SORRENTO NETWORKS CORP
Form 10-Q
June 19, 2002

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended APRIL 30, 2002

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File number: 0-15810

SORRENTO NETWORKS CORPORATION
(Exact name of Registrant as specified in charter)

New Jersey	22-2367234
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification Number)

9990 Mesa Rim Road
San Diego, California
92121
(Address of principal executive offices)
(Zip Code)

(858) 558-3960
(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Common Stock, $.30 par value per share, Outstanding: 14,534,410 shares at May 31, 2002.

This Form 10-Q, future filings of the registrant, and oral statements made with the approval of an authorized executive officer of the Registrant may contain forward looking statements. In connection therewith, please see the cautionary statements and risk factors contained in Item 2. "Fluctuations in Revenue and

Operating Results" and "Forward Looking Statements - Cautionary Statement", which identify important factors which could cause actual results to differ materially from those in any such forward-looking statements.

SORRENTO NETWORKS CORPORATION
AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
(In Thousands, except per share amounts)

	Three Months April 30
	2002
NET SALES	$ 6,003
COST OF SALES	4,515
GROSS PROFIT	1,488
OPERATING EXPENSES	
Selling and marketing	3,432
Engineering, research and development	2,534
General and administrative	1,863
Deferred stock compensation	106
Other operating expenses	97
TOTAL OPERATING EXPENSES	8,032
LOSS FROM OPERATIONS	(6,544)
OTHER INCOME (EXPENSES)	
Investment income	94
Interest expense	(1,310)
Other income (Expenses)	80
Gain on sale of marketable securities	11,656
TOTAL OTHER INCOME (EXPENSES)	10,520
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAX	3,976
NET INCOME (LOSS)	$ 3,976
EARNINGS (LOSS) PER SHARE:	
PREFERRED STOCK DIVIDENDS	-
NET GAIN (LOSS) APPLICABLE TO COMMON SHARES	$ 3,976
BASIC WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	14,323

BASIC NET INCOME (LOSS) PER COMMON SHARE	$ 0.28
DILUTED WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	18,913
DILUTED NET INCOME (LOSS) PER COMMON SHARE	$ (1.26)
COMPREHENSIVE INCOME AND ITS COMPONENTS CONSIST OF THE FOLLOWING:	
Net income (loss)	$ 3,976
Unrealized losses from marketable securities:	
Unrealized holding losses arising during the period	(1,398)
Reclassification adjustment for gains included in net income	(11,656)
NET COMPREHENSIVE INCOME (LOSS)	$ (9,078)

See accompanying notes to consolidated financial statements.

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SORRENTO NETWORKS CORPORATION
AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(In Thousands, except per share amounts)

ASSETS	
CURRENT ASSETS	
Cash and equivalents	$
Accounts receivable, net	
Inventory, net	
Prepaid expenses and other current assets	
Investment in marketable securities	
TOTAL CURRENT ASSETS	
PROPERTY AND EQUIPMENT, NET	
OTHER ASSETS	
Purchased technology, net	
Other assets	
Investment in former subsidiary	
TOTAL OTHER ASSETS	

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TOTAL ASSETS                                                                                   $
==================================================================================================
LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES
     Short-term debt                                                                           $
     Current maturities of long term debt
     Accounts payable
     Accrued liabilities and other current liabilities
     Due on redemption of preferred security of subsidiary
--------------------------------------------------------------------------------------------------
         TOTAL CURRENT LIABILITIES
--------------------------------------------------------------------------------------------------
Long-term debt and capital lease obligations
Debentures payable, net of unamortized costs and discounts
Dividends payable
--------------------------------------------------------------------------------------------------
         TOTAL LIABILITIES
--------------------------------------------------------------------------------------------------
COMMITMENTS AND CONTINGENCIES

STOCKHOLDERS' EQUITY
     Preferred stock, $.01 par value; liquidation preference $1,353
     Common stock, $.30 par value; 150,000,000 shares authorized; 14,543,298 shares issued
         14,534,410 shares outstanding at April 30, 2002;  14,209,104 shares issued and
         14,200,216 shares outstanding at January 31, 2002
     Additional paid-in capital
     Deferred stock compensation
     Accumulated deficit
     Accumulated unrealized gain on marketable securities
     Treasury stock, at cost; 8,888 shares at April 30, 2002 and
         January 31, 2002, respectively
--------------------------------------------------------------------------------------------------
         TOTAL STOCKHOLDERS' EQUITY
--------------------------------------------------------------------------------------------------
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY                                                     $
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See accompanying notes to consolidated financial statements.

SORRENTO NETWORKS CORPORATION
AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(In Thousands, except per share amounts)

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	A
	2002
CASH FLOWS FROM OPERATING ACTIVITIES	
Net income (loss) from continuing operations	$ 3,976
Adjustments to reconcile net income (loss) to net cash used in operating activities:	
Depreciation and amortization	1,358
Accounts receivable, option receivables and inventory reserves	716
(Gain) on sale of marketable securitites	(11,656)
Non-cash interest on debentures	774
Deferred and other stock compensation	106
Changes in assets and liabilities:	
Increase in accounts receivable	(1,638)
(Increase) decrease in inventories	1,061
Decrease in other current assets	48
Increase in accounts payable	1,032
Increase (decrease) in accrued and other current liabilities	15
NET CASH USED IN OPERATING ACTIVITIES	(4,208)
CASH FLOWS PROVIDED BY (USED) IN INVESTING ACTIVITIES:	
Purchase of property and equipment	(1,944)
Cash received from sale of marketable securities and other investments	13,574
Other assets	4
NET CASH PROVIDED BY (USED) IN INVESTING ACTIVITIES	11,634
CASH FLOWS PROVIDED BY (USED) IN FINANCING ACTIVITIES:	
Payments of short-term debt, net	(153)
Proceeds from long-term debt	-
Repayment of long-term debt	(24)
Proceeds from common stock	-
Proceeds from stock option and warrant exercises	-
NET CASH PROVIDED BY (USED) IN FINANCING ACTIVITIES	(177)
INCREASE(DECREASE) IN CASH AND CASH EQUIVALENTS	7,249
CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD	14,243
CASH AND CASH EQUIVALENTS - END OF PERIOD	$ 21,492

See accompanying notes to consolidated financial statements.

Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations.

Certain statements contained in this Quarterly Report on Form 10-Q, including, without limitation, statements containing the words "believes", "anticipates", "estimates", "expects", and words of similar import constitute "forward-looking statement" within the meaning of the Private Securities Litigation Reform Act of 1995. Readers are referred to the "Other Risk Factors" section of this Quarterly Report on Form 10-Q which identify important risk factors that could cause actual results to differ from those contained in the forward-looking statements.

Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the consolidated unaudited financial statements and related notes thereto. Further reference should be made to our Form 10-K for the year ended January 31, 2002.

The results of operations reflect our activities and our wholly-owned subsidiaries; this consolidated group is referred to individually and collectively as "We" and "Our".

Results of Operations/Comparison of the Quarters ended April 30, 2002 and 2001.

Net sales. Our consolidated net sales decreased $8.5 million or 59% to $6.0 million for the quarter ended April 30,2002 compared to net sales of $14.5 million for the quarter ended April 30, 2001. Net sales for our Sorrento Networks Inc.("Sorrento"), the Company's primary operating subsidiary, decreased $8.3 million or 64% to $4.8 million for the quarter ended April 30, 2002 as compared to net sales of $13.1 million for the quarter ended April 30, 2001. The reduction in sales volume reflects the continued weak telecommunications industry volumes.

Gross profit. Cost of sales consists principally of the costs of components, subcontract assembly from outside manufacturers, and in-house system integration, quality control, final testing and configuration costs. Gross margin percent on a consolidated basis decreased to 25% for the quarter ended April 30, 2002 from 34% in the quarter ended April 30, 2001. Consolidated gross profit was $1.5 million, a decrease of 70% for the quarter ended April 30, 2002 from $4.9 million for the quarter ended April 30, 2001. Gross margin percent and gross profit were negatively impacted by the substantially higher percentage of fixed overhead allocated to cost of sales as a result of the lower revenue volume for the quarter. Gross profit for Sorrento decreased to $1.0 million the quarter ended April 30, 2002, as compared to $4.5 million in the quarter ended April 30, 2001, a decrease of 77%.

Selling and marketing. Selling and marketing expenses consist primarily of employee compensation and related costs, commissions to sales representatives, tradeshow expenses and travel expenses. Selling and marketing expenses decreased to $3.4 million or $57% of net sales, for the quarter ended April 30, 2002 from $4.3 million, or 30% of net sales for the quarter ended April 30, 2001. The decrease was primarily the result of cost reduction efforts implemented and lower revenue volume for the quarter. We continue to manage our expenditures for sales and marketing in relation with the expansion of our domestic and international sales channels and the establishment of strategic relationships. We expect sales commissions to increase as our sales volume increases since many of our sales personnel earn a portion of their total compensation from commissions based on sales volume.

Engineering, research and development. Engineering, research and development expenses consist primarily of compensation related costs for engineering personnel, facilities costs and materials used in the design,

development and support of our technologies. All research and development costs are expenses as incurred. We continue to manage our research and development cost in relation to the changes in our sales volume and available capital resources in our development efforts to enhance existing products and introduce new products to our product offering. Our consolidated engineering, research and development expenses decreased to $2.5 million, or 42% of net sales, for the quarter ended April 30, 2002 from $3 million, or 22.8% of nets sales for the quarter ended April 30, 2001. The decline can primarily be attributed to decreases in product development material and personnel related costs reflecting managements planned reduction in operating expense levels.

General and administrative. General and administrative expenses consist primarily of employee compensation and related costs, legal and accounting fees, public company costs and allocable occupancy costs. Consolidated general and administrative expenses decreased to $1.9 million, or 31% of net sales, for the quarter ended April 30, 2002 from $2.8 million, or 19% of net sales, for the quarter ended April 30, 2001. The decrease in general and administrative expenses can be attributed to reductions in investment banking, professional fees and personnel related costs due to our operating expense reduction efforts.

Other income (charges). Other income (charges) from continuing operations was $10.5 million in income for the quarter ended April 30, 2002 versus a $39 charge for the quarter ended April 30, 2001. The current year quarter includes an $11.7 million gain on the sale of marketable securities as a result of the sale of 3,396,221 shares of NETsilicon, Inc common stock to Digi International, Inc. for $13.6 million in cash. The remaining shares of NETsilicon common stock was exchanged for Digi International common stock and is accounted for under marketable securities. The Company obtained 2,324,683 shares of Digi common stock on the exchange. The increase of $1.1 million in interest expense for the quarter ended April 30, 2002 from the quarter ended April 30, 2001 was primarily due to cost associated with the Company's convertible debenture which included interest of $766, paid in common stock, amortization of issuance costs of $36 and amortization of the fair value of the warrants issued to the purchasers and placement agent and the deemed beneficial conversion feature of $398. In addition, to the foregoing interest expense was partially offset by a decline in our short-term borrowings.

Income taxes. There was no provision for income taxes for the quarters ended April 30, 2002 and 2001. We have carry forwards of domestic federal net operating losses, which may be available, in part, to reduce future taxable income in the United States. However, due to potential adjustments to the net operating loss carry forwards as provided by the Internal Revenue Code with respect to future ownership changes, future availability of the tax benefits is not assured. In addition, we provided a valuation allowance in full for our

deferred tax assets, as it is our opinion that it is more likely than not that some portion or all of the deferred tax assets will not be realized.

Sorrento Networks, Inc.

Net sales. Net sales decreased 64% to $4.8 million for the three months ended April 30, 2002 from $13.1 million for the same comparable quarter last year. During the three months ended April 30, 2002, we shipped product to ten customers of which five customers represented a combined 88% of our net sales. During the quarter ended April 30, 2001, we shipped product to twelve customers of which five customers represented a combined 84% of our net sales. We expect to continue experiencing significant fluctuations in our quarterly revenues as a result of our long and variable sales cycle as well as our highly concentrated customer base. Revenues continue to be negatively impacted by weak telecommunication industry volumes.

Gross profit. Gross profit decreased 77% to $1.0 million for the quarter ended April 30, 2002 from $4.5 million for the same comparable quarter last year. Our gross margin decreased to 21% of net sales for the quarter ended April 30, 2002 from 34% of net sales for the comparable quarter last. Year. The gross margin and gross margin percentage decrease was primarily the result of a significantly higher allocation of fixed manufacturing overhead in the Company's cost of shipments for the quarter as a result of the lower revenue volume. The Company has initiated cost cutting actions in production due to the lower revenue volume and a continued slowdown in the capital expenditure spending throughout the telecom industry.

Selling and marketing. Selling and marketing expenses decreased to $3.4 million, or 70% of net sales, for the quarter ended April 30, 2002 from $4.2 million, or 32% of net sales for the same comparable quarter last year. The decrease in sales and marketing expenses resulted from cost reduction programs initiated by the Company. Sales and marketing expenses showed decreases in travel expenses, advertising expenses and reductions in personnel.

Engineering, research and development. Engineering, research and development expenses decreased to $2.4 million, or 50% of net sales, for the quarter ended April 30, 2002 from $3.2 million, or 25% of net sales, for the same comparable quarter last year. The decrease in engineering, research and development expenses was the result of decreased expenditures associated with the Company's cost reduction programs and included decreases in engineering personnel, employee relocation and recruiting expenses and reduction in material related development expenses. The number of engineering personnel decreased to 65 at April 30, 2002 from 99 at April 30, 2001.

General and administrative. General and administrative expenses decreased to $869, or 18% of net sales for the quarter ended April 30, 2002 from $1.5 million, or 11% of net sales, for the comparable quarter last year. The decrease in general and administrative expenses reflects the reduction of executive and administrative personnel and lower operating expenses, including professional banking and other fees.

Deferred and other stock compensation. Deferred and other stock compensation for the quarter ended April 30, 2002 includes $62 of amortization of deferred stock compensation and $44 of expenses resulting from the amortization of the value of stock options granted to consultants. In connection with the grants of stock options with exercise prices determined to be below the fair value of Sorrento's common stock on the date of grant, Sorrento recorded deferred stock compensation of $2.6 million, which is being amortized on an accelerated basis over the vesting period of the options.

Meret Optical Communications

Net sales. Net sales for Meret decreased to $1.2 million, or by 14% for the quarter ended April 30, 2002 from $1.4 million for the comparable quarter last year. Sales in our RF Synthesis product category decreased by 41% compared to the same quarter last year reflecting lower demand for products in this category. A portion of this decrease was offset by increased shipments of our new Coarse Wavelength Division Multiplexing ("CWDM") products that contributed approximated 13% of the revenue during the quarter. Shipments of our legacy product remained relatively unchanged when compared to the quarter ended April 30, 2002 to the prior year.

Gross Profit. Gross profit increased to $463, or by 2%, for the quarter ended April 30, 2002 from $456 for the comparable quarter last year. Meret's gross margins increased to 39% for the quarter ended April 30, 2002 from 34% for the comparable quarter last year. The positive change in gross margin was primarily the result of better pricing of our legacy products when compared to the prices that were sold at in the prior year. In addition, we made shipments during the quarter of our new CWDM products which contributed to the increase in the gross margin.

Selling and Marketing. Selling and marketing expenses decreased to $64 or 5% of net sales, for the quarter ended April 30, 2002 from $98, or 7% of net sales, for the comparable period last year. The decrease during the quarter ended April 30, 2002 compared to the same three month period last year resulted from a decrease in internal commissions. Commissionable sales were down significantly from the three months ended April 30, 2001. This combined with changes in the commission structure resulted in lower commission expense during the current quarter.

Engineering, Research and Development. Engineering, research and development expenses increased to $137 or 11% of net sales, for the quarter ended April 30, 2002 from $81 or 6% of net sales for the comparable quarter last year. The increase during the quarter ended April 30, 2002 results from the addition of four engineers to support the development of new products and the enhancement of existing products.

General and Administrative. General and administrative expenses increased to $147 or 12% of net sales for the quarter ended April 30, 2002 from $73 or 5% of net sales for the comparable quarter last year. The increase in general and administrative expenses during the quarter consisted primarily of additions in

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the administration staff, costs associated with upgrades in our business application software and, costs incurred to move the facilities to a new location.

Liquidity and Capital Resources

We finance our operations through a combination of internal funds, investments and debt and equity financing. At April 30, 2002, our working capital was $(3.0) million and included $21.5 million in cash and cash equivalents and $13.1 million of investments in marketable securities. In addition, $48.8 million of Series A Holder's obligation as a result of their exercised right of redemption was re-classified at year end January 31, 2002 as a current liability as compared to mezzanine in the Company's liability and owner's equity section of the balance sheet in the prior year. The Series A redemption of securities can only be made through lawfully available funds that would normally be generated from SNI profitable operations, which the Company does not currently have available, or foresee availability of, in the near future.

Our continuing operations used cash flows of $4.2 million during the quarter ended April 30, 2002. During the quarter ended April 30, 2001 continuing activities used cash flows of $9.3 million. The decrease in cash flows used by operations resulted primarily from gains on the sale of marketable securities and a decrease in our accounts receivable, offset by increases in inventory and accounts payable.

The Company has incurred significant losses and negative cash flows from operations for the past two years. Sorrento Networks, Inc., the Company's principal operating subsidiary, has primarily been the operating entity responsible for these losses and negative cash flows. The losses have been generated as SNI continues to develop its technology, marketing, sales and operations in its effort to become a major supplier of metro and regional optical networks world-wide. The Company has funded its operations primarily by the sale of securities and the issuance of debt. There can be no assurance that similar funding will be available in the future. Further, with the downturn in the economic environment and decreases in capital spending by telecom carriers, the Company anticipates that its current and future revenues will be negatively impacted. As a result, the Company will need to raise additional capital in the future or continue to substantially decrease its operating costs and capital spending in order to fund its operations. There can be no assurance that our available cash, future funding or reduction in operating costs will be sufficient to fund our operations in the future.

Our standard payment terms range from net 30 to net 90 days. Receivables from international customers have frequently taken longer to collect. For some of the

customers of our optical networking products, payment is required within 180 days from the date of shipment. In addition, the downturn in the telecom market has impacted many of the telecom carriers ability to purchase or pay for outstanding commitments within standard payment terms. There can be no assurance that either current or future receivables will not be impacted negatively by this economic environment.

Our investing activities during the quarter ended April 30, 2002 provided cash flows of $11.6 million. We purchased property and equipment of $1.9 million and received $13.6 million on the sale of marketable securities and other assets. During the quarter ended April 30, 2001 the investing activities of our continuing operations used cash flows of $1.9 million. This consisted primarily of $1.4 million in purchases of capital equipment and $438 in other assets.

Our financing activities during the quarter ended April 30, 2002 used cash flows of $177 which consisted primarily of repayment of debt. During the quarter ended April 30, 2001 the financing activities of our continuing operations provided cash flows of $10.2 million which consisted primarily of $9.6 million in net proceeds from a private placement for issuance of our common stock, $338 in proceeds from option and warrant exercised, $384 in proceeds from long term debt offset by $194 in repayment of short and long term debt.

In May, the Company terminated it's line of credit with Coast Savings. The line of credit totaled $1.0 million with outstanding borrowings against this line of credit was $890 at April 30, 2002. The line of credit was secured by a collateral agreement against Meret's accounts receivables, inventory and other assets.

During March 2000, our Sorrento subsidiary completed a private placement of 8,596,333 shares of its Series A Convertible Preferred Stock to a group of investors receiving net proceeds of approximately $46.6 million. Each share of our Sorrento subsidiary's Series A Preferred Stock is convertible into one share of its common stock at the option of the holder, may vote on an "as converted" basis except for election of directors, and has a liquidation preference of $5.45 per share. The shares are automatically converted into Sorrento's common stock upon an underwritten public offering by Sorrento with an aggregate offering price of at least $50 million. Since Sorrento did not complete a $50 million public offering by March 1, 2001, the holders of more than 50% of the then outstanding Series A shares may request to be redeemed at the shares then adjusted liquidation preference. In April 2001 a majority of Series A Shareholders exercised their right to redeem the Series A Preferred Stock. Such redemption can only be made out of funds deemed to be lawfully available or from a sale pro rata portion as to which a lesser amount of lawfully available funds would exist. The Company at the current time does not have such funds

which would normally be generated from operating profits of the subsidiary, Sorrento Networks, Inc.

In September 2001, certain holders of SNI's Series A preferred stock obtained a preliminary injunction for the Delaware Court of Chancery, which was affirmed by the Delaware Supreme Court in January 2002. The injunction prohibits SNI from issuing additional shares of Series A preferred stock and from incurring debt without the consent of the holders of a majority of the outstanding shares of Series A preferred stock. The Court of Chancery will decide whether to make this injunction permanent at a trial that is not currently scheduled. We cannot predict the outcome of that trial. The injunction against SNI, our principal operating subsidiary, issuing Series A preferred stock, makes it very difficult to fund SNI as its business operations require. The Company, however, does have the right to make such capital contributions to SNI to fund its operations as the Board may deem necessary. During the quarter ended April 30, 2002 the Company made capital contributions that totaled $3,750 to SNI. Capital contributions do not increase the Company's ownership interest in SNI, but rather increases the basis of our ownership interest. The Board has authorized capital contributions to be made when necessary to fund the SNI operations, but there can be no assurance that the Board will continue to authorize such contributions in the future should other funding methods continue to be unavailable.

We anticipate that our available cash resources, and marketable securities available for sale together with any necessary cost reductions will be sufficient to meet our presently anticipated capital requirements for the current fiscal year. Nonetheless, our future capital requirements may vary materially from those now planned including the need for additional working capital to accommodate planned growth, hiring and infrastructure needs. There can be no assurances that our working capital requirements will not exceed our ability to generate sufficient cash internally to support our requirements and that external financing will be available or that, if available, such financing can be obtained on terms favorable to us and our shareholders.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to our valuation of inventory and our allowance for uncollectable accounts receivable. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements:

- Inventory is evaluated on a continual basis and reserve adjustments are made based on management's estimate of future sales value, if any, of specific inventory items. Reserve adjustments are made for the difference between the cost of the inventory and the estimated market value and charged to operations in the period in which the facts that give rise to the adjustments become known.

- Accounts receivable balances are evaluated on a continual basis and allowances are provided for potentially uncollectable accounts based on management's estimate of the collectability of customer accounts. If the financial condition of a customer were to deteriorate, resulting in an impairment of their ability to make payments, an additional allowance may be required. Allowance adjustments are charged to operations in the period in which the facts that give rise to the adjustments become known.

Impact of Recent Accounting Pronouncements

In October 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" effective for financial statements issued for fiscal years beginning after December 15, 2001, and interim periods within those fiscal years. Restatement of previously issued annual financial statements is not permitted, however, comparative financial information for earlier periods shall reflect required reclassifications in presentation. SFAS 144 requires long-lived assets of continuing and discontinued operations be measured at the lesser of carrying amount or fair value less estimated selling costs. The assets and liabilities of discontinued operations shall be presented separately in the asset and liability sections of the balance rather than shown as net realizable value. We do not believe the adoption of SFAS 144 will have a material effect on our financial position or results of operations.

In August 2001, the Financial Accounting Standards Board issued SFAS 143, "Accounting for Asset Retirement Obligations" effective for fiscal years beginning after June 15, 2002. SFAS 143 requires the recognition of the fair value of liabilities for asset retirement obligations to be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. We do not believe the adoption of SFAS 143 will have a material effect, if any, on our financial position or results of operations.

In June 2001, the Financial Accounting Standards Board finalized SFAS 141, "Business Combinations", and SFAS 142, "Goodwill and Other Intangible Assets". SFAS 141 requires the use of the purchase method of accounting and prohibits the use of the pooling-of-interests method of accounting for business combinations initiated after June 30, 2001. SFAS 141 also requires that we recognize acquired intangible assets apart from goodwill if the acquired

intangible assets meet certain criteria. SFAS 141 applies to all business combinations initiated after June 30, 2001 and for purchase business combinations completed on or after July 1, 2001. Upon adoption of SFAS 142, it requires that we reclassify the carrying amounts of intangible assets and goodwill based on the criteria in SFAS 141.

SFAS 142 requires, among other things, that companies no longer amortize goodwill, but instead test goodwill for impairment at least annually. In addition, SFAS 142 requires that we identify reporting units for the purpose of assessing potential future impairments of goodwill, reassess the useful lives of other existing recognized intangible assets, and cease amortization of intangible assets with an indefinite useful life. An intangible asset with an indefinite useful life should be tested for impairment in accordance with the guidance in SFAS 142. SFAS 142 is required to be applied in fiscal years beginning after December 15, 2001 to all goodwill and other intangible assets recognized at that date, regardless of when those assets were initially recognized. SFAS 142 requires us to complete a transitional goodwill impairment test nine months from the date of adoption. We are also required to reassess the useful lives of other intangible assets within the first interim quarter after adoption of SFAS 142.

Effects of Inflation and Currency Exchange Rates

We believe that the relatively moderate rate of inflation in the United States over the past few years has not had a significant impact on our sales or operating results or on the prices of raw materials. There can be no assurance, however, that inflation will not have a material adverse effect on our operating results in the future.

The majority of our sales and expenses are currently denominated in U.S. dollars and to date our business has not been significantly affected by currency fluctuations. However, we conduct business in several different countries and thus fluctuations in currency exchange rates could cause our products to become relatively more expensive in particular countries, leading to a reduction in sales in that country. In addition, inflation in such countries could increase our expenses. In the future, we may engage in foreign currency denominated sales or pay material amounts of expenses in foreign currencies and, in such event, may experience gains and losses due to currency fluctuations. Our operating results could be adversely affected by such fluctuations.

Other Matters

See Part II, Item 1, "Other Information - Legal Proceedings".

Fluctuations in Revenue and Operating Results

The networking and bandwidth aggregation industry is subject to fluctuation and the declines and increases recently experienced by us are not necessarily indicative of the operating results for any future periods. Our operating results may fluctuate as a result of a number of factors, including the timing of orders from, and shipments to, customers; the timing of new product introductions and the market acceptance of those products; increased competition; changes in manufacturing costs; availability of parts; changes in the mix of product sales; the rate of end user adoption and carrier and private network deployment of WAN data, video and audio communication services; factors associated with international operations; and changes in world economic conditions.

Forward-Looking Statements - Cautionary Statement

All statements other than statements of historical fact contained in this Form 10-Q, in our future filings with the Securities and Exchange Commission, in our press releases and in our oral statements made with the approval of an authorized executive officer are forward-looking statements. Words such as "propose," "anticipate," "believe," "estimate," "expect," "intend," "may," "should", "could," "will" and similar expressions are intended to identify such forward-looking statements. These forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Although we believe that our expectations reflected in these forward-looking statements are based on reasonable assumptions, such statements involve risk and uncertainties and no assurance can be given that actual results will be consistent with these forward-looking statements. Important factors that could cause actual results to differ materially from those forward-looking statements include without limitation: our ability to successfully develop, sell and market our optical networking and other products; our expectations concerning factors affecting the markets for our products, such as demand for increased bandwidth; the scope and duration of the economic slowdown currently being experienced by many of our existing and prospective customers; our ability to compete successfully with companies who are much larger than we are and who have much greater financial resources at their disposal; our ability, or failure, to complete strategic alliances and strategic opportunities such as sales or spin-offs of subsidiaries or business units on terms favorable to us for reasons either within or outside our control; our ability successfully to finance our current and future needs for working capital;

changed market conditions, new business opportunities or other factors that

might affect our decisions as to the best interest of our shareholders; and other risks detailed from time to time in our reports filed with the Securities and Exchange Commission.

We wish to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical earnings and those presently anticipated or projected. These risks and uncertainties are described in the following section. We specifically decline any obligation to publicly release the result of any revisions which may be made to any forward-looking statements to reflect anticipated or unanticipated events or circumstances occurring after the date of such statements, or to update the reasons why actual results could differ from those projected in the forward-looking statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to financial market risks, including changes in interest rates and foreign currency rates. Our exposure to interest rate risk is the result of our need for periodic additional financing for our large operating losses and capital expenditures associated with establishing and expanding our operations. The interest rate that we will be able to obtain on debt financing will depend on market conditions at that time, and may differ from the rates we have secured on our current debt. Additionally, the interest rates charged by our present lenders adjust on the basis of the lenders' prime rate.

Almost all of our sales have been denominated in U.S. dollars. A portion of our expenses are denominated in currencies other than the U.S. dollar and in the future a larger portion of our sales could also be denominated in non-U.S. currencies. As a result, currency fluctuations between the U.S. dollar and the currencies in which we do business could cause foreign currency translation gains or losses that we would recognize in the period incurred. We cannot predict the effect of exchange rate fluctuations on our future operating results because of the number of currencies involved, the variability of currency exposure and the potential volatility of currency exchange rates. We attempt to minimize our currency exposure risk through working capital management and do not hedge our exposure to translation gains and losses related to foreign currency net asset exposures.

We do not hold or issue derivative, derivative commodity instruments or other financial instruments for trading purposes. Investments held for other than trading purposes do not impose a material market risk.

We believe that the relatively moderate rate of inflation in the United States over the past few years and the relatively stable interest rates incurred on short-term financing have not had a significant impact on our sales, operating results or prices of raw materials. There can be no assurance, however, that inflation or an upward trend in short-term interest rates will not have a material adverse effect on our operating results in the future should we require debt financing in the future.

SORRENTO NETWORKS CORPORATION
AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
(In Thousands, except share and per share amounts)

Sorrento Networks Corporation (formerly Osicom Technologies, Inc.) (the "Company," "We," "Our," or "Us") through its subsidiaries designs, manufactures and markets integrated networking and bandwidth aggregation products for enhancing the performance of data and telecommunications networks. Our products are deployed in telephone companies, Internet Service Providers, governmental bodies and the corporate/campus networks that make up the "enterprise" segment of the networking marketplace. We have facilities in San Diego, California, Santa Monica, California and Fremont, California. In addition, we have various sales offices located in the United States and Europe. We market and sell our products and services through a broad array of channels including worldwide distributors, value added resellers, local and long distance carriers and governmental agencies.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying financial data for the three months ended April 30, 2002 and 2001 along with financial data for January 31, 2002, has been prepared by us, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. The January 31, 2002 balance sheet was derived from audited financial statements, but does not include all disclosures required by generally accepted accounting principles. However, we believe that the disclosures we have made are adequate to make the information presented not misleading. These consolidated financial statements should be read in conjunction with the financial statements and the notes thereto included in our Annual Report on Form 10-K for the year ended January 31, 2002.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates that affect the reported amounts of assets, liabilities, revenues and expenses, the disclosure of contingent assets and liabilities. Actual results could differ from these estimates. In the opinion of Management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position, results of operations and cash flows as of April 30, 2002 and for the quarter ended April 30, 2001, have been made. The results of operations for the quarter ended April 30, 2002 are not necessarily indicative of the operating results for the full year.

Digi International, Inc. And NETsilicon, Inc.

On September 15, 1999 NETsilicon, Inc. ("NSI") completed an initial public offering in which 6,037,500 shares of its common stocks were sold (3,537,500 shares by NSI and 2,500,000 shares by us). NSI received net proceeds of $22,249 and we received net proceeds of $15,382. In addition, NSI repaid advances due us of $5,884. In connection with the initial public offering by NSI our remaining 55% interest became non-voting shares. Accordingly, our financial

statements reflected the results of operations of NSI through September 14, 1999 at which time our remaining interest were accounted for as an "available for sale security." Under this accounting, the 7.5 million shares of NSI held by us are marked-to-market at the end of each reporting period with the difference between our basis and the fair market value, as reported on NASDAQ, reported as a separate element of stockholders' equity and included in the computation of comprehensive income.

In October 2000, we sold 350,000 shares of our investment in NSI for $4,219. The purchasers had the right to receive additional NSI shares from us if the three day average high for the NSI common stock, as quoted on NASDAQ, at December 31, 2000 was less than the price paid to us by the purchasers but not less than $8.00 per share. We issued an additional 177,344 shares of NSI to the purchasers, reducing the price per share we received to $8.00 per share. Our

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former Chairman and CEO purchased 100,000 of these shares of NSI for $1,164 and received an additional 45,546 shares pursuant to the price protection provision. As a result of this transaction, our remaining interest was approximately 7.0 million shares of NSI, or 51% as of January 31, 2002 and continued to be accounted for as a marked-to-market security.

On February 13, 2002 NSI completed a merger with Digi International, Inc.("DIGI"). In connection with the merger, we exchanged our 6,972,656 shares of NSI for 2,324,683 shares of DIGI and $13,574 in cash. More information concerning DIGI is available in its public filings with the Securities and Exchange Commission.

Entrada Networks, Inc.

On August 31, 2000, we completed a merger of Entrada Networks with Sync Research, Inc. ("Sync"), a NASDAQ listed company in which we received 4,244,155 shares of the merged entity which changed its name to Entrada Networks, Inc. (ENI) . We purchased 93,900 shares of Sync in the open market during June and July, 2000 for $388 and on August 31, 2000 purchased an additional 1,001,818 shares directly from ENI for $3,306. After these transactions and ENI's issuance of additional shares to outside investors in connection with the merger we owned 49% of ENI. Accordingly, our financial statements reflected the results of operations of ENI through August 31, 2000.

Pursuant to a plan adopted by our Board of Directors prior to the merger we distributed 3,107,155 of our ENI shares on December 1, 2000 to our shareholders of record as of November 20, 2000. The distribution was made at the rate of one-fourth (0.25) of an ENI share for each of our outstanding shares. At exercise, options and warrants to acquire our common shares which were granted and unexercised as of November 20, 2000 will receive a similar number of ENI shares. Prior to January 31, 2001 we distributed 20,182 of our ENI shares upon the exercise of options and as of January 31, 2002 we have reserved 826,000 shares for future exercises of options and warrants. The cost basis of these reserved shares and related liability to the option and warrant holders is included in the investment in former subsidiary and dividends payable in the accompanying balance sheet. The aggregate distribution of our ENI shares including the shares reserved for option and warrant holders has been accounted for at our original cost of $5,122. In addition we have granted options to purchase 410,000 of our ENI shares for $3.19 per share (the merger price) to several of our then officers and consultants.

The remaining 326,034 ENI shares owned by us are accounted for as an "available for sale security". Under this accounting, these shares are marked-to-market at the end of each reporting period. The difference between our basis and the fair market value, as reported on NASDAQ, is a separate element of stockholders' equity and is included in the computation of comprehensive income. More information concerning ENI is available in its public filings with the Securities and Exchange Commission.

Deferred Stock Compensation

We account for employee-based stock compensation utilizing the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees." Accordingly, compensation cost for stock options issued to employees is measured as the excess, if any, of the fair market price of our common stock at the date of grant over the amount an employee must pay to acquire the stock. This amount appears as a separate component of stockholders' equity and is being amortized on an accelerated basis by charges to operations over the vesting period of the options in accordance with the method described in Financial Accounting Standards Board Interpretation No. 28. All such amounts relate to options to acquire common stock of

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our Sorrento subsidiary granted by it to its employees; during the three months

ended April 30, 2002 and 2001 it amortized $61 and $154, respectively, of the total $2,604 initially recorded for deferred stock compensation.

For non-employees, we compute the fair value of stock-based compensation in accordance with Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation," and Emerging Issues Tax Force (EITF) 96-18, "Accounting for Equity Instruments that are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services." All such amounts relate to options to acquire common stock of our Sorrento subsidiary granted by it to its consultants; during the three months ended April 30, 2002 and 2001 it recorded $44 and $47, respectively, for options granted to consultants.

Recent Accounting Pronouncements

In October 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long Lived Assets" effective for financial statement issued for fiscal years beginning after December 15, 2001 and interim periods within those fiscal years. Restatements of previously issued annual financial statements is not permitted, however, comparative financial information for earlier periods shall reflect required reclassifications in presentation. SFAS 144 requires long-lived assets of continuing and discontinued operations be measured at the lesser of carrying amount or fair value less estimated selling costs. The assets and liabilities of discontinued operations shall be presented separately in the asset and liability sections of the balance rather than shown as net realizable value. We do not believe the adoption of SFAS 144 will have a material effect on our financial position or results of operations.

In August 2001, the Financial Accounting Standards Board issued SFAS 143, "Accounting for Assets Retirement Obligations" effective for fiscal years beginning after June 15, 2002. SFAS 143 requires the recognition of the fair value of liabilities for asset retirement obligations to be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. We do not believe the adoption of SFAS 143 will have a material effect, if any, on our financial position or results of operations..

In June 2001, the Financial Accounting Standards Board finalized SFAS 141, "Business Combinations", and SFAS 142, "Goodwill and Other Intangible Assets". SFAS 141 requires the use of the purchase method of accounting and prohibits the use of the pooling-of-interests method of accounting for business combinations initiated after June 30, 2001. SFAS 141 also requires that we recognize acquired intangible assets apart from goodwill if the acquired intangible assets meet certain criteria. SFAS 141 applies to all business combinations initiated after June 30, 2001 and for purchase business combinations completed on or after July 1, 2001. Upon adoption of SFAS 142, it requires that we reclassify the carrying amounts of intangible assets and goodwill based on the criteria in SFAS 141.

SFAS 142 requires, among others things, that companies no longer amortize goodwill, but instead test goodwill for impairment at least annually. In addition, SFAS 142 requires that we identify reporting units for the purposes of assessing potential future impairments of goodwill, reassess the useful lives of other existing recognized intangible assets, and cease amortization of intangible assets with an indefinite useful life. An intangible asset with an indefinite useful life should be tested for impairment in accordance with the guidance in SFAS 142. SFAS 142 is required to be applied in fiscal years beginning after December 15, 2001 to all goodwill and other intangible assets recognized at that date, regardless of when those assets were initially

recognized. SFAS 142 requires us to complete a transitional goodwill impairment test nine months from the date adoption. We are also required to reassess the useful lives of other intangible assets within the first interim quarter after adoption of SFAS 142.

SORRENTO NETWORKS CORPORATION
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)
(In Thousands, except share and per share amounts)

BALANCE SHEET DETAIL

Inventories at April 30, 2002 and January 31, 2002 consist of:

	April 30, 2002	January 31, 2002
Raw material	$13,390	$14,593
Work in process	2,093	879
Finished goods	8,371	9,806
	23,854	25,278
Less: Valuation reserve	(6,470)	(6,468)
	$17,384	$18,810

Marketable Securities - Marketable securities, which consist of equity securities that have a readily determinable fair value and do not have sale restrictions lasting beyond one year from the balance sheet date, are classified into categories based on our intent. Investments not classified as held to maturity, those for which we have the intent and ability to hold, are classified as available for sale. Our investments in Digi, NETsilicon and Entrada are classified as available for sale and are carried at fair value, based upon quoted market prices, with net unrealized gains reported as a separate component of stockholders' equity until realized. Unrealized losses are charged against income when a decline in fair value is determined to be other than temporary. At April 30, 2002, and January 31, 2002 marketable securities were as follows:

	Cost	Unrealized Gains	Market Value
April 30, 2002:			
Digi	$2,020	$11,076	$13,096
Entrada	22	30	52
	$2,042	$11,106	$13,148
January 31, 2002:			
NETsilicon	$3,938	$24,142	$28,080
Entrada	22	18	40
	$3,960	$24,160	$28,120

SORRENTO NETWORKS CORPORATION
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)
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Debentures-During August 2001, we completed a private placement of our 9.75% convertible debentures receiving net proceeds of $29,749. The debentures, due August 2, 2004, have a face value of $32,200 which is convertible into our common stock at $7.21 per share. At maturity we may elect to redeem the debentures for cash and we have the options of paying the interest on these debentures in shares of our common stock. In addition, the purchaser received four year warrants to acquire an additional 3,351,840 shares of our common stock at $7.21 per share and the placement agent received five year warrants to acquire 111,651 shares of our common stock, equity securities, options or warrants at a price less than $7.21 per share or at a discount to the then market price. The conversion price and warrant exercise are subject to adjustment.

In accordance with Emerging Issues Task Force ("EITF") No. 00-27 we have accounted for the fair value of warrants issued to the purchasers and placement agent and the fair value of the deemed beneficial conversion feature, which results solely as a result of the required accounting, of the debenture as a reduction to the face value of the debentures with an offsetting increase to additional paid in capital. These amounts as well as the issuance costs paid in cash will be amortized as additional interest expense over the period the debentures are outstanding. Interest expense during the three months ended April 30, 2002 of $1.2 million at the stated 9.75% interest which is paid in common stock, amortization of issuance costs of $36 and amortization of the fair value of the warrants issued to the purchasers and placement agent and the deemed beneficial conversion feature of $398. On April 1, 2002 the Company issued 303,579 shares of our common stock in payment of $774interest for the debenture interest period ending March 31, 2002. At April 30, 2002 debentures payable consists of:

Face Value	$ 32,200
Issuance costs	(2,451)
Value of warrants and deemed beneficial conversion feature	(27,252)
Debenture book value at issuance	2,497
Accumulated amortization of	
Issuance costs	117
Value of warrants and deemed beneficial conversion feature	1,309
	$ 3,923

STOCKHOLDERS' EQUITY

We are authorized to issue the following shares of stock:
150,000,000 shares of Common Stock ($.30 par value)
2,000,000 shares of Preferred Stock ($.01 par value) of which the following series have been designated:
2,500 shares of Preferred Stock, Series A
1,000 shares of Preferred Stock, Series B
100,000 shares of Preferred Stock, Series C
3,000 shares of Preferred Stock, Series D

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)
(In Thousands, except share and per share amounts)

1,000,000 shares of Preferred Stock, Series E

We have outstanding the following shares of preferred stock:

	Shares Outstanding	Par Value	Liquidation Preference
Series D	1,353	$1	$1,353

Preferred stock dividends during the quarters ended April 30, 2002 and 2001 consist of:

	Three Months Ended April 30	
	2002	2001
Deemed dividends (Sorrento Series A)	$ -	$180

OTHER CAPITAL STOCK TRANSACTIONS

On March 22, 2001 we completed a private placement of 1,525,995 unregistered shares of our common stock receiving net proceeds of $9,645. In addition the purchasers received three year warrants to acquire an additional 381,499 shares of our common stock at $8.19 per share. For a period of 18 months from the March 22, 2001 completion date in the event the Company were to issue shares of common stock or equity securities convertible into our common stock at a price less than $6.5531 per share the purchasers would be entitled to receive additional shares of common stock.

During 2000, our Sorrento subsidiary completed a sale of 8,596,333 shares of its Series A Convertible Preferred Stock receiving net proceeds of $46,638 from a group of investors. 1,467,891 shares were purchased by entities in which our immediate past Chairman and CEO, who was an outside director at that time, was a partner or member pursuant to a previously contracted right of participation. In addition, Sorrento paid a finders fee of $1,950 through the issuance by Sorrento of an additional 357,799 shares of its Series A Convertible Preferred Stock to an entity in which our immediate past Chairman and CEO, who was an outside director at that time, was a partner. Subsequent to the purchase of 2,697,248 of these shares an officer and director of the purchaser joined the Board of Directors of Sorrento. One of our then outside directors purchased 45,872 shares and a then director of Sorrento purchased 91,744 in this placement. One of our present outside directors, who was not a director at that

time, purchased 183,486 shares in this placement. In addition, he is a director of Liberty Media Corporation which owns an 11% economic interest representing a 37% voting interest in UGC. The purchaser of 3,027,523 shares in this placement is an indirect subsidiary of UGC. Liberty Media also holds convertible debt in this Series A holder which debt it has agreed to exchange for shares in UGC.

Each share of Sorrento's Series A Preferred Stock is convertible into one share of Sorrento's common stock at the option of the holder, may vote on an "as converted" basis except for election of directors, and has a liquidation preference of $5.45 per share. The shares are automatically converted into Sorrento's common stock upon an underwritten public offering by Sorrento with an aggregate offering price of at least $50,000. If Sorrento did not complete a $50,000 public offering by March 1, 2001, the holders of more than 50% of the then outstanding Series A shares may request to be redeemed at the shares then adjusted liquidation preference. If such a request is made in writing, our Sorrento subsidiary has the obligation to redeem the shares in cash, if funds are lawfully available to such a

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redemption, or for such pro rata portion as to which a lesser amount of lawfully available funds would exist. The net proceeds from the issuance of these shares has been classified as a minority interest in the accompanying financial statements as of April 30, 2002 and January 31, 2001. The difference between the net proceeds received on the sale of these shares and their liquidation preference of $48,800 was recorded as a deemed dividend during the period from issuance to March 31, 2001. During the years ended April 30, 2002 and 2001, we recorded a deemed dividend of $0 and $180 with respect to the Sorrento Series A shares. As of April 30, 2002 and January 31, 2002 the Series A Preferred Stock has been reclassified as a current liability since the holders have exercised their right to redeem the shares.

STOCK OPTION PLANS

We have four stock options plans in effect: The 2000 Stock Incentive Plan, the 1988 Stock Option Plan, the 1997 Incentive and Non-Qualified Stock Option Plan and the 1997 Director Stock Option Plan. The stock options have been made available to certain employees and consultants. All options are granted at not less than fair value at the date of grant and have terms varying from 3 to 10 years. The purpose of these plans is to attract, retain, motivate and reward

our officers, directors, employees and consultants to maximize their contribution towards our success. At April 30, 2002 there were 4,610,540 shares under option at prices varying from $3.00 to $69.13 per share.

In addition our Sorrento subsidiary adopted its 2000 Stock Option/Stock Issuance Plan under which it has granted options to certain of its employees and directors at prices not less than fair value at the date of grant and generally vest over four years. Eligible individuals may be issued shares of common stock directly, through immediate purchase of the shares at fair value, or as a bonus tied to performance milestones No stock has been issued under the stock issuance program and at April 30, 2002 there were 14,915,227 Sorrento shares under option at prices varying from $2.00 to $6.85 per share. The holders of these options may elect to convert all or a portion of their options into options to acquire our stock at a ratio of 3.9 for one.

EARNINGS PER SHARE CALCULATION

The following data show the amounts used in computing basic earnings per share for the quarters ended April 30, 2002 and 2001.

	Three Monthes Ended April 30,	
	2,002	2,001
Net income (loss)	$ 3,976	$ (5,768)
Less: preferred dividends	--	(180)
Net income (loss) available to common shareholders used in basic EPS	$ 3,976	$ (5,948)
Average number of common shares used in basic EPS	14,322,839	13,281,938

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)
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We had a net loss for the quarter ended April 30, 2001. Accordingly, the effect of dilutive securities including convertible preferred stock, vested and non-vested stock options and warrants to acquire common stock are not included in the calculation of EPS because their effect would be antidilutive. The following data shows the effect on income and the weighted average number of shares of dilutive potential common stock.

Net income (loss) available to common shareholders used in basic EPS	$ 3,976	$ (5,948)
Less: Convertible debt issuance costs	(28,620)	--
Plus: Convertible debt interest	774	--
Net loss available to common shareholders used in diluted EPS	$ (23,870)	$ (5,948)
Average number of common shares used in basic EPS	14,322,839	13,281,938
Effect of dilutive securitites:		
Convertible debentures	4,466,021	--
Stock benefit plans	--	279,440
Stock benefit plan of subsidiary	--	56,409
Warrant exercises	123,964	2,453
Average number of common shares and dilutive potential common stock used in diluted EPS ...	18,912,824	13,620,240

The shares issuable upon exercise of options and warrants represents the quarterly average of the shares issuable at exercise net of the shares assumed to have been purchased, at the average market price for the period, with the assumed exercise proceeds. Accordingly, options and warrants with exercise prices in excess of the average market price for the period are excluded because their effect would be antidilutive.

LITIGATION

On September 10, 2001, holders of a portion of the outstanding Series A Preferred Stock of our Sorrento subsidiary obtained a preliminary injunction from the Delaware Court of Chancery prohibiting it from issuing further shares of its Series A Preferred Stock or incurring any additional debt without the consent of the holders of a majority of the currently outstanding shares of such Series A Preferred Stock. On January 23, 2002, the Delaware Supreme Court affirmed the granting of the preliminary injunction.

On October 19, 2001, an amended complaint was filed in the injunction action, adding as named defendants, the Company, our Meret subsidiary, certain present and former officers and directors of the Company and our

SORRENTO NETWORKS CORPORATION
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)
(In Thousands, except share and per share amounts)

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subsidiaries as well as our investment bankers. The amended complaint also added, among other things, claims for fraud, securities fraud, breach of fiduciary duty, conspiracy, and intentional interference with contract as well as requesting the appointment of a receiver for our Sorrento subsidiary, all which claims are based on alleged wrongs committed in connection with or since the Series A placement. Our Sorrento subsidiary and the original individual defendants have all answered this amended complaint denying all allegations of wrongdoing.

The new defendants have all moved to dismiss the amended complaint. Management believes the allegations contained in the amended complaint are without merit.

On December 14, 2001, plaintiffs filed motions to sequester the common stock of our Sorrento subsidiary owned by Meret and the Sorrento Series A preferred stock that we own, as an alternative method of obtaining jurisdiction over us and Meret in the Delaware litigation. Management also believes that these motions are without merit.

Currently, hearings on all pending motions have been taken off the Court's calendar at the request of all parties, pending the resolution of ongoing settlement discussions between the Company and the plaintiffs. While the Company is encouraged at the progress of these negotiations, there can be no assurance that a settlement will be reached.

During June 2000, we entered into various agreements with Par Chadha, our former CEO and Chairman, which, among other matters, provides for payments of $250,000 per year for three years of consulting services and loans by us for the exercise of previously granted options to acquire 1,178,500 options at prices varying from $7.03 to $49.25 per share. As the members of our Board of Directors at the time of his resignation ceased to represent more than 50% of the Board in October 2000, all payments for consulting services were accelerated and no future consulting services are required. During October 2000, Mr. Chadha exercised 71,112 options, applying the $500,000 accelerated payment to the exercise. In addition, he exercised 507,388 options for which we are contractually obligated to loan the $5,034,000 due on the exercise. During September 2001, Mr. Chadha notified us that he does not have any obligations under the agreements. We have notified him that we do not agree with his interpretation of his repayment obligations under the terms of the agreements.

During December 2001, we entered into an agreement whereby the 507,388

option exercise was rescinded. Mr. Chadha returned the 507,388 shares to us for cancellation and we cancelled the receivable due from him and restored the original option agreements. In June, 2002, the Company filed with the Superior Court of California, County of Los Angeles a Complaint for Declaratory Relief regarding the interpretation of the agreement. Should Mr. Chadha prevail in Court, the Company may be required to issue him 1,178,500 shares of the Company's stock for no consideration.

In April 2002, our former Chairman and CEO, Dr. Xin Cheng, filed a claim in arbitration seeking, among other things, payment of $500 and acceleration of the vesting of options pursuant to alleged contractual obligations of our Sorrento subsidiary. The Company is disputing these claims.

From time to time, we are involved in various other legal proceedings and claims incidental to the conduct of our business. Although it is impossible to predict the outcome of any outstanding legal proceedings, we believe that such legal proceedings and claims, individually and in the aggregate, are not likely to have a material effect on our financial position, results of operations, or cash flows.

SUBSEQUENT EVENTS

The Board of Directors of Osicom approved a two-year employment contract with Mr. Sue ending May 2002, which provides for a salary of $168 per year and the vesting of all his options to acquire our common stock granted prior to February 1, 2000. This contract may be terminated for cause. However, should Mr. Sue be terminated without cause or resign in certain circumstances prior to the end of the contract term he will receive a continuation of his salary and benefits for two years, vesting of all his options to acquire our common stock and he is required to provide consulting services to us during that period, On May 8, 2002 Mr. Sue resigned from his position effective May 17, 2002 alleging entitlement to the foregoing salary continuation and other benefits. The Company does not believe Mr. Sue is entitled to any such benefits.

The Board of Directors of Osicom entered into a two-year contact with Anne Wallace, Director of Financial Reporting, ending May 22, 2002 which provided her compensation of $200 per year, plus benefits and living expenses while on location at the Company's Santa Monica facility. This contract may be terminated for cause. However, should Ms. Wallace contract be terminated without good reason, or if she resigns for good reason, she will receive a continuation of compensation and benefits for two years, and vesting of all her options to

acquire our common stock. On May 8, 2002 Ms. Wallace gave notice to the Company that she has resigned for good reason, thus alleging entitlement to the foregoing compensation and benefits. The Company does not believe Ms. Wallace is entitled to any such benefits.

The Board of Directors of Osicom entered into a two-year employment contract with Mr. Nimrod Johnson, Corporate Controller, ending May 22, 2002, which provides for a salary of $97 per year and the vesting of all his options to acquire our common stock. This contract maybe terminated for cause. However, should Mr. Johnson be terminated without cause or resign in certain circumstances prior to the end of the contract term he will receive a continuation of his salary and benefits for two years, vesting of all his options to acquire our common stock and he is required to provide consulting services to us during that period. On May 9, 2002 Mr. Johnson resigned from his position effective May 17, 2002 alleging entitlement to the foregoing salary continuation and other benefits. The Company does not believe Mr. Johnson is entitled to any such benefits.

CONCENTRATION OF CREDIT RISK

Financial instruments that potentially subject us to concentrations of credit risk consist primarily of temporary cash investments and trade receivables. As regards the former, we place our temporary cash investments with high credit financial institutions. At times such amounts may exceed the F.D.I.C. limits. We limit the amount of credit exposure by reviewing the financial strength and credit risks of the investments and financial institutions that the Company places its cash investments. Such investments and placements may include governmental or associated agency notes or bonds, liquid money market investments with a high degree of credit rating and major national or regional banks with excellent credit history and ratings. To date our risks in these investments has been minimal.

Although we are directly affected by the economic well being of significant customers listed in the following tables, management does not believe that significant credit risk exist at April 30, 2002. We perform ongoing evaluations of our customers and require letters of credit or other collateral arrangements as appropriate. Accordingly, trade credit losses have not been significant.

The following data shows the customers accounting for more than 10% of net consolidated receivables:

	April 30, 2002	January 31, 2002
Customer A	9.2%	30.9%
Customer B	25.0%	18.6%
Customer C	--	11.8%
Customer D	25.9%	8.4%

The following data shows the customers accounting for more than 10% of net consolidated sales:

	April 30, 2002	April 30, 2001
Customer A	17.4%	24.7%
Customer B	13.7%	19.8%
Customer C	13.2%	13.9%
Customer D	14.1%	20.4%

SEGMENT INFORMATION

	Sorrento Networks	Meret Optical
Three Months Ended April 30, 2002		
Net Sales	$ 4,794	$ 1,209
Cost of Sales	3,769	746
Gross Profit	1,025	463
Operating income (loss)	(5,719)	22
Depreciation & amortization expense	769	133
Valuation allowance additions	270	447
Capital asset additions	1,662	212
Total assets	59,572	8,187
Three Months Ended April 30, 2001		
Net Sales	$ 13,139	$ 1,358
Intersegment sales	--	--
Total net sales	13,139	1,358
Cost of Sales	8,666	902
Gross Profit	4,473	456
Operating income (loss)	(4,629)	112
Depreciation & amortization expense	397	136
Valuation allowance additionals	399	172
Capital asset additions	1,396	4
Total assets	54,350	8,346

PART II
OTHER INFORMATION

Item 1: Legal Proceedings

On September 10, 2001, holders of a portion of the outstanding Series A Preferred Stock of our Sorrento subsidiary obtained a preliminary injunction from the Delaware Court of Chancery prohibiting it from issuing further shares of its Series A Preferred Stock or incurring any additional debt without the consent of the holders of a majority of the currently outstanding shares of such Series A Preferred Stock. On January 23, 2002, the Delaware Supreme Court affirmed the granting of the preliminary injunction.

On October 19, 2001, an amended complaint was filed in the injunction action, adding as named defendants, the Company, our Meret subsidiary, certain present and former officers and directors of the Company and our subsidiaries as well as our investment bankers. The amended complaint also added, among other things, claims for fraud, securities fraud, breach of fiduciary duty, conspiracy, and intentional interference with contract as well as requesting the appointment of a receiver for our Sorrento subsidiary, all which claims are based on alleged wrongs committed in connection with or since the Series A placement. Our Sorrento subsidiary and the original individual defendants have all answered this amended complaint denying all allegations of wrongdoing.

The new defendants have all moved to dismiss the amended complaint. Management believes the allegations contained in the amended complaint are without merit.

On December 14, 2001, plaintiffs filed motions to sequester the common stock of our Sorrento subsidiary owned by Meret and the Sorrento Series A preferred stock that we own, as an alternative method of obtaining jurisdiction over us and Meret in the Delaware litigation. Management also believes that these motions are without merit.

Currently, hearings on all pending motions have been taken off calendar at the request of all parties, pending the resolution of ongoing settlement discussions between the Company and the plaintiffs. While the Company is encouraged at the progress of these negotiations, there can be no assurance that a settlement will be reached.

During June 2000, we entered into various agreements with Par Chadha, our former CEO and Chairman, which, among other matters, provides for payments of $250,000 per year for three years of consulting services and loans by us for the exercise of previously granted options to acquire 1,178,500 options at prices varying from $7.03 to $49.25 per share. As the members of our Board of Directors at the time of his resignation ceased to represent more than 50% of the Board in October 2000, all payments for consulting services were accelerated and no future consulting services are required. During October 2000, Mr. Chadha exercised 71,112 options, applying the $500,000 accelerated payment to the exercise. In addition, he exercised 507,388 options for which we are contractually obligated to loan the $5,034,000 due on the exercise. During September 2001, Mr. Chadha notified us that he does not have any obligations under the agreements. We have notified him that we do not agree with his interpretation of his repayment obligations under the terms of the agreements.

During December 2001, we entered into an agreement whereby the 507,388 option exercise was rescinded. Mr. Chadha returned the 507,388 shares to us for cancellation and we cancelled the receivable due from him and restored the original option agreements. In June, 2002, the Company filed with the Superior Court of California, County of Los Angeles a Complaint for Declaratory Relief regarding the interpretation of the agreement. We have been advised by Mr. Chadha's counsel that in June 2002, Mr. Chadha filed a lawsuit against the

Company in the Superior Court of California, County of Los Angeles, also seeking declaratory relief and in addition, alleging breach of contract and fraud. The Company has not as yet received a copy of this complaint and has no further details regarding its contents. Should Mr. Chadha prevail in Court, in addition to any other relief that may be granted, the Company may be required to issue him 1,178,500 shares of the Company's stock for no consideration.

In April 2002, our former Chairman and CEO, Dr. Xin Cheng, filed a claim in arbitration seeking, among other things, payment of $500 and acceleration of the vesting of options pursuant to alleged contractual obligations of our Sorrento subsidiary. The Company is disputing these claims.

From time to time, we are involved in various other legal proceedings and claims incidental to the conduct of our business. Although it is impossible to predict the outcome of any outstanding legal proceedings, we believe that such legal proceedings and claims, individually and in the aggregate, are not likely to have a material effect on our financial position, results of operations, or cash flows.

Item 2: Changes in Securities and Use of Proceeds
Not Applicable

Item 3: Defaults Upon Senior Securities
Not Applicable

Item 4: Submission of Matters to a Vote of Security Holders
Not Applicable

Item 5: Other Information
Not Applicable

Item 6: Exhibits and Reports on Form 8-K

A. Exhibits

Consolidated Financial Statements for the Quarter Ended April 30, 2002 (included in Part I, Item 1).

B. Reports on Form 8-K
March 6, 2002 Board Appointment of new Chairman and Chief Executive Officer

SIGNATURES

Pursuant to the requirements 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.

SORRENTO NETWORKS CORPORATION
(Registrant)

June 19, 2002

By: /s/ Joe R. Armstrong

Joe R. Armstrong,
Chief Financial Officer
Principal Accounting Officer