CNE GROUP INC
Form 10QSB
August 23, 2004

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-QSB

(Mark One)

|X| Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2004

|_| Transition report under Section 13 or 15(d) of the Exchange Act of 1934

For the transition period from __________ to __________

Commission file number 1-9224

CNE GROUP, INC.
(Exact Name of Small Business Issuer as Specified in Its Charter)

DELAWARE	56-2346563
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

200 West 57th Street, Suite 507, New York, N.Y. 10019
(Address of Principal Executive Offices)

212-977-2200
(Issuer's Telephone Number, Including Area Code)

Check whether the issuer: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 |_|

The number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date.

Class	Outstanding at July 31, 2004
Common stock - par value $.00001	10,640,915 shares

PART I

FINANCIAL INFORMATION

Item 1. Financial Statements.

The following consolidated financial statements of CNE Group, Inc. and subsidiaries (collectively referred to as the "Company," unless the context requires otherwise) are prepared in accordance with the rules and regulations of the Securities and Exchange Commission for

Form 10-QSB and reflect all adjustments (consisting of normal recurring accruals) and disclosures which, in the opinion of management, are necessary for a fair statement of results for the interim periods presented. It is suggested that these financial statements be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2003, which was filed with the Securities and Exchange Commission.

The results of operations for the three and six months ended June 30, 2004 are not necessarily indicative of the results to be expected for the entire fiscal year.

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CNE GROUP, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

	June 30, 2004 (Unaudited)	December 31, 2003
ASSETS		
Current:		
Cash and cash equivalents	$ 51,592	$ 460,832
Accounts receivable, net of allowance for doubtful accounts of $64,707 in 2004 and $51,500 in 2003	280,165	208,358
Inventory	315,132	246,719
Other	10,459	27,840
Total current assets	657,348	943,749
Fixed assets, net	438,585	447,579
Intellectual property rights, net	1,418,547	1,475,145
Goodwill	7,285,894	7,285,894
Other assets	18,961	18,961
Total assets	$ 9,819,335	$ 10,171,328
LIABILITIES		
Current:		
Accounts payable and accrued expenses	$ 1,235,381	$ 1,030,203
Short-term credit arrangements	68,504	210,093
Notes payable	190,422	146,988
Debenture payable	100,000	100,000
Total current liabilities	1,594,307	1,487,284
Notes payable, net of current portion	331,921	326,045
Subordinated notes payable	916,784	1,767,000
Deferred revenue	22,610	23,620
Deferred grant revenue	300,000	300,000
Total liabilities	3,165,622	3,903,949

Commitments and contingencies (Note 1)

STOCKHOLDERS' EQUITY

Preferred stock (Note D)	134	124
Common stock (Note E)	119	101
Paid-in surplus	29,869,187	28,258,215
Accumulated deficit	(20,342,627)	(19,117,961)
	9,526,813	9,140,479
Less treasury stock, at cost - 1,238,656 shares	(2,873,100)	(2,873,100)
Total stockholders' equity	6,653,713	6,267,379
Total liabilities and stockholders' equity	$ 9,819,335	$ 10,171,328

See Notes to Consolidated Financial Statements.

CNE GROUP, INC. AND SUBSIDIARIES

Consolidated Statements of Operations

	Three Months Ended June 30,		S End
	2004	2003	2004
	(Unaudited)	(Unaudited)	(Unaudited
Revenues:			
Product sales	$ 261,962	$ 356,093	$ 893,40
Service fee income	262,518	168,519	582,65
Internet related income	25,838	34,819	57,20
	550,318	559,431	1,533,26
Cost of goods sold	281,616	278,353	785,31
Gross profit	268,702	281,078	747,94
Other expenses:			
Advertising	12,208	17,091	36,92
Compensation and related costs	453,030	313,704	821,59
General and administrative	363,083	340,419	663,29
Product development	31,368	--	37,60
Depreciation and amortization	48,857	11,083	96,35
	908,546	682,297	1,655,78
Loss before other income (expenses)	(639,844)	(401,219)	(907,83
Other income (expenses):			

Amortization of debt discount	(24,963)	(116,500)	(149,78
Interest expense	(86,460)	(148,901)	(167,34
Interest income	155	--	29
Loss before provision for income taxes	(751,112)	(666,620)	(1,224,66
Provision for income taxes	--	--	-
Net loss	$ (751,112)	$ (666,620)	$ (1,224,66
Loss per common share - basic and diluted:	$ (.07)	$ (.10)	$ (.1
Weighted average number of common shares outstanding - basic and diluted:	10,640,915	6,490,920	10,349,24

See Notes to Consolidated Financial Statements.

CNE GROUP, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

	Six Months
	2004
	(Unaudited)
Cash flows from operating activities:	
Net loss	$(1,224,666)
Adjustments to reconcile net loss to net cash used in operating activities:	
Depreciation and amortization	96,356
Provision for doubtful accounts	13,207
Issuance of common stock for services	--
Amortization of debt discount	149,784
Changes in:	
Accounts receivable	(85,014)
Inventory	(68,413)
Prepaid expenses and other assets	17,381
Accounts payable, accrued expenses and other liabilities	247,404
Net cash used in operating activities	(853,961)
Cash flows from investing activities:	
Purchase of furniture and equipment	(30,764)
Net cash used in investing activities	(30,764)

Cash flows from financing activities:	
Proceeds from issuance of 10% subordinated notes payable	--
Net proceeds from issuance of 1,750,000 shares of common stock	571,000
Proceeds from issuance of 10% notes payable - other	150,000
Principal repayments on notes payable - other	(245,515)
Payment of accounts receivable due Sellers of Econo-Comm, Inc.	--
Net cash provided by financing activities	475,485
Increase (decrease) in cash and cash equivalents	(409,240)
Cash and cash equivalents at beginning of period	460,832
Cash and cash equivalents at end of period	$ 51,592

See Notes to Consolidated Financial Statements.

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CNE GROUP, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows, continued

Supplemental disclosures of cash flow information related to continuing operations:

Cash paid during the period for:

- Interest
- Income taxes

Non-cash investing and financing activities relating to the acquisition of subsidiaries and certain intellectual property rights, conversion of debt to preferred stock, and forgiveness of interest indebtedness to an officer and an employee of the Company:

- Accounts receivable
- Inventory
- Intellectual property rights
- Intangibles
- Other assets
- Accrued expenses and other liabilities
- Interest payable
- 8% notes payable
- Issuance of preferred stock, at par
- Issuance of common stock, at par
- Paid in surplus

See Notes to Consolidated Financial Statements.

CNE GROUP, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements

NOTE A - THE COMPANY

Business

CNE Group, Inc. (the "Company" or "CNE") is a holding company whose primary operating subsidiary is SRC Technologies, Inc. ("SRC"). SRC, also a holding company, is the parent of Connectivity, Inc. ("Connectivity"), Econo-Comm, Inc. ("ECI") (d/b/a Mobile Communications), and U.S. Commlink, Ltd. ("USCL"). Connectivity, ECI and USCL market, manufacture, repair and maintain remote radio and cellular-based emergency response products to a variety of federal, state and local government institutions, and other vertical markets throughout the United States. SRC has intellectual property rights to certain key elements of these products - specifically, certain communication, data entry and telemetry devices.

The Company also generates revenue from its subsidiary, CareerEngine, Inc., which is engaged in the business of e-recruiting. This segment is not significant to the operations of the Company.

Going Concern

The Company has incurred substantial losses, sustained substantial operating cash outflows and has a working capital deficit at both June 30, 2004 and December 31, 2003. The above factors raise substantial doubt about the Company's ability to continue as a going concern. The Company's continued existence depends on its ability to obtain additional equity and/or debt financing to fund its operations and ultimately to achieve profitable operations. The Company is continuously in the process of raising additional financing and has initiated a cost reduction strategy. At June 30, 2004, management believes that the working capital deficit, losses and negative cash flow will ultimately be improved by (i) the acquisitions of SRC and ECI and (ii) cost reduction strategies initiated in January 2004. There is no assurance that the Company can obtain additional financing or achieve profitable operations or generate positive cash flow. The 2004 and 2003 financial statements do not include any adjustments relating to the recoverability or classification of recorded asset amounts or the amount and classification of liabilities that might be necessary as a result of this going concern uncertainty.

American Stock Exchange Listing

On January 2, 2004, the Company received a notice dated December 31, 2003 from the American Stock Exchange Staff indicating that the Company had demonstrated compliance with the requirements necessary for continued listing on the American Stock Exchange.

As is the case for all listed issuers, the Company's continued listing eligibility will be assessed on an ongoing basis; however, during the year ending December 31, 2004, the Company will be subject to additional scrutiny (as set forth in Section 1009(h) of the AMEX Company Guide) as is the case for any listed company that has regained compliance.

Private Financings

On April 23, 2003, the Company completed a private financing pursuant to which

it issued notes (the "Notes") in the aggregate principal amount of $1,000,000, of which $650,000 was to the officers of the Company, and 4,165,800 ten year cashless Class B Warrants, each to purchase one share of its Common

NOTE A - THE COMPANY (CONTINUED)

Stock at $0.50 per share. The Notes bear interest at the annual rate of 10% payable quarterly and were due on April 30, 2004. The aggregate number of shares for which the Warrants may be exercised must equal 15% of the Company's outstanding Common Stock on a fully-diluted basis. These Warrants are anti-dilutive until the Notes have been repaid. The due date of the Notes may be extended at the Company's option for an additional year in consideration for the issuance of 10-year warrants to purchase an additional 4% of the Company's then outstanding common stock at $0.50 per share. These Warrants would also be anti-dilutive until the Notes have been repaid. In addition, the Company valued the warrants, utilizing the Black-Scholes Pricing Model, at $699,000, which is being accounted for as debt discount and is being amortized ratably over the one-year term of the Notes.

On March 12, 2004, the Company notified the Class B Warrant holders that, to satisfy the 15% non-dilutive provisions of their Warrants, these Warrants were now exercisable for an aggregate of 5,245,200 shares of the Company's common stock at approximately $0.40 per share. On this date, the Company also exercised its option to extend the maturity date of the notes to April 30, 2005 and satisfied the requirement for the additional 4% non-dilutive interest in the Company by issuing to the noteholders Class B Warrants to purchase an additional 1,708,900 shares of the Company's common stock at $0.50 per share. The non-dilutive provisions of the Warrants terminate when all of the notes have been paid in full.

1. On September 17, 2003, the Company sold 1,250,000 shares of its Common Stock at $0.40 per share to an existing noteholder and stockholder of the Company.

2. On January 21, 2004, a secured factoring arrangement with an individual, which amounted to $300,000 at December 31, 2003, was restructured into a $300,000 unsecured Note Payable due February 10, 2005. The individual was also issued Class BB Warrants to purchase 150,000 shares of the Company's common stock at $0.50 per share.

3. On February 10, 2004, the Company sold 1,750,000 shares of its Common Stock at $0.40 per share. The net proceeds of the transaction amounted to $571,000. The Company is using the funds obtained from this financing primarily for working capital purposes.

4. On June 10, 2004, the two holders of the Company's 8% Subordinated Promissory Notes, in the aggregate principal amount of $1,000,000, converted their notes into 1,000,000 shares of the Company's Series AA 8% Cumulative Preferred Stock, par value $0.00001 per share (the "Series AA Preferred Stock"). The aggregate liquidating value of the Series AA Preferred Stock acquired by the converting noteholders, one of whom is an officer and the other an employee of a subsidiary of the Company, is $1,000,000.

5. On June 28, 2004 the Company repaid, in full, one of its outstanding

lines of credit amounting to approximately $146,000. On the same date the Company issued a secured note payable to an officer and employee of a subsidiary of the Company in the amount of $150,000. The note is secured by the equipment of a subsidiary of the Company. The note bears interest at 10% per annum and the principal and all interest thereon is due September 28, 2004.

6. On June 28, 2004 an officer and employee of a subsidiary relinquished all their rights to an aggregate 420,000 vested incentive stock options of the Company for an aggregate payment of $50,000 cash which is included in compensation and related costs

NOTE A - THE COMPANY (CONTINUED)

7. As of July 1, 2004 80% of the holders of the Company's 10% subordinated notes agreed to defer $20,000 of interest due on such date to October 1, 2004 in consideration of the Company issuing to them 153,846 Class B Warrants of the Company, each to give the holder thereof the right to purchase a share of common stock at $0.39 per share. The noteholders included two officers of the Company.

8. In June 2004, in an effort to conserve the financial resources of the Company, the Board of Directors of the Company deferred 100% of the salaries of four officers of the Company until such time as the Board deems otherwise. The accompanying financial statements include the accrued salaries owed to these officers for the amounts so deferred.

The Company is using the funds obtained from these financings primarily for working capital purposes as well as to pay certain ECI notes payable. The aforementioned financings were effected pursuant to the exemption from the registration provisions of the Securities Act of 1993 provided by Section 4(2) thereof.

NOTE B - SIGNIFICANT ACCOUNTING POLICIES

[1] Inventory:

Inventory is stated at the lower of cost (determined by first-in, first-out method) or market. The Company's inventory consists of the following:

	June 30, 2004	December 31, 2003
Raw materials	$286,632	$158,347
Work in progress	28,500	3,089
Finished goods	--	85,283
Total	$315,132	$246,719

[2] Income (loss) per share:

Basic and diluted earnings (loss) per common share have been computed in accordance with SFAS No. 128, "Earnings Per Share." Basic earnings per share ("BEPS") is computed by dividing net income (loss) by the weighted-average number of common shares outstanding during the three and six month periods ended June 30, 2004 and 2003, respectively. Common stock equivalents to purchase common stock of the Company that were outstanding at June 30, 2004 and June 30, 2003 were not included in the computation of diluted net loss per share as their effect would have been anti-dilutive.

[3] Stock-based compensation:

As permitted under SFAS No. 123, Accounting for Stock-based Compensation (SFAS No. 123), the Company has elected to continue to follow the guidance of APB Opinion No. 25, Accounting for Stock Issued to Employees (APB No. 25), and Financial Accounting Standards Board

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Interpretation No. 44, Accounting for Certain Transactions Involving Stock Compensation--an interpretation of APB Opinion No. 25 (FIN No. 44), in accounting for its stock-based employee compensation arrangements. Accordingly, no compensation cost is recognized for any of the Company's fixed stock options granted to employees when the exercise price of each option equals or exceeds the fair value of the underlying common stock as of the grant date for each stock option. Changes in the terms of stock option grants, such as extensions of the vesting period or changes in the exercise price, result in variable accounting in accordance with APB Opinion No. 25. Accordingly, compensation expense is measured in accordance with APB No. 25 and recognized over the vesting period. If the modified grant is fully vested, any additional compensation costs is recognized immediately. The Company accounts for equity instruments issued to non-employees in accordance with the provisions of SFAS No. 123.

At June 30, 2004 and December 31, 2003, the Company had a stock-based employee compensation plan - the 2003 Plan. Two of Company's subsidiaries each had separate stock-based employee compensation plans. These subsidiaries' plans were contractually terminated by the Company upon the acquisition of SRC and ECI on April 23, 2003. Furthermore, on March 14, 2003, all recipients of options granted pursuant to these plans rescinded all of their interests.

As permitted under SFAS No. 148, Accounting for Stock-Based Compensation--Transition and Disclosure, which amended SFAS No. 123, the Company has elected to continue to follow the intrinsic value method in accounting for its stock-based employee compensation arrangements as defined by APB No. 25 and related interpretations including FIN No. 44. The following table illustrates the effect on net loss and loss per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation for options granted under its plan.

Six Month Period

	Ended June 30,	
	2004	2
Net loss, as reported	$(1,224,666)	$ (9
Less, Total stock-based employee compensation expense determined under fair value-based method for all awards, net of related tax effects	(168,280)	
Pro forma net loss	$(1,392,946)	$ (9
Net loss per share - basic and diluted:		
As reported	$ (0.12)	$
Pro forma	$ (0.13)	$

On April 30, 2003, incentive stock options to purchase 1,987,500 shares of the Company's Common Stock were granted by the Incentive Compensation Committee to five officers (1,800,000) and one employee (187,500) of the Company at a weighted average exercise price of $1.32 per share. On November 4, 2003, incentive stock options to purchase 950,000 shares of the Company's Common Stock were granted by the Incentive Compensation Committee to

three officers of the Company at a weighted average exercise price of $1.09 per share. On January 21 2004, incentive stock options to purchase 601,000 shares of the Company's common stock were granted by the Incentive Compensation Committee of the Board of Directors to one officer and 18 employees of the Company at a weighted average exercise price of $0.50 per share. On April 30, 2003 (435,000), November 4, 2003 (220,000), November 21, 2003 (100,000) and January 21, 2004 (295,500), non-qualified stock options to purchase an aggregate 1,050,500 shares of the Company's Common Stock were granted by the Board of Directors to certain independent contractors of the Company. On June 10, 2004 an officer and an employee of a subsidiary of the Company relinquished all their rights to an aggregate of 420,000 incentive stock options in consideration of $50,000 cash. No options granted have been exercised.

[4] Research and development expenditures:

Research and development expenditures in connection with the development of new products are expensed as incurred unless the costs are related to a contractual arrangement.

[5] Recent accounting pronouncements:

In January 2003, the FASB issued FASB Interpretation No. 46 ("FIN 46"),

"Consolidation of Variable Interest Entities." In general, a variable interest entity is a corporation, partnership, trust, or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. In December 2003 the FASB issued FIN 46R which revised certain elements of FIN 46. The consolidation requirements of FIN 46R apply immediately to variable interest entities created after January 31, 2003. The consolidation requirements apply to older entities in the first fiscal year or interim period beginning after December 15, 2003. Certain of the disclosure requirements apply in all financial statements issued after January 31, 2003, regardless of when the variable interest entity was established. The adoption of this statement has had no effect on the Company's financial position or results of operations.

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" ("SFAS No. 149"). SFAS No. 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities under FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities". This Statement requires that contracts with comparable characteristics be accounted for consistently as either derivatives or hybrid instruments. This Statement is effective for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003. The adoption of this statement has had no effect on the Company's financial statements.

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CNE GROUP, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." SFAS No. 150 changes the accounting for certain financial instruments that under previous guidance issuers could account for as equity. It requires that those instruments be classified as liabilities in balance sheets. The guidance in SFAS No. 150 is generally effective for all financial instruments entered into or modified after May 31, 2003, and otherwise is effective on July 1, 2003. The adoption of this statement has had no effect on the Company's financial statements.

NOTE C - CONVERSION OF 8% SUBORDINATED NOTES PAYABLE

On June 10, 2004, the two holders of the Company's 8% Subordinated Notes Payable, in the aggregate principal amount of $1,000,000, converted their notes into 1,000,000 shares of the Company's Series AA 8% Cumulative Preferred Stock, par value $0.00001 per share (the "Series AA Preferred Stock"). The aggregate liquidating value of the Series AA Preferred Stock acquired by the converting noteholders, one of whom is an officer and the other an employee of a subsidiary of the Company, is $1,000,000. Including the aforementioned conversion, the Company currently has issued and outstanding an aggregate of 2,000,000 shares of

Series AA Preferred Stock, which has a liquidating preference of $2,000,000 over all other equity of the Company.

NOTE D - PREFERRED STOCK

Preferred Stock consists of the following:

	June 30, 2004	December 31, 2003
Par value per share	$ 0.00001	$ 0.00001
Authorized number of shares	25,000,000	25,000,000
Issued and outstanding number of shares:		
Series AA	2,000,000	1,000,000
Series A	1,697,966	1,697,966
Series B	4,400	4,400
Series C	9,735,875	9,735,875
Total	13,438,241	12,438,241

The Series AA Preferred Stock has an 8% cumulative dividend, payable in common stock or cash, and a liquidating preference over all other CNE equity of $2,000,000. The Series A Preferred Stock has a liquidating preference over all other CNE equity except the Series AA of $1,697,961. The Series B Preferred Stock has a liquidating preference over all other CNE equity except the Series AA and A Preferred Stock of $440,000. The Series C Preferred Stock has no liquidating preference.

NOTE E - COMMON STOCK

Common Stock consists of the following:

	June 30, 2004	December 31, 2003
Par value per share	$ 0.00001	$ 0.00001
Authorized number of shares	40,000,000	40,000,000
Issued number of shares	11,879,571	10,129,571
Less, Treasury shares	(1,238,656)	(1,238,656)
Issued and outstanding number of shares	10,640,915	8,890,915

NOTE F - WARRANTS

Outstanding warrants to acquire common stock of the Company consists of:

Type of Warrant	Exercise Date	Expiration Date	Exercise Price	June 30, 2004 Shares o
Class A	October 22, 2008	April 22, 2013	$1.00	1,697,966
Class B	April 23, 2003	April 30, 2013	$0.50	--
Class B	April 23, 2003	April 30, 2013	$0.40	5,245,200
Class B	March 12, 2004	April 30, 2013	$0.50	1,708,900
Class BB	May 10, 2003	May 10, 2006	$0.50	20,000
Class BB	June 10, 2003	June 10, 2006	$0.50	20,000
Class BB	July 10, 2003	July 10, 2006	$0.50	20,000
Class BB	August 10, 2003	August 10, 2006	$0.50	20,000
Class BB	September 10, 2003	September 10, 2006	$0.50	20,000
Class BB	October 10, 2003	October 10, 2006	$0.50	20,000
Class BB	June 10, 2003	June 10, 2006	$2.50	10,000
Class BB	July 10, 2003	July 10, 2006	$3.00	10,000
Class BB	August 10, 2003	August 10, 2006	$4.00	10,000
Class BB	September 10, 2003	September 10, 2006	$4.50	10,000
Class BB	October 10, 2003	October 10, 2006	$5.00	10,000
Class BB	January 21, 2004	February 4, 2009	$0.50	150,000
Class BB	February 10, 2004	February 10, 2014	$1.00	350,000
Class C	October 22, 2008	April 22, 2013	$1.00	9,735,875
Class F	January 1, 2004	December 31, 2009	$3.00	1,150,000
Class B(1)	Immediate	March 31, 2005	$6.00	25,000
Class B(1)	Immediate	June 28, 2005	$6.00	62,500
				20,295,441

(1) Class B warrants and Units of a subsidiary of the Company are exercisable for the Company's common shares.

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CNE GROUP, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements

NOTE G - ACQUISITIONS AND RELATED UNAUDITED PRO FORMA FINANCIAL INFORMATION

The purchase price of the acquisition of SRC and ECI was allocated to the assets and liabilities acquired, both tangible and intangible based on fair values (as determined by an independent appraiser), with the excess of the purchase price over the fair value of the net assets acquired of $7,285,894 being recorded as Goodwill. The fair value of the intellectual property rights, amounting to $1,550,609, acquired in the related financing was also determined by an independent appraiser. Due to these acquisitions and related financing, SRC has acquired intellectual property rights to certain key elements of these products - specifically, certain communication, data entry and telemetry devices.

The Company's consolidated financial statements include the results of operations of SRC from its respective acquisition dates. The following unaudited pro forma information presents a summary of our consolidated results of operations as if the SRC and ECI acquisitions and the related financing had taken place on January 1, 2003 for the three and six-month periods ended June 30, 2003. The SRC and ECI acquisitions have been recorded in accordance with SFAS No. 141; therefore, no amortization of goodwill or intangible assets without determinable lives related to SRC and ECI is reflected in the prior year

amounts. These pro forma results have been prepared for comparative purposes only and do not purport to be indicative of the results of operations which actually would have resulted had the acquisitions occurred on January 1, 2003.

	Pro forma	
	Three Months Ended June 30, 2003	Six Months Ended June 30, 2003
	Unaudited	Unaudited
Revenues	$ 673,251	$ 1,201,933
Expenses	1,522,113	2,694,324
Pro forma net loss	$ (848,862)	$(1,492,391)
Pro forma net loss per share:		
Basic and diluted	$ (0.13)	$ (0.15)

NOTE H - STOCK OPTION PLANS

At June 30, 2004, the Company had a stock-based employee compensation plan - the 2003 Stock Incentive Plan. Two of Company's subsidiaries each had separate stock-based employee compensation plans prior to the acquisition of SRC and ECI. These subsidiaries' plans were contractually terminated by the Company upon the acquisition of SRC and ECI on April 23, 2003. Furthermore, on March 14, 2003, all recipients of options granted pursuant to these terminated plans rescinded all of their interests.

2003 Stock Incentive Plan

On April 30, 2003, the Board of Directors of the Company approved the 2003 Stock Incentive Plan, which provided, among other matters, for incentive and non-qualified stock options to purchase 3,500,000 shares of the Company's common stock. On November 4, 2003, the 2003 Stock Incentive Plan was amended by the Board of Directors of the Company, ratified by a majority of the stockholders of the Company on December 18, 2003, to increase the number of shares of Common Stock for which the incentive and non-qualified stock options may be granted from 3,500,00 to 5,000,000. On April 16, 2004, the 2003 Stock Incentive Plan was further amended by the Board of Directors of the Company, ratified by

NOTE H - STOCK OPTION PLANS (CONTINUED)

a majority of the stockholders of the Company on June 18, 2003, to increase the number of shares of Common Stock for which the incentive and non-qualified stock options may be granted from 5,000,00 to 10,000,000. The purpose of the 2003 Stock Incentive Plan is to provide incentives to officers, key employees, directors, independent contractors and agents whose performance will contribute to the long-term success and growth of the Company, to strengthen the ability of the Company to attract and retain officers, key employees, directors, independent contractors and agents of high competence, to increase the identity of interests of such people with those of the Company's stockholders and to help build loyalty to the Company through recognition and the opportunity for stock

ownership. The Plan is administered by the Incentive Compensation Committee of the Board.

On April 30, 2003, incentive stock options to purchase 1,987,500 shares of the Company's Common Stock were granted by the Incentive Compensation Committee to five officers (1,800,000) and one employee (187,500) of the Company at a weighted average exercise price of $1.32 per share. On November 4, 2003, incentive stock options to purchase 950,000 shares of the Company's Common Stock were granted by the Incentive Compensation Committee to three officers of the Company at a weighted average exercise price of $1.09 per share. On January 21 2004, incentive stock options to purchase 601,000 shares of the Company's common stock were granted by the Incentive Compensation Committee of the Board of Directors to one officer and 18 employees of the Company at a weighted average exercise price of $0.50 per share. On April 30, 2003 (435,000), November 4, 2003 (220,000), November 21, 2003 (100,000) and January 21, 2004 (295,500), non-qualified stock options to purchase an aggregate 1,050,500 shares of the Company's Common Stock were granted by the Board of Directors to certain independent contractors of the Company. On June 28, 2004 an officer and employee of a subsidiary relinquished all their rights to an aggregate 420,000 vested incentive stock options of the Company for an aggregate payment of $50,000 cash. No options granted have been exercised.

Stock option activity, for the six-month period ended June 30, 2004, under the 2003 Stock Incentive Plan is summarized as follows:

	Six-Month Period Ended June 30, 2004		
	Incentive Shares	Non-Qualified Shares	Weighted Average Exercise Price
Options outstanding at December 31, 2003	2,937,500	755,000	$ 1.14
Options granted	601,000	295,500	$ 0.50
Options cancelled	(420,000)	--	$ 0.50
Options outstanding at June 30, 2004	3,118,500	1,050,500	$ .97
Options available at June 30, 2004	5,831,000		$ 1.09

CNE GROUP, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements

NOTE H - STOCK OPTION PLANS (CONTINUED)

The following table presents information relating to stock options outstanding at June 30, 2004 relating to the 2003 Incentive Stock Plan:

Options Outstanding		Options Available	
Range of	Weighted Average	Weighted Average Remaining	Weighted Average

Exercise Price	Shares	Exercise Price	Life in Years	Shares	Exercise Price
$0.15 - $3.00	4,169,000	$ .97	8.31	5,831,000	$ 1.09

Note I - CONTINGENCIES

On August 19, 2004, two of the Company's officers, who are also directors, informed the Company that their employment contracts may have been breached which could cause the acceleration of certain future compensation relating thereto amounting up to an aggregate of $1,003,000. The Company does not believe that it has committed any breach of these agreements and, accordingly, has not incurred the claims that these officers may be asserting.

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

General

CNE Group, Inc. (the "Company," "CNE" or "we") is a holding company whose primary operating subsidiary is SRC. SRC, also a holding company, is the parent of Connectivity, ECI, and US Commlink. These companies, which we acquired on April 23, 2003, market, manufacture, repair and maintain remote radio and cellular-based emergency response products to a variety of federal, state and local government agencies as well as other vertical markets located throughout the United States. In addition, we engage in the business of e-recruiting through our subsidiary, CareerEngine, Inc. The e-recruiting business does not generate a significant part of our revenue, and is not significant to the operations of the Company.

Acquisition of all of the outstanding stock of SRC and ECI

On April 23, 2003 we issued (i) 899,971 shares of our common stock, (ii) 1,697,966 shares of our non-voting Series A Preferred Stock and an equal number of ten year Class A Warrants, (iii) 4,400 shares of our Series B Preferred Stock, and (iv) 9,735,875 shares of our non-voting Series C Preferred Stock and a like number of ten year Class C Warrants, for 100% ownership of SRC and ECI. In addition, ECI's sellers retained certain of ECI's trade receivables aggregating approximately $100,000. We also acquired a patent related to the operation of ECI's business in exchange for notes aggregating $2,000,000 bearing 8% interest. The consolidated financial statements include the operating results of SRC and ECI from the date of acquisition. The details of such transactions are set forth below.

SRC

On April 23, 2003, we issued to Michael J. and Carol L. Gutowski, the former principal common stockholders of SRC and each currently an executive officer of the Company, an aggregate of 4,867,937 shares of its non-voting Series C Preferred Stock and a like number of ten year Class C Warrants, each to purchase one share of its Common Stock at $1.00 per share. The Class C Warrants are not exercisable or detachable from the Series C Preferred Stock prior to 66 months after their issuance. Mr. Gutowski is also a current director of the Company.

We issued to the other former common stockholders of SRC, including Larry M. Reid, currently one of the Company's directors and executive officers, an aggregate of 899,971 shares of its Common Stock, 1,697,966 shares of its non-voting Series A Preferred Stock and a like number of ten year non-detachable

Class A Warrants, each to purchase one share of its Common Stock at $1.00 per share. The Class A Warrants are not exercisable or detachable from the Series A Preferred Stock prior to 66 months after their issuance.

We issued an aggregate of 4,400 shares of our Series B Preferred Stock to the former holders of the SRC Series B Preferred Stock.

ECI

On April 23, 2003, the Company issued to Thomas Sullivan and Gary Eichsteadt, the former stockholders of ECI and currently, respectively, an executive officer and employee of the Company, an aggregate of 4,867,938 shares of its Series C Preferred Stock and a like number of Class C Warrants. In addition, Messrs. Eichsteadt and Sullivan retained certain of ECI's trade receivables aggregating approximately $100,000. We also acquired a patent ("ECI Patent) related to the operation of ECI's business from Mr. Eichsteadt for notes in the aggregate principal amount of $2,000,000, bearing interest at the annual rate of 8%, payable quarterly, and due on October 31, 2008. The notes were secured by a certain Pledge Agreement. Mr. Sullivan remained an executive officer ECI. On July 31, 2003, we transferred all the stock of ECI to SRC and ECI became a wholly-owned subsidiary of SRC.

On May 19, 2003, Mr. Eichsteadt assigned $1,500,000 of the aforementioned 8% notes equally to Mr. Sullivan, Mr. Gutowski and Mrs. Gutowski. On August 31, 2003, Mr. and Mrs. Gutowski converted their notes aggregating $1,000,000 into 1,000,000 shares of the Company's Series AA Preferred Stock. On June 28, 2004, Messrs. Sullivan and Eichsteadt converted their notes aggregating $1,000,000 into 1,000,000 shares of the Company's Series AA Preferred Stock.

The Series AA Preferred Stock has an 8% cumulative dividend, payable in common stock or cash, and a liquidating preference over all other CNE equity of $2,000,000. The Series A Preferred Stock has a liquidating preference over all other CNE equity except the Series AA of $1,697,961. The Series B Preferred Stock has a liquidating preference over all other CNE equity except the Series AA and A Preferred Stock of $440,000. The Series C Preferred Stock has no liquidating preference.

The total consideration, including acquisition costs, was allocated based on the estimated fair values of the net assets acquired on the acquisition date.

	ECI	SRC	Total
Tangible assets	$ 588,492	$ 292,979	$ 881,471
Patents	1,379,789	170,820	1,550,609
Goodwill	2,766,233	4,519,661	7,285,894
Liabilities	(2,144,771)	(857,033)	(3,001,804)
Net asset value	$ 2,589,743	$ 4,126,427	$ 6,716,170

There were no relationships between us or any of our affiliates and any of the sellers of the assets we acquired prior to the acquisition transactions.

Catastrophe of September 11, 2001

Our headquarters were located at Suite 2112 of Two World Trade Center in New York City. The catastrophe of September 11, 2001 involved no injury to any of our employees. However, with the complete destruction of the building, all of our leasehold improvements, furniture and fixtures, and office and computer equipment located at this site were also destroyed. Since the attack through the date of the acquisitions and financing set forth above, our management had been preoccupied with the relocation and reestablishment of our businesses, assessing and processing of insurance claims with the assistance of a risk manager with our insurers, and seeking sources of financing. The Company received insurance proceeds in amounts that have exceeded the net carrying value of the destroyed assets. We also had insurance coverage for other than assets destroyed. In 2003, we received all outstanding insurance claims relating to the catastrophe.

In addition, we applied for governmental assistance grants related to the catastrophe. In 2002 and 2003 we received grants aggregating $300,000. The grants have a restriction that could require their repayment, specifically if we were to relocate a substantial portion our operations outside of New York City before May 1, 2005. Until such time as this restriction no longer applies, we will classify the grants as a liability of the Company. We will remove the liability and record grant income on our financial statements when these restrictions lapse or are satisfied or, alternatively, repay such grants if the above condition is not satisfied.

Critical Accounting Policies and Estimates

The preparation of financial statements in accordance with U.S. generally accepted accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of net revenue and expenses during the reporting period. On an ongoing basis, we evaluate our estimates, including those related to our allowance for doubtful accounts, inventory reserves, goodwill and purchased intangible asset valuations, and asset impairments. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies, among others, affect the significant judgments and estimates we use in the preparation of our consolidated financial statements:

Revenue Recognition

We recognize product revenue when persuasive evidence of an arrangement exists, the sales price is fixed, the service is performed or products are shipped to customers, which is when title and risk of loss transfers to the customers, and collectibility is reasonably assured.

Allowance for Doubtful Accounts

We evaluate the collectibility of our accounts receivable based on a combination of factors. In circumstances where we are aware of a specific customer's inability to meet its financial obligations to us, we record a specific allowance to reduce the net receivable to the amount we reasonably believe will be collected. For all other customers, we record allowances for doubtful

accounts based on the length of time the receivables are past due, the prevailing business environment and our historical experience. If the financial condition of our customers were to deteriorate or if economic conditions were to worsen, additional allowances may be required in the future.

At June 30, 2004 our allowance for doubtful accounts was $64,707 or 18.8% of gross receivables, compared to $51,500 or 19.8% of gross receivables as of December 31, 2003. The decrease in the reserve as a percentage of gross receivable from prior period is the result of a increase in accounts receivable and a decrease in the need for an allowance for doubtful accounts.

Inventory Valuation

At each balance sheet date, we evaluate our ending inventories for excess quantities and obsolescence. This evaluation includes analyses of sales levels by product and projections of future demand. If inventories on hand are in excess of forecasted demand, we provide appropriate reserves for such excess inventory. If we have previously recorded the value of such inventory determined to be in excess of projected demand, or if we determine that inventory is obsolete, we write off these inventories in the period the determination is made. Remaining inventory balances are adjusted to approximate the lower of our cost or market value. If future demand or market conditions are less favorable than our projects, additional inventory write-downs may be required, and would be reflected in cost of revenues in the period the revision is made.

Valuation of Goodwill, Purchased Intangible Assets and Long-Lived Assets

We perform goodwill impairment tests on an annual basis and on an interim basis if an event or circumstance indicates that it is more likely than not that impairment has occurred. We assess the impairment of other amortizable intangible assets and long-lived assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors

we consider important that could trigger an impairment review include significant underperformance to historical or projected operating results, substantial changes in our business strategy and significant negative industry or economic trends. If such indicators are present, we evaluate the fair value of the goodwill. For other intangible assets and long-lived assets we determine whether the sum of the estimated undiscounted cash flows attributable to the assets in question is less than their caring value. If less, we recognize an impairment loss based on the excess of the carrying amount of the assets over their respective fair values. Fair value of goodwill is determined by using a valuation model based on market capitalization. Fair value of other intangible assets and long-lived assets is determined by future cash flows, appraisals or other methods. If the long-lived asset determined to be impaired is to be held and used, we recognize an impairment charge to the extent the anticipated net cash flows attributable to the asset are less than the asset's carrying value. The fair value of the long-lived asset then becomes the asset's new carrying value, which we depreciate over the remaining estimated useful life of the asset.

Recent Accounting Pronouncements

In January 2003, the FASB issued FASB Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities." In general, a variable interest entity is a corporation, partnership, trust, or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial

resources for the entity to support its activities. FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The consolidation requirements of FIN 46 apply immediately to variable interest entities created after January 31, 2003. The consolidation requirements apply to older entities in the first fiscal year or interim period beginning after December 15, 2003. Certain of the disclosure requirements apply in all financial statements issued after January 31, 2003, regardless of when the variable interest entity was established. The adoption of this statement has had no effect on the Company's financial position or results of operations.

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" ("SFAS No. 149"). SFAS No. 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities under FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities. This Statement requires that contracts with comparable characteristics be accounted for consistently as either derivatives or hybrid instruments. This Statement is effective for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003. The adoption of this statement has had no effect on our financial statements.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." SFAS No. 150 changes the accounting for certain financial instruments that under previous guidance issuers could account for as equity. It requires that those instruments be classified as liabilities in balance sheets. The guidance in SFAS No. 150 is generally effective for all financial instruments entered into or modified after May 31, 2003, and otherwise is effective on July 1, 2003. The adoption of this statement has had no effect on our financial statements.

A. Results of Operations:

Three-Month Period Ended June 30, 2004 Compared to the Three-Month Period Ended June 30, 2003

Revenues

Total revenues decreased to $550,318 for the three-month period ended June 30, 2004 from $559,431 for the three-month period ended June 30, 2003 due to a reduction of the contracts awarded to SRC and its subsidiaries.

Product sales income decreased to $261,962 for the three-month period ended June 30, 2004 from $356,093 for the three-month period ended June 30, 2003 due to a reduction of the contracts awarded to SRC and its subsidiaries.

Service fee income increased to $262,518 for the three-month period ended June 30, 2004 from $168,519 for the three-month period ended June 30, 2003 as we had we had three months of activity of SRC and its subsidiaries in the six months ended June 30, 2004 compared to only two months of activity of SRC and its subsidiaries in the six months ended June 30, 2003.

Internet related income decreased to $25,838 for the three-month period

ended June 30, 2004 from $34,819 for the three-month period ended June 30, 2003 as the operations of our subsidiary, CareerEngine, Inc. have continued to decline due to our relatively small size in the e-recruiting industry.

Cost of Goods Sold

Costs of goods sold, which relates to product sales and related service fee income did not change substantially for the three-month period ended June 30, 2004 ($281,616) as compared to the three-month period ended June 30, 2003 ($278,353).

Other Expenses

Total other expenses increased to $908,546 for the three-month period ended June 30, 2004 from $682,297 for the three-month period ended June 30, 2003 as we had we had three months of activity of SRC and its subsidiaries in the six months ended June 30, 2004 compared to only two months of activity of SRC and its subsidiaries in the six months ended June 30, 2003.

Advertising expenses modestly decreased to $12,208 for the three-month period ended June 30, 2004 from $17,091 for the three-month period ended June 30, 2003 as we decreased our attendance at industry trade shows. These expenditures relate to the acquired operations of SRC and its subsidiaries.

Compensation and related costs increased to $453,030 for the three-month period ended June 30, 2004 from $313,704 for the three-month period ended June 30, 2003 as we had we had three months of activity of SRC and its subsidiaries in the six months ended June 30, 2004 compared to only two months of activity of SRC and its subsidiaries in the six months ended June 30, 2003.

General and administrative expenses increased to $363,083 for the three-month period ended June 30, 2004 from $340,419 for the three-month period ended June 30, 2003 due to the costs associated with the acquisition and related operations of SRC and its subsidiaries, and the professional fees associated the significantly increased operations of the Company.

Product development expenses increased to $31,368 for the three-month period ended June 30, 2004 from nil for the three-month period ended June 30, 2003 due to certain initiatives commenced by SRC and its subsidiaries to develop products to meet our customers' future requirements.

Depreciation and amortization expenses increased to $48,857 for the three-month period ended June 30, 2004 from $11,083 for the three-month period ended June 30, 2003, due to the net effect of the depreciation and amortization expense relating to the relatively long-life fixed assets and intellectual property rights associated with the acquisition of SRC and its subsidiaries in the three-month period ended June 30, 2004, and the depreciation of certain short-life assets of the Company that remained in the three-month period ended June 30, 2003.

Other Items

Amortization of debt discount decreased to $24,963 for the three-month

period ended June 30, 2004 from $116,500 for the three-month period ended June 30, 2003 due to the change in the monthly rate of amortization of the debt discount ($699,000) related to the 10% subordinated notes issued on April 23, 2003 from $58,250 to $8,321. The change in the amortization rate was caused by the extension of the maturity date of the notes from April 30, 2004 to April 30, 2005.

Interest expense decreased to $86,460 for the three-month period ended June 30, 2004 from $148,901 for the three-month period ended June 30, 2003 due primarily to the net effect of the issuance of the Company's 10% and 8% subordinated notes in April 2003 and the cessation of interest expense on a subsidiary's 12% Debentures Payable and Tax Assessment Payable in July and August 2003.

Operating Loss

On a pre-tax basis, we had a net loss before income taxes of $751,112 for the three-month period ended June 30, 2004 compared with a net loss before income taxes of $666,620 for the three-month period ended June 30, 2003.

Our net loss for the three-month period ended June 30, 2004 was $751,112 compared with a net loss of $666,620 for the three-month period ended June 30, 2003. For the three-month period ended June 30, 2004, net loss per common share, basic and diluted, was $0.07 per share. For the three-month period ended June 30, 2003, net loss per common share, basic and diluted, was $0.10 per share.

Six-Month Period Ended June 30, 2004 Compared to the Six-Month Period Ended June 30, 2003

Revenues

Total revenues increased to $1,533,260 for the six-month period ended June 30, 2004 from $604,470 for the six-month period ended June 30, 2003 as we had six months of activity of SRC and its subsidiaries in the six months ended June 30, 2004 compared to only two months of activity of SRC and its subsidiaries in the six months ended June 30, 2003.

Product sales income increased to $893,400 for the six-month period ended June 30, 2004 from $356,093 for the six-month period ended June 30, 2003 as we had six months of activity of SRC and its subsidiaries in the six months ended June 30, 2004 compared to only two months of activity of SRC and its subsidiaries in the six months ended June 30, 2003.

Service fee income increased to $582,653 for the six-month period ended June 30, 2004 from $168,519 for the six-month period ended June 30, 2003 as we had six months of activity of SRC and its subsidiaries in the six months ended June 30, 2004 compared to only two months of activity of SRC and its subsidiaries in the six months ended June 30, 2003.

Internet related income decreased to $57,207 for the six-month period ended June 30, 2004 from $79,858 for the six-month period ended June 30, 2003 as the operations of our subsidiary, CareerEngine, Inc. have continued to decline due to our relatively small size in the e-recruiting industry.

Cost of Goods Sold

Costs of goods sold, which relates to product sales and related service fee income increased to $785,315 for the six-month period ended June 30, 2004 from $278,353 for the six-month period ended June 30, 2003 as we had six months of activity of SRC and its subsidiaries in the six months ended June 30, 2004 compared to only two months of activity of SRC and its subsidiaries in the six months ended June 30, 2003.

Other Expenses

Total other expenses increased to $1,655,784 for the six-month period ended June 30, 2004 from $882,317 for the six-month period ended June 30, 2003 as we had six months of activity of SRC and its subsidiaries in the six months ended June 30, 2004 compared to only two months of activity of SRC and its subsidiaries in the six months ended June 30, 2003.

Advertising expenses increased to $36,928 for the six-month period ended June 30, 2004 from $17,091 for the six-month period ended June 30, 2003 as we had six months of activity of SRC and its subsidiaries in the six months ended June 30, 2004 compared to only two months of activity of SRC and its subsidiaries in the six months ended June 30, 2003.

Compensation and related costs increased to $821,592 for the six-month period ended June 30, 2004 from $403,935 for the six-month period ended June 30, 2003 as we had six months of activity of SRC and its subsidiaries in the six months ended June 30, 2004 compared to only two months of activity of SRC and its subsidiaries in the six months ended June 30, 2003.

General and administrative expenses increased to $663,299 for the six-month period ended June 30, 2004 from $438,021 for the six-month period ended June 30, 2003 due to the costs associated with the acquisition and related operations of SRC and its subsidiaries, and the professional fees associated the significantly increased operations of the Company.

Product development expenses increased to $37,609 for the six-month period ended June 30, 2004 from nil for the six-month period ended June 30, 2003 due to certain initiatives commenced by SRC and its subsidiaries to develop products to meet our customers' future requirements.

Depreciation and amortization expenses increased to $96,356 for the six-month period ended June 30, 2004 from $23,270 for the six-month period ended June 30, 2003, due to the net effect of the depreciation and amortization expense relating to the relatively long-life fixed assets and intellectual property rights associated with the acquisition of SRC and its subsidiaries in the six-month period ended June 30, 2004, and the depreciation of certain short-life assets of the Company that remained in the six-month period ended June 30, 2003.

Other Items

Amortization of debt discount increased to $149,784 for the six-month period ended June 30, 2004 from $116,500 for the six-month period ended June 30, 2003 due the combined effect of an increased period of time that

the amortization of the debt discount ($699,000), relating to the 10% subordinated notes issued in April 2003, pertained and the change in the rate of amortization when the notes were extended for an additional year in March 2004.

Interest expense decreased to $167,342 for the six-month period ended June 30, 2004 from $236,843 for the six-month period ended June 30, 2003 due primarily to the net effect of the issuance of the Company's 10% and 8% subordinated notes in April 2003 and the cessation of interest expense on a subsidiary's 12% Debentures Payable and Tax Assessment Payable in July and August 2003.

Operating Loss

On a pre-tax basis, we had a net loss before income taxes of $1,224,666 for the six-month period ended June 30, 2004 compared with a net loss before income taxes of $909,543 for the six-month period ended June 30, 2003.

Our net loss for the six-month period ended June 30, 2004 was $1,224,666 compared with a net loss of $909,543 for the six-month period ended June 30, 2003. For the six-month period ended June 30, 2004, net loss per common share, basic and diluted, was $0.12 per share. For the six-month period ended June 30, 2003, net loss per common share, basic and diluted, was $0.15 per share.

B. Liquidity and Capital Resources

The Company has incurred substantial losses, sustained substantial cash outflows from operating activities and had a working capital deficit at June 30, 2004 and December 31, 2003. The above factors raise substantial doubt about the Company's ability to continue as a going concern. The Company's continued existence depends on its ability to obtain additional equity and/or debt financing to fund its operations, financial obligations as they become due, and ultimately to achieve profitable operations. The Company is continuously in the process of raising additional financing and has initiated a cost reduction strategy. At June 30, 2004 and December 31, 2003, management believed that the working capital deficit, losses and negative cash flow will ultimately be improved by (i) the acquisitions of SRC and ECI, (ii) cost reduction strategies initiated in January 2004, and (iii) additional equity and debt financing activities in addition to those set forth in the financial statements. On January 2, 2004, the Company received a notice dated December 31, 2003 from the American Stock Exchange indicating that the Company had demonstrated compliance with the requirement for continued listing on the Exchange. As is the case for all listed issuers, the Company's continued listing eligibility will be assessed on an ongoing basis; however, during the year ending December 31, 2004, the Company will be subject to additional scrutiny (as set forth in Section 1009(h) of the AMEX

Company Guide) as is the case for any listed company that has regained compliance. There is no assurance that the Company can obtain additional financing or achieve profitable operations or generate positive cash flow.

Off-Balance Sheet Arrangements

At June 30, 2004 and December 31, 2003, the Company had no off-balance sheet arrangements.

Operating Activities

We utilized $853,961 of cash in operating activities during the six-month period ended June 30, 2004. We had a net loss of $1,224,666 during this period, which included an aggregate of $172,347 of non-cash items, including depreciation and amortization, amortization of debt discount and allowance for doubtful accounts. In addition to the impact of non-cash items, our operating activities for the six-month period ended June 30, 2004 also reflected an increase in accounts receivable, inventory, and accrued expenses and other liabilities, and a decrease in prepaid expenses and other assets.

We utilized $639,138 of cash in operating activities during the six-month period ended June 30, 2003. We had a net loss of $909,543 during this period which included depreciation, a non-cash item, amounting to $23,270. In addition to the impact of non-cash items, our operating activities for the six-month period ended June 30, 2003 also reflected an increase in accounts receivable and inventory, and a decrease in prepaid expenses and other assets, and accrued expenses and other liabilities.

On January 21, 2004, we took several initiatives to address our operating cash deficiency, which included, but were not limited to, the reduction and/or elimination of certain executive salaries, waiving of certain interest payments due officers and/or directors, waiving of certain accounts receivable due an officer and employee, and the reduction of certain administrative costs. In addition, we raised gross proceeds of $700,000 (net cash proceeds of $571,000) in February 2004 from the sale of our common stock (see "Financing Activities" below), and restructured (i) certain short-term credit arrangements into a $300,000 Note payable due in February 2005 (see Note A to our Consolidated Financial Statements) and (ii) a certain line of credit into a $150,000 secured note payable.

Financing Activities

On April 23, 2003, we issued $1,000,000 in principal amount of our 10% Subordinated Notes due April 30, 2004 to investors for a 15% non-dilutive interest in the Company in the form of 4,165,800 cashless Class B Warrants, each to purchase one share of Common Stock at $0.50 per share. We had the option to extend the maturity date of the notes to April 30, 2005 in consideration for issuing the noteholders an additional 4% non-dilutive interest in the Company. The notes also require prepayment in an amount equal to 100% of any net financing

proceeds obtained by us after the issuance of the notes. The noteholders waived this provision to the extent of $2,000,000 through April 15, 2004, of which $1,200,000 was raised. The investors included two of our officers. Interest is payable, in arrears, calendar quarterly. We valued the Warrants, utilizing the Black-Scholes Pricing Model, at $699,000, which is being accounted for as debt discount and is being amortized ratably over the initial one-year term of the Notes.

On March 12, 2004, we notified the Class B Warrant holders that, to satisfy the 15% non-dilutive provisions of their Warrants, these Warrants were now exercisable for an aggregate of 5,245,200 shares of our common stock at approximately $0.40 per share. On this date, we also exercised our option to extend the maturity date of the notes to April 30, 2005 and satisfied the requirement for the additional 4% non-dilutive interest in

the Company by issuing to the noteholders Class B Warrants to purchase an additional 1,708,900 shares of our common stock at $0.50 per share. The non-dilutive provisions of the Warrants terminate when all of the notes have been paid in full.

In addition, on September 17, 2003, we sold 1,250,000 shares of our common stock at $0.40 per share to an existing noteholder and stockholder of the Company.

On February 10, 2004, the Company sold 1,750,000 shares of our common stock at $0.40 per share in consideration of $700,000 cash (net cash proceeds of $571,000).

We are using the funds obtained from these financings to pay certain ECI notes payable and for working capital. The financings were effected pursuant to the exemption from the registration provisions of the Securities Act of 1993 provided by Section 4(2) thereof.

We did not have any material commitments for capital expenditures as of June 30, 2004.

C. Inflation

Due to the nature of our business, inflation does not significantly impact the Company's operations.

Item 3. Controls and Procedures

The Chief Executive Officer and Chief Financial Officer of the Company have conducted an evaluation of the effectiveness of disclosure controls and procedures pursuant to Rule 13a-14 of the Exchange Act. Based on that evaluation, they have concluded that the Company's disclosure controls and procedures are effective in ensuring that all material information required to be filed in this Quarterly Report on Form 10-QSB has been made known to them in a timely fashion. There have been no significant changes in internal controls, or in other factors that could significantly affect internal controls, subsequent to the date they completed their evaluation.

PART II

OTHER INFORMATION

Item 1. Legal Proceedings.

The Company is a party to various vendor related litigations. Based on the opinion of management and legal counsel, the Company has accrued an estimated liability of approximately $100,000.

Item 5. Other Information.

On April 28, 2004, the Company's Board of Directors approved the Company's Code of Business Conduct and Ethics for the Directors, Officers and Employees of CNE Group, Inc. (the "Code"). The Company has posted the Code on its corporate website: www.cnegroupinc.com.

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits:

31.1 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 from the Company's Chief Executive Officer

31.2 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 from the Company's Chief Financial Officer

32.1 Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

A statement regarding the computation of per share earnings is omitted because the computation is described in Note B of the Notes to Consolidated Financial Statements (Unaudited) in this Form 10-QSB.

(b) Reports on Form 8-K:

The Company filed a report on Form 8-K on February 10, 2004 and two reports on Form 8-K on June 14, 2004 and a report on Form 8-K on July 9, 2004.

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CNE GROUP, INC.

/s/ George W. Benoit

Date: August 14, 2004

George W. Benoit, Chairman of the Board of Directors, and Chief Executive Officer

/s/ Anthony S. Conigliaro

Date: August 14, 2004

Anthony S. Conigliaro, Vice President and Chief Financial Officer