
2006		758
2007		339
2008 and thereafter		365
	$	3,192

Rent expense totaled $591,000, $496,000 and $595,000 during fiscal 2003, 2002 and 2001, respectively.

Purchase Obligations

As of June 30, 2003, GoVideo had inventory purchase obligations totaling $10,738,000, which were part of the normal course of business.

Litigation

On April 11, 2003 Sharp Electronics filed suit against Correlant in the United States District Court for the District of Delaware. The complaint alleged cancellation of a purchase order outside the allowable cancellation timeframe under the terms of the purchase order. The complaint sought payment of the purchase order totaling $1,150,000. Correlant filed an answer on June 16, 2003, stating the components delivered by Sharp Electronics did not meet product specification and were unusable. On that same date, Correlant filed a counter suit for seeking recovery of components previously delivered by Sharp, which also did not meet product specification. Correlant sought to recover damages totaling $1,450,000. On January 21, 2004 Sharp agreed to settle all disputes with Correlant for $500,000, which was accrued as of June 30, 2003. Additionally, as part of the settlement, Correlant dropped its countersuit.

On January 3, 2001, Lotus Pacific filed a lawsuit in the United District Court Eastern District of New York against William Hu, which complaint was subsequently amended July 30, 2002. In the amended complaint, Lotus Pacific brought claims for breach of fiduciary duty, professional negligence, accounting and conversion relating to transfers in December 2000 of approximately $3,600,000 million from Mr. Hu s attorney trust account. Mr. Hu was alleged to be the Company s counsel from January 1998 and later its former CEO from January 2001 to June 29, 2001.

On January 16, 2002, Lotus Pacific filed a lawsuit in the Supreme Court of the State of New York, New York County against USS Online, Travelway, and Huaya Lu Tung, seeking to recover $1,800,000 in principal and interest due on loans made to USS Online (See Note 8), and seeking to pierce the corporate veil and recover such amounts from defendants Travelway and Huaya Lu Tung. The Company is a holder of a 28% minority interest in USS Online, and Travelway is the 72% equity owner of USS Online. The Company asserted that Ms. Tung was the Chairperson and sole owner of Travelway and Chairperson of USS Online and the former Treasurer of the Company.

In February 2003, the Company entered into a settlement agreement with USS Online, Travelway, Mr. Hu, Ms. Tung, Lotus International Holdings Corp (LIH), a shareholder of the Company and three individuals to settle all claims against the defendants in the two cases cited above, subject to a number of conditions. In entering into the settlement agreement, none of the defendants admitted or conceded any liability in connection with the claims asserted in the cases. As conditions to the settlement agreement, the Company was required to receive: (a) 3,000,000 shares of the Company s common stock; (b) a promissory note of LIH in the principal amount of $4,000,000, payable on February 19, 2008, with interest accruing at a rate of 3% per annum (the Note); (c) a stock pledge agreement, granting to the Company a first priority security agreement in 1,000,000 shares of the Company s common stock as partial security for the Note (the Pledged Shares); (d) original stock certificates representing the Pledged Shares; (e) personal guaranty of the Note; and (f) all of the assets of USSF. To date, the Company has received 3,000,896 shares of the Company s common stock. However, the Company has not received stock certificates for the Pledged Shares or the assets of USSF and has made demand on the other parties for fulfillment of the conditions to the settlement. The Company has reserved the right to take all actions for breach of the settlement, including reinstituting the original action. The 3,000,896 shares of common stock received as part of the settlement are accounted for as treasury stock and valued at $150,000 based on the adjusted closing sales price of $0.05 per share as reported by the National Quotation Bureau s Pink Sheets and has been recorded in Other income (expense) on the consolidated statement of operations.

Note 15 Employee Benefit Plan

Lotus has a 401(k) salary deferral Plan (Lotus Deferral Plan), which is funded based on employee contributions. The terms of the original Lotus Deferral Plan do not require Lotus to make contributions to the Deferral Plan on behalf of each eligible employee. As such, there were no matching contributions during fiscal 2003, 2002 or 2001.

During April 2003, GoVideo established a 401(k) plan (GoVideo Deferral Plan). The terms of the GoVideo Deferral Plan do not require GoVideo to make a contribution. Rather, matching contributions are on a discretionary basis, equal to a percentage of an employee s contribution to the GoVideo Deferral Plan for the year. There were no matching contributions during fiscal 2003.

Correlant has a 401(k) salary deferral Plan (Correlant Deferral Plan), which is funded based on employee contributions. The terms of the original Correlant Deferral Plan provide for contributions to the Correlant Deferral Plan on behalf of each eligible employee (as defined) in an amount equal to 50% on the first 4% of the eligible employee s deferred compensation contribution (as defined). Beginning January 1, 2001, Correlant changed its contribution to 100% of the first 6% of the eligible employee s deferred compensation contributions. Correlant s contributions to the Deferral Plan were $213,000, $196,000 and $64,000 for fiscal 2003, 2002 and 2001, respectively. See Note 18.

Note 16 Segment and Geographic Information

Segment Information

FASB Statement 131, *Disclosures about Segments of an Enterprise and Related Information* (SFAS 131), establishes standards for reporting information about operating segments. Operating segments are defined as components of an enterprise about which separate financial information is available and is evaluated regularly by the chief operating decision maker, or decision making group. The Company s chief operating decision maker is the Chief Executive Officer. The Company is organized geographically and by line of business. While the Chief Executive Officer evaluates results in a number of different ways, the primary basis for which the allocation of resources and financial results are assessed is by product type. Prior to fiscal 2003, the Company operated in one industry segment: the development, manufacture and distribution of products used for broadband Internet access, including data-over-cable equipment and digital subscriber line (DSL) access and networking devices. Subsequent to the purchase of GoVideo on April 18, 2003, the Company added an additional segment to its operations: the development, marketing, and distribution of innovative, high performance consumer electronic products. As such, segment information is only shown for fiscal 2003. The following table presents a summary of the Company s businesses and operating segments (*in thousands*):

		As of or for the Year Ended June 30, 2003
Broadband Internet access products:		
Net revenues	$	10,178
Cost of net revenues		7,919
Gross profit		2,259
Loss from operations	$	(9,971)
Total assets	$	24,603
Consumer electronics:		
Net revenue		9,325
Cost of net revenues		7,513
Gross profit		1,812
Income from operations	$	669
Total assets	$	20,166

Total operating segments:		
Net revenue		19,503
Cost of net revenues		15,432
Gross profit		4,071
Loss from operations attributable to operating segments	$	(9,302)
Total assets attributable to operating segments	$	44,769

Disclosed in the table below is the reconciliation of the loss from operations attributable to operating segments to loss from continuing operations before income taxes and non-controlling interest and total assets attributable to operating segments to total assets (*in thousands*):

		As of or for the Year Ended June 30, 2003
Loss from operations attributable to operating segments	$	(9,302)
Corporate general and administrative expenses		(3,614)
Total other income (expense), net		4,068
Income (loss) from continuing operations before income taxes and non-controlling interest	$	(8,848)
Total assets attributable to operating segments	$	44,769
Total assets attributable to non-reporting segments		8,218
Total assets	$	52,987

Geographic Information

During fiscal 2003, 2002 and 2001, the Company recorded revenues throughout the United States, Taiwan, Japan and Europe as determined by the final destination of the product. The following table summarizes total net revenues attributable to significant countries (*in thousands*):

	Year Ended June 30,					
		2003		2002		2001
Japan	**$**	**54**	$	30,033	$	175,893
Taiwan		**9,446**		20,757		9,178
United States		**9,527**		5,090		78,121
Europe and other		**476**				
	$	**19,503**	$	55,880	$	263,192

Presented below is information regarding identifiable assets from continuing operations, classified by operations located in the United States and Asia (*in thousands*):

	June 30,					
		2003		2002		2001
United States	**$**	**52,586**	$	52,842	$	88,460
Asia		**401**		500		28,754
	$	**52,987**	$	53,342	$	117,214

Note 17 Selected Quarterly Financial Data (unaudited)

The following table sets forth selected unaudited quarterly information for the Company s last two fiscal years. The Company believes that all necessary adjustments (which consisted only of normal recurring adjustment) have been included in the amounts stated below to present fairly the results of such periods when read in conjunction with the financial statements and related notes included elsewhere herein *(in thousands, except per share data):*

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Fiscal 2003:				
Total net revenues	**$ 4,325**	**$ 2,725**	**$ 2,047**	**$ 10,406**
Gross profit	**1,569**	**403**	**63**	**2,036**
Net loss	**$ (1,415)**	**$ (2,380)**	**$ (23)**	**$ (2,548)**
Net loss per share basic	**$ (0.02)**	**$ (0.04)**	**$ 0.00**	**$ (0.04)**
Fiscal 2002:				
Total net revenues	$ 20,315	$ 13,817	$ 11,166	$ 10,582
Gross profit	264	205	2,295	3,175
Net loss	$ (6,454)	$ 14,341	$ (3,679)	$ (23,183)
Net loss per share basic	$ (0.10)	$ 0.22	$ (0.06)	$ (0.36)

Note 18 Subsequent Events

In July 2003, GoVideo entered into a financing agreement last amended and restated in May 2004. The maximum line of credit available was $40,000,000 (reduced to $30,000,000 on July 15, 2004) limited by a borrowing base determined by specific inventory and receivable balances, and provides for cash loans, letters of credit and acceptances. The agreement, as amended, matures July 21, 2007. Interest is charged at prime plus 1/2 percent subject to a minimum of not less than $15,000 per calendar month. GoVideo pays a monthly fee on the unused balance of the line of credit of 0.25 percent per year. Borrowings under GoVideo s line of credit are collateralized by all of GoVideo s assets and up to $5,000,000 of the credit facility is guaranteed by Lotus. Under the current credit facility, GoVideo is required to comply with certain financial covenants and conditions including minimum levels of net income. During April and June, 2004 GoVideo did not comply with the financial covenants by not earning the required minimum net income. GoVideo received a waiver letter from the lender for the April 2004 noncompliance. However, the lender will not waive the June 2004 noncompliance. As a result, interest charged could increase from prime plus 1/2 percent to prime plus three percent. GoVideo is currently attempting to negotiate amendments to the credit agreement to reduce the thresholds required by the financial covenants.

Subsequent to June 30, 2003, the Company advanced $7,462,000 to Go Video to fund Go Video s inventory purchases and fund operating expenses. GoVideo paid back $1,200,000 of the advance on June 30, 2004. The remaining advances, which accrue interest at annual rates of 3% to 5%, were due at various dates through January 2004. The advances have not been repaid, and Go Video and the Company are currently negotiating extensions for the due dates.

In connection with the President and co-founder s resignation from Correlant in July 2003 (See Note 1), the Company entered into an Employment Separation Agreement/Consulting Agreement with the former President. Under the terms of the agreement, Correlant agreed to pay to the former President $20,000 and repurchase 327,000 Correlant shares held by the former President for $0.07 per share for a total of $23,000. To date, the former President remains in possession of his Correlant stock. In addition, the Company agreed to pay the former President $23,000 per month for one year to provide advice and input related to certain Correlant business matters.

In connection with the VP of Engineering and co-founder s resignation from Correlant in July 2003 (See Note 1), the Company entered into an Employment Separation Agreement/Consulting Agreement with the former VP of Engineering. Under the terms of the agreement, Correlant agreed to pay the former VP of Engineering $2,000 and repurchase 272,000 Correlant shares held by the former VP of Engineering for $0.07 per share for a total of $19,000. To date, the former VP of Engineering remains in possession of his Correlant stock. In addition, the Company agreed to pay the former VP of Engineering $20,000 per month for one year to provide advice and input related to certain Correlant business matters.

In August 2003, the Company entered into a new facility lease and moved its executive offices. The lease, which commenced on August 1, 2003, is on a month-to month basis and provides for monthly rental of $4,000 per month.

In September 2003, the Company entered into an agreement with TCL Information Technology Industrial (Group) Ltd, an affiliate of TCL Industries whereby the Company sold its 50% interest in TCL Digital for an aggregate amount of $5,604,000. $1,842,000 was applied to repay the sum payable under the promissory note dated August 18, 2003 issued by the Company in favor of TCL International Holdings Limited (TCL Holdings), TCL Industries parent company. The balance of $3,762,000 was paid to the Company. The gain on the sale was $1,053,000.

From September 2003 through June 2004, the Company repurchased 6,936,000 shares of its common stock at $0.30 per share for a total cost of $2,081,000. The Board of Directors plans to continue to review potential repurchases of its common stock and will continue to approve the repurchase transactions on a case by case basis.

On March 7, 2004, the Company s board of directors adopted resolutions proposing and approving a change of the Company s name from Lotus Pacific, Inc. to Opta Corporation. On June 29, 2004, the Company filed a Preliminary Information Statement, Schedule 14C, with the Securities and Exchange Commission (SEC) to inform all stockholders of the approval of an amendment to the Company s Certificate of Incorporation providing for the name change. A majority of the Company s stockholders consented in writing to the name change. The name change will become effective upon filing the Definitive Information statement, Schedule 14C, with the SEC.

In March 2004, GoVideo executed two-year employment agreements with its top executives for an aggregate base salary of $779,000 per year, plus a severance package to include nine to ten months of base salary for terminations without cause.

On April 1, 2004, Lotus filed an action against TurboComm, in New Jersey Federal Court, asserting two causes of action for breach of contract, and over $900,000 unpaid interest. On May 27, 2004, Lotus filed a Request to Enter Default against TurboComm. On June 29, 2004, a Default was entered against TurboComm. Lotus is in the process of reaching a settlement with TurboComm.

On April 14, 2004, Correlant filed a lawsuit against TurboComm in the District Court of Taiwan seeking to collect TurboComm s outstanding debt of approximately $2,300,000. Correlant sold products to TurboComm and paid certain license fees on TurboComm s behalf. Correlant invoiced TurboComm for all products and license fees, yet TurboComm refuses to pay. On July 30, 2004, Correlant reached a settlement agreement with TurboComm. Under the agreement, Correlant agreed to with withdraw its lawsuit against TurboComm in exchange for the transfer of 700,000 Series A and 300,000 Series C shares of Correlant preferred stock owned by TurboComm. Both parties mutually agreed to release and discharge any and all claims that each may have against the other party.

On July 7, 2004, the Company s Board of Directors approved the commencement of a new wholly-owned subsidiary, Go Video DigiTech (Huizhou) Co., Ltd. (DigiTech), which will be located in Guangdong, China. DigiTech will market GoVideo s MP3 players. The Company plans to invest approximately $ 500,000 in the new subsidiary. TCL Multimedia Electronics R&D Center (TCL

Multimedia), an affiliate company of TCL, is currently expending some resources during the start up phase of GoVideo China.

On July 7, 2004, the Company s Board of Directors approved the closure of Beijing Lotus. All assets of Beijing Lotus will be transferred to DigiTech.

As part of the wind down and cessation of Correlant s historical operations, Correlant s Board of Directors approved the termination of the Correlant Deferral Plan effective August 31, 2004.

Between November 2003 and June 2004, GoVideo obtained credit terms from various suppliers totaling approximately $16,000,000 through corporate guarantee letters from TCL Industries Holdings Limited (a significant shareholder of the Company) and TCL Holdings, both of which are related parties. In addition, GoVideo is able to obtain more advantageous terms from certain vendors in China by purchasing products from those vendors through TCL.