SORRENTO NETWORKS CORP
Form 10-K/A
May 12, 2004

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K/A

(Mark One)

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

For the fiscal year ended January 31, 2004

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)

Delaware (State or other jurisdiction of incorporation or organization)	04-3757589 (IRS Employer Identification Number)
9990 Mesa Rim Road San Diego, California (Address of principal executive offices)	92121 (Zip Code)

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

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, Par Value $0.001	NASDAQ
Title of each class	Name of exchange on which registered

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 by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S is not contained herein, and will not be contained, to the best of Registrant's knowledge, in a definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).
Yes [_] No [X]

The Registrant's revenues for its most recent fiscal year were $25,462,000

The aggregate market value of voting stock based upon the bid and asks price held by non-affiliates of the Registrant on July 31, 2003 was $23,429,101.

Number of shares outstanding of the Registrant's only class of common stock as of March 31, 2004 (the latest practicable date): 16,672,682.

The Company is filing 10-K/A to supplement its disclosure under Schedule 14A regarding audit fees and the role of the audit committee and to update Item 6. Selected Financial Data.

DOCUMENTS INCORPORATED BY REFERENCE:
None.

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PART I

Item 1. Business

Introduction

This Annual Report on Form 10-K may contain forward-looking statements that involve risks and uncertainties. Such statements include, but are not limited to, statements containing the words "believes, "anticipates," "expects," "estimates" and words of similar import. Our actual results could differ materially from any forward-looking statements, which reflect, management's opinions only as of the date of this report, as a result of such risks and uncertainties. We undertake no obligation to revise or publicly release the results of any revisions to these forward-looking statements. Readers should carefully review the risk factors set forth below in "Factors That May Affect Future Results" and in other documents the company files from time to time with the Securities and Exchange Commission, including its quarterly reports on Form 10-Q.

We are a leading supplier of intelligent optical networking solutions for access, metropolitan and regional applications worldwide. Our solutions enable communication carriers and service providers to offer broadband networking services over their existing optical fiber infrastructure. Our technologies permit telecommunications service providers to increase fiber capacity and fiber bandwidth utilization, reduce network costs and complexity over scalable and efficient networking platforms. Our optical networking systems support a wide variety of protocols, mixed speeds of traffic and accommodate changing traffic patterns directly over optical networks.

Our product solutions include optical access, optical transport, and network management solutions optimized for access, metro and regional markets, and combine to create powerful, cost-effective, and easy-to-manage optical networks. Our dense wavelength division multiplexing, or DWDM, and coarse wavelength division multiplexing, or CWDM, platforms can be used in enterprise, access, metropolitan and regional network applications. WDM technology allows many optical signals to be transmitted simultaneously on the same optical fiber by using different wavelengths of light to distinguish the signals. This technology increases optical network capacity and flexibility.

Our comprehensive suite of optical networking interfaces and optical access multiplexers allow us to also address video on demand, storage area networking, data center fail-over recovery, and internet connectivity applications. Our CWDM products provide a low cost, entry-level solution that can be used for enterprise and carrier access applications and that complement our DWDM product line. Multiplexing is a process that combines a number of lower speed data streams into one high-speed data stream.

We also have two powerful network management solutions for our CWDM and DWDM product line. Addressing all key management aspects - fault, configuration, performance, and security - these systems conform to North American and international standards and are simple to learn and use. We have a robust, carrier-class management system that offers broad functionality, including equipment/facilities management, fault management, performance monitoring, security control, alarm filtering, and remote download. We also have an enterprise network management solution that provides an intuitive graphical interface and covers operations, administration, maintenance, and provisioning functionality for our DWDM networks.

We currently have an installed base with over 20 communications service providers and system integrators worldwide, including AT&T Broadband, now Comcast Corporation, Deutsche Telekom, Cox Communications, Time Warner Telecom, United Pan-Europe Communications, El Paso Global Networks and Edison Carrier Solutions.

Understanding Our Market

Rapid Growth in Bandwidth Demand

Fueled by the growth of the Internet, the volume of data traffic transmitted across telecommunications networks now exceeds voice traffic. The growth of data traffic is attributable to increased Internet usage, increased access speeds and greater use of bandwidth intensive applications. Bandwidth means the capacity to move information down a communications channel. Bandwidth is defined by the highest data rates that can be transmitted by that channel and is commonly measured in bits per second.

Migration of Network Infrastructure

Traditional copper-based and SONET/SDH based telecommunications infrastructures were originally designed for voice traffic. These infrastructures do not scale effectively to provide the bandwidth needed to support the growth in high-speed data traffic. In addition, these infrastructures need network-wide upgrades in order to accommodate growing traffic thus resulting in long delays for provisioning new services.

DWDM and CWDM technologies are more flexible, more efficient and more scalable networking alternatives for meeting the growing demand for bandwidth and new broadband services. Broadband means technologies or networks that have the ability to transmit high data rates. DWDM is a sophisticated opto-electronics technology that uses multiple wavelengths of light very efficiently to greatly increase the number of video, data or voice channels of information that can be sent on a single optical fiber. Synchronous Optical Network, SONET, is a telecom transmission protocol for high-speed transmission over fiber optic cable, which was introduced by Bell Communications in 1984 and quickly accepted by American National Standards Institute. SDH stands for Synchronous Digital Hierarchy, which is transmission protocol for high-speed transmission over fiber optic cable published in 1988 by the Consultative Committee for International Telegraph and Telephony. It is a transmission protocol used outside the United States, mostly in Europe, that is similar to SONET.

DWDM networks were first deployed in long-haul applications. However, optical solutions specifically designed to address the challenges faced by access and metropolitan markets have significantly lagged in deployment. Accordingly, access and metro networks are considered to be traffic bottlenecks in the fast and efficient transmission of data.

Enhanced Competition in the Service Provider Market

Worldwide deregulation in the telecommunications industry has led to an increase in the number of service providers seeking to address the growing demand for bandwidth. In the U.S. and internationally, traditional service providers such as incumbent local exchange carriers (ILECs), inter-exchange carriers (IXCs) and post, telephone and telegraph companies (PTTs) are seeing new entrants in the broadband networking market seeking to capitalize on the growing demand for bandwidth. A number of competitors to these incumbents are building new data-centric networks to address the present bandwidth bottlenecks in the metropolitan markets, including utilities and cable television companies which are upgrading their current networks and are leveraging existing investments in fiber optic infrastructure to deliver high-speed data services in both the local and regional markets. This enhanced competition in the carrier and service provider markets is driving increased capital expenditures on network infrastructure that is focused on delivering scalable high-speed data services in a cost efficient manner.

Network Topography

The following describes each of the network segments within the optical network hierarchy:

- Long-haul networks are high capacity networks that connect service providers and carry voice and data across large geographic regions, typically spanning distances up to 4,000 kilometers. Long-haul networks are relatively simple networks, built around SONET/SDH technology and are primarily designed only to satisfy service provider long haul network capacity requirements.

- Metropolitan core (metro-core) networks connect the central offices of service providers in a metropolitan area and facilitate the transport and switching of traffic within extended metropolitan areas and between the network edge and long-haul networks. Metropolitan core networks are typically implemented in ring configurations and reach ring circumferences up to 300 kilometers. In order to efficiently use the optical network, sub-rate multiplexing devices aggregate traffic into wavelengths carrying higher speed aggregate bit rates across telecommunications networks. Regional networks typically transport voice and data traffic between cities across distances of 200 to 600 kilometers or more.

- Access networks connect enterprises or traffic aggregation nodes, in multiple locations throughout metropolitan areas, to service providers' central offices or connect different end-user locations to each other. In order to efficiently use the optical network, optical access devices aggregate traffic from end users into wavelengths or wavelength bands for transport across

telecommunications networks. Because access networks must support the varying demands of end users, these networks tend to be very complex.

Metropolitan Area Optical Network Opportunity

Although optical technologies are being deployed in long-haul networks to relieve capacity constraints, these solutions are not specifically designed to address the issues inherent in metropolitan and regional optical networks. Data is normally mapped into the voice multiplexing hierarchy for transport over the long-haul network. Metropolitan optical networks are characterized by varying traffic patterns and protocols as well as varied topologies and end-user requirements, making them more complex and difficult to manage than long haul networks. As a result, service providers have only recently begun to exploit the benefits of optical technologies in metropolitan optical networks.

The optical networking market has seen a substantial downturn. The metro WDM market, which was expected to increase, has also experienced a slowdown as capital spending has declined throughout the telecommunications industry. Although we believe that the metro WDM world-wide market will grow significantly in the years to come, such growth is not likely to occur until capital spending resumes in the markets we serve, and we are unable to assess at present when this might take place.

Regional Optical Network Opportunity

In addition to the metropolitan market, recent engineering enhancements have permitted the use of DWDM networking platforms for regional optical networking applications. This development opens up the opportunity to address a portion of the substantial long haul market. In some regions, e.g., Europe, regional solutions apply to the majority of the networks installed. Industry researchers recently started looking at reclassifying the regional market opportunity, although statistical data for this market are not available.

Specific Challenges Facing Metropolitan and Regional Optical Networks

Service providers face numerous specific challenges in addressing metropolitan and regional optical networks:

Scalability Limitations. Originally constructed for voice traffic, the current network infrastructure based on SONET/SDH technology does not allow for the network efficiencies necessary to address the shift to a predominantly data-driven network. Due to its inherent lack of scalability, the current network infrastructure may require service providers to undertake the expensive and tedious process of replacing network equipment or adding new layers of similar equipment in response to changes or increases in bandwidth demand. Alternative approaches to WDM are being developed by other vendors to address the scalability of the SONET/SDH networks. These nonstandard solutions are called next generation SONET/SDH and can minimize the wasted bandwidth of legacy SONET/SDH. While these solutions allow carriers to combine voice and data on the same network, such solutions do not, however, expand the amount of bandwidth available and are, therefore, unable to accommodate the need for large amounts of bandwidth.

Need to Support Multiple Protocols. Metropolitan optical networks are characterized by a wide variety of protocols. The inability to support multiple protocols and services from a single platform further increases the cost and complexity of the metropolitan networks. Alternative approaches to WDM are being developed by other vendors to address the requirement for support of multiple services. These nonstandard solutions are called multi-service provisioning platforms (MSPP). These solutions generally carry out protocol conversions and are much more complex than WDM solutions.

Market Downturn. Virtually all telecom related market segments have suffered a decline in demand in the current economic downturn. What was once viewed as only a long-haul decline in market demand has now affected the regional and metropolitan networks as both enterprise and carrier business have cut back capital spending. Although we expect that demand in the regional and metropolitan markets will be strong in future periods, there are no assurances that capital spending will resume within this sector in the near term.

Several Stages of Conversion. Present solutions require several conversions to transport data through a metropolitan network. In the access networks, aggregation of traffic often requires protocol conversions into a common protocol before optical transmission. In the central office, data is often demultiplexed and converted into electrical signals for regeneration, switching or further aggregation into higher capacity links and then reconverted into optical signals for transmission in the metro-core network.

Inefficient Bandwidth Utilization. Within metropolitan optical networks, service providers must cater to end-users with varying access speeds. Current optical access solutions do not make efficient use of scarce wavelength resources. Service providers must assign a full wavelength to each signal, whether or not the end-user requires the full bandwidth potential of each wavelength.

Difficulty of Network Management. Multiple protocols and services, coupled with the lack of standards that exist in metropolitan optical networks, make network management functions, such as performance monitoring and configuration, exceedingly difficult. Lack of a robust network management platform further adds to the cost and complexity of metropolitan optical networks.

Need for New, Enhanced Service Offerings to Generate New Revenue Opportunities. Service providers are searching for next-generation solutions that will enable them to generate additional sources of revenue from offering new or enhanced services to their customers. Current solutions typically require the service provider to deploy equipment that is specifically designed for a particular service and transmission rate. Next-generation solutions must be able to offer enhanced features, wavelength provisioning and bandwidth-on-demand, that end-users will increasingly request from service providers.

Our Solution

Our solutions feature products designed to specifically address the shortcomings of legacy SONET/SDH networks and to facilitate offering new services throughout metropolitan and regional optical networks. We enable our customers to meet the rapidly growing demand for bandwidth by offering end-to-end access, metropolitan and regional optical networking solutions for the aggregation, transport and management of traffic. Our current products, including our GigaMux'r' 6400 DWDM transport system, our EPC'TM' sub-rate multiplexing modules, our GigaMux'r' 3200 and 1600 DWDM and CWDM transport systems, as well as the network management product line that includes GigaView'TM', TeraManager'TM' and TeraConfigurator'TM', are specifically designed to meet the unique requirements of access metropolitan and regional markets.

Our optical networking solutions offer numerous benefits including:

Cost Effective Entry-Level Access Solution. Our GigaMux'r' 3200 and 1600 DWDM and CWDM platforms allow low cost multiplexing of up to sixteen wavelengths carrying a mix of protocols and signals for access applications. The 3200 and 1600 products enable customers to seamlessly and costs effectively mix CWDM and DWDM on the same platform and on the same fiber. These products also provide patented.

Cost effective and feature rich in wavelength management capabilities. The 3200 and 1600 products also reduce customer operating costs by enabling the same modules to be used across every platform, thereby reducing sparing costs.

Scalable Architecture. We have created an optical networking solution that simultaneously transmits voice, data, and video over optimized fiber channels. The modular architecture of our solution enables service providers to incrementally expand capacity as their bandwidth needs increase. This simple, scaleable, and functional solution solves short and long-term service provider problems, which enhances their ability to reduce costs and offer value-added services. For example, a service provider can begin deployment with a single channel and later expand up to 64 channels, providing up to 640 gigabits per second, or Gbps, of transmission capacity without interrupting existing traffic. A fiber channel is a serial data transfer architecture standard conceived for new mass storage devices and other peripheral devices that require very high bandwidth connections. Bit rates for fiber channels are either 1.06 Gbps or 2.1 Gbps.

Protocol and Signal Transparency. Our suite of solutions transports a mix of protocols and signals, including SONET/SDH, Asynchronous Transfer Mode (ATM) over SONET, Internet Protocol (IP) over SONET, Gigabit Ethernet, Fibre Channel and Enterprise System Connectivity in their native formats over numerous wavelengths in the same fiber. This transparency provides operational simplicity in that the service provider can offer networking connectivity without having to worry about protocol conversions. This is particularly important in metropolitan areas where multiple protocols are utilized and data transmission rates change often. The transparency of our solution eliminates the unnecessary conversions from optical to electrical and back to optical, as well as eliminates several layers of equipment that would otherwise be required in the transport and switching of traffic, thus reducing network complexity and signal latency.

Protocol Aggregation. Our EPC'TM' optical access multiplexer aggregates traffic, of varied rates utilizing a wavelength per direction of transmission, from businesses and network points of presence for transport throughout optical networks. This aggregation allows better utilization of wavelengths and lowers capital expenditures of telecom service providers by reducing investments in excess network capacity.

Manageability. The design of our end-to-end optical networking solution will allow service providers to perform network management from a single platform with our TeraManager'TM' product. This intelligent optical network element management software platform provides fault, configuration, performance, and security management utilizing an easy-to-use graphical user interface that allows point and click network provisioning and monitoring.

Regional Optical Transport. Our solution permits service providers to expand beyond the confines of metropolitan networks using the same platform for metropolitan and regional applications. Regional networks can now be built using the lower cost solutions developed for the metropolitan environment.

Our Strategy

Our objective is to become a leading supplier of intelligent optical networking solutions for metro and regional applications worldwide. The key elements of our strategy are to:

Enhance our optical networking solutions

We intend to continue to enhance our existing family of optical networking products and to introduce new products that increase the functionality of our end-to-end optical solution. We introduced TeraManager'TM' and TeraConfigurator'TM' in our management solution portfolio in fiscal 2002. We introduced a new 10-port Gigabit Ethernet multiplexer in December 2003 for video on demand and large commercial applications. The combination of our GigaMux'r' optical transport products, with the EPC'TM' sub-rate multiplexers, and TeraManager'TM', our carrier class network management product, creates an intelligent all-optical transport solution.

Leverage our engineering expertise

We intend to leverage our engineering expertise in the areas of optical, mechanical, electrical and network management design to continue to provide leading end-to-end metropolitan and regional optical networking systems and to expand our market share. We believe we were the first company to commercially ship a metropolitan optical networking product using DWDM technology. As of January 31, 2004, we had a skilled team of 49 engineers that continually focus on developing products for the metropolitan and regional optical transport market. We believe that our technological expertise has been the key to our success and will enable us to rapidly develop new product offerings and end-to-end optical solutions for the metropolitan and regional markets.

Allow our customers to leverage their fiber assets by offering revenue-generating services

The majority of our existing customers and targeted customers have a large amount of fiber assets in the metropolitan and regional network infrastructure. We intend to continue to develop and provide solutions that will enable our customers to leverage their existing fiber infrastructure to deliver

revenue-generating services, while reducing their overall network costs. In addition, we believe our existing customer base provides us with an advantage when competing for new customers. We intend to continue to work closely with our customers and invest in sales and marketing resources to maintain our high level of customer service and remain responsive to our customers' changing needs.

Aggressively pursue expense reduction initiatives

We continue to aggressively pursue cost reduction initiatives to bring our expenses in line with current and future anticipated revenues. Such reductions may affect the size of our workforce, and may require decreasing our operating expenses and capital spending. During the past two fiscal years we have concentrated on implementing initiatives that have lowered our operating costs and anticipate the need for continued cost reductions if sales volume does not increase in the near future.

Maintain our sales, service and support organizations worldwide

We intend to continue to market our products worldwide. We currently have sales, service and support teams in North America, Europe and Asia. We believe that sales, service and support efforts on a customer-by-customer basis are most effective due to the technical evaluation and significant investments that are made by our customers.

Expand our product and customer base through careful acquisitions

We intend to expand our addressable market by adding "best-of-breed" optical access products to our metro/regional portfolio and enhance our edge-to-core network offerings. The recent acquisition of LuxN, Inc., is a prime example of such expansion. LuxN supplies optical access equipment for the network edge using CWDM and DWDM technology. LuxN's Operations Systems Modification of Intelligent Network Elements (OSMINE) certified products enable delivery of high-bandwidth data, storage, video, and voice services for service providers, cable Multiple Service Operators or MSOs, and enterprises. Our union with LuxN broadens our 30-plus blue-chip customer base by adding over 20 new customers including Time Warner Telecom, Hawaii I-Net, Yipes Enterprise Services, and numerous universities.

Products

Our family of optical networking systems is designed to provide our customers with end-to-end solutions for the metropolitan and regional optical networking markets. Our transport, access, switching and network management systems include the following products, some of which are still in development.

GigaMux'r' 6400 -- DWDM Optical Transport

Our GigaMux'r' 6400 optical transport product utilizes DWDM technology to expand the capacity of new and existing fibers and enable traffic to travel throughout metropolitan optical networks without optical to electrical to optical conversions at each intermediate node. Our GigaMux'r' 6400 features wavelength translation, wavelength multiplexing, optical amplification, optical add-drop multiplexing, protection switching and performance monitoring. The scalable and modular architecture of our GigaMux'r' 6400 product enables service providers to easily and cost-effectively expand their existing networks as bandwidth requirements increase. The GigaMux'r' 6400 can simultaneously transport multiple protocols bi-directionally over one or more fibers, which reduces the cost and complexity of the network. As part of our focus on video-on-demand transport, we recently introduced a 10-port Gigabit Ethernet multiplexer for GigaMux'r' 6400 metro/regional DWDM system targeted at the cable multi-system operator community.

Our GigaMux'r' 6400 product is Network Equipment Building Standards; or NEBS, level III certified. As of January 31, 2004, we have shipped our GigaMux'r' product to over 20 direct carrier customers or resellers worldwide. Our GigaMux'r' product includes the following key features:

Scalability: the system can grow from 1 to 64 protected channels (640 Gbps/fiber) without a major upgrade or service interruption.

Protocol transparency: the system can aggregate and transport SONET/SDH (OC-3/STM-1 through OC-192/STM-64 carrying voice, IP or ATM traffic), ESCON, Fibre Channel, Fast Ethernet, Gigabit Ethernet and video.

Modular protection: the system's modular protection system allows redundancy to be implemented at any point in the network.

Add/drop channels: the system is equipped with add/drop modules that allow specific channels to be added or dropped while all other channels pass through. Our filter subsystem can add or drop from single channels to larger wavelength bands.

Reach: Up to 600 kilometers with optical amplifiers and up to 1,000 km with the addition of dispersion compensation.

EPC'TM' - Sub-Rate Access Multiplexers

Electric Photonic Concentrator, or EPC'TM', is our sub-rate access multiplexer product that aggregates a wide variety of traffic from businesses and network points of presence for high-speed transport throughout optical networks. The traffic is aggregated for transmission on a single wavelength over the GigaMux'r' 6400. EPC'TM' is designed to lower the cost and increase the efficiency of bandwidth delivery within optical networks.

Our EPC'TM' products aggregate the following protocols:

Ten one Gigabit Ethernet channels onto one 10 Gigabit wavelength

16 OC-3 channels or 4 OC-12 channels, or a combination thereof, over a single OC-48 wavelength

Two one Gigabit Ethernet channels, or four fractional Gigabit Ethernet channels, over a single OC-48 wavelength

Eight ESCON channels over a single OC-48 wavelength

GigaMux'r' 3200 and 1600 - DWDM and CWDM Optical Transport

Our GigaMux'r' 3200 and 1600 platforms feature the flexibility and value needed for optical access and metro applications. The GM 3200 and 1600 can scale up to 16 protected wavelengths of DWDM or 8 protected wavelengths of CWDM, respectively, optimizing the cost of ownership for differing application needs. The system features wavelength translation, wavelength multiplexing, optical amplification, optical add-drop multiplexing, protection switching, and comprehensive management and performance monitoring.

The GM 3200 and 1600 modules are supported in 4 different chassis options (GM 3234, GM 3217, GM 1608, and GMX 128), ranging from 1 to 64 wavelengths in capacity. All modules are common across multiple chassis allowing ease and simplicity of sparing and flexible provisioning. Whether the CWDM/DWDM equipment is positioned at the Central Office or customer premise, Sorrento utilizes an industry leading form factor to keep rack space to a minimum. The operational flexibility is extended to multi-rate software provisioning, varying methods of protection, with DC and AC power support across all chassis. The GM 3200 and 1600 design is focused on providing simple intelligent optical access solutions at a low cost of ownership to the carrier providing a quick ROI with ease of implementing new revenue services.

Our GigaMux'r' 3200 and 1600 products are Network Equipment Building Standards; or NEBS, level III certified. As of January 31, 2004, we have shipped our GigaMux'r' 3200-1600 products to over 20 customers worldwide. Our GM 3200 - 1600 product includes the following key features:

Affordable pay-as-you-grow architecture featuring a low entry price, modular design, and the ability to add more services without interrupting the existing traffic.

Multi-rate, multi-protocol on the same hardware, supporting GbE, 1G & 2G Fibre Channel, ESCON, FICON, OC-3 thru OC-192, digital video, 10 GbE LAN/WAN PHY and more.

Support for all access and metro topologies (including point-to-point, linear add/drop, ring, and mesh) over single or dual fibers with distances over 250 km.

Four different chassis options starting at 2RU in height (3.5") and scaling from 1 to 64 wavelengths in capacity.

Cost effective In-Wavelength Management, eliminating the need for a separate Optical Supervisory Channel.

Support for both CWDM and DWDM in the same chassis and on the same fiber, utilizing the same form factor for all modules - maximizing service flexibility and greatly reducing sparing and inventory costs.

TeraManager'TM' -- Element Management System

TeraManager'TM' is our TL1-based intelligent element management software platform that provides fault, configuration, performance and security management for all the Sorrento networks products and for networks built with such products. Service providers can operate our network management platform through an easy-to-use graphical user interface, which gives users a complete network view and enables point and click provisioning and monitoring.

Our TeraManager'TM' product includes the following features:

- Fault, configuration, security and performance management
- Carrier class performance
- Interface with higher layer operation support systems

Meret Optical Communications

Our optical networking subsidiary, Meret Communications, Inc., doing business as Meret Optical Communications, also markets our new CWDM product, as well as feature-rich video transport and switching, radio frequency, or RF, transmission, and RF synthesis products.

Customers

Our target customer base includes wholesale and retail broadband service providers, such as inter-exchange carriers, local and foreign telephone companies, the telecom affiliates of utility companies (utilicoms), cable television service providers, system integrators and distributors.

Our customers generally fit the following customer profiles:

- Wholesale Network Providers--these customers provide wavelength and broadband services to communication service providers and include telecommunication carriers, cable companies and utilicoms.

- Managed Services Providers--these customers provide wavelength and broadband services to enterprises and include telecommunication carriers, cable companies, utilicoms and Internet Service Providers.

- System Integrators--companies that specialize in providing turnkey networking solutions for enterprise networks and applications such as data-center connectivity and storage area networks.

- Large Enterprises--large enterprise customers are generally large organizations with complex networking needs, usually spanning multiple locations and difficult types of network requirements. Enterprise customers include industrial corporations, government agencies, and utilities.

- Small and Medium Businesses--these customers have a need for networks as well as connection to the Internet and/or to their business partners. However, they generally have limited resources. Therefore, we provide product through systems integrators or Value Added Resellers.

Our customer base is highly concentrated. In fiscal year 2004, five customers accounted for 48% of net sales. In fiscal year 2003, five customers accounted for 84% of net sales, during fiscal year ended January 31, 2002 five customers accounted for 62% of sales. We expect this customer concentration to continue for the foreseeable future.

For fiscal 2004, we shipped our optical networking products to a total of 23 customers worldwide. Three customers, AT&T Broadband, now Comcast Corporation, Cox Communications and Looking Glass Networks each represented more than 10% of our net sales for fiscal 2004 and AT&T Broadband, now Comcast Corporation, Cox Communications and Deutsche Telekom each represented more than 10% of our net sales for fiscal 2003

Key Relationships

Three customers, AT&T Broadband, Cox Communications and Deutsche Telekom each represented more than 10% of our net sales for fiscal 2002.

We have entered into long-term agreements with some of our customers, including:

AT&T Broadband Network Solutions (Now Comcast Business Communications)

In February 2000, we entered into a strategic alliance agreement with AT&T Broadband Network Solutions (now Comcast Business Communications), or AT&T Broadband. Under the terms of this agreement, AT&T Broadband and we agreed to negotiate in good faith concerning the implementation of a number of joint sales and marketing initiatives. AT&T Broadband also agreed to help introduce our technology to individuals at other AT&T divisions and to provide feedback concerning our products' performance. The initial term of this agreement expired in February 2002 and was automatically renewed for an additional one-year term in February 2002, February 2003 and February 2004. Similar automatic renewals will occur in each succeeding February. Either AT&T Broadband or we may terminate the agreement for any reason upon ninety days notice. In addition, we concurrently entered into an equipment purchase agreement. The equipment purchase agreement expired in February 2002 and was automatically renewed for an additional one-year term in February 2002, February 2003 and February 2004. Similar automatic renewals will occur in each succeeding February. Either AT&T Broadband or we may terminate the agreement for any reason upon ninety days notice. We started shipping our products to AT&T Broadband in the second quarter of fiscal year 2001.

In November 2002, we entered into a separate exclusive supplier agreement with AT&T Broadband. Under this agreement, we became AT&T Broadband's exclusive supplier, subject to certain exceptions, of dense and course wavelength division multiplexing equipment that AT&T Broadband uses to provide UFO Communications, Inc., a private service provider, with certain services on certain AT&T Broadband networks. The initial term of this agreement is five years and continues after the initial term until either party gives 90 days written notice terminating the agreement.

Looking Glass Networks

In August 2001, we entered into an equipment purchase agreement with Looking Glass Networks, or LGN. Under the terms of this agreement, LGN agreed to purchase metro DWDM optical networking equipment from Sorrento as the primary supplier. LGN also agreed to receive early adopter access to new and emerging Sorrento technologies, and to serve as a beta tester for new and emerging equipment and to provide feedback concerning our products' performance. The initial term of this agreement expires in August 2004 and will be automatically renewed for additional one-year terms. Either LGN or Sorrento may terminate the agreement at the end of the initial or any renewal term upon ninety days notice. We started shipping our products to LGN in the third quarter of fiscal year 2002.

Time Warner Telecom

In April 2001, we entered into an equipment purchase agreement with Time Warner Telecom, or TWT. Under the terms of this agreement, TWT agreed to purchase CWDM and DWDM optical networking equipment from Sorrento. The initial term of this agreement expired in April 2003 and was automatically renewed for an additional one-year term in April 2004. Similar automatic renewals will occur in each succeeding April. TWT may terminate the agreement for any reason upon thirty days notice.

Sales and Marketing

Our sales effort is currently focused on North America, Europe and Asia. As of January 31, 2004, our sales and marketing organization included 36 employees, including account managers, sales engineers, support personnel, product managers and marketing personnel. In North America and Europe, we sell our products through our direct sales force as well as through system integrators. Our international direct sales force is located in the United Kingdom, France and Germany. In Asia, we sell our products though system integrators.

In support of our worldwide selling efforts, our marketing team targets potential customers through in-depth market analysis. Our marketing objectives include building market awareness and acceptance of our products as well as expanding our customer base. Our customer acquisition strategy has focused on targeting customers who are aggressively building network infrastructure and are looking to leverage existing fiber assets to generate additional revenue from broadband services. This focus has led to strategic supply agreements with several MSOs, utilities, and CLECs. We also plan to target incumbent carriers as they expand the development of their metropolitan and regional fiber networks. Marketing personnel coordinate our participation in trade shows, seminars and industry events and conduct media relation's activities with trade and general business publications. We participate in many industry organizations responsible for developing standards that are used in optical networks.

Customer Service and Support

Our customer service and support team provides a critical component of our customer satisfaction initiative. This team provides support to our customers allowing them to successfully design and implement their optical networks. All services can be customized to meet the needs our customers. Our staff is experienced, and has the equipment necessary to support both installation and problem resolution. A variety of installation service packages support the implementation from start up to upgrades and maintenance. Specialists are available 7 days a week, 24 hours a day. We offer a Technical Assistance Center including field services support. Multiple technical support service agreements allow our customers to define the level of support they require. Our customer service and support team provides installation, maintenance and training programs addressing the product, installation and maintenance processes and can be delivered at the customer location or at our training facility.

We currently provide service and support to our international customers on a direct basis and are establishing service and support agreements throughout the world. To date revenues from service and support agreements have not been material. We intend to continue to develop our internal team to meet the needs of our customers and will utilize strategic partners to allow us to provide greater value when appropriate.

We provide a total service solution. Our hardware products are warranted against defects for a period of 12 to 36 months dependent on purchase agreements, including technical support and parts repair/replacement. We also offer support contracts for a fee to our customer base, thereby allowing our customers to select a service plan tailored to their own particular needs.

Engineering, Research and Development

We have assembled a team of highly skilled engineers with extensive experience in the fields of optical, mechanical, electrical and network management design. We believe that our success in introducing DWDM optical technology for use in the metropolitan and regional markets was a result of our strength in research and development. As of January 31, 2004, 49 employees were engaged in engineering, research and development efforts. Our research and development efforts are focused on new product development as well as enhancing performance and reliability of our existing products. We believe that our research and development efforts are key in maintaining technical competitiveness, delivering innovative products, and addressing the needs of the regional and metropolitan market.

Our engineering, research and development expenses were $8.0 million, $9.0 million and $13.7 million for the years ended January 31, 2004, 2003 and 2002, respectively. The decrease in our engineering, research and development expenses was primarily due to headcount and expense reduction programs initiated by the Company as a result of decreased capital spending levels from our major telecom customers during these periods.

Manufacturing and Quality

We outsource the manufacturing of our products. We design our products and perform system integration, quality control, final testing and configuration at our San Diego, California and Sunnyvale locations. Our Sunnyvale facility is ISO 9001:2000 certified and we have begun the process of upgrading our San Diego facility from ISO 9002:1994 to ISO 9001:2000. By meeting such standards, we assure our customers that we meet internationally recognized standards for quality, customer care and sound management practices. We believe that outsourcing our

manufacturing allows us to conserve working capital, flexibly respond to changes in market demand and quickly deliver products to our customers.

We currently purchase products from our contract manufacturers and other suppliers on a purchase order basis. We generally do not enter long-term contracts with our contract manufacturers or suppliers, and they are not obligated to perform services for us for any specific period or at any specified price, except as may be provided in a particular purchase order. We purchase a limited number of key components used in the manufacturing of our products from a limited number of suppliers and some of our components are purchased exclusively from a single supplier on a purchase order basis. Management believes that other suppliers could be identified to provide similar components on comparable terms. A change of suppliers, however, could cause a delay in manufacturing and a possible loss of sales, which would affect operating results adversely.

Patent, Trademarks and Licenses

We currently hold approximately 39 patents and have several patent applications pending. Although we attempt to protect our intellectual property rights through patents, trademarks, and copyrights, maintaining certain technology as trade secrets and other measures, we cannot assure that any patent, trademark, copyright or other intellectual property rights owned by us will not be invalidated, circumvented or challenged, that such intellectual property rights will provide competitive advantages to us or that any of our pending or future patent applications will be issued with the scope of the claims sought by us, if at all. We cannot assure that others will not develop technologies that are similar or superior to our technology, duplicate our technology or design around the patents that we own. In addition, effective patent, copyright and trade secret protection may be unavailable or limited in certain foreign countries in which we do business or intend to do business in the future. We also have licensed and may in the future license technologies from other companies on a non-exclusive basis. For example, one of our CWDM products incorporates technology purchased from Entrada Networks, Inc., our former affiliate, that we then enhanced to complete a commercially feasible product.

We believe that the future success of our business will depend on our ability to translate the technological expertise and innovation of our personnel into new and enhanced products. We cannot assure that the steps taken by us will prevent misappropriation of our technology. In the future, we may take legal action to enforce our patents and other intellectual property rights, to protect our trade secrets, to determine the validity and scope of the proprietary rights of others, or to defend against claims of infringement or invalidity. Such litigation could result in substantial costs and diversion of resources and could harm our business and operating results.

As is common in our industry, we have from time to time received notification from other companies of intellectual property rights held by those companies upon which our products may infringe. Any claim or litigation, with or without merit, could be costly, time consuming and could result in a diversion of management's attention, which could harm our business. If we were found to be infringing on the intellectual property rights of any third party, we could be subject to liabilities for such infringement, which could be material, and could be required to seek licenses from other companies or to refrain from using, manufacturing or selling certain products or using certain processes. Although holders of patents and other intellectual property rights often offer licenses to their patent or other intellectual property rights, no assurance can be given that licenses would be offered, that the terms of any offered license would be acceptable to us or that failure to obtain a license would not cause our operating results to suffer.

Working Capital Practices

We have historically maintained high levels of inventories to meet output requirements of our customers and to ensure an uninterrupted flow of inputs from suppliers. We have however, initiated active and aggressive programs to reduce our inventories and conserve working capital resources on an ongoing basis. It is not our standard policy to grant customers the right to return merchandise that performs according to specifications. Typical payment terms require payment within thirty to sixty days from the date of shipment.

We perform ongoing credit evaluations of each customer's financial condition and extend unsecured credit related to the sales of various products. From time to time we receive financial instruments such as letters of credit for payments for international customers. At January 31, 2004, accounts receivable due from Cox Communications, KLA Tencor, CNT and Time Warner Telecom accounted for 16%, 12%, 12% and 11% respectively, of net

receivables. At January 31, 2003, accounts receivable due from AT&T Broadband, Cox Communications, DeltaNet and Inoc accounted for 31%, 16%, 19% and 30% respectively, of net receivables.

Our Backlog

At January 31, 2004, we had backlog that totaled $2.1 million compared to $5.0 million at January 31, 2003. Our backlog consists of orders confirmed with a purchase order for products to be shipped within twelve months to customers with approved credit status. We do not believe that backlog, as of any particular date, should be used as an indication of sales for any future period for two reasons. First, orders are increasingly being booked and shipped in a short period of time and therefore may never be calculated in the backlog amount at the end of any particular quarter. Second, customers have and can change delivery schedules or cancel orders without a significant penalty.

Competition

The market for optical networking equipment is extremely competitive and subject to rapid technological change. We expect competition to continue to be significant in the future. Our primary competitors in the DWDM market include vendors of optical networking and infrastructure equipment such as ADVA AG Optical Networking, CIENA Corporation, Cisco Systems, Lucent Technologies, Fujitsu and Nortel Networks, as well as private companies that have been or will be focusing on our target markets. Our primary competitors for our CWDM products include ADVA AG Optical Networking and CIENA Corporation, as well as private companies that have been or will be focusing on our target markets. Many of our competitors have significantly greater financial resources and are able to devote these greater resources to the development, promotion, sales and support of their products. In addition, many of our competitors have more extensive customer relationships than we do, including relationships with our potential customers. We believe each of our competitors has optical networking products in various stages of development.

We believe the principal competitive factors in the optical networking market are:

- product performance, features, functionality and reliability;
- price/performance characteristics;
- timeliness of new product introductions;
- relationships with existing customers;
- service, support and financing; and
- financial stability and strength of company.

We believe our products compete favorably with our competition within our marketplace.

The competitors for Meret's legacy products include Pesa, Artel, RGB Spectrum, Utah Scientific, and many other companies.

Increased competition may result in further price reductions, reduced gross margins and loss of market share, any of which could materially and adversely affect our business, operating results and financial condition. There can be no assurance that we will be able to compete successfully against current and future competitors, or that competitive factors will not have a material adverse effect on our business, operating results and financial condition.

Environmental Compliance

We are required to file environmental compliance reports with the Federal Food and Drug Administration regarding the emissions levels of our laser-based products, which are used in fiber optics communications. All of our products comply with required safety level standards.

Employees

As of January 31, 2004, we had 132 employees, of which 49 were in engineering, research and development, 36 in sales and marketing, and the remainder in manufacturing and in general and administrative functions. Of the 49 employees in engineering, research and development 20 have master's degrees and 14 have doctorate degrees.

We also employ a number of part-time and temporary personnel from time to time in various departments. Our future success will depend in part on our ability to attract, retain and motivate highly qualified technical and management personnel, for whom competition is intense. None of our employees are covered by a collective bargaining agreement and we believe that our relations with our employees are good.

Forward-Looking Statements--Cautionary Statement

All statements other than statements of historical fact contained in this Form 10-K, 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 successfully to finance our current and future needs for working capital; our ability to keep our common stock listed on the NASDAQ Stock Market; 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; 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.

Factors That May Affect Future Results

In connection with the safe harbor contained in the Private Securities Reform Act of 1995 we are hereby identifying important factors that could cause actual results to differ materially from those contained in any forward-looking statements made by us or on our behalf. Any such statement is qualified by reference to the following cautionary statements:

The telecom industry has experienced a significant downturn in the past several years and continues to remain unpredictable as to future capital spending level for carriers with whom we depend upon our revenues. Current world turmoil, economic uncertainty and an equity market that is difficult to raise new capital, could cause our future revenues to decrease. A significant downturn in our revenues would have a negative impact upon our existing working capital and have a negative impact on our stock price. In addition, we would be faced with the need to raise additional working capital of which there is no certainty that such working capital would be available.

We have substantial debt, and we may not generate sufficient cash flow to meet our debt service obligations if revenues significantly decreased.

Our total debt consists primarily of approximately $12.4 million principal amount of 7.5% debentures with a maturity date in August 2007, and mortgage debt of approximately $3.6 million. The amount of our debt could have important consequences, including:

- impairing our ability to obtain additional financing for working capital, capital expenditures, acquisitions or general corporate purposes;

- requiring us to dedicate a substantial portion of our operating cash flow to paying principal and interest on indebtedness, thereby reducing the funds available for operations;

- impairing our ability to adjust rapidly to changing market conditions, invest in new or developing technologies, or take advantage of significant business opportunities that may arise;

- placing us at a competitive disadvantage compared to our competitors that have less debt; and

- making us more vulnerable if the current general economic downturn continues or if our business experiences difficulties.

If we cannot generate sufficient revenues, we may not be able to meet our debt service obligations, repay our debt when due, or comply with other covenants in the 7.5% debentures. If we breach our obligations under the 7.5% debentures, the holders could require repayment of all amounts owed, and we may not have sufficient cash reserves to repay such amounts.

We may be unable to raise the funds necessary to repay or refinance our indebtedness.

We are obligated to make interest payments on the 7.5% debentures on a quarterly basis each year until 2007, when the 7.5% debentures mature. We have the option to pay interest in shares of our common stock and in additional 7.5% debentures to a certain limitation rather than cash. Upon maturity in August 2007 we may need additional capital to fund the repayment of the 7.5% debentures. Our ability to arrange financing and the cost of financing if necessary, to repay these debentures will depend upon many factors, including:

- our ability to deliver a good business model whereby we generate profitable results;
- general economic and capital markets conditions generally, and in particular the non-investment grade debt market;
- credit availability from banks or other lenders;
- investor confidence in the telecommunications industry generally and our company specifically; and
- provisions of tax and securities law that are conducive to raising capital.

If we need additional funds and are unable to raise them, our inability to raise them will have an adverse effect on our operations. If we decide to raise additional funds by incurring debt, we may become subject to additional or more restrictive financial covenants and ratios.

A significant number of shares of our common stock issued in connection with the restructuring transaction we undertook in June 2003, and in connection with the December 2003 and January 2004 private placements, may be sold into the market. This could cause the market price of our common stock to drop significantly, even if our business is doing well.

Pursuant to the restructuring transaction we undertook in June 2003 with the former holders of our subsidiary's Series A Preferred Stock and our then outstanding 9.75% Senior Convertible Debentures, we registered for resale 15,000,000 shares of our common stock that were issued and are issuable or potentially issuable in connection with the restructuring transaction. As part of the restructuring transaction, we issued an aggregate principal amount of $13.1 million of 7.5% convertible debentures, which are convertible into approximately 2,416,975 shares at a conversion price of $5.42.

Additionally, in the December 2003 and January 2004 private placements, we sold 5,061,613 shares of our common stock and issued warrants to purchase 2,530,806 shares of common stock to investors, and warrants to purchase 506,161 shares of common stock to the placement agent in the private placement.

Sales of a substantial number of shares of our common stock within any narrow period of time could reduce the market price of our common stock. Additionally, unless we achieve revenue growth and/or cost savings and other business economies sufficient to improve our operating performance, which we cannot assure, there could be a negative impact on our future stock price. We have a history of losses and expect to incur future losses.

We have incurred operating losses during the years ended January 31, 2004, 2003 and 2002 of $17.6 million, $31.3 million and $37.2 million, respectively, and as of January 31, 2004, we had an accumulated deficit of $193.8 million. We expect that we could continue to incur losses in the future. If we do not become profitable, the value of our stock will decrease. We have large expenses in the areas of sales and marketing, research and development, manufacturing, and general and administrative expenses that are not covered by our current sales volume and resulting gross margin. Currently, the majority of revenues are from shipments of our optical networking product lines. In order for us to become profitable, we will need to generate and sustain higher revenue, improve our gross margins on products while maintaining reasonable expense levels.

Our history of losses and expectation of future losses could have an impact on our ability to finance our business and risk our ability to continue operating.

We have incurred significant losses and may incur significant losses in the future. Such losses could cause our equity balance to fall below necessary levels so that we are in violation of minimum listing requirements for our publicly traded stock on the NASDAQ National Market, which could cause significant decline in stockholder value and stock price.

Your percentage of ownership and voting power, and the price of our common stock may decrease because we may issue a substantial number of shares of common stock, or securities convertible or exercisable into our common stock.

We have the authority to issue up to one hundred fifty million shares of our common stock and two million shares of our preferred stock without stockholder approval. We have also previously issued warrants to certain of our stockholders which will be exercisable to purchase approximately3.5 million shares of our common stock.

In fiscal 2004, we issued 1,879,340 shares of our common stock in connection with our acquisition of LuxN, Inc., a Delaware corporation, which we acquired by the merger of our wholly-owned subsidiary with and into LuxN. In addition, we issued warrants to purchase approximately 400,000 of our shares of common stock in connection with the merger.

We may also issue additional warrants and options to purchase shares of our common stock. These future issuances could be at values substantially below the price paid for our common stock by current stockholders. We may conduct additional future offerings of our common stock, preferred stock, or other securities with rights to convert the securities into shares of our common stock, which may result in a decrease in the value or market price of our common stock. Further, the issuance of preferred stock could have the effect of delaying, deferring or preventing a change of ownership without further vote or action by the stockholders and may adversely affect the voting and other rights of holders of common stock.

Our industry is highly competitive, and we may not have the resources required to compete successfully.

The market for optical networking equipment is extremely competitive. We expect competition to intensify in the future. Our primary sources of competition include vendors of optical networking and infrastructure equipment such as ADVA AG Optical Networking, CIENA Corporation, Cisco Systems, Lucent

Technologies and Nortel Networks, as well as private companies that have been or will be focusing on our target markets. The competitors for Meret's legacy products include Pesa, Artel, RGB Spectrum, Utah Scientific, and many other companies. We may also face competition from a number of other companies that have announced plans for new products to address the same network problems that our products address. Many of our current and potential competitors have significantly greater sales and marketing, technical, manufacturing, financial and other resources than we do. Our competitors also may have more extensive customer relationships than us, including relationships with our current and potential customers. If we are unable to compete successfully against our current and future competitors, we could experience pricing pressures, reduced gross margins and order cancellations, any one of which could seriously harm our business.

Our business may be seriously harmed if the market for optical networking products in metropolitan and regional areas does not develop as we expect.

Our current and future product offerings are focused on the needs of providers that service regional and metropolitan areas. The market for optical networking products in regional and metropolitan areas is not yet mature, and we cannot be certain that a feasible market for our products will develop or be sustainable. In addition, the market has suffered a cutback in capital spending from both enterprise and carrier customers as a result of poor economic conditions. If this market does not develop, or develops more slowly than we expect or continues to be impacted by the reduction in capital spending, our business may be seriously harmed. Furthermore, the optical networking industry is subject to rapid technological change, and newer technology or products developed by others could render our products less competitive or obsolete. In developing our products, we have made, and will continue to make, assumptions about the optical networking standards that our customers and competitors may adopt. If the standards adopted are different from those, which we have chosen to support, market acceptance of our product would be significantly reduced and our business will be seriously harmed.

Our future growth depends on our ability to attract new customers, and on our customers' ability to sell additional services to their own customers.

Most of our potential customers evaluate optical networking products for deployment in large telecommunications systems that they are installing. There are limited number of potential customers for our products. If a potential customer does not select us, our revenues and ability to grow our business may seriously harmed. Similarly, much of our growth depends on our customers' success in selling communications services based on our products and complementary products from others. Our success will depend on our ability to effectively anticipate and adapt to customer requirements and offer products and services that meet customer demands. Any failure of our current or prospective customers to purchase products from us for any reason, including a downturn in their business, would seriously harm our ability to grow our business.

If we fail to establish and successfully maintain strategic alliances, long-term contracts and relationships with distributors and system integrators, our ability to grow and be profitable may be seriously harmed.

Strategic alliances and long-term contracts are an important part of our effort to expand our sales opportunities and technological capabilities. To date, we have entered into strategic alliances with AT&T Broadband, now Comcast Corporation, and United Pan-Europe Communications. In addition we have long-term contracts with Cox Communications, Looking Glass Networks and Time Warner Telecom. We cannot be certain that our existing alliances and long-term contracts will not be cancelled or that we will be able to enter additional strategic alliances on terms that are favorable to us. With the exception of two agreements we recently entered into with TCI Network Solutions, Inc., d/b/a AT&T

Broadband Network Solutions, and UFO Communications, Inc., our agreements to date with our strategic allies are non-exclusive, and we anticipate that future agreements will also be on a non-exclusive basis. These agreements are generally short term, have no minimum financial commitments on either side and can be cancelled without significant financial consequence. In addition, we cannot be certain that our existing and any future strategic alliances will be successful. As we expand internationally, we will increasingly depend upon distributors and system integrators. Our ability to grow and be profitable may be seriously harmed if

we fail to establish and maintain strategic alliances, long-term contracts and relationships with distributors and system integrators.

We rely on a small number of customers for most of our revenues and any loss, cancellation, reduction or delay in sales to, or collections from, any single customer could seriously harm our business.

Our customer base is highly concentrated. Historically, orders from a relatively limited number of customers accounted for most of our net sales. For the fiscal year ending January 31, 2004, five customers accounted for 43% of net sales, during the fiscal year ended January 31, 2003, five customers accounted for 58% of net sales and in fiscal year 2002 five customers accounted for 70% of our net sales. We expect that, for the foreseeable future, sales to a limited number of customers will continue to account for a high percentage of our net sales. We currently do not have any long-term purchase commitments with any of our customers, and we are subject to the varying purchase cycles of our customers. Our concentrated customer base significantly increases the credit risks associated with slow payments or non-payments by our customers. The loss or delay of orders or slow or non-payment from, any of our largest customers could adversely impact our business.

Our backlog at any point may not be a good indicator of expected revenues.

Our backlog at the beginning of each quarter typically is not sufficient to achieve expected sales for the quarter. To achieve our sales objective, we are dependent upon obtaining orders during each quarter for shipment during that quarter. Furthermore, our agreements with our customers typically provide that they may change delivery schedules and cancel orders within specified times which are typically 30 days or more prior to the scheduled shipment date, without significant penalty. Our customers have in the past built, and may in the future build, significant inventory in order to facilitate more rapid deployment of anticipated major projects or for other reasons. Decisions by such customers to reduce their inventory levels have led and could lead to reductions in purchases from us. These reductions, in turn, have and could cause fluctuations in our operating results and have had and could have caused an adverse effect on our business, financial condition and results of operations in periods in which the inventory is reduced.

Our operating results are likely to fluctuate significantly and may fail to meet or exceed the expectations of securities analysts or investors, causing our stock price to decline.

Our revenues and operating results may vary significantly from quarter to quarter and year to year due to a number of factors, many of which are outside of our control and any of which may cause our stock price to fluctuate. Some of the factors that may affect us include changes in market demand for our optical networking products, the cost and availability of components used in our products, the timing and amount of customer orders, the length and unpredictability of the sales and deployment cycles of our products, the timing of new product introductions and enhancements by our competitors and ourselves, changes in our pricing or the pricing of our competitors, our ability to attain and maintain production volumes and quality levels of our products, and general economic conditions as well as those specific to the telecommunications and related industries.

If we are unable to comply with regulations affecting our customers' industries, our revenues may be seriously harmed.

Our customers are involved in industries that are subject to extensive regulation by domestic and foreign governments. If we fail to conform our products to these regulatory requirements, we could lose sales and our business could be seriously harmed. Additionally, any failure of our products to comply with relevant regulations could delay their introduction and require costly and time-consuming engineering changes.

The time that our customers and potential customers require for testing and qualification before purchasing our products can be long and variable, and may require us to invest significant resources without any assurances of sales, which may cause our results of operations to be unpredictable.

Before purchasing our products, potential customers typically undertake a lengthy evaluation, testing and product qualification process. In addition, potential customers often require time consuming field trials of our products. Our sales effort requires the effective demonstration of the benefits of our products to, and significant training of, potential customers. In addition, even after deciding to purchase our products, our customers may take several years to deploy our products. The timing of deployment depends on many factors, including the sophistication of a customer and the complexity and size of a customer's networks. Our sales cycle, which is the period from the time a sales lead is generated until the recognition of revenue, can often be longer than one year.

The length and variability of our sales cycle is influenced by a variety of factors beyond our control, including our customers' build out and deployment schedules, our customers' access to product purchase financing, our customers' needs for functional demonstration and field trials, and the manufacturing lead time for our products. Because our sales cycles are long and variable and may require us to invest significant resources without any assurances of sales, our results of operations may be unpredictable.

The GigaMux'r' 6400 and 3200 products, EPC'TM', and TeraManager'TM' are our only currently available significant products, and if they are not commercially successful, our revenue will not grow and we may not achieve profitability.

If our customers and potential customers do not adopt, purchase and successfully deploy our GigaMux'r', EPC'TM', and TeraManager'TM' products in large numbers, our revenue may not grow and our business, financial condition and results of operations will be seriously harmed. Because the market for our products is relatively new, future demand for our products is uncertain and will depend on the speed of adoption of optical networking, in general, and optical equipment in metro and regional networks, in particular.

If we are not able to develop and commercialize new or enhanced products, our operating results and competitive position will be seriously harmed.

Our growth depends on our ability to successfully fund and develop new and enhanced products. The development of new or enhanced products is a costly, complex and uncertain process that requires us to anticipate accurately future technological and market trends. Our next generation of transport and network management products is currently under development. We cannot be sure whether these or other new products will be successfully developed and introduced to the market on a timely basis, or at all. We will need to complete each of the following steps to successfully commercialize these and any other new products, complete product development, qualify and establish component suppliers, validate manufacturing methods, conduct extensive quality assurance and reliability testing, complete software validation, and demonstrate systems interoperability.

Each of these steps presents serious risks of failure, rework or delay, any one of which could adversely affect the rate at which we are able to introduce and market our products. If we do not develop these products in a timely manner, our competitive position and financial condition could be adversely affected.

In addition, as we introduce new or enhanced products, we must also manage the transition from older products to newer products. If we fail to do so, we may disrupt customer ordering patterns or may not be able to ensure that adequate supplies of new products can be delivered to meet anticipated customer demand. Any failure to effectively manage this transition may cause us to lose current and prospective customers.

If our products do not interoperate with our customers' networks, installations will be delayed or cancelled or our products could be returned.

Many of our customers require that we design products to interoperate with their existing networks, each of which may have different specifications and utilize a variety of protocols. Our customers' networks contain multiple generations of products that have been added over time as these networks have grown and evolved. Our products must intemperate with all of the products within these networks as well as future products in order to meet our customers' requirements. If we are required to modify our product design to be compatible with our customers' systems to achieve a sale, it may result in a longer sales cycle, increased research and development expense and reduced margins on our products. If our products do not interoperate with those of our customers' networks, installations could be delayed, orders for our products could be cancelled or our products could be returned, any of which could seriously harm our business.

Our products may have errors or defects that we find only after deployment, which could seriously harm our relationship with our customers and our reputation.

Our customers may discover errors or defects in our products, and our products may not operate as expected. If we are unable to fix errors or other problems that may be identified on a timely basis, we could experience losses of or delays in revenues and loss of market share, loss of customers, failure to attract new customers or achieve market acceptance, diversion of engineering resources, increased service and warranty costs, and legal actions by our customers. Any failure of our current or planned products to operate as expected could delay or prevent their adoption and seriously harm our relationship with our customers and our reputation.

We depend upon contract manufacturers and any disruption in these relationships may cause us to fail to meet the demands of our customers and damage our customer relationships.

We use contract manufacturers to manufacture and assemble some of our products in accordance with our specifications. We currently have three U.S.-based contract manufacturers. We do not have long-term contracts with any of them, and none of them is obligated to perform services for us for any specific period or at any specified price, except as may be provided in a particular purchase order. We may not be able to effectively manage our relationships with these manufacturers and they may not meet our future requirements for timely delivery or provide us with the quality of products that our customers and we require.

Each of our contract manufacturers also builds products for other companies. We cannot be certain that they will always have sufficient quantities of inventory available to fill our orders, or that they will allocate their internal resources to fill these orders on a timely basis. Qualifying a new contract manufacturer and commencing volume production is expensive and time consuming and could result in a significant interruption in the supply of our products. If we are required to change contract manufacturers, we may suffer delays that could lead to the loss of revenue and damage our customer relationships.

We rely on a limited number of suppliers and single suppliers for some of our components, and our sales and operating results may be seriously harmed if our supply of any of these components is disrupted.

Our contract manufacturers and we currently purchase several key components of our products from single and limited sources. We purchase each of these components on a purchase order basis and have no long-term contracts for these components. In the event of a disruption in supply or if we receive an unexpectedly high level of purchase orders, we may not be able to develop an alternate source in a timely manner or at favorable prices. Any of these events could hurt our ability to deliver our products to our customers and negatively affect our operating margins. In addition, our reliance on our suppliers exposes us to potential supplier production difficulties or quality variations. Any such disruption in supply would seriously affect our present and future sales.

We expect the average selling prices of our products to decline, which may reduce gross margins and revenue.

Our industry has experienced erosion of average product selling prices. We anticipate that the average selling prices of our products will decline in response to competitive pressures, increased sales discounts, and new product introductions by our competitors or other factors. Such reduced sales prices require us to reduce our costs in order to maintain or improve our existing gross margins. If we are unable to achieve sufficient cost reductions and increases in sales volumes, the decline in average selling prices will reduce our gross margins and revenue.

If we are unable to hire or retain highly skilled personnel, we may not be able to operate our business successfully.

Our future success depends upon the continued services of our key management, sales and marketing, and engineering personnel, many of whom have significant industry experience and relationships. Many of our personnel could be difficult to replace. We do not have "key person" life insurance policies covering any of our personnel. The loss of the services of any of our key personnel could delay the development and introduction of, and have a negative impact on our ability to sell, our products. Competition for highly skilled personnel is intense in our industry, and we may not be able to attract and retain qualified personnel, which could seriously harm our business.

If we become subject to unfair hiring claims, we could incur substantial costs in defending ourselves.

Companies in our industry whose employees accept positions with competitors frequently claim that their competitors have engaged in unfair hiring practices. We cannot assure you that we will not receive claims of this kind in the future as we seek to hire qualified personnel or that those claims will not result in material litigation. We could incur substantial costs in defending ourselves or our employees against such claims, regardless of their merits. In addition, defending ourselves from such claims could divert the attention of our management away from our operations.

We may be unable to protect our intellectual property, which could limit our ability to compete.

We rely on a combination of patent, copyright, trademark and trade secret laws and restrictions on disclosure to protect our intellectual property rights. We also enter into confidentiality or license agreements with our

employees, consultants and corporate partners, and control access to, and distribution of, our software, documentation and other proprietary information. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy or otherwise obtain and use our products or technology. Monitoring unauthorized use of our products is difficult, and we cannot be certain that the steps we have taken will prevent unauthorized use of our technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States. If competitors gain access to our technology, our ability to compete could be harmed.

We could become subject to litigation regarding intellectual property rights, which could seriously harm our business and require us to incur significant costs.

In recent years, there has been significant litigation in the United States involving patents and other intellectual property rights. We may be a party to litigation in the future to protect our intellectual property or as a result of an allegation that we infringe upon others' intellectual property rights. Any parties asserting that our products infringe upon their proprietary rights would force us to defend ourselves and possibly our customers or manufacturers against the alleged infringement. These claims and any resulting lawsuits, if successful, could subject us to significant liability for damages and invalidation of our proprietary rights. Additionally, any claims and lawsuits, regardless of their merits, would likely be time-consuming and expensive to resolve and would divert management time and attention.

Any claims of infringement on the intellectual property rights of others could also force us to do one or more of the following: stop selling, incorporating or using our products that use the challenged intellectual property, obtain from the owner of the infringed intellectual property right a license to sell or use the relevant technology, which may not be available to us on reasonable terms, or at all, or redesign- those products that use such technology. If we are forced to take any of the foregoing actions, our business may be seriously harmed. However, we intend to vigorously protect our intellectual property against all material challenges.

If necessary licenses of third-party technology are not available to us or are very expensive, our products could become obsolete.

We have been licensing, and may be required to license, technology from third parties to develop new products or product enhancements. We cannot assure you that third-party licenses will be available to us on commercially reasonable terms, if at all. If we are required to obtain any third-party licenses to develop new products and product enhancements, we could be required to obtain substitute technology, which could result in lower performance or greater cost, either of which could seriously harm the competitiveness of our products.

Our international operations could subject us to risks due to currency fluctuations and changes in foreign government regulations, which could harm our business.

Our international operations are subject to a number of risks, including changes in foreign government regulations and telecommunications standards, import and export license requirements, tariffs, taxes and other trade barriers, fluctuations in currency exchange rates, difficulty in collecting accounts receivable, the burden of complying with a wide variety of foreign laws, treaties and technical standards, difficulty in staffing and managing foreign operations, and political and economic instability.

The majority of our sales and expenses have been denominated in U.S. dollars. However, in the future a larger portion of our sales and expenses may 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 do not currently engage in foreign exchange hedging transactions to manage our foreign currency exposure.

If we do not effectively address our financial, managerial and manufacturing processes, we may not be able to successfully expand our business.

Our business has experienced wide fluctuations in sales volume from quarter to quarter, which places a significant strain on our management systems and resources. Our ability to successfully offer our products and implement our business plan in a rapidly evolving market requires an effective planning and management process. We will need to continue to improve our financial, managerial and manufacturing processes and reporting systems, and will need to continue to expand, train and manage our workforce worldwide. Many of our competitors have set-up manufacturing facilities and operations offshore into significantly less expensive labor and product markets. Our ability to produce our products at similar favorable production costs could harm our ability to compete in the markets we serve. If we fail to effectively address the above requirements, our ability to pursue business opportunities and expand our business could be harmed.

Our stock price may be volatile which may affect your ability to sell shares at or above the offering price or result in securities litigation against us.

The stock market in general, the NASDAQ Stock Market and the stock of optical networking companies in particular, have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to a company's operating performance. We expect the price of our common stock to fluctuate. The offering price may not be indicative of the prices that will prevail in the public market after the offering. The trading price of our common stock could fluctuate in response to factors including those described elsewhere in this annual report and:

- General market and economic conditions;
- Announcements of technological innovations or new products;
- Publicity regarding actual or potential results with respect to technologies or products under development; and
- Other events or factors, many of which are beyond our control.

These broad market and industry factors may cause our stock price to decline, regardless of our actual operating performance. In the past, following periods of volatility in the market price of a company's securities, securities class-action litigation has often been instituted against that company. Securities class-action litigation, if instituted, could result in substantial costs and a diversion of management's attention and resources, which would harm our profitability.

Definitions

As used in this Annual Report on Form 10-K, the following terms have the meanings indicated:

"ATM" means Asynchronous Transfer Mode, which is a type of networking technology based on transferring data in cells or packets of a fixed size. The small, constant cell size allows ATM equipment to transmit video, audio, and data over the same network, and assure that no single type of data overtakes the line. Current implementations of ATM support data transfer rates of 25 Mbps to 2.48 Gbps.

"Backbone" means a main segment of a network carrying large amounts of traffic. Individual metro and interoffice rings are attached to the backbone.

"Bandwidth" means the capacity to move information down a communications channel. Bandwidth is defined by the highest data rates that can be transmitted by that channel and is commonly measured in bits per second (bps). For example, Ethernet has a 10 Mbps bandwidth and OC-192 has 10 gigabits per second bandwidth.

"Bridge" means a device that connects two or more networks of the same access method (Ethernet to Ethernet or Token Ring to Token Ring) by making simple forward/don't forward decisions on each data packet received from any of the networks to which it is connected.

"Broadband" means technologies or networks that have the ability to transmit high data rates.

"CLEC" means a Competitive Local Exchange Carrier.

"Concentrator" means the connection point, more sophisticated than a hub, incorporating different types of cable connections, back-up power supply, data-gathering capability for management purposes and possibly even bridge and router features as well.

"CWDM" means Coarse Wavelength Division Multiplexing, which is a sophisticated opto-electronics technology that uses multiple wavelengths of light spaced at least 400 Ghz apart to increase the number of video, data or voice channels of information that can be sent on a single optical fiber in a transmission system.

"DWDM" means Dense Wavelength Division Multiplexing, which is a sophisticated opto-electronics technology that uses multiple wavelengths of light very efficiently to greatly increase the number of video, data or voice channels of information that can be sent on a single optical fiber in a transmission system.

"ESCON"--Enterprise System Connectivity--means a protocol for 200 Mbps signal transmission speed over fiber optic cable.

"Ethernet" means a 10 Mbps speed network that runs over thick coaxial cable (10BASE5), thin coaxial cable (10BASE2), twisted-pair (10BASE-T), and fiber-optic cable. It is the most widely used LAN technology and the most popular form of Ethernet is 10BASE-T. Ethernet is a network specification that was developed at Xerox Corp's Palo Alto Research Center, and made into a network standard by Digital, Intel, and Xerox.

"Fast Ethernet" means a 100 Mbps speed network that runs over thick coaxial, twisted-pair, and fiber-optic cable. Fast Ethernet is 10 times faster than Ethernet.

"FDDI" means a Fiber Distributed Data Interface and is a fiber optic network that supports transmission speeds up to 100 Mbps.

"Fibre Channel" means a serial data transfer architecture standard conceived for new mass storage devices and other peripheral devices that require very high bandwidth connections. Bit rates for Fibre channel are either 1.06 Gbps or 2.1 Gbps.

"Gigabit Ethernet" means a 1000 Mbps speed network that runs fiber-optic cable for wide area network connections.

"HDTV" means high definition television, which is a new type of television that provides much better resolution than current television. HDTV is slowly being implemented into the broadcast networks.

"Hub" means a central connection device to which many network tributaries are connected.

"ILEC" means Incumbent Local Exchange Carrier and is a telephone company that provides local services and does not offer long distance services. All the regional operating companies after the break-up of AT&T became ILECs.

"ISDN" means an Integrated Services Digital Network and is an all-digital communications network that provides a wide range of services on a switched basis. Voice, data and video can be simultaneously transmitted on one line from a source.

"ISO" means International Standards Organization. Founded in 1946, ISO is an international organization composed of national standards bodies from over 75 countries. ISO has defined a number of important computer standards; the most significant of which is perhaps is OSI (Open Systems Interconnection), a standardized architecture for designing networks.

"ISP" means an Internet Service Provider.

"ITU" means International Telecommunications Union, which is an intergovernmental organization through which private and public organizations develop telecommunications. The ITU was founded in 1865 and became a United Nations agency in 1947 and it is responsible for adopting international tax treaties, regulations and standards governing telecommunications.

"IXC" means an inter-exchange carrier, a long distance telephone company or a carrier that specializes in connecting central offices of local service providers. This carrier typically does not offer services to end users. AT&T, MCI and Sprint are IXCs. A carrier that provides the backbone of competitive local exchange carriers can also be considered as an IXC. Therefore, an IXC can provide service in both metropolitan and in long haul networks.

"LAN" means a Local Area Network and is a high-speed communications system designed to link computers for the purpose of sharing files, programs and various devices such as printers and high-speed modems within a small

geographic area such as a workgroup, department or single floor of a multi-story building. LANs may include dedicated computers or file servers that provide a centralized source of shared files and programs.

"MSO" means a Multiple Service Operator, which is typically a cable TV operator that offers multiple services such as video, voice and data.

"Multiplexing" means a process that combines a number of lower speed data transmissions into one high-speed data transmission by splitting that total available bandwidth into narrower bands (frequency division) or by allotting a common channel to several different transmitting devices one at a time in sequence (time division). The opposite function of separating the data channels into their original format is called demultiplexing.

"OC-1, OC-3, OC-12, OC-48, OC-192" means the SONET bit rates of 51.85Mbps, 155 Mbps, 622 Mbps, 2.5 Gbps and 10Gbps transmission speeds for signals over fiber optic cables. The number in the end of the term corresponds to the equivalent multiple of OC-1 capacity (e.g., OC-192 means equivalent to 192 times OC-1)

"OEMs" means original equipment manufacturers.

"Opto-Electro-Optical" means Optical-Electrical-Optical which describes the conversion of optical signals to electric and back to optical. Typically, devices performing this function in the electrical domain and the signals need to be converted back to optical for transmission over optical fibers.

"Packet" means the "envelope" in which the network software places a message being sent from one station to another station in a network. One of the key features of a packet is that it contains the destination address in addition to the data.

"POTS" means "plain old telephone service" which refers to the standard telephone service over copper lines that most homes use. In contrast, telephone services based on high-speed, digital communications lines, such as ISDN and FDDI, are not POTS. The main distinction between POTS and non-POTS services is speed and bandwidth. POTS is generally restricted to about 52Kbps.

"Protocol" means a standard developed by international standards bodies, individual equipment vendors, and ad hoc groups of interested parties to define how to implement a group of services in one or more layers of the OSI model. The Open Systems Interconnect ("OSI") reference model was developed by the ISO to define all the services a LAN should provide. Ethernet and Token Ring, for example, are both protocols that define different ways to provide the services called for in the Physical and Data Link Layers of the OSI model.

"PTT" means Postal, Telephone and Telegraph, and refers to a generic telephone company outside the United States. Typically, a PTT is state owned and can operate both local and long distance services.

"RBOC" means a Regional Bell Operating Company.

"Router" means a network translator that reads network-addressing information within packets to provide greater selectivity in directing traffic over multiple network segments. It is a more complex inter-networking device.

"SDH" means Synchronous Digital Hierarchy, which is transmission protocol for high speed transmission over fiber optic cable published in 1988 by the Consultative Committee for International Telegraph and Telephony. It a hierarchy similar to SONET but in this case the lowest bit rate channel is STM-1 (155 Mbps).

"SONET" means a transmission protocol for high-speed transmission over fiber optic cable, which was introduced by Bell Communications in 1984 and quickly accepted by American National Standards Institute.

"Switch" means a device that allows the network operator to vary and select connections between network nodes at very high speeds.

"T-1" means a dedicated phone connection supporting data rates of 1.544 Mbps. A T-1 line actually consists of 24 individual channels, each of which supports 64Kbps and can be configured to carry voice or data traffic. T-1 lines are sometimes referred to as DS-1 lines.

"TCP/IP" means Transmission Control Protocol/Internet Protocol, which is a suite of protocols used for communications between two or more devices.

"TDM" means time division multiplexing which is a multiplexing process that combines a number of lower speed data transmissions into one high-speed data transmission by allotting a common channel to several different transmitting devices one at a time in sequence.

"Token Ring" means a 4 Mbps or 16 Mbps speed network that uses different technology than Ethernet to co-ordinate the transmission of data among nodes.

"WAN" means a Wide Area Network and is a communications network that connects geographically dispersed users. Typically, a WAN consists of two or more LANs. The largest WAN in existence is the Internet.

Item 2. Properties.

We are headquartered in our San Diego, California facility that we own consisting of approximately 36,000 square feet used for offices, research and development and manufacturing. We also own a 47,000 square foot facility in San Diego, California adjacent to our headquarters that is used for offices, manufacturing and customer support.

For the fiscal year 2004 we occupied an additional 40,668 square feet used for office, research and development and manufacturing activities under lease as detailed below:

Location	Square Footage	Facility Type	Expiration Date
Sunnyvale, California	35,288	Office/Manufacturing	December 31, 2004
Stuttgart, Germany	5,380	Office	December 31, 2005

We believe our facilities are suitable and adequate to meet our current needs. See Note E to the Consolidated Financial Statements contained in Part II herein for terms and amounts of mortgages on the facility we own.

Item 3. Legal Proceedings

On June 4, 2003, we consummated the exchange transaction and cancelled all outstanding Series A Convertible Preferred Stock and 9.75% Senior Convertible Debentures. The Exchange Agreement provides that the litigation instituted by the former holders of Series A stock be dismissed with prejudice against the Company, its subsidiaries, its current officers and directors, and other defendants who execute an appropriate release, and without prejudice against all other defendants. This dismissal will require court approval, which is in the process of being obtained by counsel for all parties.

In addition, claims in arbitration were filed by two of our former financial officers and employees who worked in our former Santa Monica office, which has since been closed, alleging that their resignations in May 2002 were for "good reason" as defined in their employment agreements, all of which were to expire on May 22, 2002. One of the claims was settled in May 2003 for $45 thousand, approximately the value of legal fees incurred by the plaintiff. The other claim was resolved in August 2003 by an arbitrator who ruled in our favor. As part of the arbitration ruling, both parties were responsible for their own legal fees.

A former officer of our SNI subsidiary brought suit alleging breach of a consulting agreement we entered into with him in March 2002, following his resignation "for good reason" as defined in his employment agreement. He was seeking acceleration of consulting fees due to him under his consulting agreement in the amount of $229 thousand. This suit was settled in January 2004 for approximately $150 thousand in full settlement and a mutual release of claims from both parties.

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 4: Submission of Matters to a Vote of Security Holders

The annual meeting of shareholders of Sorrento Networks Corporation (the "Meeting") was held on January 8, 2004.

Elections of Directors

The shareholders elected each of the seven nominees for directors as listed in the Sorrento Networks Corporation's proxy statement dated December 3, 2003. The directors will hold office for one-year terms ending at the next Annual Meeting or until their successors have been duly elected and qualified.

The proxies received by Sorrento Networks Corporation for the Meeting were voted as follows:

DIRECTOR	VOTES FOR	VOTES AGAINST
1 Phillip W. Arneson	7,647,206	519,518
2 Donne F. Fisher	7,785,513	381,211
3 Robert L. Hibbard	7,647,206	519,518
4 Gary M. Parsons	7,785,513	381,211
5 Larry J. Matthews	7,785,513	381,211
6 Don Herzog	7,785,513	381,211
7 Tom Schilling	8,030,228	136,496

Additional Shares to LuxN Shareholders

To approve the issuance of common shares associated with the LuxN acquisition that exceeds 20% of the current outstanding shares of the Company as of the acquisition date. Upon approval, the cash held under restriction would be released to the Company for general working capital purposes

PROPOSAL	VOTES FOR	VOTES AGAINST	VOTES ABSTAIN	UNVOTED
Additional Shares to LuxN Shareholders	2,224,914	144,537	22,358	5,774,915

Appointment of Auditors

The shareholders ratified the appointment of BDO Seidman, LLP as Sorrento Networks Corporation's independent auditors. The proxies received by Sorrento Networks Corporation for the Meeting were voted as follows:

PROPOSAL	VOTES FOR	VOTES AGAINST	VOTES ABSTAIN	UNVOTED
3 BDO Seidman, Auditors	8,120,038	29,276	17,410	--

PART II

Item 5. Market for Company's Common Equity and Related Stockholder Matters.

Our common stock has been traded on the NASDAQ Small Cap Market under the symbol FIBR since 1994. On December 16, 1998, we commenced trading on the NASDAQ National Market System under the same symbol.

The following table sets forth the high and low sale prices per share of our common stock as reported on the NASDAQ National Market for the periods indicated. Quotations represent inter-dealer prices; they do not include retail markups, markdowns, or commissions; and, they may not represent actual transactions.

Fiscal 2002-2003	High	Low
Quarter from February 1, 2002 to April 30, 2002........	$73.20	$40.00
Quarter from May 1, 2002 to July 31, 2002..............	$53.00	$13.20
Quarter from August 1, 2002 to October 31, 2002........	$14.80	$ 2.40
Quarter from November 1, 2002 to January 31, 2003......	$15.07	$ 4.15

Fiscal
2003-2004

Quarter from February 1, 2003 to April 30, 2003........	$ 8.30	$ 4.96
Quarter from May 1, 2003 to July 31, 2003..............	$ 5.98	$ 2.27
Quarter from August 1, 2003 to October 31, 2003........	$ 3.81	$ 2.25
Quarter from November 1, 2003 to January 31, 2004......	$ 5.35	$ 2.38

On March 31, 2004, the average of the high and low bid quotation for our common stock was $3.13 per share. There is no assurance that a market in our common stock will continue.

Approximate Number of Holders of Common Stock

As of March 31, 2004, there were approximately 756 holders of record, including brokerage firms and nominees, of our common stock. We believe that the number of beneficial owners of our common stock substantially exceeds this number.

Dividends

We have never paid any cash dividends on our common stock. The present policy of the Board of Directors is to retain all available funds to finance the planned level of operations. In light of the anticipated cash needs of our business, it is not anticipated that any cash dividends will be paid to the holders of our common or preferred stock in the foreseeable future.

Sale of Unregistered Securities

During fiscal year 2004, we issued the following securities that were not registered under the Securities Act of 1933:

June 04, 2003	Exchange Agreement	8,029,578 shares of common stock
June 04, 2003	Legal Settlement	54,314 shares of common stock
August 08, 2003	LuxN, Inc. Acquisition	1,879,340 shares of common stock
December 31, 2003	Private Placement	2,140,101 shares of common stock
January 26, 2004	Private Placement	2,921,512 shares of common stock

The registration statements for the above listed common stock issuances have been filed with the Securities and Exchange Commission and have become effective.

Securities Authorized For Issuance Under Equity Compensation Plans

The following table provides information as of January 31, 2004 regarding compensation plans (including individual compensation arrangements) under which equity securities of Sorrento are authorized for issuance.

Plan Category	Number of Securities To Be Issued Upon Exercise Of Outstanding Options, Warrants and Rights (a)	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights (b)	Number of Remaining A Future Issuan Compensa (Excluding Reflected i
Equity Compensation Plans Approved by security Holders *(FIBR)	2,114,769	$19.77	5
Equity Compensation Plans not Approved by Security Holders (SNI)	1,887,000	$ 5.35	18,0
Total	4,001,769	$12.97	18,6

* As adjusted for stock splits.

See Note K to the Consolidated Financial Statements for information regarding the material features of the above plans. Each of the above plans provides that the number of shares with respect to which options may be granted, and the number of shares of Common Stock subject to an outstanding option, shall be proportionally adjusted in the event of a subdivision or consolidation of shares or the payment of a stock dividend on Common Stock, and the purchase price per share of outstanding options shall be proportionately revised.

Item 6. Selected Financial Data

The following table sets forth selected consolidated financial data with respect to our five most recent fiscal years ended January 31. The selected consolidated statement of operations data set forth below for each of our three most recent fiscal years, and the selected consolidated balance sheet data set forth at January 31, 2004 and 2003, are derived from our consolidated financial statements which have been audited by BDO Seidman, LLP, independent certified public accountants, as indicated in their report which is included elsewhere in this annual report. The selected consolidated statement of operations data set forth below for each of the two fiscal years ended January 31, 2001 and 2000, and the consolidated balance sheet data set forth below at January 31, 2002, 2001 and 2000 are derived from our audited consolidated financial statements not included in this annual report. The selected consolidated financial data should be read in conjunction with our consolidated financial statements, and the notes thereto including Note A and B which discusses our significant acquisition and disposition
included elsewhere in this annual report, and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7.

Fiscal Year Ended January 31,

	2004	2003	2002	2001	2
Statement of Operations Data:	(a) (b)	(b)	(b)	(b)	
Net sales	$ 25,462	$ 25,137	$ 40,827	$ 44,641	$ 6
Gross margin	$ 5,693	$ 3,320	$ 9,320	$ 13,171	$ 3
Operating loss	$(17,634)	$(31,329)	$(37,154)	$(50,415)	$ (
Net loss from continuing operations	$ (6,233)	$(26,210)	$(43,136)	$(41,905)	$ (
Net income (loss) per share from continuing operations: (c)					
Basic	$ (.87)	$ (33.29)	$ (62.00)	$ (74.20)	$

Diluted	$ (.87)	$ (33.29)	$ (76.32)	$ (74.20)	$
Balance Sheet Data:					
Cash and cash equivalents	$ 17,617	$ 7,747	$ 14,243	$ 9,965	$ 1
Working capital (deficit)	$ 25,806	$(36,460)	$ 5,839	$ 71,993	$18
Total assets	$ 50,096	$ 55,805	$ 90,339	$113,123	$22
Total debt (including short-term debt redeemable preferred stock)	$ 16,027	$ 21,987	$ 72,122	$ 24,770	$ 2
Stockholders' equity (deficit)	$ 22,994	$(34,476)	$ 18,217	$ 39,733	$20

The Consolidated Statement of Operations and Balance Sheet data shown above reflect the following:

(a) The results of operations for LuxN, Inc. are reflected from August 8, 2003 forward.

(b) Operating (loss) and (loss) from continuing operations includes net capital restructuring charges of approximately $1.8 million in fiscal year 2003 and additions to inventory reserves of $602 thousand, $4.1 million, $4.0 million and $3.7 million, $1.6 million which negatively affected gross margin in fiscal year 2004, 2003, 2002, 2001 and 2000, respectively.

(c) All per share data have been restated to reflect the twenty-for-one split of our common stock that became effective on October 28, 2002.

(d) Entrada Networks, Inc. is reflected through August 31, 2000. On August 31, 2000, we completed a merger of our then subsidiary 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 thousand and on August 31, 2000 purchased an additional 1,001,818 shares directly from ENI for $3.3 million. 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.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Certain statements contained in this Annual Report on Form 10-K, including, without limitation, statements containing the words "believes", "anticipates", "estimates", "expects", and words of similar import constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Readers are referred to the "Other Risk Factors" section of this Annual Report on Form 10-K, as well as the "Financial Risk Management" and "Future Growth Subject to Risks" sections contained herein, which identify important risk factors that could cause actual results to differ from those contained in the forward-looking statements.

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".

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 uncollectible 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 materially 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:

- Revenue recognition. Revenue is generally recognized when the products are shipped, all substantial contractual obligations, if any, have been satisfied, and the collections of the resulting receivable is reasonably assured. When title does not pass to the customer at time of shipment, revenue is not recognized until all contractual requirements are met and title has transferred. During this transition period, the amount of the sale and/or installation is shown in deferred revenue.

  Revenue from installation is recognized as the services are performed to the extent of the direct costs incurred. To date, installation revenue has not been material. Revenue from service obligations, if any, is deferred and recognized over the life of the contract. Inventory or demonstration equipment shipped to potential customers for field trials is not recorded as revenue. We accrue for warranty costs, sales returns and other allowances at the time of shipment. Although our products contain a software component, the software is not sold separately and we are not contractually obligated to provide software upgrades to our customers.

- Inventory. Inventory is evaluated on a continual basis and management must make estimates about the future customer demand for our products, taking into account both the economic conditions and growth potential of our customers. 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. A misinterpretation or misunderstanding of these conditions or uncertainty in the future outlook of our industry or the economy, or the failure to estimate correctly, could result in inventory losses in excess of the provisions determined to be appropriate at the time of the balance sheet.

- Accounts receivable. Accounts receivable balances are evaluated on a continual basis and management regularly reviews the financial stability of individual customers. This analysis involves a judgment of the customer's current and projected financial condition and the positive or negative effects of the current and projected industry outlook, as well as that of the economy in general. Allowances are provided for potentially uncollectible accounts based on management's estimate of the collectability and the probability of default 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.

- Intangible assets. We currently have intangible assets that include assets with finite lives, such as our purchased technology. The determination of related estimated useful lives and whether these assets are impaired involves judgments based upon short and long-term projections of future performance. We have no goodwill or indefinite life intangible assets. Other intangible assets with finite lives continue to be amortized over their useful lives.

- Legal contingencies. We are subject to proceedings, lawsuits and other claims, including proceedings under laws and government regulations related to securities, environmental, labor, product and other matters. We are required to assess the likelihood of any adverse judgments or outcomes to these matters, as well as potential ranges of probable losses. A determination of the amount of reserves required, if any, for the contingencies is based on a careful analysis of each individual issue with the assistance of outside legal counsel. Our reserves may change in the future due to new developments in each matter or changes in approach such as a change in settlement strategy in dealing with these matters. For more information, see Note H to the consolidated financial statements.

- Income taxes. We currently have no provisions for income taxes. We have carry forward 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.

LuxN, Inc.

On August 8, 2003, we completed our acquisition of LuxN, Inc. in which we paid $14.8 million in cash, 1,879,347 shares of our common stock and 400,000 warrants to purchase our common stock at an exercise price of $3.05 per share. At the effective time of the merger, our wholly-owned subsidiary, Lambda Acquisition Corp., was merged with and into LuxN, with LuxN being the surviving corporation in the merger. From the date of acquisition to January 31, 2004, the results of LuxN's operations have been combined with the company in our discussion below unless separately addressed.

Overview

Sorrento Networks was originally incorporated in New Jersey under the name of Osicom Technologies, Inc. In fiscal 2003, we changed our name to Sorrento Networks Corporation to better reflect the name of our primary subsidiary, Sorrento Networks, Inc. We reincorporated in Delaware during fiscal 2004. Presently headquartered in San Diego, California, we are a developer and manufacturer of intelligent optical networking solutions for metropolitan and regional applications worldwide.

Beginning in fiscal 2002, the global telecommunications market deteriorated, reflecting a significant reduction in capital spending by established service providers. This trend intensified during fiscal 2003 and continued through fiscal 2004. Reasons for this reduction include the general economic slowdown, network overcapacity, customer bankruptcies, network build-out delays and limited capital availability. As a result, our sales and results of operations have been and may continue to be adversely affected. The significant slowdown in capital spending has created uncertainty as to the level of demand in our target markets. In addition, the level of demand can change quickly and can vary over short periods of time. As a result of the uncertainty and variations in our markets, accurately forecasting future results, earnings and cash flow is increasingly difficult.

As discussed in more detail throughout our MD&A:

- Our consolidated results of operations during the past three years were adversely affected by the rapid and sustained deterioration of the telecommunications market. After several years of significant growth, our revenues declined during fiscal 2003 and 2002 by 38% and 9% respectively, as compared to the respective prior year. The significant reduction in capital spending by service providers, among other factors, contributed to this decline. There was no significant change in fiscal 2004, which includes $3.9 million in revenue from our newly acquired subsidiary LuxN, Inc., when compared to the prior year. If the revenue from LuxN is excluded for comparison purposes our revenue declined 14% for fiscal 2004 when compared to the prior year;

- Our gross margin rates, which historically had exceeded 40%, fell precipitously beginning in fiscal 2002. The rapid decline in revenue from decreased market demand led to significant inventory charges and high-unabsorbed fixed cost, which, among other factors, adversely affected our gross margin rates;

- Management implemented a cost reduction program during fiscal 2002. As a result, total operating expenses have declined from $63.6 million in fiscal 2001 to $23.3 million in fiscal 2004, a reduction of over $40 million;

These were the key factors that resulted in losses from continuing operations of $17.6 million, $31.3 million and $37.2 million respectively for fiscal 2004, 2003 and 2002, respectively.

During 2004, we took several steps to improve our balance sheet and strengthen our ability to compete in the marketplace, including:

- On March 6, 2003, we and our wholly-owned subsidiary Sorrento Networks, Inc. entered into an Exchange Agreement with the holders of our 9.75% Senior Convertible Debentures (the "Debentures") and the Series A Convertible Preferred Stock (the "Preferred Stock") of Sorrento Networks, Inc. The Exchange Agreement and associated documents contemplated an exchange

(the "Exchange") of the Debentures and the Preferred Stock at closing into shares of common stock and $12.5 million of our new 7.5% secured convertible debentures (the "New Debentures"). Certain holders of the Preferred Stock would also receive additional New Debentures of approximately $600 thousand to pay certain legal fees.

The Exchange Agreement was approved by shareholders on May 29, 2003 and was completed and became effective on June 4, 2003 pursuant to which we exchanged current outstanding debentures and Series A Preferred Stock for common stock and an issuance of a smaller principal amount of new debentures.

- Our acquisition of LuxN, Inc was completed on August 8, 2003. At the effective time of the merger, our wholly-owned subsidiary, Lambda Acquisition Corp., was merged with and into LuxN, with LuxN being the surviving corporation in the merger. Pursuant to the Agreement and Plan of Merger, each share of LuxN common stock outstanding at the effective time of the merger was cancelled. As consideration for the transaction, holders of LuxN's Series A-1 Preferred Stock with an aggregate pro-rata portion of $14.8 million of LuxN's net cash elected to receive cash at closing, and the holders of LuxN's Series A-1 Preferred Stock with an aggregate pro-rata portion of $3.8 million of LuxN's net cash elected to receive our common stock at closing. We issued 1,374,194 shares of our common stock to the holders of LuxN's

Series A-1 Preferred Stock at the closing and issued an additional 505,153 shares upon receipt of our shareholders' approval. In addition, we issued warrants to purchase 400,000 of our shares of common stock at an exercise price of $3.05 per share to the holders of LuxN's Series A-1 Preferred Stock. We did not assume or exchange any outstanding options or warrants to purchase shares of LuxN stock.

- The first of two private placements' the Company completed in fiscal 2004, closed on December 31, 2003. In exchange for $6.35 million in gross proceeds, Sorrento issued 2,140,101 new shares of Sorrento common stock, and warrants to purchase 1,070,051 new shares of Sorrento's common stock. The effective price in the private placement was $2.97 for each unit consisting of one share of common stock and a warrant to purchase one-half of a share of common stock. The warrants have an exercise period of five-years with an exercise price of $2.97 per share. The warrants are exercisable in cash, representing a potential $2.17 million in additional proceeds, bringing the total gross proceeds of this offering to approximately $9.5 million upon full exercise of the warrants.

- On January 26, 2004 the second private placement was completed raising $10 million in gross proceeds. In connection with the financing, Sorrento issued 2,921,512 new shares of Sorrento common stock and warrants to purchase 1,460,756 new shares of Sorrento's common stock. The effective price in the private placement was $3.44 for each unit. Each unit consists of one share of common stock and a warrant to purchase one-half of a share of common stock. The warrants have an exercise period of five-years and an exercise price of $3.44 per share. The warrants are callable after one year under certain circumstances. The warrants are exercisable in cash, representing a potential $5 million in additional proceeds, bringing the total gross proceeds of this offering to approximately $15 million assuming the warrants are fully exercised in cash. The warrants provide for a cashless exercise under certain circumstances.

As we look forward to fiscal 2005, we believe that the general economic recovery that began in 2004 will gradually take hold within the telecommunications marketplace. Although our backlog entering fiscal 2005 remains low at slightly over $2 million; the increased level of inquiries and quote activity from both current and potentially new customers leads us to believe industry overcapacity has, to a large extent, been absorbed and, as such, we anticipate gradual improvement in our business commencing in mid-fiscal 2005.

Results of Operations: Comparison of the Years Ended January 31, 2004 and January 31, 2003

Net sales

Total revenues in 2004 were flat. Revenue in the United States increased reflecting the acquisition of LuxN. Revenues in Europe declined 42%, as the economic downturn, which was initially felt in the United States, more severely impacted European sales in 2004. In addition, 2004 saw a revenue increase in Asia of over 81% due to increased sales activity in Japan.

Product revenues decreased 5% while service revenues increased 111%. Service revenues were higher due to increased product deployments, offset by competitive pricing pressure. The contribution to revenue from the LuxN acquisition was $3.8 million in product and service revenue from August 8, 2003 to fiscal year end January 31, 2003.

Geographic Revenues

	For the years ended January 31,			2004 vs 2003		2003 vs 2002	
	2004	2003	2002	Change $	Change %	Change $	Change %
United States	$18,445	14,803	$28,341	$ 3,642	25	$(13,538)	(48)
Europe	5,455	9469	10,130	(4,014)	(42)	(661)	(7)
Asia	1,562	865	2,356	697	81	(1,491)	(63)
Consolidated	$25,462	25,137	$40,827	$ 325	1	$(15,690)	(38)

Revenues by geographic regions are based on the location of the customer.

Gross Profit

	For the years ended January 31,			2004 vs 2003		2003 vs 2002	
	2004	2003	2002	Change $	Change %	Change $	Change %
United States	$3,725	$3,751	$5,996	$ (26)	--	$(2,245)	(37)
Europe	1,507	(487)	2,618	1,994	409	(3,105)	(119)
Asia	461	--	708	461	100	(708)	(100)
Consolidated	$5,693	$3,264	$9,322	$2,429	74	$(6,058)	(65)

Gross Profit by geographic region is based on the location of the customer.

Gross profits. Improvement in fiscal 2004 reflects improvements in U.S. production and overhead related costs combined with the non-recurrence of obsolescence and inventory valuation reserves taken in fiscal 2003.

Selling and marketing. Selling and marketing expenses consist primarily of employee compensation and related costs, commissions to sales representatives, tradeshow expenses and travel expenses. Our consolidated selling and marketing expenses decreased to $8.4 million, or 33% of net sales, for fiscal 2004 from $12 million, or 48% or net sales for fiscal 2003. The decline was primarily the result of continued cost reduction efforts and a reduction in both our U.S. and foreign sales offices.

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 expensed as incurred. We continue to manage our research and development costs 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 $8.0 million, or 32% of net sales, for fiscal 2004 from $9.0 million, or 36% of net sales, for fiscal 2003. The decline can primarily be attributed to decreases in product development material and personnel related costs.

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 $6.5 million, or 26% of net sales, for fiscal 2004 compared to $12.8 million, or 51% of net sales, for fiscal 2003. The decrease in general and administrative expenses can be attributed to a decrease in professional fees including reduced legal fees and lower facility related expenses.

Other operating expenses. Other operating expenses for both fiscal 2004 and 2003 included approximately $320 and $400 thousand, respectively of purchased technology amortization expense related to acquisitions.

Other income (expenses). Other income (expenses) from continuing operations increased to $11.4 million in income for fiscal 2004 from $5.1 million in fiscal 2003. This increase reflects a net gain on the capital restructuring of $17.6 million, combined with reduced interest expense reflecting the capital restructuring in fiscal 2004. Partially offsetting these improvements were the write-off of our investment in UFO Communications of approximately $5 million together with a lower gain from the sales of DIGI stock in fiscal 2004 versus fiscal 2003.

The Company acquired LuxN Inc. on August 8, 2003 whereby it paid $14.8 million in cash, and issued 1,879,347 shares of our common stock and 400,000 warrants to purchase our common stock at an exercise price of $3.05 per share. Upon valuing the purchase price and allocating the price to the assets and liabilities acquired, it was determined that net assets acquired exceeded the purchase price by $87 thousand. This excess of net asset acquired over the amount paid for the acquisition is reflected as a reduction to long lived assets.

Income taxes. There was no provision for income taxes for fiscal years 2004 and 2003. 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 assets will not be realized. Our prior management did not file our tax returns for over six years. We had losses during each of these years and do not believe there is tax liability for any of them, other than a nominal penalty for failure to file a return. We filed all delinquent state and federal tax returns in fiscal 2004 and are now current.

As with any purchase it is possible the net operating loss carry-forward for taxes may be limited, possibly reduced to zero.

Sorrento Networks

Net sales. Net sales decreased to $18.7 million, or 17%, for fiscal 2004 from $22.4 million for fiscal 2003. In fiscal 2004 our top five customers accounted for 67% of our net sales, compared to 69% net sales contributed from the top five customers in 2003. We expect to continue experiencing significant fluctuations in our annual revenues as a result of our long and variable sales cycle as well as our highly concentrated customer base. Revenue was negatively impacted by weak telecommunication industry volumes and management's determination to not pursue low gross margin projects.

Gross profit. Gross profit was $4.2 million for fiscal 2004, an increase of 35% from $3.1 million for fiscal 2003. Gross margin increased to 22% of net sales for fiscal 2003 from 14% for fiscal 2003. The increase was due primarily to the cost reductions efforts started in fiscal year 2003 as well as increases to our obsolescence and inventory value reserves in fiscal 2003.

Selling and marketing. Sales and marketing expenses declined to $7.4 million, or 39% of net sales, for fiscal 2004 from $11.7 million, or 52% of net sales, for fiscal 2003. The decrease in sales and marketing expenses resulted primarily from a reduction in personnel and related costs, decreased travel expenses, trade show participation, and advertising expenses.

Engineering, research and development. Engineering, research and development expenses decreased to $5.7 million, or 30% of net sales, for fiscal 2004 from $8.5 million, or 38% of net sales, for fiscal 2003. The decline in engineering, research and development expenses was the result of decreased expenditures associated with fewer engineering personnel combined with a reduction in material related development expenses.

General and administrative. General and administrative expenses decreased to $3.4 million, or 18% of net sales, for fiscal 2004 from $7.6 million, or 34% of net sales, for fiscal 2003. The decline in general and

administrative expenses reflects the reduction of executive and administrative personnel and reduced expense levels reflecting our continuing cost reduction program.

Deferred and other stock compensation. Deferred and other stock compensation for the fiscal year ended January 31, 2004 includes $51 thousand of amortization of deferred stock compensation resulting from the value of stock options granted to consultants compared to $433 thousand for the prior fiscal year. In connection with the grants of stock options with exercise prices determined to be below the fair value of our common stock on the date of grant, SNI recorded deferred stock compensation of $2.6 million, which was fully amortized in 2004.

Meret Optical Communications

Net sales. Net sales decreased to $2.8 million, or 10%, for fiscal 2004, from $3.1 million for fiscal 2003. The reduction in sales volume reflects the continued weakness in the telecommunications industry.

Gross profit. Gross profit increased to $471 thousand, or 131%, for fiscal 2004 from $204 thousand for fiscal 2003. Gross margin as a percentage of net sales increased to 16% for fiscal 2004 compared to 7% for the comparable period last year. The improvement was due primarily to non-recurrence of fiscal 2003 additions to our obsolescence reserves.

Selling and marketing. Sales and marketing expenses decreased to $113 thousand, or 4% of net sales, for fiscal 2004, compared to $315 thousand, or10% of net sales, for fiscal 2003. This decline was a direct result of fewer sales employees and reduced commissions reflecting changes in the commission structure during 2004.

General and administrative. General and administrative expenses were eliminated due to consolidation of operations per the exchange agreement dated June 4, 2003, which requires Sorrento Networks Corporate subsidiaries to be consolidated into a single entity. In preparation for combining Sorrento Networks subsidiaries into a single entity, general and administrative, engineering and research and development for Meret were combined with Sorrento Networks, Inc.

Other operation expenses. Other operating expenses increased to $320 thousand, or 11% of net sales for fiscal 2004 from $421 thousand, or 14% of net sales, for fiscal 2003. These costs represent the amortization of purchased technology related to prior acquisitions.

Results of Operations: Comparison of the Years Ended January 31, 2003 and January 31, 2002

Net sales. Our consolidated net sales decreased $15.7 million or 38% to $25.1 million for fiscal 2003 when compared to net sales of $40.8 million for fiscal 2002. Net sales for Sorrento Networks Inc., our primary operating subsidiary, decreased $13.6 million or 38% to $22.4 million for fiscal 2003 as compared to net sales of $36.0 million in fiscal 2002. Net sales for our Meret Optical segment decreased $1.7 million or 35% in fiscal 2003 to $3.1 million of which $296 thousand was inter-company sales as compared to net sales of $4.8 million in fiscal year 2002.

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 13% for fiscal 2003 from 23% in fiscal 2002. Consolidated gross profit was $3.3 million, a decrease of 65% for fiscal 2003 from $9.3 million for fiscal 2002. Gross margin percent and gross profit were impacted negatively by increases in inventory reserves and sales that were made at lower gross profit margins than the prior year. Gross profit for our Sorrento subsidiary decreased to $3.1 million in fiscal 2003, as compared to $7.7 million in fiscal 2002, a decrease of 60%. An increase in our inventory reserves taken in the second quarter, accounted for $3.0 million of the decrease in gross profit for SNI. The gross profit of our Meret Optical segment decline to $204 thousand in fiscal 2003, as compared to $1.7 million in fiscal 2002, a decrease of 88%. This decline was primarily the result of an increase in our inventory reserve of $1.0 million, taken in the second quarter and a decrease in revenue volume.

Selling and marketing. Selling and marketing expenses consist primarily of employee compensation and related costs, commissions to sales representatives, tradeshow expenses and travel expenses. Our consolidated selling and marketing expenses decreased to $12.0 million, or 48% of net sales, for fiscal 2003 from $16.2 million, or 40% or net sales for fiscal 2002. The decline was primarily the result of cost reduction efforts implemented, a reduction in both our U.S. and foreign sales offices and lower revenue volume for the year.

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 expensed as incurred. We continue to manage our research and development costs 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 $9.0 million, or 36% of net sales, for fiscal 2003 from $13.7 million, or 34% of net sales, for fiscal 2002. The decrease can primarily be attributed to decreases in product development material and personnel related costs.

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 remained consistent at $12.8 million, or 51% of net sales, for fiscal 2003 compared to 31% of net sales, for fiscal 2002. The increase in general and administrative expenses as a percentage of net sales can be attributed to an increase in professional fees associated with the capital restructuring partially offset by a decrease in personnel related costs.

Other operating expenses. Other operating expenses for both fiscal 2003 and 2002 included approximately $400 thousand of amortization of purchased technology related to acquisitions included in Meret. During the fiscal year ended January 31, 2002, we recorded a $2.7 million valuation allowance against option receivables from our former CEO and Chairman.

Other income (expenses). Other income (expenses) from continuing operations increased to $5.1 million in income for fiscal 2003 from $6.0 million in expense for fiscal 2002. Investment income increased by $1.6 million during the fiscal year ended January 31, 2003 from the comparable period last year due to increased investments of our cash surplus in short-term investments. The increase of $6.3 million in interest expense for the fiscal year ended January 31, 2003 from the prior fiscal year is primarily due to the interest incurred on our convertible debentures and an adjustment relating to the amortization of both the beneficial conversion feature of the value allocated to the issuance of warrants on our senior convertible debentures. The $5.5 million of interest on these debentures includes the stated 9.75% interest of $2.3 million of which $2.0 million was paid in common stock and $292 thousand was paid in cash, amortization of issuance costs of $259 thousand, and amortization of the fair value of the warrants issued to the purchasers and placement agent and the deemed beneficial conversion feature of $2.9 million. Other income increased by $313 thousand during the fiscal year ended January 31, 2003 from the prior fiscal year resulting primarily from favorable gains on foreign currency exchanges. Gains on marketable securities increased by $15.5 million for the fiscal year ended January 31, 2003 from the prior fiscal year. $11.7 million of this increase relates to the realized gain on our 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 were exchanged for Digi International common stock and are accounted for under marketable securities. We obtained 2,324,683 shares of Digi common stock on the exchange, of which 1,162,342 shares were later sold back to Digi for $3.6 million in cash and a gain of $2.6 million. The remaining $1.2 million increase results from an impairment allowance taken on our available for sale investment in Entrada and $1.0 million in realized losses on the sale of 1,051,000 shares of Entrada in the prior fiscal year.

Income taxes. There was no provision for income taxes for fiscal years 2003 and 2002. 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 assets will not be realized. Our prior management did not file our tax returns for over six years. We had losses during each of these years and do not believe there is tax liability for any of them, other than a nominal penalty for failure to file a return. We have filed our federal returns and are in the process of preparing and filing all our delinquent state tax returns.

Sorrento Networks

Net sales. Net sales decreased to $22.4 million, or 38%, for fiscal 2003 from $36.0 million for fiscal 2002. In fiscal 2003, eighteen customers accounted for 92% of our net sales compared with eleven customers, which accounted for 94% in fiscal 2002. We expect to continue experiencing significant fluctuations in our annual revenues as a result of our long and variable sales cycle as well as our highly concentrated customer base. Revenue

continues to be negatively impacted by weak telecommunication industry volumes and management determination to not pursue low gross margin projects.

Gross profit. Gross profit was $3.1 million for fiscal 2003, a decrease of 59% from $7.7 million for fiscal 2002. Gross margin decreased to 14% of net sales for fiscal 2003 from 21% for fiscal 2002. The declines were due primarily to the increases in our obsolescence and inventory value reserves taken in the second quarter and of a significantly higher fixed manufacturing overhead in our cost of shipments for the year as a result of the lower revenue volume. We have 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. Sales and marketing expenses decreased to $11.7 million, or 52% of net sales, for fiscal 2003 from $15.7 million, or 44% of net sales, for fiscal 2002. The decrease in sales and marketing expenses resulted primarily from a reduction in personnel and related costs, decreased travel expenses, trade show participation, and advertising expenses. The number of sales and marketing personnel decreased to 36 at January 31, 2003 from 38 at January 31, 2002.

Engineering, research and development. Engineering, research and development expenses decreased to $8.5 million, or 38% of net sales, for fiscal 2003 from $13.2 million, or 37% of net sales, for fiscal 2002. The decrease in engineering, research and development expenses were the result of decreased expenditures associated with the decrease in engineering personnel and related costs and a reduction in material related development expenses. The number of engineering personnel decreased to 29 at January 31, 2003 from 67 at January 31, 2002.

General and administrative. General and administrative expenses decreased to $7.6 million, or 34% of net sales, for fiscal 2003 from $6.9 million, or 19% of net sales, for fiscal 2002. The decrease in general and administrative expenses reflects the reduction of executive and administrative personnel and lower operating expenses. The number of general and administrative personnel decreased to 11 at January 31, 2003 from 15 at January 31, 2002.

Deferred and other stock compensation. Deferred and other stock compensation for the fiscal year ended January 31, 2003 includes $433 thousand of amortization of deferred stock compensation resulting from the value of stock options granted to consultants compared to $812 thousand for the prior fiscal year. In connection with the grants of stock options with exercise prices determined to be below the fair value of our common stock on the date of grant, SNI 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 decreased to $3.1 million, or 36%, for fiscal 2003 of which $296 thousand was inter-company sales, from $4.8 million for fiscal 2002. The reduction in sales volume reflects the continued weak industry volumes.

Gross profit. Gross profit decreased to $204 thousand, or 88%, for fiscal 2003 from $1.7 million for fiscal 2002. Gross margin as a percentage of net sales decreased to 7% for fiscal 2003 compared to 35% for the comparable period last year. These declines were due primarily to the increases in our obsolescence reserves taken in the second quarter and a higher fixed manufacturing overhead in our cost of shipments for the quarter as a result of the lower revenue volume.

Selling and marketing. Sales and marketing expenses decreased to $315 thousand, or 10% of net sales, for fiscal 2003, compared to $435 thousand, or 9% of net sales, for fiscal 2002. This decrease was a direct result of reduced internal commissions, due primarily to lower revenue volume and changes in the commission structure, resulting in lower commission expense for the year.

Engineering, research and development. Engineering, research and development expenses increased to $514 thousand, or 17% of net sales compared to $417 thousand, or 9% of net sales, for fiscal 2002. This increase 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 $283 thousand, or 9% of net sales during fiscal 2003 from $200 thousand, or 4% of net sales, for fiscal 2002. The increase in general and administrative expenses during fiscal 2003 resulted primarily from additions in the administration staff, costs associated with upgrades in our business application software and costs incurred to move the facilities to a new location.

Other operation expenses. Other operating expenses increased to $421 thousand, or 14% of net sales for fiscal 2003 from $372 thousand, or 8% of net sales, for fiscal 2002. These costs represent the amortization of purchased technology related to prior acquisitions. The increase represents and adjustment made to record amortization not previously recorded on purchased technology.

Liquidity and Capital Resources

We finance our operations through a combination of internal funds, investments and debt and equity financing. At January 31, 2004, our working capital was $25.9 million including $17.6 million in cash and cash equivalents and $504 thousand of investments in marketable securities.

We believe that our available cash combined with cash anticipated to be available from future operations, will be sufficient for our working capital requirement for the next 12 months.

Cash Flow for the Years Ended January 31, 2004, 2003 and 2002

Continuing Operations

Our operations used $15.6 million during fiscal 2004 as compared to $14.2 million in fiscal 2003. Significant items impacting the change in cash flows used by operations are: the lower net loss in fiscal 2004, the fiscal 2004 gain on restructuring, the realized loss on non-marketable securities, the reduced year-to-year gain on sale of marketable securities, and decreases in accounts payable, deferred revenue and accrued expenses. We do not anticipate the recurrence of significant cash flow impacts due to restructuring or the marketable/non-marketable security items in fiscal 2005.

We have incurred significant losses and negative cash flows from operations for the past two years. Sorrento Networks, Inc., our principal operating subsidiary has primarily been the operating entity responsible for these high losses and negative cash flows. The losses have been generated as SNI continues to develop its technology, marketing and sales and operations in its effort to become a major supplier of metro and regional optical networks world-wide. In addition, we incurred significant restructuring costs of approximately $2.8 million in 2003 associated with restructuring of our obligations under our Senior Convertible Debentures and Series A Holders obligations.

Our standard payment terms range from net 30 to net 60 days. Receivables from international customers have frequently taken longer to collect. 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 this continued economic environment will not impact either current or future receivables negatively.

Investing Activities

In fiscal 2004, our investing activities provided cash flows of $9.8 million. We received $6.4 million on the sale of marketable securities and other investments. In addition we disposed of $1.3 million in property and equipment related to disposals and returns of demo equipment.

Our investing activities during fiscal 2003 provided cash flows of $9.1

million. We received $17.2 million from the sale of DIGI stock. Partially offsetting were the $5 million cash investment in UFO Communications and $3.3 million of property and equipment purchases. In fiscal 2002, our investing activities used $4.0 million. Cash used in investing activities during fiscal 2002 included purchases of property and equipment of $3.2 million and $900 thousand in other assets.

Financing Activities

Our financing activities provided net cash of $15.7 million reflecting $15.9 million in net cash received in the private placement sale of common stock in December 2003 and January 2004. In fiscal 2003 our financing activities used cash of $1.4 million and consisted primarily of repayment of our line of credit and long-term debt. Our financing activities during fiscal 2002 provided us $40.1 million and consisted primarily of financing activities from

the sale of common stock in March 2001 which generated proceeds of $9.6 million and a convertible debenture financing in August 2001 which raised $29.7 million.

Contractual Cash Obligations

The following tables quantify our future contractual obligations and commercial commitments as of January 31, 2004 (dollars in thousands):

Contractual Obligations

	Payments due in fiscal years						
	Total	2005	2006	2007	2008	2009	Thereafter
Long-term Debt....................	$ 3,585	$ 47	$ 54	$ 58	$ 63	$ 68	$3,295
Capital Leases....................	54	54	--	--	--	--	--
Purchase Orders...................	1,755	1,655	100				
Employment Contracts(b)...........	783	783					
Operating Leases..................	824	551	152	46	41	34	--
7.5% convertible debentures (a)...	12,338	--	--	12,338	--	--	--
Total.............................	$19,339	$3,090	$306	$12,442	$104	$102	$3,295

(a) Maturity date, August 2, 2007

(b) Reflects payments due under change of control provisions under certain employment contracts that may be triggered by the sale of the Company in 2005.

Contingent Liabilities

See footnote "G", under Contingent Liabilities

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.

Impact of Recent Accounting Pronouncements

In January 2003, the FASB issued FASB Interpretation ("FIN") No. 46, "Consolidation of Variable Interest Entities", and interpretation of Accounting Research Bulletin No. 51, "Consolidated Financial Statements", FIN No. 46 explains how to identify variable interest entities and how an enterprise assesses its interests in a variable interest entity to decide whether to consolidate that entity. This Interpretation requires existing unconsolidated variable interest entities to be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among parties involved. FIN No. 46 is effective immediately for variable interest entities created after January 31, 2003, and to variable interest entities in which an enterprise obtains an interest after that date. The Interpretation applies in the first fiscal year or interim period beginning after June 15, 2003, to variable interest entities in which an enterprise holds a variable interest that is acquired before February 1, 2003. We adopted FIN No. 46 with no material effect on our financial position or results of operations.

In November 2002, the FASB issued FIN 45, which expands previously issued accounting guidance and disclosure requirements for certain guarantees. FIN 45 requires us to recognize an initial liability for the fair value of

an obligation assumed by issuing a guarantee. The provision for initial recognition and measurement of the liability will be applied on a prospective basis to guarantees issued or modified after December 31, 2002. The adoption of FIN 45 did not materially affect our consolidated financial statements.

In August 2001, the Financial Accounting Standards Board issued SFAS No. 143, Accounting for Asset Retirement Obligations. This Statement is effective for fiscal years beginning after June 15, 2002. SFAS 143 provides accounting requirements for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. Under the Statement, the asset retirement obligation is recorded at fair value in the period in which it is incurred by increasing the carrying amount of the related long-lived asset. The liability is accreted to its present value in each subsequent period and the capitalized cost is depreciated over the useful life of the related asset. The adoption of SFAS 143 did not have a material effect on our financial position or results of operations.

In November 2002, the Emerging Issues Task Force ("EITF") reached a consensus on Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables." EITF Issue No. 00-21 provides guidance on how to account for arrangements that involve the delivery or performance of multiple products, services and/or rights to use assets. The provisions of EITF Issue No. 00-21 applied to revenue arrangements entered into in fiscal periods beginning after June 15, 2003.

In December 2003, the SEC issued SAB 104, which supersedes SAB 101, Revenue Recognition in Financial Statements. The primary purpose of SAB 104 is to rescind the accounting guidance contained in SAB 101 related to multiple element revenue arrangements, which was superseded as a result of the issuance of EITF 00-21. We adopted EITF 00-21 and SAB 104 with no material impact on our financial statements.

Other Matters

See Item 3. "Legal Proceedings" contained herein.

Item 7A. 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.

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.

A 100 basis point change in the variable interest ratewould not result in a significant change in interest expense during fiscal 2005.

Item 8. Financial Statement and Supplementary Data.

The consolidated financial statement are listed in the index to the consolidated financial statements in Part IV, item 15 (a)1.

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

none

Item 9a. Controls and Procedures.Disclosure Controls and Procedures

The Company maintains controls and procedures designed to ensure that it is able to collect the information it is required to disclose in the reports it files with the SEC, and to process, summarize and disclose this information within the time periods specified in the rules of the SEC. The Company's Chief Executive and Chief Financial Officers are responsible for establishing and maintaining these procedures, and, as required by the rules of the SEC, evaluate their effectiveness. Based on their evaluation of the Company's disclosure controls and procedures which took place as of a date within 90 days of the filing date of this report, the Chief Executive and Chief Financial Officers believe that these procedures are effective to ensure that the Company is able to collect, process and disclose the information it is required to disclose in the reports it files with the SEC within the required time periods.

Internal Controls

The Company maintains a system of internal controls designed to provide reasonable assurance that; transactions are executed in accordance with management's general or specific authorization; transactions are recorded as necessary (1) to permit preparation of financial statements in conformity with accounting principles generally accepted in the United States, and (2) to maintain accountability for assets; access to assets is permitted only in accordance with management's general or specific authorization; and the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

Since the date of the most recent evaluation of the Company's internal controls by the Chief Executive and Chief Financial Officers, there have been no significant changes in such controls or in other factors that could have significantly affected those controls including any corrective actions with regard to significant deficiencies and material weaknesses.

PART III

Item 10. Directors and Executive Officers of the Company

On March 31, 2004, our directors and executive officers were:

Name	Age	Position
Phillip W. Arneson...	67	Chief Executive Officer, President, and Chairman of the Board

Donne F. Fisher......	65	Director (i), (ii)
Don Herzog...........	36	Director (i) (ii)
Robert L. Hibbard....	51	Director (ii)
Larry J. Matthews....	75	Director (i), (ii)
Gary M. Parsons......	53	Director (ii)
Tom Schilling........	41	Director (i)
Joe R. Armstrong.....	55	Chief Financial Officer

(i) member of the Audit Committee

(ii) member of the Compensation Committee

Donne F. Fisher, with his financial management background has been appointed as the Financial Expert on the Audit committee. The Audit committee is enhanced with the financial expertise of Tom Schilling who has served as CFO to Cincinnati Bell. Donne F. Fisher is independent as described in Section 14A of the General Rules and Regulations of the Securities Exchange Act of 1934.

Our By-Laws provide that the members of the Board of Directors be elected annually by our Shareholders for one-year terms. Each director who is not one of our employees or our subsidiaries is paid an annual retainer of $24,000 per year, payable at a rate of $2,000 per month. If an outside director is not nominated for re-election or re-elected, the unpaid remainder of his $24,000 annual retainer shall be paid by the Company in a lump sum upon his departure. In addition, each director who is not an employee of our company or our subsidiaries receives $1,250 for each Board of Directors or committee meeting attended. Directors who serve as the chairman of a committee receive an additional $750 for each committee meeting attended and all other committee members receive $500. The Board of Directors has two committees: Audit and Compensation. There are no family relationships between any directors and officers.

Phillip W. Arneson has been our Chairman and Chief Executive Officer of the Company since March 2002. He previously served as our President and Chief Operating Officer from October 2001 until his appointment as Chairman and Chief Executive Officer. He also has served as one of our directors since October 2000 and currently serves on the Meret Communications, Inc. and Sorrento Networks, Inc. Boards of Directors. From 1996 to 2001, Mr. Arneson held the position of Executive Vice President for privately held Frandsen Corporation, a diversified financial and manufacturing company where he was responsible for growing the enterprise through acquisitions, internal growth, and strategic partnerships. Additionally, he served as President of two of its operating companies. Mr. Arneson has served several public and private technology companies in executive management, holding positions as Chief Executive Officer, President and Group Vice President as well as having extensive experience as a director of such companies. From 1982 to 1986, he served as Executive Vice President of Allied Signal's Electronic Sector and as Chief Executive Officer of its subsidiary, Amphenol Corp. In 1986, Mr. Arneson's technology group garnered the prestigious IR-100 award for the development of an integrated fiber optics phase modulator. Mr. Arneson holds a B.S. in Electrical Engineering from the University of Minnesota's Institute of Technology and is a veteran, U.S. Marine Corps.

Donne F. Fisher has served as one of our directors since November 2001 and is chairman of our Audit Committee. Mr. Fisher is currently President of Fisher Capital Partners, Ltd., a private venture capital and investment company he founded in 1991. From 1982 to 1996, Mr. Fisher held various executive officer positions with Tele-Communications, Inc. ("TCI") and its subsidiaries including Executive Vice President and Treasurer. He was a TCI director from 1980 until 1999 when TCI merged into AT&T Corporation. Since his retirement in 1996, Mr. Fisher has been a consultant to TCI (now AT&T Broadband). Mr. Fisher also serves as a director of Liberty Media Corporation, a former subsidiary of AT&T, and General Communications, Inc., a diversified telecommunications provider.

Robert L. Hibbard has served as one of our directors since November 2001 and is chairman of our Compensation Committee. Mr. Hibbard is an attorney and management consultant in private practice in which he handles a wide variety of commercial matters including technology licensing and the structuring of merger and acquisitions transactions. From 1997 to 1999, Mr. Hibbard was Chief Executive Officer of Kim Technologies International, Inc., a privately held developer of electromechanical "super" capacitors for wireless applications. From 1994 to 1997, Mr. Hibbard was Vice President and General Counsel at Allied Signal Engines, and from 1987 to 1994, Assistant General Counsel at Allied Signal Aerospace. Mr. Hibbard holds a bachelors degree from Gustavus Adolphus College and a J.D. from Marquette University Law School, where he was a member of the Marquette Law Review.

Don Herzog has served as one of our directors since October 2003. He is an investment professional who worked most recently for the firm of Zimmer Lucas Partners in New York City from 2001 to 2003. Prior to that, he was with the venture capital firm Odyssey Capital from 2000 to 2001. Mr. Herzog earned his MBA at Carnegie Mellon from 1998 to 2000. Mr. Herzog received a B. S. in electrical engineering from Drexel University in 1990 prior to eight years as a naval officer.

Gary M. Parsons has served on our Board of Directors since October 2000. Since 1996, Mr. Parsons has held the position of Chairman of the Board for XM Satellite Radio Holdings, Inc., and in October 2001 was named Chairman and Chief Executive Officer of Mobile Satellite Ventures, LLP. From 1996 to April 2002, Mr. Parsons served as Chairman of Motient Corporation, a wireless data firm. On January 10, 2002, Motient filed a voluntary

bankruptcy petition in connection with a prearranged restructuring of its debt and emerged from bankruptcy on May 1, 2002. From 1990 to 1996, Mr. Parsons held a number of executive positions at MCI Communications, Inc., including Executive Vice President, Chief Executive Officer of MCI Metro, Inc., and President of MCI's Southern Division. From 1984 to 1990, Mr. Parsons held the responsibilities of Executive Vice President at Telecom*USA, a fiber-optic and long distance venture subsequently acquired by MCI. Mr. Parsons holds a B.S. in Electrical and Computer Engineering from Clemson University and a MBA from the

University of South Carolina.

Larry J. Matthews has served on our Board of Directors since August 2002. Mr. Matthews was a co-founder of Zytec Corporation, a manufacturer of high performance electronics for the telecommunications and computer industries. Mr. Matthews served as an officer and director of Zytec, which grew from a start-up operation to a public company with revenues exceeding $250 million annually during his tenure. In 1992, Zytec won the National Baldridge Quality Award. A public offering of Zytec was completed in 1994. In 1997, Zytec merged with Computer Products Corporation to form Artesyn Technologies (ATSN, NASDAQ). Mr. Matthews currently serves on Artesyn's board as a director. He also serves on the Board of Veritec, Inc. (VRTC.OB, OTC BB), a seller of microprocessor-based encoding and decoding systems products. From January 1999 to June 2000, Mr. Matthews served as Veritec's Acting President and Chief Executive Officer. Mr. Matthews holds a Bachelor of Engineering degree from Iowa State University, and serves on the boards of several privately held companies.

Tom Schilling has served on our Board of Directors since October 2003. He was most recently Chief Financial Officer of Cincinnati Bell Inc. (fka Broadwing Inc.), serving from 2002-2003. Prior to that, and from 1999, Mr. Schilling was Senior VP and Chief Financial Officer of Broadwing Communications, a subsidiary of Cincinnati Bell. Further, Mr. Schilling was Chief Financial Officer of AutoTrader.com from 1998-1999, and from 1993-1998 held several management positions with MCI Communications, Inc. He holds a B.S. in accounting from Indiana University.

Joe R. Armstrong has served as our Chief Financial Officer since January 2001. He brings over 25 years of corporate finance, investor relations, treasury, legal and management experience to the Company, having spent 15 years with State Of The Art, a leading provider of accounting software. As chief financial officer, vice president, finance and secretary of State Of The Art, he managed two rounds of venture capital financing, the company's initial public offering and several significant acquisitions and mergers. Prior to joining us, Mr. Armstrong most recently served as CFO for The Bohlin Company. Previously, he was director of marketing finance and financial planning for MAI Basic Four Corporation and a certified public accountant for Vicenti, Lloyd and Stutzman, a regional public accounting firm. Mr. Armstrong holds both bachelors and masters degrees in business from Utah State University.

Our other key employees include:

Name	Age	Position
Subrata Datta	41	Chief Technical Officer
Mary A. Lay	46	Vice President, Finance
Andrew Nguyen	44	Vice President, Engineering
Manfred Seehagen	55	Vice President, European Operations
Marc W. Thurman	54	Vice President, Operations
Mitchell R. Truelock	35	Vice President, Corporate Development

Subrata Datta has served as Chief Technical Officer since October 2003 and previously served as our Vice President of Engineering. Mr. Datta joined Sorrento upon our acquisition of Distributed Systems International, Inc. in

1996. From 1996 to 1999 he was responsible for all engineering development for the LAN adapter and hub/switch products. Prior to joining us, Mr. Datta helped develop the ANSI FDDI and FDDI-II standards and design network components and system-level products for DSI. Prior to DSI, Mr. Datta had extensive design experience while working at AT&T Bell Laboratories on the 3B20 Duplex computer system, based on highly fault tolerant architectures, high-reliability and stringent up-time requirements. Before working for AT&T Bell Laboratories, Mr. Datta worked for IBM's Yorktown Research Center where he focused on FDDI development for their RS6000 workstation systems. Mr. Datta holds a M.S. and B.S. in Electrical Engineering from the Cooper Union School of Engineering.

Mary A. Lay has served as Vice President, Finance since July 2002 and joined us in March 2002 as Controller. Ms. Lay brings over 20 years of corporate finance, treasury and management experience to the Company. Ms. Lay's previous experience includes contract and permanent position as Corporate Controller and Chief Financial Officer at several companies including On-Point Technology Systems, Inc., Curtis Coleman Company and Nexergy Tauber. Ms. Lay holds a B.A. in Financial Accounting from National University, an M.B.A. from the University of Phoenix and is a certified public accountant.

Andrew Nguyen has served as Vice President of Engineering since October 2003. Mr. Nguyen served as LuxN's Vice President, Engineering since August 2000, during which time he was responsible for all product development including the delivery of high-availability carrier-class optical transport platforms and network management software products. Prior to joining LuxN, Mr. Nguyen served as Vice President, Engineering for Allied Telesyn International (ATI), a leading supplier of fiber transceivers/media-converter products and workgroup/enterprise IEEE802.3 L2/L3 repeaters/switches/routers. Prior to ATI, Mr. Nguyen worked at Motorola, Ricoh and Epson Research Center, developing and delivering successful products to the market. Mr. Nguyen holds a B.S. in Electrical Engineering from San Jose State University.

Manfred Seehagen has served as our Vice President of European Operations since September 2002 and joined Sorrento Networks in March 1999 as the Director of Sales and Marketing for our German subsidiary. He has a computer science and electronics background as well as several years of sales and marketing experience with ITT Telecommunications, Standard Electrik Lorenz and Alcatel. Mr. Seehagen has also been an active member of ZVEI (Zentralverband der Elektrotechnik und Elektronikindustrie), the German electrical and electronic manufacturers' association where he was a representative in several telecommunications working groups.

Marc Thurman has served as Vice President, Operations since April 2001. Mr. Thurman oversees our manufacturing and operations, supply chain management, and quality assurance functions. He brings to us nearly 25 years of manufacturing operations, supply chain management and quality assurance experience on leading edge technologies and products for the computer and telecommunication markets. Mr. Thurman's previous experience includes service since 1971, in various functions at Packard Bell NEC, ComCrypt Systems, IDEA Courier, Inc., Sidereal Corporation, Intel Corporation, RTE Corporation, and Western Electric. In his most recent position, Mr. Thurman had manufacturing responsibilities including internal production, contract manufacturing (EMS) and third party manufacturing (TPM), supporting revenues of $2 billion. Mr. Thurman holds a B.S. in Electrical Engineering from Oregon State University as well as an M.B.A. degree from

University of Portland.

Mitchell R. Truelock has served as Vice President of Corporate Development since January 2004. Prior to accepting his current position he was our Vice President, Sales and Marketing and had responsibility for North American and Asia Pacific sales, marketing, product management and customer support. Mr. Truelock joined us in January 2003 as Vice President, Strategic Planning after having consulted with us since August 2002. Prior to joining us, from February 2000 to November 2001, Mr. Truelock was a Vice President in the communications equipment group at Banc Boston Robertson Stephens, a technology investment bank. From June 1998 to February 2000, Mr. Truelock was a Vice President in the technology group at Dain Rauscher Wessels, a technology investment bank. From September 1995 to June 1998, Mr. Truelock was a corporate attorney at Cooley Godward LLP where he focused on mergers and acquisitions, private financings and initial public offerings for technology companies. Mr. Truelock holds a L.L.M. in corporate securities at Georgetown University Law, a J.D. from Southern Methodist University, and a BBA in accounting from the University of Texas at Austin.

Item 11. Executive Compensation

The following tables set forth the annual compensation for the Company's Chief Executive Officer ("CEO") for the fiscal year ended January 31, 2004, and for the four most highly compensated executive officers of the Company, other than the CEO, who were serving as executive officers at the end of our fiscal year and whose salary and bonus exceeded $100,000.

Summary Compensation Table

	Annual Compensation				
Name and Principal Position	Year	Salary ($)	Bonus ($)(A)	Other Annual Compensation ($)(B)	All Other Compensation ($)(C)(D)(E)
Phillip W. Arneson, Chairman ...	2004	265,780	185,000	--	80,137
Chief Executive Officer	2003	245,387	205,000	--	72,066
	2002	60,582	25,000	--	12,547
				--	--
Joe R. Armstrong	2004	215,778	150,000	--	27,398
Chief Financial Officer	2003	191,927	165,000	--	20,962
	2002	175,011	--	--	--
Marc Thurman, VP	2004	180,003	36,000	--	--

Operations	2003	180,003	31,127	--	--
Subrata Datta	2004	175,011	26,250	--	--
Chief Technical Officer	2003	175,011	8,750	--	--
	2002	175,011	--		
Mitchell R. Truelock, VP	2004	175,011			
Corporate Development	2003	13,462			

(A) Bonus compensation represents performance and retention bonuses paid in fiscal years 2004, 2003 and 2002. In fiscal year 2004, Mr. Arneson, Mr. Armstrong, Mr. Thurman and Mr. Datta received performance bonuses of $185,000, $150,000, $36,000 and $26,250 respectively.

In fiscal year 2003, Mr. Arneson received the final payment of $5,000 of his $30,000 signing bonus per his employment contract, which took effect October 2001, a performance bonus of $125,000 and a retention bonus of $75,000. Mr. Armstrong received a performance bonus of $105,000 and a retention bonus of $60,000.

In fiscal year 2002, Mr. Arneson received a signing bonus per his employment contract, which took effect October 2001 of $25,000.

(B) Other compensation for Mr. Arneson for fiscal year 2004 consists of temporary living expenses paid by the company of $6,325, vacation accrual buy-out of $26,312 and tax and estate planning of $7,500. Other compensation for Mr. Arneson for fiscal year 2003 consists of temporary living expenses paid by the company of $48,930 and vacation accrual buy-out of $23,237. In fiscal year 2002, Mr. Arneson had temporary living expenses of $12,547.

(C) Other compensation for Mr. Armstrong represents vacation accrual buy-out.

Long-Term Incentive Plans

We have has no long-term incentive plans other than our various stock option plans.

Option Grants--Year Ended January 31, 2004

There were no option grants exercised for the year ended January 31, 2004 for any of the Named Executive Officers.

The following table sets forth information concerning each exercise of stock options during the year ended January 31, 2004 by each of the Named Executive Officers and the January 31, 2004, value of unexercised options.

Aggregated Option Exercises in Fiscal Year 2004 and January 31, 2004
Option Values

	Shares Acquired On Exercise	Value Realized ($)	Number of Securities Underlying Unexercised Options at Fiscal Year-End ($)	Valu In- at F

Name	(#)		Exercisable	Unexercisable	Exercis
Phillip W. Arneson................	--	--	454,052	60,497	$940,
Joe R. Armstrong..................	--	--	264,720	38,048	$553,
Marc Thurman......................	--	--	6,959	51,041	$594,
Subrata Datta.....................	--	--	2,803	50,521	$309,
Mitchell R. Truelock..............	--	--	0	150,000	$

(A) Options are "in-the-money" if, on January 31, 2004, the $5.01 market price of the Common Stock exceeded the exercise price of such options. The value of such options is calculated by determining the difference between the aggregate market price of the Common Stock covered by such options on January 31, 2004, and the aggregate exercise price of such options.

Employment Agreements

On March 1, 2002 Mr. Arneson assumed the role of our Chairman, President and Chief Executive Officer. On April 30, 2002, our Board of Directors approved an employment agreement with Mr. Arneson regarding the terms of his employment as Chairman, Chief Executive Officer and President, which superseded his August 2001 contract. The agreement provides for annual compensation of $250,000. The agreement also calls for the vesting, as of March 1, 2002, of the 6,250 options granted Mr. Arneson on September 17, 2001, and the granting of 23,750 additional stock options (adjusted for the 1-for-20 reverse split) at a strike price equal to the closing price of our common stock on NASDAQ on March 1, 2002, which shares are to vest at the rate of 1,000 shares per month beginning on April 1, 2002, continuing for 12 months, when 5,000 additional shares vest, and beginning on May 1, 2003, 1,125 shares will vest each month. The employment is at will; however, if Mr. Arneson should be terminated without cause or resign in certain circumstances, he would receive a lump sum severance payment of two years' base salary and vesting of all stock options, and health and life benefits; he would be required to provide exclusive consulting services for two years following his termination. The agreement also calls for the reimbursement of living expenses in San Diego at the rate of $2,750.00 per month while Mr. Arneson remains employed. In the event of a change of control, merger or sale of our company, Mr. Arneson is entitled to receive an immediate payment equal to two year's salary, health and life insurance benefits for two years and vesting of all his options. In June 2003, our Board of Directors clarified the termination section of Mr. Arneson's contract and authorized increases in annual compensation to $275,000, and monthly living allowance to $3,250. In June 2003, the Board of Directors also approved an amendment to Mr. Arneson's employment agreement to provide that in the event Mr. Arneson is terminated without cause, he shall continue to receive his then existing health and life insurance benefits for a period of four years.

In May 2002, we entered into an employment agreement with Mr. Armstrong, our CFO, which provides for an annual salary of $200,000 per year plus bonus of $20,000, which was paid in a lump-sum, in June 2002, and 10,500 options (adjusted for the 1-for-20 reverse split) to acquire our common stock vesting over two years. The contract is for no specified term and Mr. Armstrong is an at-will employee such that the company or Mr. Armstrong may terminate employment at any time, with or without cause or notice, and with or without reason, subject to the rights and obligations as provided in the contract. However, should Mr. Armstrong be terminated without cause he will receive a lump-sum severance payment of one year's salary, health and life benefits for one year and vesting of all his options. In the event of a change of control, merger or sale of our company, Mr. Armstrong is entitled to receive an immediate payment equal to one year's salary, health and life insurance benefits for one year and vesting of all his options. In June 2003, our Board of Directors authorized an increase in Mr. Armstrong's annual compensation to $225,000.

In January 2004, we entered into an employment agreement with Mr. Truelock, our Vice President, Corporate Development, which provides for an annual salary of $200,000 per year plus a performance bonus of up to $100,000 under certain conditions, and 100,000 options to acquire our common stock that vest over three years. The agreement also calls for us to reimburse Mr. Truelock up to $15,000 for relocation expenses incurred. The contract is for no specified term and Mr. Truelock is an at-will employee which allows us to discontinue Mr. Truelock's employment at any time, with or without cause or notice, and with or without reason. However, should Mr. Truelock be terminated without cause prior to certain conditions in the contract, he will receive two months salary continuation and accelerated vesting of his outstanding options. If Mr. Truelock is terminated by us without cause within six (6) months subsequent to a change in control that is not a hostile takeover, he will also receive accelerated vesting of his outstanding options.

Compliance with Section 16(a) of the Exchange Act

Section 16(a) of the Securities Exchange Act of 1934 (the "Exchange Act") requires our directors and executive officers and persons who own more than ten percent of a registered class of our equity securities to file reports of beneficial ownership and changes in beneficial ownership with the Securities and Exchange Commission (the "Commission"). The rules promulgated by the Commission under Section 16(a) of the Exchange Act require those persons to furnish us with copies of all reports filed with the Commission pursuant to Section 16(a).

During the fiscal year ended January 31, 2004, Don Herzog and Tom Schilling received stock option grants that were not reported by the required filing date. These directors have now filed the required forms as required under Section 16(a) of the Exchange Act.

Item 12. Security Ownership of Certain Beneficial Owners and Management

The following table sets forth certain information, as of January 31, 2004, regarding the ownership of our common stock by (i) each of our directors; (ii) each of the present executive officers; (iii) each person known to us to beneficially own 5% or more of our common stock; and (iv) all of our directors and executive officers as a group. Except as indicated, all persons named as beneficial owners of our common stock have sole voting and investment power with respect to the shares indicated as beneficially owned by them. All persons named have an address at c/o Sorrento Networks Corporation, 9990 Mesa Rim Road, San Diego, California 92121, unless otherwise indicated.

Name of Beneficial Owner (A)	Common Stock Number of Shares	Common Stock Percentage of Outstanding(J)
Phillip W. Arneson (B)	478,500	2.9%
Donne F. Fisher (C)	68,879	*
Robert L. Hibbard (D)	47,216	*
Gary M. Parsons (E)	44,750	*
Larry J. Matthews (F)	43,417	*
Don Herzog (G)	25,000	*
Tom Schilling (H)	25,000	*
Joe Armstrong (I)	280,221	1.7*
All Directors, and Executive Officers as a Group	1,012,983	6.1%
Rajendra Singh (J) 7925 Jones Branch Drive, Suite 6400 McLean, VA 22102	873,132	5.35%
Belmarken Holdings, BV (K) Boeing Avenue 53 1119 PE Schiphol Rijk The Netherlands, PF	2,094,379	12.84%

* Less than 1%

(A) All information with respect to beneficial ownership of the shares is based upon filings made by the respective beneficial owners with the Securities and Exchange Commission or information provided by such beneficial owners to us.

(B) Includes exercisable options held by Mr. Arneson to acquire 478,250 shares of common stock, and 250 shares of common stock purchased in June 2002.

(C) Includes exercisable options to acquire 44,666 shares of common stock held by Mr. Fisher and 24,212 shares of common stock received in distribution of stock to our former Series A Preferred Stock holders and interest payments on the 7.5% Convertible Debenture outstanding. Mr. Fisher is a director of Liberty Media Corporation, which owns an approximate 74% economic interest representing an approximate 94% voting interest in UnitedGlobalCom, Inc. ("UGC"). Belmarken Holding, B.V., an indirect subsidiary of UGC, holds 2,059,195 shares of our common stock. Liberty Media also holds convertible debt of United Pan-Europe

Communications, N.V., a subsidiary of UGC, which it has agreed to exchange for additional shares in UGC. Mr. Fisher meets all the current requirements for an independent director.

(D) Includes exercisable options to acquire 47,166 shares of common stock held by Mr. Hibbard and 50 shares of common stock purchased in July 2002.

(E) Represents options to acquire shares of our common stock, which were granted to Mr. Parsons consistent with, and upon the same terms, conditions and vesting schedules as, option grants made to other members of our Board of Directors.

(F) Represents options to acquire shares of our common stock, which were granted to Mr. Matthews consistent with, and upon the same terms, conditions and vesting schedules as, option grants made to other members of our Board of Directors

(G) Represents options to acquire shares of our common stock, which were granted to Mr. Herzog consistent with, and upon the same terms, conditions and vesting schedules as, option grants made to other members of our Board of Directors

(H) Represents options to acquire shares of our common stock, which were granted to Mr. Schilling consistent with, and upon the same terms, conditions and vesting schedules as, option grants made to other members of our Board of Directors

(I) Includes exercisable options to acquire 280,071 shares of common stock held by Mr. Armstrong and 150 shares of common stock purchased in June 2002.

(J) Represents holdings reported by Rajendra Singh, Neera Singh, Cherrywood Holdings, Inc., Telcom Ventures, L.L.C., and Telcom-SNI Investors, L.L.C. on June 16, 2003 on Form 13-G, "General Statement of Beneficial Ownership." Includes 647,348 shares of common stock and 225,784 shares underlying convertible debentures held by the reporting persons.

(K) Represents holdings reported by Belmarken Holdings, BV on June 16, 2003 on Form 13-D, "General Statement of Beneficial Ownership." Includes 1,601,723 shares of common stock and 492,656 shares underlying convertible debentures held by the reporting person.

Item 13. Certain Relationships and Related Transactions.

Two of our customers are subsidiaries of UnitedGlobalCom, Inc ("UGC"), which is the parent of Belmarken Holding, B.V., a holder of approximately 12.8% of our shares of common stock, and indirect subsidiaries of UGC. During fiscal 2004, we recorded sales of $483,093, including deferred revenue, to these customers and these customers had no outstanding receivables at January 31, 2004. As noted above, Mr. Fisher is a director of Liberty Media Corporation, which is a shareholder of UGC and debt holder in one of its indirect subsidiaries. Mr. Fisher was not one of our directors when we made these sales and extended credit to these customers. However, indirect subsidiaries of UGC continue to be among our customers, namely UPC.

In February 2003, we entered into a consulting agreement with Mr. Robert Hibbard, to provide services to the Board of Directors and management of the company at a consulting rate of $175 per hour and a retainer of $20,000 per month for six months. Mr. Hibbard agrees to make himself available to the Company for not less than 20 hours per week. This agreement supersedes his August 2002 consulting agreement. Nearly all of Mr. Hibbard's consulting work for us has involved matters being considered or reviewed by the board or by committees of the board. His work has included structuring and implementing our 2003 Equity Incentive Plan for employees, participation in settlement negotiations for pending litigation, assistance in our capital restructuring and improving our intellectual property policies and procedures, among other matters. In fiscal years 2004 and 2003, Mr. Hibbard was paid $204,950 and $91,836 respectively, in consulting fees.

During July 2000, we agreed to loan $300,000 for three years at the applicable federal rate provided for in Internal Revenue Code Section 1274 to Mr. Jacobson in connection with accepting employment as our Senior Vice President, Legal. This is a full recourse loan and Mr. Jacobson has pledged his options to acquire our common stock and any options he may receive from any of our subsidiaries as collateral. Mr. Jacobson has received $300,000 in advances under this loan agreement for which the interest rate is 6.6%. On July 3, 2002, a new note covering the $300,000 was incorporated in Mr. Jacobson's employment contract. The term remained the same as the July 2000 note, with all unpaid, accrued interest and principal due and payable on August 30, 2003. In December 2002,

Mr. Jacobson paid $39,330 on his loan that included payment of all prior interest due and the remainder applied to his principal balance. Mr. Jacobson is no longer in our employ. As of January 31, 2004, Mr. Jacobson's loan outstanding to the Company totaled $297,961.

Item 14. Principal Accountant Fees and Services

Audit Fees

BDO Seidman, LLP billed us $299,887 and $168,441 in the aggregate, for professional services for the audit of our annual financial statements for fiscal 2004 and 2003 respectively, and for the review of our interim financial statements, which are included in our Quarterly Reports on Form 10-Q for fiscal 2004.

BDO Seidman, LLP billed us $84,317 and $9,265 for other audit-related fees for fiscal year 2004 and 2003 respectively.

Tax Fees

BDO Seidman, LLP billed us $290,650 and $193,250 for fiscal 2004 and 2003 respectively, for domestic and international tax preparation work.

Financial Information Systems Design and Implementation Fees

BDO Seidman, LLP did not provide and did not bill nor was paid any fees for, financial information systems design and implementation services in fiscal 2004 and 2003 as described in Paragraph (C)(4)(ii) of Rule 2-01 of Regulation S-X.

All Other Fees

BDO Seidman, LLP has billed us $50,695 in the aggregate, for professional services rendered for all services other than those services captioned "Audit Fees", "Tax Fees" and "Financial Information Systems Design and Implementation Fees" in fiscal 2003. These services included consulting and other services.

All non-audit services were reviewed with the Audit Committee, which concluded that the provision of such services by BDO Seidman, LLP was compatible with the maintenance of that firm's independence in the conduct of its auditing function.

AUDIT COMMITTEE POLICY ON PRE-APPROVAL OF SERVICES PERFORMED BY THE INDEPENDENT AUDITORS

The independence of the Company's independent auditors is critical to ensure the integrity of the Company's financial statements. To assure that the services performed by the independent auditors do not impair their independence, the Audit Committee has established a policy governing pre-approval of services to be provided by the independent auditors.

The independent auditors will submit a report, which includes an aggregate of services in the following four categories expected to be rendered during the year and the related range of fees, to the Audit Committee for its approval:

1. Audit services comprise the work necessary for the independent auditors to render an opinion on the audit of the consolidated financial statements of the Company as well as work that generally only the independent auditors can reasonably be expected to provide, including separate audits of the Company's subsidiaries, services associated with SEC registration statements, periodic reports and other documents issued in connection with securities offerings.

2. Audit-related services are assurance and related services that are reasonably related to the performance of the audit or review of the Company's financial statements, including financial statement audits of businesses to be divested, employee benefit plan audits, agreed-upon or expanded audit procedures to meet certain regulatory requirements, and certain attestation services.

3. Tax services include selected non-U.S. tax compliance and limited assistance with tax audits involving federal, state and international tax consulting projects commenced prior to December 1, 2001.

4. Other services include attestation services required in connection with governmental requests/reviews and other attestation services performed in connection with nonfinancial information.

From time to time, circumstances may arise in which it will become necessary to engage the independent auditors for additional services not contemplated in the original pre-approval (e.g., new services or approved services exceeding the pre-approved range of fees). In those instances, the Audit Committee requires specific pre-approval before engaging the independent auditors.

The Audit Committee has delegated limited pre-approval authority to the Audit Committee Chair. Any services and associated fees approved by the Audit Committee Chair will be reported to the Audit Committee at its next meeting.

For fiscal year 2004 no audit fees were approved after the work was performed.

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

(a) Exhibits and Consolidated Financial Statement Schedules

1. Financial Statements: (see index to financial statements at page F-1)

Independent Certified Public Accountants' Reports

Consolidated Balance Sheets at January 31, 2004 and 2003

Consolidated Statements of Operations for the Years Ended January 31, 2004, 2003 and 20

Consolidated Statements Comprehensive Income for the Years Ended January 31, 2004, 2003

Consolidated Statement of Stockholders' Equity for the Years Ended January 31, 2004, 20

Consolidated Statements of Cash Flows for the Years Ended January 31, 2004, 2003 and 20

Notes to Consolidated Financial Statements

2.Exhibits:

3.1 Certificate of Amendment to the Certificate of Incorporation dated October 15, 2002 (A).

3.2 Certificate of Correction to the Certificate of Amendment to the Certificate of Incorporation dated November 6, 2002 (A).

3.3 Certificate of Incorporation dated May 14, 2003 (J).

3.4 Amendment and Restated By-Laws of the Registrant (J).

3.5 Certificate of Amendment to the Certificate of Incorporation dated May 30, 2003 (

4.1 1988 Stock Option Plan (J).

4.2 Amended and restated 1997 Incentive and Non-Qualified Stock Option Plan (K).

4.3 1997 Directors Stock Option Plan (K).

4.4 2000 Stock Incentive Plan (K).

4.5 2000 Employee Stock Purchase Plan (K).

4.6 2000 Stock Option/Stock Issuance Plan of Sorrento Networks, Inc. (K).

4.7 Form of Senior Convertible 9.75% Debenture due August 2, 2004 (F).

4.8 Form of Warrant dated August 2, 2001 (F).

4.9 Form of 7.5% Convertible Debenture Due August 2, 2007 (F).

4.10 Form of Warrant, expiry date August 2, 2007 (F).

4.11 Sorrento Networks Corporation 2003 Equity Incentive Plan (K).

4.12 Series D Preferred Stock Certificate of Designation (I).

4.13 Series F Preferred Stock Certificate of Designation (I).

10.1 Agreement dated June 12, 2000 with Par Chadha (G).

10.2 Agreement dated May 22, 2000 with Rohit Phansalkar (G).

10.3 Agreement dated May 22, 2000 with Christopher E. Sue (G).

10.4 Agreement dated August 22, 2000 with Leonard N. Hecht (G).

10.5 Agreement dated May 22, 2000 with John A. Mason (N).

10.6 Agreement dated July 12, 2000 with Richard L. Jacobson (N).

10.7 Securities Purchase Agreement dated as of August 1, 2001 (J).

10.8 Escrow Agreement dated as of August 1, 2001 (J).

10.9 Registration Rights Agreement dated as of August 2, 2001 (J).

10.10 Agreement dated March 1, 2002, with Phillip W. Arneson (N).

10.11 Exchange Agreement dated March 6, 2003 (F).

10.12 Form of Registration Rights Agreement with Exchanging Holders (F).

10.13 Agreement dated May 17, 2002 with Joe R. Armstrong (N).

10.14 Agreement dated July 3, 2003 with Richard L. Jacobson (N).

10.15 Agreement dated February 1, 2003 with Robert L. Hibbard (N).

21.0 Subsidiaries of the Registrant (S).

23.0 Consent of BDO Seidman LLP--filed herewith

31.1 Certification of Phillip W. Arneson, Chief Executive Officer, pursuant to 18 U.S. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed

31.2 Certification of Joe R. Armstrong, Chief Financial Officer, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed

99.1 Code of Ethics for Senior Executive and Financial Officers

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The foregoing are incorporated by reference from the Registrant's filings as indicated:

(A) Form 10-QSB for the quarter ended July 31, 1996

(B) Form 10-K for the year ended January 31, 1988

(C) Form S-3 dated February 25, 1997

(D) Proxy Statement dated December 1, 1999

(E) Proxy Statement dated May 13, 1988

(F) Proxy Statement dated November 21, 1997

(G) Proxy Statement dated December 11, 2000

(H) Form 10-KSB for year ended January 31, 1996

(I) Form 10-Q for the quarter ended October 31, 2000

(J) Form 10-K for the year ended January 31, 2001

(K) Form 8-K dated August 3, 2001

(L) Form 10-K for the year ended January 31, 2002

(M) Form 8-K dated October 25, 2002

(N) Proxy Statement dated April 15, 2003.

(O) Registration Statement on Form S-3/A, filed with the SEC on May 27, 2003.

(P) Proxy Statement dated December 3, 2003

NOTE: Certain previously filed exhibits are no longer being incorporated by reference (and therefore not numerically listed) as the underlying documents have either expired or are no longer material or relevant.

(b) Reports on Form 8-K

January 24, 2002 Delaware Supreme Court ruling

November 5, 2002 Non-compliance with NASDAQ listing requirements

November 12, 2002 Five-year supply agreement

December 10, 2002 Restructuring Letter of Intent and term sheet

March 12, 2003 Exchange Agreement and associated documents

April 11, 2003 Results of Operations and Financial Condition

May 12, 2003 Sale of Marketable Securities

May 12, 2003 Settlement Agreement reached with Former Employee

May 29, 2003 Adjournment of Special Meeting of Shareholders

May 30, 2003 Special Meeting of Shareholders

June 3, 2003 Results of Operations and Financial Condition

June 9, 2003 Completion of Capital Restructuring Plan

August 5, 2003 Results of Operation and Financial Condition

October 23, 2003 Acquisition or Disposition of Assets

September 10, 2003 Results of Operations and Financial Condition

December 31, 2003 Private Placement of Common Stock

January 27, 2004 Private Placement of Common Stock

SORRENTO NETWORKS CORPORATION
AND SUBSIDIARIES

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

The Shareholders of Sorrento Networks Corporation

San Diego, California

We have audited the accompanying consolidated balance sheets of Sorrento Networks Corporation (a Delaware corporation) and subsidiaries (collectively the "Company") as of January 31, 2004 and 2003 and the related consolidated statements of operations and comprehensive loss, stockholders' equity (deficit) and cash flows for each of the three years in the period ended January 31, 2004. These consolidated 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.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. These 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 our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of January 31, 2004 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended January 31, 2004 in conformity with accounting principles generally in the United States of America.

/s/ BDO Seidman, LLP

BDO Seidman, LLP
Los Angeles, California

April 9, 2004, except for Note Q which is as of April 22, 2004.

SORRENTO NETWORKS CORPORATION
AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(In Thousands)

	January 31, 2004	Jan
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 17,617	$
Accounts receivable, net (Notes P and S)	3,754	
Inventory, net (Notes B and T)	13,893	
Prepaid expenses and other current assets (Note N)	972	
Investment in marketable securities (Note B)	504	
Notes receivable	242	
TOTAL CURRENT ASSETS	36,982	
PROPERTY AND EQUIPMENT, NET (Notes C and E)	12,267	
OTHER ASSETS		
Purchased technology, net (Note B)	110	
Investment in non-marketable securities (Note B)	--	
Other assets (Notes A and B)	654	

Notes receivable	83	
TOTAL OTHER ASSETS	847	
TOTAL ASSETS	$ 50,096	$
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
CURRENT LIABILITIES		
Current maturities of long term debt (Note E)	$101	
Accounts payable	2,887	
Deferred revenue	878	
Accrued professional fees	832	
Other accrued liabilities and current liabilities (Note G)	6,478	
Due on redemption of preferred security of subsidiary (Note J)	--	
TOTAL CURRENT LIABILITIES	11,176	
Long-term debt and capital lease obligations (Note E,S and G)	3,538	
Debentures payable (Note F)	12,388	
Dividends payable (Note A)	--	
TOTAL LIABILITIES	27,102	
COMMITMENTS AND CONTINGENCIES (Note G)		
STOCKHOLDERS' EQUITY (DEFICIT) (Note Iand J)		
Preferred stock, $.01 par value; liquidation preference $1,353	1	
Common stock,$0.001 par value; 150,000,000 shares authorized; 16,315,361 shares issued 16,314,917 shares outstanding at January 31, 2004; 886,494 shares issued 886,050 shares outstanding at January 31, 2003	16	
Additional paid-in capital	216,434	
Deferred stock compensation	--	
Accumulated deficit	(193,769)	(
Accumulated other comprehensive loss	381	
Treasury stock, at cost; 444 shares at January 31, 2004 and January 31, 2003, respectively	(69)	
TOTAL STOCKHOLDERS' EQUITY (DEFICIT)	22,994	
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 50,096	$

See accompanying notes to consolidated financial statements.

SORRENTO NETWORKS CORPORATION
AND SUBSIDIARIES

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

	Twelve Months January 2004	2003
NET SALES (Notes B and S)	$ 25,462	$ 25,13
COST OF SALES	19,769	21,81
GROSS PROFIT	5,693	3,32
OPERATING EXPENSES		
Selling and marketing	8,406	12,02
Engineering, research and development	8,025	8,99
General and administrative	6,525	12,77
Deferred compensation	51	43
Other operating expenses	320	42
TOTAL OPERATING EXPENSES	23,327	34,64
LOSS FROM OPERATIONS	(17,634)	(31,32
OTHER INCOME (EXPENSES)		
Investment income (loss) (Note B)	(5,860)	27
Interest expense	(4,396)	(9,61
Other income (expenses) (Note J)	17,631	21
Gain (loss) on sale of marketable securities (Note B)	4,026	14,24
TOTAL OTHER INCOME (EXPENSES)	11,401	5,11
NET LOSS	$ (6,233)	$(26,21
LOSS PER COMMON SHARE (Note M)		
BASIC		
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING (IN THOUSANDS)	7,205	78
NET LOSS PER COMMON SHARE:		
BASIC NET LOSS PER COMMON SHARE	(0.87)	$ (33.2
DILUTED		
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING (IN THOUSANDS)	7,205	78
NET LOSS PER COMMON SHARE:		
DILUTED NET LOSS PER COMMON SHARE	(0.87)	$ (33.2
COMPREHENSIVE LOSS AND ITS COMPONENTS CONSIST OF THE FOLLOWING:		
Net loss	$ (6,233)	$(26,21
Components of other comprehensive loss		
Foreign currency translation	208	-
Unrealized holding gains (losses) arising during the period	1,173	(6,98
Reclassification adjustment for gains (losses) included in net loss	(4,026)	(14,24
NET COMPREHENSIVE LOSS	$ (8,878)	$(47,44

See accompanying notes to consolidated financial statements.

SORRENTO NETWORKS CORPORATION
AND SUBSIDIARIES
For the Year Ended January 31, 2004

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)
(In Thousands)

	Common Stock Shares	Common Stock Amount	Preferred Stock Shares	Preferred Stock Amount	Additional Paid-in Capital	D Com
Balance at January 31, 2003	886	$ 5,318	2	$1	$144,887	
Common stock par value revaluation		(5,317)			5,317	
Warrants issued in connection with Restructuring					436	
Common stock issuance						
Common stock issued in connection with capital restructuring	8,030	8			43,512	
Common stock issued in connection with debenture principal and interest payment	377	--			1,215	
Common stock issued in connection with LuxN acquisition	1,879	2			4,935	
Common stock issued in connection with legal settlement	54	--			162	
Common stock issued in connection with Pipe 1 financing	2,140	2			5,836	
Common stock issued in connection with Pipe 2 financing	2,922	3			9,139	
Unrealized (losses) on available for sale securities						
Warrants issued in connection with the LuxN acquisition					878	
Reclassification adjustment for (gains) losses realized in net loss						
foreign currency translation adjustments						
Deferred stock compensation of subsidiary					46	
Expenses paid with stock issuances	27				71	
Amortization of deferred stock compensation						
Net loss						
Balance at January 31, 2004	16,315	$ 16-	2	$1-	$216,434	

	Accumulated Deficit	Treasury Stock Shares	Treasury Stock Amount	Accumulated Other Comprehensive Loss	Stock Eq De

Balance at January 31, 2003	$(187,536)	1	$(69)	$2,928	$(3
Common stock par value revaluation					
Warrants issued in connection with Restructuring					
Common stock issuance					
Common stock issued in connection with capital restructuring					4
Common stock issued in connection with debenture principal and interest payment					
Common stock issued in connection with LuxN acquisition					
Common stock issued in connection with legal settlement					
Common stock issued in connection with Pipe 1 financing					
Common stock issued in connection with Pipe 2 financing					
Unrealized (losses) on available for sale securities				(2,854)	(
Warrants issued in connection with the LuxN acquisition					
Reclassification adjustment for (gains) losses realized in net loss				99	
foreign currency translation adjustments				208	
Deferred stock compensation of subsidiary					
Expenses paid with stock issuances					
Amortization of deferred stock compensation					
Net loss	(6,233)				(
Balance at January 31, 2004	$(193,769)	1	$(69)	$ 381	$ 2

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See accompanying notes to consolidated financial statements.

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SORRENTO NETWORKS CORPORATION
AND SUBSIDIARIES
For the Year Ended January 31, 2003

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)

(In Thousands)

	COMMON STOCK Shares	COMMON STOCK Amount	PREFERRED STOCK Shares	PREFERRED STOCK Amount	ADDITIONAL PAID IN CAPITAL	NOTES RECEIVABLE OPTIONS
Balance at January 31, 2002	710	$4,263	2	$1	$143,705	$--
Stock option and warrant exercises (Notes I, J and M)	1	9			(9)	
Unrealized losses on available for sale securities (Note B)						
Deferred stock compensation of subsidiary (Note B)					183	
Expenses paid with stock issuances (Note I)	175	1,046			1,008	
Amortization of deferred stock compensation (Note B)						
Net loss						
BALANCE AT JANUARY 31, 2003	886	$5,318	2	$1	$144,887	$--

	ACCUMULATED DEFICIT	TREASURY STOCK Shares	TREASURY STOCK Amount	Accumulated OTHER COMPREHENSIVE LOSS	TOTAL STOCKHOLDE EQUITY(DEFI
Balance at January 31, 2002	$(161,326)	1	$(69)	$ 24,160	$ 10,47
Stock option and warrant exercises (Notes I, J and M)					
Unrealized losses on available for sale securities (Note B)				(21,232)	(21,23
Deferred stock compensation of subsidiary (Note B)					
Expenses paid with stock issuances (Note I)					2,05
Amortization of deferred stock compensation (Note B)					43
Net loss	(26,210)				(26,21
BALANCE AT JANUARY 31, 2003	$(187,536)	1	$(69)	$ 2,928	$(34,47

See accompanying notes to consolidated financial statements.

SORRENTO NETWORKS CORPORATION
AND SUBSIDIARIES

For the Year Ended January 31, 2002
(Restated)

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)
(In Thousands)

	COMMON STOCK		PREFERRED STOCK		ADDITIONAL PAID IN CAPITAL	NOTES RECEIVABLE OPTIONS
	Shares	Amount	Shares	Amount		
Balance at January 31, 2001	630	$3,782	2	$1	$114,994	$(5,034)
Debentures private placement (Notes F)	24				20,676	
Stock option and warrant exercises (Notes I, J and M)	(20)	23			(1,321)	5,034
Unrealized losses on available for sale securities (Note B)						
Deferred stock compensation of subsidiary (Note B)					187	
Expenses paid with stock issuances (Note I)					(18)	
Amortization of deferred stock compensation (Note B)						
Private placement subsidiary (Note J)	76	458			9,187	
Deemed dividend (Note I)						
Net loss						
BALANCE AT JANUARY 31, 2002	710	$4,263	2	$1	$143,705	$ --

	ACCUMULATED DEFICIT	TREASURY STOCK		Accumulated OTHER COMPREHENSIVE LOSS	TOTAL STOCKHOLDE EQUITY(DEFI
		Shares	Amount		
Balance at January 31, 2001	$(118,010)	1	$(69)	$ 44,949	$(39,77
Debentures private placement (Notes F)					20,67
Stock option and warrant exercises (Notes I, J and M)					3,73
Unrealized losses on available for sale securities (Note B)				(20,789)	(20,78
Deferred stock compensation of subsidiary (Note B)					
Expenses paid with stock issuances (Note I)					(1
Amortization of deferred stock compensation (Note B)					81
Private placement subsidiary (Note J)					9,64
Deemed dividend (Note I)	(180)				(18
Net loss	(43,136)				(43,13
BALANCE AT JANUARY 31, 2002	$(161,326)	1	$(69)	$ 24,160	$ 10,47

See accompanying notes to consolidated financial statements.

SORRENTO NETWORKS CORPORATION
AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands)

	Year Ended J	
	2004	200
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (6,233)	$(26,
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	3,673	4,
Realized loss on investment in non-marketable securities	5,025	
Accounts receivable and inventory reserves	(530)	(1,
Expenses paid through issuances of securities	233	2,
(Gain) loss on sale of marketable securities	(4,026)	(14,
Non-cash interest on debentures (Note F)	2,726	6,
Gain on capital restructuring	(13,629)	
Deferred and other stock compensation (Note B)	51	
Other non-cash	(43)	
Changes in assets and liabilities net of effects of business entity divestitures:		
(Increase) decrease in accounts receivable	1,891	3,
(Increase) decrease in inventories	4,719	5,
(Increase) decrease in other current assets	186	
(Increase) decrease in notes receivable	(325)	
Increase (decrease) in accounts payable	(2,689)	(
Increase (decrease) in deferred revenue	(3,111)	3,
Increase (decrease) in accrued expenses	(3,304)	1,
Increase (decrease) in other current liabilities	(189)	
NET CASH USED IN OPERATING ACTIVITIES	(15,575)	(14,
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisition of business, net of cash acquired	1,506	
Purchase of property and equipment	1,604	(3,
Proceeds from sale of marketable securities and other investments	6,360	17,
Purchase of non-marketable securities	--	(5,
Purchase of other assets	316	
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	9,786	9,

See accompanying notes to consolidated financial statements

SORRENTO NETWORKS CORPORATION
AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS--(Continued)
(In Thousands)

	Year Ended Ja	
	2004	2003
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from short-term debt, net of repayments	--	(1,04
Proceeds from long-term debt (Note E)	--	-
Repayment of short-term debt	(36)	-
Repayment of long-term debt (Note E)	(192)	(36
Proceeds from debentures (Note F)	--	-
Proceeds from common stock (Note J)	15,887	-
Proceeds from stock option and warrant exercises (Note K)	--	-
Other	--	-
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	15,659	(1,40
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	9,870	(6,49
CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD	7,747	14,24
CASH AND CASH EQUIVALENTS - END OF PERIOD	$17,617	$ 7,74

See accompanying notes to consolidated financial statements.

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 and Sunnyvale, 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.

A. THE COMPANY AND BASIS OF PRESENTATION

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 materially differ from these estimates.

We have incurred significant losses and negative cash flows from operations for the past several years. Sorrento Networks, Inc. ("SNI"), the Company's principal operating subsidiary has primarily been the operating entity responsible for these high losses and negative cash flows. The losses have been generated as SNI continues to develop its technology, marketing and sales and operations in its effort to become a major supplier of metro and regional optical networks worldwide

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation--The balance sheets and the consolidated statement of operations for the years ended January 31, 2004, 2003 and the consolidated statement of operations for the year ended January 31, 2002 reflect our accounts and all subsidiaries controlled by us after the elimination of significant intercompany transactions and balances. On August 8, 2003, we complete the acquisition of LuxN, Inc. the results of which are reflected in consolidation from that date forward. The consolidated group is referred to individually and collectively as the "Company," "We," "Our," or "Us."

Use of Estimates--The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 materially differ from these estimates. In the opinion of Management, all adjustments (which include normal recurring adjustments and charges described in the notes to the financial statements) necessary to present fairly the financial position, results of operations and cash flows for the years ended January 31, 2004, 2003 and 2002 have been made.

Cash and Cash Equivalents--All cash on hand and in banks, certificates of deposit and other liquid investments with original maturities of three months or less, when purchased are considered to be cash equivalents. All such investments are recorded at market value using the specific identification method; unrealized gains and losses are reflected in other comprehensive income.

Accounts Receivable--In the normal course of business, we extend unsecured credit to our customers related to the sales of various products. Typically credit terms require payment within thirty days from the date of shipment or upon customer acceptance for installation sales.

Allowance for Doubtful Accounts--We provide an allowance for doubtful accounts based on our continuing evaluation of our customers' credit risk and on specifically identified amounts that we believe to be un-collectable. We also record additional allowance based on certain percentages of our aged receivables, which are determined based on historical experience and our assessment of the general financial conditions affecting our customer base. If our actual collections experience changes, revisions to our allowance may be required. We have a limited number of customers with individually large amounts due at any given balance sheet date. Any unanticipated change in one of those customer's credit worthiness or other matters affecting the collectability of amounts due from such customers, could have a material affect on our results of operations in the period in which such changes or events occur. After all attempts to collect a receivable have failed, the receivable is written off against the allowance.

Sources of Supply--The Company currently purchases important components of its products, from a limited selection of suppliers. Although there are a limited number of manufacturers of these components, management believes that the other suppliers could provide similar components on comparable terms. A change in suppliers, however, could cause a delay in manufacturing and a possible loss of sales, which could affect operating results adversely.

Inventory--Inventory, comprised of raw materials, work in process, finished goods and spare parts, is stated at the lower of cost (weighted average method) or market. We periodically evaluate our on-hand stock and make appropriate disposition of any stock deemed excess or obsolete. Inventories at January 31, 2004 and 2003 consist of:

	2004	2003
Raw material	$ 20,744	$10,767
Work in process	3,133	2,804
Finished goods	5,416	6,326
	29,293	19,897
Less: Valuation reserve	(15,400)	(5,963)
	$ 13,893	$13,934

Marketable Securities--Marketable securities at January 31, 2004 consist of investments in Entrada Networks, Inc ("ENI"). Our investment in ENI is classified as available for sale and is 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 recorded against other comprehensive income when a decline in fair value is determined to be other than temporary. At January 31, 2004, and 2003 marketable securities were as follows:

	Cost	Unrealized Gains	Market Value
January 31, 2004:			
Entrada	$ 31	$ 56	$ 87
Certificate of Deposit	416	1	417
	$ 447	$ 57	$ 504

January 31, 2003:			
DIGI	$1,009	$2,884	$3,893
Entrada	22	44	66
	------	------	------
	$1,031	$2,928	$3,959
	======	======	======

On August 31, 2000, we completed a merger of our then subsidiary 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 $3.3 million. 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.

On December 9, 2002, we sold one-half of our holdings in DIGI for $3.10 per share. The purchaser of the stock was DIGI, itself. The proceeds from this sale, in the amount of $3.6 million, were deposited on December 13, 2002. The remaining 1,162,341 DIGI shares were sold on May 2, 2003 for $4.26 per share. The purchase, of the stock was again DIGI. The proceeds from this sale in the amount of approximately $5 million, were deposited on May 7, 2003.

In accordance with a settlement agreement reached between Sorrento Networks and our former Chairman and Founder, Par Chadha, 566,000 shares of ENI stock were transferred to Mr. Chadha in exchange for mutual releases

by the Company and Mr. Chadha and certain of his affiliates. The stock transfer was complete on July 1, 2003 and had a value of $88 thousand. In addition, we transferred 128,214 shares of ENI stock to settle a dispute between a former employee and the Company. The value of the transfer was $20 thousand and was complete on July 16, 2003.

The remaining 458,286 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 maker value, as reported on NASDAQ, is a separate element of stockholders' equity and is included in the computation of comprehensive income.

Fair Value of Financial Instruments--The fair value of financial instruments is determined by reference to various market data and other valuation techniques as appropriate. We believe that there are no material differences between the recorded book values of our financial instruments and their estimated fair value.

Property and Equipment--Property and equipment are recorded at historical cost. Depreciation and amortization are provided over the estimated useful lives of the individual assets or the terms of the leases if shorter using accelerated and straight-line methods. Property and equipment are reviewed for impairment whenever events or circumstances indicate that the asset's undiscounted expected cash flows are not sufficient to recover its carrying amount. We measure impairment loss by comparing the fair market value, calculated as the present value of expected future cash flows, to its net book value. Impairment losses, if any, are recorded currently.

Capitalized Leases--Capitalized leases are initially recorded at the present value of the minimum payments at the inception of the contracts, with an equivalent liability categorized as appropriate under current or non-current liabilities. Such assets are depreciated on the same basis as described above. Interest expense, which represents the difference between the minimum payments and the present value of the minimum payments at the inception of the lease, is allocated to accounting periods using a constant rate of interest over the lease.

Purchased Technology--Technology assets were acquired in connection with historical acquisition.These assets were analyzed during and after the close of the acquisition. The undiscounted projected future cash flows from the purchased technology are compared to its carrying value to indicate any impairment. No impairment has been identified. The carrying value is $110 thousand and is amortized over its remaining estimated economic life (7 years) using the straight-line method. Accumulated amortization was $2.7 million and $2.4 million at January 31, 2004 and 2003, respectively.

We assess the recoverability of purchased technology primarily by determining whether the amortization of the net book value of purchased technology over its remaining life can be recovered through undiscounted future operating cash flows of the acquired operation. The amount of the impairment, if any, of the net book value of the excess cost over net assets acquired is measured by determining the fair value of these assets primarily based on projected discounted future operating cash flows from the purchased technologies using a discount rate commensurate with our cost of capital.

Research and Development--We expense research and development costs as incurred in accordance with Statement of Financial Accounting Standards ("SFAS") No. 2, "Accounting for Research and Development Costs." Research and development costs are costs associated with products or processes for which technological feasibility has not been proven and future benefits are uncertain. In-process research and development purchased by us includes the value of products and processes in the development stage and have not reached technological feasibility; this amount is expensed at the date of purchase.

Other investments--Other investments in fiscal 2004, included in other assets, include non-marketable securities held in other companies including a privately held competitive local exchange carrier, and a broadband services carrier, UFO Communications, Inc. ("UFO"). The investment in UFO, $5.03 million, was written down to zero value in fiscal 2004, when a secondary round of financing was concluded in which we chose not to participate.

Revenue Recognition--We generally recognize product revenue when the products are shipped, all substantial contractual obligations, if any, have been satisfied, and the collection of the resulting receivable is reasonably assured. When title does not pass to the customer at time of shipment, revenue is not recognized until all contractual requirements are met and title has transferred. During this transition period, the amount of the sale and/or installation is shown in deferred revenue.

To date, installation revenue has not been material. Revenue from service obligations, if any, is deferred and recognized over the life of the contract. Inventory or demonstration equipment shipped to potential customers for field trials is not recorded as revenue. We accrue for warranty costs, sales returns and other allowances at the time of shipment. Although our products contain a software component, the software is not sold separately and we are not contractually obligated to provide software upgrades to our customers.

Warranty and Customer Support--We typically warrant our products against defects in materials and workmanship for a period of one to five years from the date of sale and a provision for estimated future warranty and customer support costs is recorded when revenue is recognized. To date, warranty and customer support costs have not been material.

Income Taxes--Income taxes are accounted for in accordance with Statement of Financial Accounting Standards No. 109 "Accounting for Income Taxes." The statement employs an asset and liability approach for financial accounting and reporting of deferred income taxes generally allowing for recognition of deferred tax assets in the current period for future benefit of net operating loss and research credit carry forwards as well as items for which expenses have been recognized for financial statement purposes but will be deductible in future periods. A valuation allowance is recognized, if on the weight of available evidence it is more likely than not that some portion or all of the deferred tax assets will not be realized. (See Note L)

Advertising--We expense advertising expenditures as incurred.

Loss Per Common Share--We compute earnings per share based on the provision of SFAS No. 128, "Earnings Per Share." Basic income and loss per common share is computed by dividing net income or loss available to common shareholders by the weighted average number of common shares outstanding during each period presented. Diluted EPS is based on the weighted average number of common shares outstanding as well as dilutive potential common shares, which in our case consist of convertible securities outstanding, shares issuable under stock benefit plans, and shares issuable pursuant to warrants. In computing diluted EPS, net income or loss available to common shareholders is adjusted for the after-tax amount of interest expense recognized in the period associated with convertible debt. Potential common shares are not included in the diluted loss per share computation for the years ended January 31, 2004, 2003 and 2002 as they would be anti-dilutive. All references in the financial statements of common shares and per share data give effect to the 1-for-20 stock split effective October 28, 2002. (See Note M)

Foreign Currency Translation--Our foreign operations have been translated into U.S. dollars in accordance with the principles prescribed in SFAS No. 52, "Foreign Currency Translation." For the periods presented the current rate method was used whereby all assets and liabilities are translated at period end exchange rates, and the resultant translation adjustments would have been included as a separate component of stockholders' equity had such adjustments been material. Revenues and expenses are translated at the average rates of exchange prevailing throughout the period, and the resultant gains and losses are included in net earnings.

Stock-Based 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. The amount of deferred stock compensation 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 our Sorrento subsidiary granted by it to its employees; during the fiscal years ended January 31, 2004, 2003 and 2002, we amortized $51 thousand, $250 thousand and $625 thousand of the total $2.6 million 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 (SFAS) No. 123, "Accounting for stock-Based Compensation," and Emerging Issues Task 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 Networks subsidiary granted by it to its consultants; during the fiscal years ended January 31, 2004, 2003 and 2002, we recorded $46 thousand, $183 thousand and $187 thousand for options granted to consultants.

Computer Software for Internal Use--Statement of Position ("SOP") 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use," is effective for financial statements with fiscal years

beginning after December 15, 1998. The SOP provides guidance on accounting for the costs of computer software developed or obtained for internal use. The SOP requires that we continue to capitalize certain costs of software developed for internal use once certain criteria are met. The adoption of SOP 98-1 had no effect on our financial position or results of operations.

In January 2003, the FASB issued FASB Interpretation ("FIN") No. 46, "Consolidation of Variable Interest Entities", and interpretation of Accounting Research Bulletin No. 51, "Consolidated Financial Statements", FIN No. 46 explains how to identify variable interest entities and how an enterprise assesses its interests in a variable interest entity to decide whether to consolidate that entity. This Interpretation requires existing unconsolidated variable interest entities to be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among parties involved. FIN No. 46 is effective immediately for variable interest entities created after January 31, 2003, and to variable interest entities in which an enterprise obtains an interest after that date. The Interpretation applies in the first fiscal year or interim period beginning after June 15, 2003, to variable interest entities in which an enterprise holds a variable interest that is acquired before February 1, 2003. We adopted FIN No. 46 with no material effect on our financial position or results of operations.

In November 2002, the FASB issued FIN 45, which expands previously issued accounting guidance and disclosure requirements for certain guarantees. FIN 45 requires us to recognize an initial liability for the fair value of an obligation assumed by issuing a guarantee. The provision for initial recognition and measurement of the liability will be applied on a prospective basis to guarantees issued or modified after December 31, 2002. The adoption of FIN 45 did not materially affect our consolidated financial statements.

In August 2001, the Financial Accounting Standards Board issued SFAS No. 143, Accounting for Asset Retirement Obligations. This Statement is effective for fiscal years beginning after June 15, 2002. SFAS 143 provides accounting requirements for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. Under the Statement, the asset retirement obligation is recorded at fair value in the period in which it is incurred by increasing the carrying amount of the related long-lived asset. The liability is accreted to its present value in each subsequent period and the capitalized cost is depreciated over the useful life of the related asset. The adoption of SFAS 143 did not have a material effect on our financial position or results of operations.

In November 2002, the Emerging Issues Task Force ("EITF") reached a consensus on Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables." EITF Issue No. 00-21 provides guidance on how to account for arrangements that involve the delivery or performance of multiple products, services and/or rights to use assets. The provisions of EITF Issue No. 00-21 applied to revenue arrangements entered into in fiscal periods beginning after June 15, 2003.

In December 2003, the SEC issued SAB 104, which supersedes SAB 101, Revenue Recognition in Financial Statements. The primary purpose of SAB 104 is to rescind the accounting guidance contained in SAB 101 related to multiple element revenue arrangements, which was superseded as a result of the issuance of EITF 00-21. We adopted EITF 00-21 and SAB 104 with no material impact on our financial statements.

C. PROPERTY AND EQUIPMENT

Property and equipment of the Company consisted of the following components as of January 31, 2004 and 2003:

	2004	2003
Manufacturing, engineering and plant equipment and software...	$ 17,397	$ 19,822
Office furniture and fixtures................................	3,192	3,154
Land and building..	6,721	6,721
Leasehold and building improvements..........................	1,294	1,294
Total property and equipment..............................	28,604	30,991
Less: Accumulated depreciation and amortization..............	(16,337)	(13,888)
Net book value..	$ 12,267	$ 17,103

Depreciation expense for fiscal 2004, 2003 and 2002 was $ 3.3 million, $3.6 million, and $2.4 million respectively.

D. SHORT TERM DEBT

The Company has no short-term debt other than the current portion of long-term debt.

E. LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS

Long-term debt and capital lease obligations at January 31, 2004 and 2003 consisted of the following:

	2004	2003
Variable rate 30 year mortgage note payable (5.5% over LIBOR rate); interest rate at January 31, 2004 and 2003 was 6.71% and 8.95% respectively.........	$1,253	$1,269
Fixed rate 30 year mortgage note payable; interest rate at January 31, 2004 was 7.6%...	2,332	2,361
Obligations under capital leases (See Note G)...............................	54	237
	3,639	3,866
Less: Current portion...	101	222
	$3,538	$3,644

On March 25, 1996, Meret completed the purchase of a 35,000 square foot facility in San Diego, California for $1,779 in cash. On April 24, 1996, Meret entered into a mortgage agreement with a lender in the amount of $1,331 amortized over 30 years with an adjustable interest rate of 5.5% over the LIBOR rate, adjusted bi-annually. Monthly principal and interest payments are $11 thousand. The interest rate at January 31, 2004 was 6.71%.

In October 2000, we completed our purchase of a 41,000 square foot facility immediately adjacent to our existing San Diego, California facility. The purchase price was $4,805 including the assumption of existing indebtedness of $2,417. Monthly principal and interest payments are $18 and at the end of the 30-year term on January 1, 2010 the remaining balance of $2,109 is due. The loan has a fixed interest rate of 7.6%.

Long- term and capital lease obligations at January 31, 2004 are payable by year as follows:

2005...	$ 101
2006...	54
2007...	58
2008...	63
2009...	68
2010 and later...	3,295
	$3,639

F. DEBENTURES

Debentures - During August 2001, we completed a private placement of our 9.75% convertible debentures receiving net proceeds of $29.8 million. The debentures, due August 2, 2004 had a face value of $32.2 million, which was convertible into our common stock at $144.20 per share. At maturity, we could have elected to redeem the debentures for cash and we had the option of paying the interest on these debentures in shares of our common stock. In addition, the purchasers received four year warrants to acquire an additional 167,592 shares of our common stock at $144.20 per share and the placement agent received five year warrants to acquire 5,583 shares of our common stock, equity securities, options or warrants at a price less than $144.20 per share or at a discount to the then market price. The conversion price and warrant exercise were subject to adjustment.

In accordance with Emerging Issues Task Force ("EITF") No. 00-27 we 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 resulted 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, were amortized as additional interest expense over the period the debentures were outstanding.

On March 6, 2003, we and our wholly-owned subsidiary Sorrento Networks, Inc. entered into an Exchange Agreement with the holders of our 9.75% Senior Convertible Debentures (the "9.75% Debentures") and the Series A Convertible Preferred Stock (the "Preferred Stock") of Sorrento Networks, Inc. The Exchange Agreement and associated documents contemplated an exchange (the "Exchange") of the 9.75% Debentures and the Preferred Stock at closing into shares of common stock and $12.5 million of our new 7.5% Secured Convertible Debentures (the "7.5% Debentures"). Certain holders of the Preferred Stock would also receive additional 7.5% Debentures of approximately $600 thousand to pay certain legal fees. With the elimination of liability from the preferred stock conversion and the reduction in total debt relating to the debentures, offset by the value of the common stock issuance associated with the transaction there was a net gain on the restructuring of $13.7 million.

The Exchange Agreement was approved by shareholders on May 29, 2003 and was completed and became effective on June 4, 2003 pursuant to which we exchanged current outstanding debentures and Series A Preferred Stock for common stock and an issuance of a $13.1 million principal amount of 7.5% Debentures.

Interest expense for fiscal year 2004 on the 9.75% debentures, through the June 4, 2003 exchange date, of $3.5 million included the stated 9.75% interest rate of $1.1 million, amortization of issuance costs of $275 thousand and amortization of the fair value of the warrants issued to the purchasers and placement agent and deemed beneficial conversion feature of $2.2 million.

Interest expense on the 7.5% debentures during fiscal year 2004 was $561 thousand.

The 7.5% debentures are convertible at any time at the option of the holders into shares of common stock at a conversion price of $5.42, the fair value on the date of the exchange. The debentures mature on August 2, 2007 and are secured by substantially all of our assets and those of our subsidiaries (with certain exceptions).

At January 31, 2004 and January 31, 2003 debentures payable for the 7.5% debentures consisted of:

	(thousands)	
	January 31, 2004	January 31, 2003
Face value of 7.5% convertible debentures.....	$11,788	$--
Face value of new debentures for legal fees...	600	--
Book value of debentures at issuance..........	$12,388	$--

G. LEASES, OTHER COMMITMENTS AND CONTINGENCIES

Rental expense under operating leases was $763 thousand, $1.6 million, and $1.3 million for the years ended January 31, 2004, 2003 and 2002, respectively. The table below sets forth minimum payments under capital and operating leases with remaining terms in excess of one year at January 31, 2004:

	Capital Leases	Operating Leases
2005...	$55	$551
2006...	--	152
2007...	--	46
2008...	--	41
2009...	--	34
2010 and thereafter................................	--	--
	55	$824
Less: Amount representing interest...................	(1)	
Present value of minimum annual rentals..............	$54	

The net book value of equipment under capital leases was $495 thousand and $657 thousand at January 31, 2004 and 2003, respectively.

Other Commitments

In March 2001, our Meret subsidiary entered into a $2.7 million supplier agreement. The agreement requires a minimum monthly cash outlay of $50 thousand extending over a period of fifty-four months. The remaining balance at January 31, 2004 of $853 thousand is expected to end in March 2005. The product being acquired is a component used in a product for one of Meret's customers for which there is a five-year sales contract.

Employment contract payments due under change of control provisions under certain employment contracts that may be triggered by the sale of the Company in 2005 is expected to be valued at $783 thousand.

Contingent Liabilities

In the merger agreement among our predecessor corporation (Osicom Technologies, Inc.), Entrada, and Sync Research, Inc., Osicom agreed to indemnify and hold our former subsidiary harmless against liability arising from the termination of a certain pension plan if the subsidiary's losses exceeded $250 thousand, but only for such losses that exceeded $250 thousand. The pension plan was acquired as a result of the purchase of a division of Cray Communications in 1996 which later became Entrada.

Upon the acquisition of this former subsidiary, the seller had the right to terminate the plan for five years following the acquisition and was responsible for funding the plan. If the pension plan was not terminated in the five years following the acquisition, the agreement called for the parties to agree as to a mutually satisfactory arrangement for the termination or continuation of the plan. In the third quarter, we were advised by the successor corporation that the termination cost of the pension plan could total approximately $2.9 million if the plan was terminated. Continued funding of the pension plan also remains an unresolved issue and if funding is not kept current with regard to legal requirements the pension plan could default. We currently hold in escrow approximately $500 thousand in Series D Preferred Stock as a security against possible losses resulting from this pension plan. As of this date, the parties have not agreed to a resolution regarding the pension plan in future periods.

While we do not believe that we are liable for the continued costs associated with future funding or a cost associated upon termination, it is possible the pension plan could result in litigation among the parties if they cannot agree to an acceptable resolution. The Company has reserved approximately $1 million for possible contingencies which we believe is adequate to cover potential claims regarding the plan.

LITIGATION

On June 4, 2003, we consummated the exchange transaction and cancelled all outstanding Series A Convertible Preferred Stock and 9.75% Senior Convertible Debentures. The Exchange Agreement provides that the litigation instituted by the former holders of Series A stock be dismissed without prejudice against the Company, its subsidiaries, its current officers and directors, and other defendants who execute an appropriate release, and without prejudice against all other defendants. This dismissal will require court approval, which is in the process of being obtained by counsel for all parties.

In accordance with a settlement agreement reached between us and our former Chairman and Founder, Par Chadha, 566,000 shares of ENI stock were transferred to Mr. Chadha in exchange for mutual releases by the Company and Mr. Chadha and certain of his affiliates. The stock transfer was complete on July 1, 2003 and had a value of $88 thousand.

In addition, claims in arbitration were filed by two of our former financial officers and employees who worked in our Santa Monica office, which has since been closed, alleging that their resignations in May 2002 were for "good reason" as defined in their employment agreements, all of which were to expire on May 22, 2002. One of the claims was settled in May 2003 for $45 thousand. While the other claim was resolved by an arbitrator in August 2003 who ruled in our favor.

A former officer of our SNI subsidiary brought suit alleging breach of a consulting agreement we entered into with him in March 2002, following his resignation "for good reason" as defined in his employment agreement. He

was seeking acceleration of consulting fees due to him under his consulting agreement in the amount of $229 thousand. This suit was settled on December 1, 2003 for $15 thousand and $150 thousand of Sorrento common stock that was distributed to him June 4, 2003.

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 proceeding and claims, individually and in the aggregate, are not likely to have a material adverse effect on our financial position, results of operations, or cash flows.

I. STOCKHOLDERS' EQUITY

Effective as of October 28, 2002, we implemented a one-for-twenty reverse split of our outstanding shares of common stock. No fractional shares were issued in connection with the reverse stock split. In lieu of fractional shares, stockholders will receive a cash payment based on the market price, after adjustment for the effect of the stock combination. The par value of the common stock changed to $6.00 per share and the number of authorized shares decreased from 150 million to 7.5 million shares of common stock. The reverse stock split also affects options, warrants and other securities convertible into or exchangeable for shares of the Company's common stock that were issued and outstanding immediately prior to the effective time of the stock combination. Preferred stock was not affected.

We are authorized to issue the following shares of stock:

150,000,000 shares of Common Stock ($0.001 par value)

2,000,000 shares of Preferred Stock ($.01 par value) of which the following series have been designated:

3,000 shares of Preferred Stock, Series D

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

We have outstanding the following shares of preferred stock:

	Shares Outstanding	Par Value	Liquidation Preference
Series D............................	1,353	$0.01	$1,353
	1,353	$0.01	$1,353

During January 2001, we issued 86,464 shares of our common stock in conversion of 1,500 shares of our Series D preferred stock. The remaining 1,353 shares of our non-voting, non-dividend bearing Series D preferred stock are being held in escrow pending resolution of acquisition contingencies including liabilities related to funding deficits related to a terminated defined benefit pension plan of Entrada. Payments by the seller towards these liabilities will have no effect on our financial results and payments, if any, by us will reduce the face value of the preferred stock. Each share of Series D preferred stock is convertible into common stock at the market value at the date of conversion and we have the right to redeem the shares prior to conversion for 100% of their conversion value.

J. OTHER CAPITAL STOCK TRANSACTIONS AND BUSINESS ACQUISITIONS

Stock Split--In October 2002, approval was granted for a one-for-twenty reverse stock split effective October 28, 2002. The effect of this stock split was reflected in the financial statements retroactively as if the stock split occurred at the beginning of the earliest period reported.

On June 4, 2003, we consummated the Exchange Agreement and cancelled all outstanding Series A Convertible Preferred Stock. In connection to our capital and corporate restructuring plan, we issued 8,029,578 shares of common stock to the holders of the 9.75% debentures and the Series A Convertible Preferred Stock upon consummation of the Exchange. The Company's $32.2 million in convertible debentures were converted into

common shares of the Company and a portion of $12.5 million in secured convertible 7.5% debentures that mature in August 2007. In addition, all Series A Convertible Preferred Stock were converted into common shares of the Company and a portion of the $12.5 million in secured convertible debentures. The outstanding Series A Convertible Preferred Stock "put" of $48.8 million against SNI was withdrawn. Certain Series A Convertible Preferred stockholders also received a total of $600 thousand in additional secured convertible 7.5% debentures to pay certain legal fees.

There was an aggregate gain, net of tax, on the capital restructuring transaction of $13.6 million. The conversion of the SNI Series A Convertible Preferred Stock into common stock and a portion of the $12.5 million 7.50% convertible debenture resulted in a net gain of $48.8 million. The gain was off-set by the loss on the value of the warrants and beneficial conversion feature on the $32.2 million, 9.75% convertible debentures, converted to common stock and a portion of the 7.50% convertible debenture. The consolidated net gain on the capital restructuring transaction was $13.8 million for the quarter ending July 31, 2003.

On August 8, 2003, we acquired LuxN Inc. for a combination of stock, warrants, and cash. Stockholders of LuxN were given the option of exchanging shares of LuxN stock for either their pro-rata portion of LuxN's net cash or shares of Sorrento's common stock. In addition to the cash or Sorrento common stock, stockholders of LuxN have the right to receive warrants to purchase an aggregate of 400 thousand shares of Sorrento common stock, with an exercise price of $3.05 per share, the fair market value on the date of the acquisition. The warrants will be held in escrow for a period of six months to satisfy any successful indemnification claims. At closing, Sorrento issued 1,374,194 million shares of common stock with an additional 505,146 shares of common stock issued after shareholder approval was received in January 2004.

Private Placements-- The first of two private placements' the Company completed in fiscal 2004, closed on December 31, 2003. In exchange for $6.35 million in gross proceeds, Sorrento issued 2,140,101 new shares of Sorrento common stock, and warrants to purchase 1,070,051 new shares of Sorrento's common stock. The effective price in the private placement was $2.97 for each unit consisting of one share of common stock and a warrant to purchase one-half of a share of common stock. The warrants have an exercise period of five-years with an exercise price of $2.97 per share.

On January 26, 2004, the second private placement was completed raising $10 million in gross proceeds. In connection with the financing, Sorrento issued 2,921,512 new shares of Sorrento common stock and warrants to purchase 1,460,756 new shares of Sorrento's common stock. The effective price in the private placement was $3.44 for each unit. Each unit consists of one share of common stock and a warrant to purchase one-half of a share of common stock. The warrants have an exercise period of five-years and an exercise price of $3.44 per share. The warrants are callable after one year under certain circumstances. The warrants provide for a cashless exercise under certain circumstances.

Business Acquisitions-- The Company acquired LuxN Inc. on August 8, 2003. The results of LuxN's operations have been included in the consolidated financial statements since that date LuxN's product line supplies optical access equipment to the network edge using coarse and dense wavelength division multiplexing (CWDM and DWDM) technology. LuxN's OSMINE-certified products enable delivery of high-bandwidth data, storage, video and voice services for service providers, cable MSOs and enterprises. See the acquisition footenote R.

K. STOCK OPTION PLANS

We have five stock option plans in effect: The 2003 Equity Incentive Plan, 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. We account for these plans under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations. No stock-based employee compensation cost is reflected in net income, as all options granted under these plans had an exercise price equal to the market value of the underlying common stock on the date of grant.

The following table summarizes the activity in the plans:

	Number of	Weighted Average

	Shares	Exercise Price
Shares under option at January 31, 2001.........	253,361	$618.60
Granted....................................	43,685	$150.40
Exercised..................................	(4,913)	$163.40
Canceled...................................	(61,606)	$519.60
Shares under option at January 31, 2002.........	230,527	$566.00
Granted....................................	112,555	$ 25.31
Canceled...................................	(48,805)	$406.62
Shares under option at January 31, 2003.........	294,277	$387.53
Granted....................................	1,953,734	$ 2.93
Canceled...................................	(133,242)	$581.73
Shares under option at January 31, 2004.........	2,114,769	$ 19.77

Additional information relating to stock options outstanding and exercisable at January 31, 2004 summarized by exercise price are as follows:

	Outstanding			Exercisable	
		Weighted Average			
Exercise Price Per Share	Shares	Life (Years)	Exercise Price	Shares	Weighted Aver Exercise Pri
$ 2.88-- $ 19.99........	1,998,542	9.44	3.21	870,917	3.47
$ 20.00-- $ 49.99........	10,671	8.33	31.58	10,666	31.57
$ 50.00-- $ 99.99........	36,868	8.10	56.57	35,067	56.85
$100.00-- $ 199.99........	15,998	5.60	140.23	15,563	140.78
$200.00-- $ 299.99........	4,837	3.62	255.93	4,837	255.93
$300.00-- $ 399.99........	3,078	645	350.79	3,078	350.79
$400.00-- $ 499.99........	13,755	6.29	448.53	13,755	448.53
$500.00-- $ 599.99........	417	2.84	569.20	417	569.20
$600.00-- $ 699.99........	--	--	--	--	--
$700.00-- $ 799.99........	30,503	6.29	718.37	30,503	718.37
$800.00-- $ 899.99........	--	--	--	--	--
$900.00-- $1,382.40........	100	6.00	985.00	100	985.00
$ 2.88-- $1,382.40........	2,114,769	9.30	19.77	984,903	38.86

At January 31, 2004, the Company has five stock-based employee compensation plans.

In order to provide more prominent and frequent disclosures about the effects of stock-based compensation as required under SFAS 148, "Accounting for Stock-Based Compensation - Transition and Disclosure", the following table summarizes the pro forma effect of stock-based compensation on net income and earnings (loss) per share as if the optional expense recognition provisions of SFAS 123 had been adopted.

We account for these plans under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related

Interpretations. No stock-based employee compensation cost is reflected in net loss, as all options granted under these plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net loss and loss per share if the company had applied the fair value recognition provisions of FASB Statement No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation.

	Years Ended January 31,		
	2004	2003	2002
Net loss:			
As reported	$(6,233)	$(26,210)	$(43,136)
Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(3,689)	(5,581)	(3,842)
Pro forma	(9,922)	(31,791)	(46,978)
Loss per share:			
Basic EPS as reported	$ (0.87)	$ (33.29)	$ (62.00)
Pro forma basic EPS	(1.38)	(40.37)	(67.60)
Diluted EPS as reported	(0.87)	(33.29)	(76.32)
Pro forma diluted EPS	(1.38)	(40.37)	(91.80)

BLACK-SCHOLES ASSUMPTIONS

	For the Fiscal Year ending January 31,		
	2004	2003	2002
Expected Life	3 years	3 years	3 years
Volatility	46%	180%	140%
Risk Free Interest Rate Range	1.29 - 2.39%	2.15 - 4.50%	2.91 - 4.50%
Dividend yield	0%	0%	0%
Fair Value Weighted Average of options issued	$ 2.78	$ 22.19	$ 83.60

The fair value of stock options used to compute pro forma net loss and pro forma loss per share disclosures is estimated using the Black-Scholes option-pricing model, which was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, this model requires the input of subjective assumptions, including the expected price volatility of the underlying stock. Projected data for expected volatility and expected life of stock options is based upon historical and other data. Changes in these subjective assumptions can materially affect the fair value estimate, and therefore the existing valuation models may not provide a reliable single measure of the fair value of the Company's employee stock options.

Sorrento Networks Inc.

In addition SNI adopted its 2000 Stock Option/Stock Issuance Plan in February 2000 under which it has granted options to certain of its employees, directors and consultants. All options are generally granted 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, either through immediate purchase of the shares at fair value or as a bonus tied to performance of services or the attainment of prescribed milestones. No milestones were attained and, no stock has been issued under the stock issuance program.

The option activity for this plan for the year ended January 31, 2004 is summarized as follows:

	Number of Shares	Weighted Average Exercise Price
Shares under option at January 31, 2001...	18,735,904	$5.34
Granted..............................	1,193,064	$5.45
Exercised............................	(22,300)	$2.60
Canceled.............................	(4,592,236)	$5.52
Shares under option at January 31, 2002...	15,314,432	$5.30
Canceled.............................	(12,018,429)	$5.39
Shares under option at January 31, 2003...	3,296,003	$4.93
Canceled.............................	(1,409,003)	$4.40
Shares under option at January 31, 2004...	1,887,000	$5.34

Additional information relating to the stock options of SNI outstanding and exercisable at January 31, 2004 summarized by exercise price are as follows:

	Outstanding			Exercisable	
		Weighted Average			
Exercise Price Per Share	Shares	Life (Years)	Exercise Price	Shares	Weighted Average Exercise Price
$2.00...........	55,000	6.05	$2.00	55,000	$2.00
$5.45...........	1,832,000	6.23	$5.45	1,829,750	$5.45
$2.00 - $5.45...	1,887,000	6.22	$5.34	1,844,750	$5.34

The holders of the options of our Sorrento subsidiary may elect to convert all or a portion of their options into options to acquire our stock at a ratio of 78 for one. During the year ended January 31, 2004, no shares were exchanged for FIBR options, during 2003, 2,340,585 shares were exchanged for FIBR options and during January 31, 2002, no options were converted.

Tender Offer

In May 2002, our Board of Directors approved an employees' stock option exchange program. Under the program, employees holding options to purchase Sorrento Networks Corp. common stock were given the opportunity to exchange certain shares of their existing options, those with exercise prices above $150.00 per share, for new options to purchase an equal number of shares of Sorrento common stock. The new options were granted six months and one day after the cancellation of the old options. The exercise price of the new options was $109.00, the market price on the last reported trading price of Sorrento common stock on their grant date. Options for 34,960 shares of Sorrento Networks Corp. common stock were exchanged in the program. (Adjusted for 1-20 reverse split).

Options held by the company's executives and officers were not included in the exchange program.

L. INCOME TAXES

Our provision for taxes on income for the years ended January 31, 2004, 2003 and 2002 consists of:

Year ended January 31, 2004:	
Current....................	$--
Deferred...................	--
Total......................	$--
Year ended January 31, 2003:	
Current....................	$--
Deferred...................	--
Total......................	$--

Year ended January 31, 2002:

Current....................	$--
Deferred...................	--
Total......................	$--

Our domestic operations generate permanent and temporary differences for depreciation, amortization, valuation allowances and tax attributes arising from acquisitions. We have recorded a 100% valuation allowance against our deferred tax assets, including net operating loss and research credit carry forwards, in accordance with the provisions of Statement of Financial Accounting Standards No. 109. Such allowance is recognized if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

	2004	2003
Deferred tax assets:		
Research and development credits...	$ 63	$ 63
Tax loss carry forwards............	56,023	65,754
Purchase accounting................	1,269	2,057
Depreciable assets.................	379	583
Other liabilities and reserves.....	8,633	5,613
Reserve for loss on investment.....	2,010	
Gross deferred tax assets.......	68,377	74,070
Less: valuation allowance..........	(68,377)	(74,070)
Deferred tax asset..............	$ --	$ --

At January 31, 2004, we had federal net operating losses which may be available to reduce future taxable income. Among potential adjustments which may reduce available loss carry forwards, the Internal Revenue Code of 1986, as amended, (IRC), reduces the extent to which net operating loss carry forwards may be utilized in the event there has been an "ownership change" of a company as defined by applicable IRC provisions. We believe that the issuances of its equity securities and transfers of ownership of outstanding equity securities may have resulted in one or more such ownership changes and intends to analyze the impact of such transfers on the continued availability, for tax purposes, of the net operating losses incurred through January 31, 2004. Further ownership changes, as defined by the IRC, may reduce the extent to which any net operating losses may be utilized. The NOLs were reduced under IRC section 108 by $48,804,000 in connection with the capital restructuring. The NOL carry forwards expire as follows:

2020....................	$ 39,483
2021....................	36,780
2022....................	32,508
2023....................	19,480
2024....................	24,367
	$152,618

The reconciliation between income tax expense and a theoretical United States tax computed by applying a rate of 35% for the years ended January 31, 2004, 2003 and 2002, is as follows:

	2004	2003	2002
Income (loss) before income taxes.......	$ (6,233)	$(22,610)	$(43,136)
Theoretical tax (benefit) at 35%........	(2,181)	(7,914)	(15,098)
Impact of non-qualified stock options...	--	--	(434)
Change in Valuation Allowance...........	(5,693)	10,750	16,862
Other individually immaterial items.....	1,896	(2,836)	(1,330)
Impact of acquisition	(5,978)		--
	$ --	$ --	$ --

M. EARNINGS PER SHARE CALCULATION

The following data show the amounts used in computing basic earnings per share. The number of shares used in the calculations for the years ended January 31, 2004, 2003 and 2002 reflect a 1-for-20 reverse stock split effective October 28, 2002.

	2004	2003	2002
Net loss	$ (6,233)	$(26,210)	$(43,1
Less: deemed dividend	--	--	(1

Net loss available to common shareholders used in basic EPS	$ (6,233)	$(26,210)	$(43,3
Average number of common shares used in basic EPS	7,205,033	787,407	698,3

We incurred a net loss for the years ending January 31, 2004, 2003 and 2002. Accordingly, the effect of dilutive securities including convertible debentures, 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.

	2004	2003	2002
Net loss available to common shareholders used in basic EPS	$ (6,233)	$(26,210)	$(43,3
Interest on convertible debt (net of tax)......................	(639)	(4,826)	(18,4
Net loss available to common shareholders after assumed conversions of dilutive securities..........................	$ (5,594)	$(31,036)	$(61,7
Average number of common shares used in dilutive EPS...........	7,205,033	787,407	808,7

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.

N. OTHER RELATED PARTY TRANSACTIONS

Summarized below are all material related party transactions entered into by us and our subsidiaries during the periods presented not otherwise disclosed in these notes.

In February 2003, we entered into a consulting agreement with Mr. Robert Hibbard, a member of the Board of Directors, to provide services to the company at a consulting rate of $175 per hour plus a retainer of $20 thousand per month for six months. Mr. Hibbard agrees to make himself available to the Company for not less than 20 hours per week. This agreement supersedes his August 2002 consulting agreement and terminated in February 2004. Nearly all of Mr. Hibbard's consulting work for us has involved matters being considered or reviewed by the board or by committees of the board. His work has included structuring and implementing our 2003 Equity Incentive Plan for employees, participation in settlement negotiations for pending litigation, assistance in our capital restructuring and improving our intellectual property policies and procedures, among other matters. In fiscal years 2004 and 2003 Mr. Hibbard was paid $205 thousand and $92 thousand respectively, in consulting fees.

During fiscal 2002, we paid a total of $55 thousand to Phillip W. Arneson as a Director of the Company. The amounts paid included $24 thousand for consulting work performed for a special Committee of the Board, $21 thousand for various other consulting services including outsourcing advice and organizational matters, attendance fees of $6 thousand for Board and Committee meetings and $5 thousand in reimbursable expenses. Consulting fees were paid at a rate equal to normal fees for attendance at Board meetings.

During July 2000, we agreed to loan $300 thousand for three years at the applicable federal rate provided for in Internal Revenue Code Section 1274 to our Senior Vice President, Legal, an officer of the company, associated with his relocation and initial employment. This is a full recourse loan and the officer has pledged his options to acquire our common stock and any options he may receive from any of our subsidiaries as collateral. The officer received $300 thousand in advances under this loan agreement for which the interest rate is 6.6%. On July 3, 2002 a new note covering the $300 thousand was incorporated in his employment contract. The term remained the same as the July 2000 note, with all unpaid, accrued interest and principal due and payable on August 30, 2003. In December 2002, the officer paid $39 thousand on his loan that included payment of all prior interest due and the remainder applied to his principal balance. In August 2003, the officer left the employment of the company. As part of his departure, the officer signed filing documents that if were to not repay the loan, these documents could be used to obatin a default judgment in favor of the company. As of January 31, 2004 the former officer's loan outstanding to the Company totaled $298. Subsequent to our fiscal year end the former officer has made, payments against the loan to keep it in good standing.

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 thousand per year for three years of consulting services and loans by us for the exercise of previously granted options to acquire 58,925 options at prices varying from $140.60 to $985.00 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 3,556 options, applying the $500 thousand accelerated payment to the exercise. In addition, he exercised 25,369 options for which we are contractually obligated to loan the $5.0 million 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 25,369 option exercise was rescinded. Mr. Chadha returned the 25,369 shares to us for cancellation and we cancelled the receivable due from him and restored the original option agreements. The required non-cash expense as a result of the rescission equal to the difference between the amount of the loan receivable and the market value of the returned shares was recorded as a reserve of $2.7 million against the receivable during the year ended January 31, 2002 and is included in other operating expenses in the accompanying income statement. This rescission agreement did not resolve any underlying dispute as to the option loan repayment obligations. In accordance with a settlement agreement reached between us and our former Chairman and Founder, Par Chadha, 566,000 shares of ENI stock were transferred to Mr. Chadha in exchange for mutual releases by the Company and Mr. Chadha and certain of his affiliates. The stock transfer was complete on July 1, 2003 and had a value of $88 thousand.

On September 30, 2001, our then Chairman and CEO executed a two year consulting agreement with a senior officer of the company, whereby he was to to be paid a salary at $250 thousand per year plus benefits and the vesting of all his options to acquire our common stock. In July 2002, a dispute arose in the agreement whereby the company stopped payment of the monthly consulting fees. In August 2003, the dispute was resolved by the company paying $197 thousand in full settlement and a mutual release of claims. The settlement included $15 thousand in legal costs incurred by the officer. Upon settlement, the Company received notice from an attorney that stated he represented the officer and the officer had refused to pay his legal fees and was notifying us that an attorney's lien was being placed on the settlement proceeds for his portion. As a result of the notice, $70 thousand was placed in escrow with our legal firm pending release upon resolution with the officer and his attorney.

O. SUPPLEMENTAL CASH FLOW DISCLOSURES

Interest expense for the years ended January 31, 2004, 2003 and 2002 was $4.4 million, $9.7 million, $3.3 million and, respectively. During fiscal 2004, $248 thousand was paid in cash and the remaining $4.4 million neither provided for nor used cash. For fiscal years 2003 and 2002, $9.3 million and $2.6 million of the interest expense neither provided nor used cash.

P. CONCENTRATIONS 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 and limits. At times such amounts may exceed the F.D.I.C. limits. We limit the amount

of exposure with any one financial institution and believe that no significant concentration of credit risk exists with respect to cash investments. No accounts at a single bank accounted for more than 10% of current assets.

Although we are directly affected by the economic well being of significant customers listed in the following tables, we do not believe that significant credit risk exists at January 31, 2004. We perform ongoing evaluations of our customers and require letters of credit or other collateral arrangements as appropriate. Accordingly, trade receivable credit losses have not been significant.

The following data shows the customers accounting for more than 10% of net receivables at January 31 2004 and 2003:

	2004	2003
Customer A	--%	29.6%
Customer B	--	18.7
Customer C	10.3	--
Customer D	10.7	15.9
Customer E	1.1	31.2

The following data shows the customers accounting for more than 10% of net sales during the years ended January 31, 2004, 2003 and 2002:

	2004	2003	2002
Customer A	10.7%	23.0%	14.9%
Customer B	13.6	19.0	23.9
Customer C	0.4	12.2	16.3
Customer D	0.2	1.3	7.8
Customer E	6.6	0.6	6.9
Customer F	0.7	--	5.6
Customer G	12.2	--	0.5

As of January 31, 2004 we had the following Notes Receivable from one of our customers:

Notes Receivable

	Payments due in fiscal years						
	Total	2005	2006	2007	2008	2009	Therea
Long-term Notes Receivable 5%	$325	$242	$83	$--	$--	$--	$-

The company holds a single note maturing April 2005.

Q. SUBSEQUENT EVENTS

On April 22, 2004, Sorrento Networks Corporation, a Delaware corporation ("Sorrento"), entered into an Agreement and Plan of Merger, dated as of April 22, 2004, with Zhone Technologies, Inc., a Delaware corporation ("Zhone") and Selene Acquisition Corp., a Delaware corporation and wholly-owned subsidiary of Zhone ("Merger Sub"). Pursuant to the Merger Agreement and subject to the terms and conditions set forth therein, Merger Sub will merge with and into Sorrento, with Sorrento surviving as a wholly-owned subsidiary of Zhone (the "Merger"). At the effective date of the Merger, each outsatanding share of Sorrento common stock will be exchanged for 0.9 shares of Zhone common stock, and each option, warrant and other securities exercisable or convertible into shares subject to the approval of the stockholders of both Zhone and Sorrento and other customary closing conditions.

On March 8, 2004 the warrants and cash were distributed thereby resolving all purchase price contingencies associated with the purchase of LuxN, Inc. As part of the LuxN, Inc. purchase consideration, the Company had

placed 400,000 warrants and cash into excrow pending the expiration of an indemnification period for the Company. The Company has reflected the resolution of these purchase price contigencies as of January 31, 2004.

R. BUSINESS ACQUISITION

On August 8, 2003, we completed our acquisition of LuxN, Inc., pursuant to an Agreement and Plan of Merger, dated as of June 25, 2003, between Sorrento and LuxN. At the effective time of the merger, our wholly-owned subsidiary, Lambda Acquisition Corp., was merged with and into LuxN, with LuxN being the surviving corporation in the merger.

As consideration for the transaction, holders of LuxN's Series A-1 Preferred Stock with an aggregate pro-rata portion of $14.8 million of LuxN's net cash held elected to receive cash at closing, and holders of LuxN's Series A-1 Preferred Stock with an aggregate pro-rata portion of $3.8 million of LuxN's net cash held elected to receive our common stock at closing. We issued 1,374,194 shares of our common stock to the holders of LuxN's Series A-1 Preferred Stock at the closing, and issued an additional 505,153 shares upon receipt of our shareholders' approval. In addition, we issued warrants to purchase 400,000 of our shares of common stock at an exercise price of $3.05 per share to the holders of LuxN's Series A-1 Preferred Stock

The aggregate purchase price was $20.9 million including $14.8 million in cash,$4.9 million of common stock, $878 thousand of warrants and $414 of related costs. The Company issued 1,879,347 shares of common stock valued at the date of issuance and 400,000 warrants with an exercise price of $3.05 valued on the date of issuance.. Upon valuing the purchase price and allocating the purchase price to the assets acquired and liabilities assumed, it was determined that the net assets exceeded the purchase price by $87 thousand. This excess of net assets acquired over the amount paid for the acquisition is reflected as a reduction to long lived assets.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition.

	At August 8, 2003 (in thousands)
Current assets	$25,901
Property, plant and equipment	--
Intangible assets	--
Total assets acquired	25,901
Current liabilities	(4,918)
Total liabilities assumed	(4,918)
Net assets acquired	$20,983

Consolidated Pro Forma Statement of Operations as of January 31, 2004
(in thousands)

	Sorrento Networks Consolidated	LuxN, Inc	Total
Revenue	$21,611	$ 5,313	$ 26,924
Net (Loss)	(3,674)	(7,579)	(11,253)
Earnings per Share	(0.51)	(1.05)	(1.56)

Consolidated Pro Forma Statement of Operation as of January 31, 2003
(in thousands)

	Sorrento Networks Consolidated	LuxN, Inc	Total
Revenue	$ 25,137	$ 3,958	$ 29,095
Net (Loss)	(26,210)	(27,325)	(53,535)
Earnings per Share	(12.13)	(12.64)	(24.77)

S. SEGMENT INFORMATION

Information for the years ended January 31, 2004, 2003 and 2002 in the table below is presented on the same basis utilized by the Company to manage its business. The segments according to product lines are as follows: Sorrento Networks, and LuxN are "Optical Networking", Meret, and other. Export sales and certain income and expense items are reported in the geographic area where the final sale to customers is made, rather than where the transaction originates. We have no material long-term assets outside the United States. The accounting policies of the segments are the same as the policies described in the "Summary of Significant Accounting Policies." Each segment operates independent of one another. The company evaluates the performance of each segment and distributes resources to them based on earnings before income taxes, excluding corporate charges ("Segment income (loss) from operations"). Any corporate charges that are allocated to the segments are allocated as a percentage of revenue. These charges, if any, are recorded under "other income (expenses)" and are eliminated in the consolidation process. "Other income (expenses) is not shown in the supplemental segment information contained below.

Geographical Information

The table below present external revenues based on the locations of the customer:

	2004	2003	2002

Net sales:			
United States	$18,445	$14,803	$28,341
Asia	1,562	865	1,340
Europe	5,455	9,469	10,130
Other	--	--	1,016
Total net sales	$25,462	$25,137	$40,827

Products and Service Revenue

The table below presents external revenues for groups of similar products and services:

	2004	2003	2002
Net sales:			
Optical networking	$22,592	$22,373	$36,034
Switching and access	2,870	2,764	4,793
Total net sales	$25,462	$25,137	$40,827

Supplemental Segment Information:

	Optical Networking	Meret	Other	Consolidated
As of January 31, 2004:				
Revenues from external customers	$ 22,592	$ 2,870	$ --	$ 25,462
Cost of goods sold	17,370	2,399	--	19,769
Gross profit	5,222	471	--	5,693
Segment income/(loss) from operations	(14,862)	235	(3,007)	(17,634)
Depreciation and amortization expense	3,168	410	95	3,673
Valuation allowance additions (reductions):				
Receivables and inventory	(4,931)	(1,822)	--	(6,753)
Capital asset additions, net	(1,611)	7	--	(1,604)
Total assets	35,045	4,512	20,539	50,096

	Optical Networking	Meret	Other	Consolidated
As of January 31, 2003:				
Revenues from external customers	$ 22,373	$ 2,764	$ --	$ 25,137
Cost of goods sold	19,257	2,560	--	21,817
Gross profit	3,116	204	--	3,320
Segment income/(loss) from operations	(25,017)	(1,329)	(4,929)	(31,329)
Depreciation and amortization expense	3,257	702	103	4,063
Valuation allowance additions:				
Receivables and inventory	(704)	(316)	--	(1,020)
Capital asset additions, net	3,201	62	70	3,333
Total assets	31,497	5,375	18,933	55,805

	Optical Networking	Meret	Other	Consolidated
As of January 31, 2002:				
Revenues from external customers	$ 36,034	$4,793	$ --	$ 40,827
Cost of goods sold	28,384	3,123	--	31,507
Gross profit	7,650	1,670	--	9,320
Segment income/(loss) from operations ...	(28,993)	246	(8,407)	(37,154)
Depreciation and amortization expense ...	2,039	543	212	2,794
Valuation allowance additions:				
Receivables and inventory	5,328	269	987	5,597
Other	812	--	1,788	2,600
Capital asset additions, net	3,116	67	52	3,235
Total assets	36,089	7,282	46,968	90,339

T. VALUATION AND QUALIFYING ACCOUNTS

Changes in the inventory valuation reserve were as follows:

Balance at January 31, 2001	$ 2,792
Additions charged to costs and expenses	4,038

Amounts used during year	(362)
Balance at January 31, 2002	6,468
Additions charged to costs and expenses	4,152

Amounts used during year	(4,657)
Balance at January 31, 2003	5,963
Balance of LuxN at August 8, 2003	14,134
Additions charged to costs and expenses	692
Amounts used during year	(5,389)
Balance at January 31, 2004	$15,400

Changes in the accounts receivable valuation reserve were as follows:

Balance at January 31, 2001	$ 1,002
Additions charged to costs and expenses	1,558
Amounts used during year	(821)
Balance at January 31, 2002	1,739
Additions charged to costs and expenses	1,531
Amounts used during year	(2,046)
Balance at January 31, 2003	1,224
Balance of LuxN at August 8, 2004	57
Additions charged to costs and expenses	333
Amounts used during year	(1,090)
Balance at January 31, 2004	$ 524

U. UNAUDITED QUARTERLY FINANCIAL DATA (Unaudited)

Amounts in thousands, except per share amounts.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
Year ended January 31, 2004:					
Net sales	$ 7,861	$ 4,476	$ 6,726	$ 6,399	$ 25,462
Gross profit (loss)	1,954	1,363	1,835	541	5,693
Income (loss) from operations	(3,618)	(4,093)	(4,544)	(5,379)	(17,634)
Net income (loss)	(6,222)	12,514	(4,817)	(7,708)	(6,233)
Net income (loss) per share:					
Basic	(7.02)	2.13	(0.47)	(0.66)	(0.87)
Diluted	(14.33)	1.72	(0.47)	(0.66)	(0.87)
Year ended January 31, 2003:					
Net sales	$ 6,003	$ 5,199	$ 5,525	$ 8,410	$ 25,137
Gross profit	1,488	(2,300)	962	3,170	3,320
Loss from operations	3,976	(15,806)	(6,922)	(7,458)	(26,210)

Net loss	3,976	(15,806)	(6,922)	(7,458)	(26,210)
Net loss per share:					
Basic	5.60	(21.40)	(8.86)	(8.42)	(33.29)
Diluted	(25.20)	(45.20)	(34.54)	(32.64)	(33.29)

SIGNATURES

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

SORRENTO NETWORKS CORPORATION

By: /s/ Joe R. Armstrong Date: May 7, 2004

Joe R. Armstrong
Chief Financial Officer
Principal Accounting Officer

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

By: /s/ Phillip W. Arneson Date: May 7, 2004

Phillip W. Arneson
Chairman and Director
Chief Executive Officer

By: /s/ Donne F. Fisher Date: May 7, 2004

Donne F. Fisher
Director

By: /s/ Gary M. Parsons Date: May 7, 2004

Gary M. Parsons
Director

By: /s/ Robert L. Hibbard Date: May 7, 2004

Robert L. Hibbard
Director

By: /s/ Larry J. Matthews Date: May 7, 2004

Larry J. Matthews

Director

By: /s/ Tom Schilling Date: May 7, 2004

Tom Schilling
Director

By: /s/ Don Herzog Date: May 7, 2004

Don Herzog
Director

STATEMENT OF DIFFERENCES

The trademark symbol shall be expressed as.............................. 'TM'
The registered trademark symbol shall be expressed as.................... 'r'
The service mark symbol shall be expressed as........................... 'sm'