

Edgar Filing: CNE GROUP INC - Form 10QSB

CNE GROUP INC  
Form 10QSB  
August 12, 2005

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

FORM 10-QSB

(Mark One)

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

For the quarterly period ended June 30, 2005  
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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.  
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(Exact Name of Small Business Issuer as Specified in Its Charter)

DELAWARE  
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56-2346563  
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(State or Other Jurisdiction of  
Incorporation or Organization)

(I.R.S. Employer  
Identification No.)

255 West 36th Street, Suite 800, New York, N.Y. 10018  
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(Address of Principal Executive Offices)

212-300-2112  
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(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  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 August 1, 2005 -----
Common stock - par value \$.00001 -----	11,424,248 shares -----

PART I

FINANCIAL INFORMATION

Item 1. Financial Statements.

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CNE GROUP, INC. AND SUBSIDIARIES

Consolidated Balance Sheet

	June 30, 2005	December 31, 2004
	----- (Unaudited)	-----
<b>ASSETS</b>		
Current:		
Cash and cash equivalents	\$ 101,391	\$ 84,408
Accounts receivable, net of allowance for doubtful accounts of \$66,000 in 2005 and \$51,000 in 2004	172,887	172,010
Inventory	313,322	260,487
Other	8,964	8,273
	-----	-----
Total current assets	596,564	525,178
Fixed assets, net	333,243	394,509
Intellectual property rights, net	1,305,349	1,361,948
Goodwill	7,285,894	7,285,894
Prepaid expenses and other assets	7,661	21,265
	-----	-----
Total assets	\$ 9,528,711	\$ 9,588,794
	=====	=====
<b>LIABILITIES</b>		
Current:		
Accounts payable and accrued expenses	\$ 1,627,724	\$ 1,476,124
Interest payable	246,904	128,050
Short-term credit arrangements	96,859	191,395
Line of credit	3,524	19,199
Current portion of notes payable	--	17,243
Notes and debenture payable	850,000	850,000
10% subordinated notes payable	1,000,000	966,710
Other notes payable	42,690	23,330
	-----	-----
Total current liabilities	3,867,701	3,672,051
Notes payable, net of current portion	--	22,059
Deferred grant revenue	--	300,000
	-----	-----
Total liabilities	3,867,701	3,994,110
	-----	-----
Commitments and contingencies		
<b>STOCKHOLDERS' EQUITY</b>		
Preferred stock	145	134
Common stock	127	121
Paid-in surplus	30,243,169	29,919,185
Accumulated deficit	(21,709,331)	(21,451,656)
	-----	-----
Less treasury stock, at cost - 1,238,656 shares	8,534,110	8,467,784
	(2,873,100)	(2,873,100)
	-----	-----

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Total stockholders' equity	5,661,010	5,594,684
	-----	-----
Total liabilities and stockholders' equity	\$ 9,528,711	\$ 9,588,794
	=====	=====

See Notes to Consolidated Financial Statements.

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CNE GROUP, INC. AND SUBSIDIARIES

Consolidated Statements of Operations

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005 (Unaudited)	2004 (Unaudited)	2005 (Unaudited)	2004 (Unaudited)
Revenues:				
Product sales	\$ 132,836	\$ 261,962	\$ 512,961	\$ 1,014,823
Service fee income	152,230	262,518	352,414	694,932
Internet related income	18,491	25,838	64,953	129,906
	-----	-----	-----	-----
Cost of goods sold	303,557	550,318	930,328	1,811,654
	150,340	281,616	327,869	659,332
	-----	-----	-----	-----
Gross profit	153,217	268,702	602,459	1,174,802
	-----	-----	-----	-----
Other expenses:				
Advertising	16,477	12,208	34,285	66,493
Compensation and related costs	189,686	453,030	401,287	814,363
General and administrative	218,526	363,083	459,692	928,779
Product development	--	31,368	--	62,736
Depreciation and amortization	48,342	48,857	97,547	195,094
	-----	-----	-----	-----
	473,031	908,546	992,811	2,067,465
	-----	-----	-----	-----
Loss before other income (expenses)	(319,814)	(639,844)	(390,352)	(892,663)
Other income (expenses):				
Amortization of debt discount	(8,327)	(24,963)	(33,290)	(67,580)
Grant income	300,000	--	300,000	600,000
Interest expense	(64,252)	(86,460)	(134,125)	(270,737)
Interest income	63	155	91	183
	-----	-----	-----	-----
	(92,330)	(751,112)	(257,676)	(738,234)
Loss before provision for income taxes	(92,330)	(751,112)	(257,676)	(892,663)
	-----	-----	-----	-----
Provision for income taxes	--	--	--	--
	-----	-----	-----	-----
Net loss	\$ (92,330)	\$ (751,112)	\$ (257,676)	\$ (892,663)

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	=====	=====	=====	=====
Loss per common share - basic and diluted:	\$ (.01)	\$ (.07)	\$ (.02)	\$
Weighted average number of common shares outstanding - basic and diluted:	11,324,248	10,640,915	11,057,582	1

See Notes to Consolidated Financial Statements.

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CNE GROUP, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

	Six Months E 2005 ----- (Unaudited)
Cash flows from operating activities:	
Net loss	\$ (257,676)
Adjustments to reconcile net loss to net cash used in operating activities:	
Depreciation and amortization	97,547
Provision for doubtful accounts	15,000
Issuance of common stock for services	54,000
Amortization of debt discount	33,290
Changes in:	
Accounts receivable	(15,877)
Inventory	(72,756)
Prepaid expenses and other assets	12,913
Accounts payable, accrued expenses and deferred grant revenue	(2,953)
	-----
Net cash used in operating activities	(136,512)
	-----
Cash flows from investing activities:	
Purchase of furniture and equipment	(20,318)
	-----
Net cash used in investing activities	(20,318)
	-----
Cash flows from financing activities:	
Proceeds from issuance Series G Preferred Stock	220,000
Proceeds from sale of 333,333 shares of restricted common stock	50,000
Net proceeds from issuance of 1,750,000 shares of common stock	
Proceeds from notes payable	20,000
Principal repayments on notes payable - other	(150,153)
	-----
Net cash provided by financing activities	139,847
	-----

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Increase (decrease) in cash and cash equivalents	(16,983)
Cash and cash equivalents at beginning of period	84,408
	-----
Cash and cash equivalents at end of period	\$ 101,391
	=====

Supplemental disclosures of cash flow information related to continuing operations:

Cash paid during the period for:

Interest	\$ 16,666
Income taxes	\$ --

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

Interest payable	--
8% notes payable	--
Issuance of preferred stock, at par	--
Paid in surplus	--

See Notes to Consolidated Financial Statements.

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

### NOTE A - THE COMPANY

The following consolidated financial statements of CNE Group, Inc. and subsidiaries (collectively referred to as the "Company or "CNE," 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, 2004, which was filed with the Securities and Exchange Commission.

The results of operations for the three months ended June 30, 2005 are not necessarily indicative of the results to be expected for the entire fiscal year.

### Business

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CNE Group, Inc. is a holding company whose primary operating subsidiaries are SRC Technologies, Inc. ("SRC") and U.S. Commlink, Ltd. ("USCL"). SRC, also a holding company, is the parent of Connectivity, Inc. ("Connectivity") and Econo-Comm, Inc. (d/b/a Mobile Communications) ("ECI"). 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. The Company has intellectual property rights to certain key elements of these products - specifically, certain communication, data entry and telemetry devices.

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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

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The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. The Company has incurred substantial losses, sustained substantial operating cash outflows and has a working capital deficit at both June 30, 2005 and December 31, 2004. 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 attempting to raise additional financing and has initiated a cost reduction strategy. At June 30, 2005 management believes that the working capital deficit, losses and negative cash flow will ultimately be improved by (i) cost reduction strategies initiated in January and June 2004, (ii) additional equity and debt financing activities, and (iii) a merger/acquisition transaction or a transaction of a similar nature in addition to those set forth in the financial statements. . The Company has been notified that, subject to the procedural requirements of the American Stock Exchange, its stock could be delisted (see "American Stock Exchange Listing" below). There is no assurance that the Company can obtain additional financing or achieve profitable operations or generate positive cash flow. The 2005 and 2004 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.

For information relating to a merger transaction entered into by the Company see Note F - Subsequent Event.

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

#### NOTE A - THE COMPANY (CONTINUED)

##### Private Financings

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1. On or about April 1, 2005, two individuals, both of whom are adult children of the Company's Chief Executive Officer, purchased 545,000 shares of the Company's Series G Preferred Stock at a price of \$0.20 per share. The Series G Preferred Stock is non voting, has no liquidating preference over the Common Stock and each share is automatically convertible into two shares of Common Stock when such conversion has been approved by the Company's Common Stockholders.
  2. On or about April 12, 2005, four individuals, three of whom are adult children or related thereto of the Company's Chief Executive Officer, purchased 500,000 shares of the Company's Series G Preferred Stock at a price of \$0.20 per share.
  3. On or about April 20, 2005, an individual purchased 100,000 shares of the Company's Series G Preferred Stock at a price of \$0.20 per share.

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4. On or about March 15, 2005, the Company borrowed \$25,000 from a lender evidenced by a secured convertible subordinated note due on September 15, 2005 and bearing interest at the annual rate of 20% payable at maturity. The note was (i) secured by approximately \$42,000 in one of the Company's bank accounts; (ii) convertible into the Company's Common Stock at the rate of \$0.24 per share, subject to certain anti-dilution provisions; and (iii) subordinated to the Company's Senior Indebtedness as that term is defined therein. On June 10, 2005 the company repaid this note in full. In addition, on or about April 15, 2005, the Company sold to this lender, for an aggregate purchase price of \$50,000, 333,333 shares of restricted Common Stock and three-year warrants to purchase an aggregate of 100,000 shares of Common Stock at \$0.50 per share, subject to appropriate anti-dilution provisions.

### American Stock Exchange Listing

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On May 5, 2005, the Company received notice from the American Stock Exchange ("AMEX") Staff indicating that at December 31, 2004 it did not meet certain of AMEX's continuing listing standards, specifically its (i) Stockholders' Equity being less than \$6,000,000 (Section 1003(a)(iii) of the AMEX Company Guide) and (ii) financial condition has become so impaired that it appears questionable that it will be able to continue operations and/or meet its obligations as they mature (Section 1003(a)(iv) of the AMEX Company Guide).

AMEX requested the Company to submit a plan that would demonstrate to AMEX the Company's ability to regain compliance (the "Plan"). On June 6, 2005 the Company submitted the Plan. On June 13, 2005, the Staff notified the Company that it had determined that the Plan did not make a reasonable demonstration of the Company's ability to regain compliance with the continued listing standards, as required by Section 1009 of the Company Guide and, as provided by Section 1009(d) thereof, the Staff has determined to proceed with the filing of an application with the Securities and Exchange Commission to strike the Company's common stock from listing and registration on AMEX.

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

#### NOTE A - THE COMPANY (CONTINUED)

In accordance with Sections 1203 and 1009(d) of the Company Guide the Company had a limited right to appeal the Staff's determination at an oral hearing or one based on a written submission before a Listing Qualifications Panel. The Company requested, and was subsequently granted, an oral hearing on August 8, 2005 to appeal the Staff's determination. The Company is awaiting the decision of the Listings Qualifications Panel. The Company can give no assurance that its appeal will be successful.

If the appeal is successful the Plan is subject to the approval and to periodic monitoring by AMEX. Assuming the Company achieves its scheduled financial milestones as determined by AMEX, the Company may have until November 5, 2005 to regain compliance with the continuing listing requirements. If the Company it does not achieve its scheduled financial milestones as determined by AMEX, the Company will lose its AMEX listing.

At June 30, 2005, our Stockholders' Equity was approximately \$5,661,000, our current assets were \$597,000, and our current liabilities were \$3,868,000 that

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primarily included notes payable (\$1,850,000 due as of June 30, 2005) and related interest payable amounting to approximately \$2,097,000. No event of default has been declared by any holder thereof as of the date hereof. Management and the noteholders, who include certain of our directors, officers and an employee who is also a director, are currently renegotiating the terms of these notes. There is no assurance that we can obtain additional financing or achieve profitable operations or generate possible cash flow or that we can retain our listing.

### 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, 2005	December 31, 2004
	-----	-----
Raw materials	\$295,166	\$242,061
Work in progress	15,656	15,926
Finished goods	2,500	2,500
	-----	-----
Total	\$313,322	\$260,487
	=====	=====

#### [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 month periods ended March 31, 2005 and 2004. Common Stock equivalents to purchase Common Stock of the Company that were outstanding at June 30, 2005 and 2004 were not included in the computation of diluted net loss per share as their effect would have been anti-dilutive.

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

### NOTE B - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### [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 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,



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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, 2005 and December 31, 2004, the Company had a stock-based employee compensation plan - the 2003 Plan.

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,	
	2005	2004
Net loss, as reported	\$(257,676)	\$(1,224,666)
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	\$(257,676)	\$(1,392,946)
Net loss per share - basic and diluted:		
As reported	\$(0.02)	\$(0.12)
Pro forma	\$(0.02)	\$(0.13)

On May 10, 2005, pursuant to a litigation Settlement Agreement dated January 10, 2005, the Company tendered an aggregate of 850,000 shares of the Company's Common Stock to Larry M. Reid, Michael J. Gutowski and Carol L. Gutowski in exchange for all of their (i) incentive stock

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

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

options (1,550,000), (ii) Series AA Preferred Stock (1,000,000), (iii) Series A Preferred Stock (305,336) and related Class A Warrants (305,336), and (iv) Series C Preferred Stock (4,867,937) and related Class C Warrants (4,867,937).

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On May 9, 2005, the Company tendered 850,000 shares of its common stock in accordance with the applicable provisions of the settlement agreement. On or about July 9, 2005, Mr. and Mrs. Gutowski and Mr. Reid delivered to the Company those securities required to be delivered by the settlement agreement. The Company subsequently retired these securities.

### [4] Recent accounting pronouncements:

In January 2003, the FASB issued FIN 46, Consolidation of Variable Interest Entities (VIE's), and a revision to FIN 46 in December 2003 (together, "FIN 46"), which requires identification of the Company's participation in VIE's. VIE's are defined as entities with a level of invested equity that is not sufficient to fund future activities to permit them to operate on a stand-alone basis, or whose equity holders lack certain characteristics of a controlling financial interest. For entities identified as VIE's, FIN 46 sets forth a model to evaluate potential consolidation based on the assessment of which party to a VIE, if any, bears a majority of the risk of the VIE's expected losses, or stands to gain from a majority of the VIE's expected returns. FIN 46 also sets forth certain disclosures regarding interest in VIE's that are deemed significant, even if consolidation is not required. FIN 46 is effective for all VIE's created after January 31, 2003. The Company adopted FIN 46 during 2003 and the adoption of this interpretation did not have an impact on the Company's consolidated financial statements in 2005 or 2004.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity. SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003. The Company adopted this standard during 2003 and the adoption did not have an impact on the Company's consolidated financial statements in 2004 or 2003. During December 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 153, Exchanges of Nonmonetary Assets -- An Amendment of APB Opinion No. 29. APB Opinion No. 29, Accounting for Nonmonetary Transactions ("APB 29") required that nonmonetary exchanges be accounted for at fair value, subject to certain exceptions. SFAS 153 has removed the exception for nonmonetary exchanges of similar productive assets, and replaced it with an exception for exchanges that lack commercial substance. The provisions of SFAS 153 are effective prospectively for all nonmonetary asset exchanges in fiscal periods beginning after June 15, 2004. The adoption of this standard did not have an impact on the Company's consolidated financial statements in 2005 and 2004.

During December 2004, FASB issued SFAS No. 123 (Revised 2004), Share-Based Payment ("SFAS 123R"). SFAS 123R replaces SFAS No. 123, Accounting for Stock-Based Compensation (SFAS 123), and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. SFAS 123R requires companies to recognize the compensation cost related to share-based

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### NOTE B - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

payment transactions with employees in the financial statements. The compensation cost is measured based upon the fair value of the instrument issued. Share-based compensation transactions with employees covered within SFAS 123R include share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. SFAS 123 included a fair-value-based method of accounting for share-based payment transactions with employees, but allowed companies to continue to apply the guidance in APB 25 provided that they disclose in the footnotes to the financial statements the pro forma net income if the fair-value-based method been applied. The Company is currently reporting share-based payment transactions with employees in accordance with APB 25 and provides the required disclosures. SFAS 123R will be effective for the Company beginning January 1, 2006.

In implementing SFAS 123R the Company will apply the modified prospective application transition method. The modified prospective application transition method requires the application of this standard to:

- o All new awards issued after the effective date;
- o All modifications, repurchased or cancellations of existing awards after the effective date; and
- o Unvested awards at the effective date.

For unvested awards, the compensation cost related to the remaining "requisite service" that has not been rendered at the effective date will be determined by the compensation cost calculated currently for either recognition or pro forma disclosures under SFAS 123. The Company will be adopting the modified prospective application of SFAS 123R.

### NOTE C - RESTRUCTURING OF CERTAIN NOTES PAYABLE

As of June 30, 2005, the Company's (i) 10% Subordinated Notes amounting to \$1,000,000, (ii) 18% Promissory Note amounting to \$300,000, (iii) 10% Secured Note amounting to \$150,000, and (iv) 24% Secured Notes amounting to \$150,000, were all due and payable. Unpaid interest relating to these notes amounting to approximately \$220,000 is also due and payable. As of the date hereof, no event of default has been declared by any holder thereof. Management and the noteholders, which include directors, officers and an employee of the Company who is also a director, are currently renegotiating the terms of these notes.

### NOTE D - LITIGATION

- [1] The Company is a party to various vendor related litigations. Management of the Company has accrued a liability of approximately \$100,000 and, accordingly, this liability has been reflected in accounts payable and accrued expenses.
- [2] On August 19, 2004, two of the Company's then officers, Michael J. Gutowski and Larry M. Reid, who were then also directors, informed the Company that their employment contracts may have been breached. On August 27, 2004, these officers filed suit against the Company in the United States District Court, Southern District of Florida, alleging that (i) their employment contracts had been

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

### NOTE D - LITIGATION (CONTINUED)

[3] breached and (ii) certain future compensation relating thereto to be paid to them amounting up to an aggregate of \$1,003,000 had been accelerated. On October 5, 2004, Carol L. Gutowski, then an officer of one of the Company's subsidiaries and a former director of the Company, instituted a suit against the subsidiary in the Circuit Court, 17th Judicial Circuit, Broward County, Florida, alleging (i) a breach of her employment agreement with the subsidiary and (ii) that certain future compensation relating thereto to be paid to her from the subsidiary amounting up to an aggregate of \$274,000 had been accelerated.

The Company reported that it did not believe that it had committed any breach of these agreements and, accordingly, had not incurred the claims that these officers alleged. In addition, the Company reported that it believed that these officers had committed violations of their employment agreements and had taken other actions that had damaged the Company. Accordingly, the Company filed a defense to these actions and asserted appropriate counterclaims.

On January 10, 2005, both of the aforementioned actions were settled. In accordance therewith, the parties agreed, among other things, as follows:

1. Each party will release the other from any and all claims except for any obligations set forth in the settlement agreement and the legal actions between the parties, including both the Federal Court and Florida Circuit Court actions, will be dismissed with prejudice;
2. The parties shall bear their own fees and expenses relating to the litigation;
3. Messrs. Reid and Gutowski and Ms. Gutowski shall be released from the non-competition provisions of their respective employment contracts;
4. Messrs. Reid and Gutowski agreed to resign as directors of the Company; and
5. Messrs. Reid and Gutowski and Ms. Gutowski shall exchange, in the aggregate, (i) all of their Class AA (1,000,000 shares), Class A (305,336 shares), and Class C (4,867,937 shares) Preferred Stock of the Company, and (ii) all issued incentive stock options of the Company, aggregating 1,550,000 in the aggregate, for 850,000 shares of our Common Stock if the exchange is made on or prior to May 10, 2005, 950,000 shares if the exchange is made on or prior to June 9, 2005, or 1,050,000 shares if the exchange is made on or prior to July 9, 2005 subject to certain restrictions relating to the sale thereof.

The settlement agreement has been being filed with the United States District Court Southern District of Florida, Case No: 04-61125-Civ-Cooke/McAliley, Michael J. Gutowski and Larry M. Reid, Plaintiffs, v. CNE Group, Inc., Defendant/Counter-Plaintiff, v. Michael J. Gutowski, Larry M. Reid and Carol L. Gutowski, Counter-Defendants.

On May 9, 2005, the Company tendered 850,000 shares of its common stock in accordance with the applicable provisions of the settlement agreement. On or about July 9, 2005, Mr. and Mrs. Gutowski and Mr. Reid delivered to the Company those securities required to be delivered by the settlement

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agreement. The Company subsequently retired these securities. All other provisions of the settlement agreement have also been satisfied by both parties.

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

#### NOTE E - CONSULTING AGREEMENT

On May 11, 2005 the Company entered into a consulting Agreement with an individual that included the issuance of 300,000 shares of its restricted Common Stock and three-year warrants to purchase an aggregate of 250,000 shares at \$0.46 per share, subject to appropriate anti-dilution provisions.

#### NOTE F - SUBSEQUENT EVENT

On July 28, 2005, the Company signed an Agreement of Plan to Merge with Arrow Resources Development Ltd. ("Arrow"), a Bermuda registered company based in New York City, to merge operations subject to stockholder approval. The current stockholders and creditors of the Company. will retain 4% of the common stock of the Company, and the stockholders of Arrow, at Closing, will be issued 96% of the common stock of the Company, on a fully diluted basis. In connection therewith, the Company will issue 10,000,000 shares of its Series AAA Preferred Stock which will be automatically convertible into such number of shares of the Company's common Stock as shall equal 96% of the then number of outstanding shares if and when stockholder approval is obtained for such conversion.

Arrow is initiating the commercial development of timber resources and a eucalyptus plantation operation in Papua, New Guinea through Arrow Pacific Resources PNG Ltd. ("APR"), an affiliated company. Arrow has entered into a Marketing Agreement with APR to act as the publicly-listed management, financial and corporate operations arm for all of APR's timber activities in Papua, New Guinea.

APR has been granted licenses from the government of Papua, New Guinea for the development of plantation operations on more than 750,000 acres of land. The Marketing Agreement provides for Arrow to receive 10% of the gross sales generated by all plantation operations, from all resources and any and all derivative products (e.g. paper, pulp, chips).

The Agreement of Plan to Merge replaces the previous transaction announced on June 1, 2005, in which CNE Group's Board of Directors approved a spin-off to its stockholders of a recently formed subsidiary.

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

#### General -----

We are a holding company whose primary operating subsidiaries are SRC and US Commlink. SRC, also a holding company, is the parent of Connectivity and ECI. These companies, which we acquired on April 23, 2003, market, manufacture, repair and maintain remote radio and cellular-based emergency

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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.

Catastrophe of September 11, 2001  
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In 2001, our headquarters were located at Suite 2112 of Two World Trade Center in New York City. In April and September 2002, and August 2003, we received governmental assistance grants related to the catastrophe aggregating \$300,000. The grants had a restriction that could require their repayment, specifically if we were to relocate a substantial portion our operations outside of New York City. On May 1, 2005 the restriction lapsed and, accordingly, we removed the liability and recorded grant income on our financial statements.

Critical Accounting Policies and Estimates  
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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:

Allowance for Doubtful Accounts, Revenue Recognition  
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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.

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.

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At June 30, 2005, our allowance for doubtful accounts was \$66,000 or 28.1% of gross receivables, compared to \$51,000 or 22.9% of gross receivables as of December 31, 2004. The increase in the reserve as a percentage of gross receivables at June 30, 2005 as compared to December 31, 2004 is primarily the result of increased requirement for an allowance for doubtful accounts at June 30, 2005 than at December 31, 2004.

### Inventory Valuation

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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

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#### Assets

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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

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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 carrying 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

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In January 2003, the FASB issued FIN 46, Consolidation of Variable Interest Entities (VIE's), and a revision to FIN 46 in December 2003 (together, "FIN 46"), which requires identification of our participation in VIE's. VIE's are defined as entities with a level of invested equity that is not sufficient to fund future activities to permit them to operate on a stand-alone basis, or whose equity holders lack certain characteristics of a controlling financial interest. For entities identified as VIE's, FIN 46 sets forth a model to evaluate potential consolidation based on the assessment of which party to a VIE, if any, bears a majority of the risk of the VIE's expected losses, or stands to gain from a majority of the VIE's expected returns. FIN 46 also sets forth certain disclosures regarding interest in VIE's that are deemed significant, even if consolidation is not required. FIN 46 is effective for all VIE's created after January 31, 2003. We adopted FIN 46 during 2003 and the adoption of this interpretation did not have an impact on our consolidated financial statements in 2005 or 2004.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity. SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003. We adopted this standard during 2003 and the adoption did not have an impact on our consolidated financial statements in 2005 or 2004.

During December 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 153, Exchanges of Nonmonetary Assets -- An Amendment of APB Opinion No. 29. APB Opinion No. 29, Accounting for Nonmonetary

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Transactions ("APB 29") required that nonmonetary exchanges be accounted for at fair value, subject to certain exceptions. SFAS 153 has removed the exception for nonmonetary exchanges of similar productive assets, and replaced it with an exception for exchanges that lack commercial substance. The provisions of SFAS 153 are effective prospectively for all nonmonetary asset exchanges in fiscal periods beginning after June 15, 2004. The adoption of this standard did not have an impact on our consolidated financial statements in 2005 or 2004.

During December 2004, FASB issued SFAS No. 123 (Revised 2004), Share-Based Payment ("SFAS 123R"). SFAS 123R replaces SFAS No. 123, Accounting for Stock-Based Compensation (SFAS 123), and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. SFAS 123R requires companies to recognize the compensation cost related to share-based payment transactions with employees in the financial statements. The compensation cost is measured based upon the fair value of the instrument issued. Share-based compensation transactions with employees covered within SFAS 123R include share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. SFAS 123 included a fair-value-based method of accounting for share-based payment transactions with employees, but allowed companies to continue to apply the guidance in APB 25 provided that they disclose in the footnotes to the financial statements the pro forma net income if the fair-value-based method been applied. We are currently reporting share-based payment transactions with employees in accordance with APB 25



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and provides the required disclosures. SFAS 123R will be effective for us beginning January 1, 2006.

In implementing SFAS 123R we will apply the modified prospective application transition method. The modified prospective application transition method requires the application of this standard to:

- o All new awards issued after the effective date;
- o All modifications, repurchased or cancellations of existing awards after the effective date; and
- o Unvested awards at the effective date.

For unvested awards, the compensation cost related to the remaining "requisite service" that has not been rendered at the effective date will be determined by the compensation cost calculated currently for either recognition or pro forma disclosures under SFAS 123. We will be adopting the modified prospective application of SFAS 123R.

### A. Results of Operations:

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Three-Month Period Ended June 30, 2005 Compared to the Three-Month Period  
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Ended June 30, 2004  
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#### Revenues

Total revenues decreased to \$303,557 for the three-month period ended June 30, 2005 from \$550,318 for the three-month period ended June 30, 2004 primarily due to a reduction of the contracts awarded to Connectivity and ECI.

Product sales income decreased to \$132,836 for the three-month period ended June 30, 2005 from \$261,962 for the three-month period ended June 30, 2004 primarily due to a reduction of the contracts awarded to Connectivity.

Service fee income decreased to \$152,230 for the three-month period ended June 30, 2005 from \$262,518 for the three-month period ended June 30, 2004 primarily due to a reduction of the contracts awarded to Connectivity.

Internet related income decreased to \$18,491 for the three-month period ended June 30, 2005 from \$25,838 for the three-month period ended June 30, 2004 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 decreased to \$150,340 for the three-month period ended June 30, 2005 from \$281,616 for the three-month period ended June 30, 2004 due to the related decrease in revenues

#### Other Expenses

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Total other expenses decreased to \$473,031 for the three-month period ended June 30, 2005 from \$908,546 for the three-month period ended June 30, 2004 as the effect of certain cost reduction initiatives, including the reduction of our executive personnel, which when instituted effected the three-month period ended June 30, 2005 however did not effect the three month period ended June 30, 2004.

Advertising expenses increased to \$16,477 for the three-month period ended June 30, 2005 from \$12,208 for the three-month period ended June 30, 2004 as we increased our attendance at industry trade shows.

Compensation and related costs decreased to \$189,686 for the three-month period ended June 30, 2005 from \$453,030 for the three-month period ended June 30, 2004 as we instituted certain payroll reduction initiatives in, primarily, the third quarter of 2004, including the reduction of our executive personnel.

General and administrative expenses decreased to \$218,526 for the three-month period ended June

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30, 2005 from \$363,083 for the three-month period ended June 30, 2004 due to the decreased cost and use of professional services in the operations of the Company.

Product development expenses decreased to nil for the three-month period ended June 30, 2005 from \$31,368 for the three-month period ended June 30, 2004 due to the cessation of certain initiatives commenced by SRC and its subsidiaries to develop products to meet our customers' future requirements.

Depreciation and amortization expenses modestly decreased to \$48,342 for the three-month period ended June 30, 2005 from \$48,857 for the three-month period ended June 30, 2004

### Other Items

Amortization of debt discount decreased to \$8,327 for the three-month period ended June 30, 2005 from \$24,963 for the three-month period ended June 30, 2004 as the debt discount was fully amortized at April 30, 2005. There was one month of amortization in the three-month period ended June 30, 2005 as compared to three months in the three-month period ended June 30, 2004.

Interest expense decreased to \$64,252 for the three-month period ended June 30, 2005 from \$86,460 for the three-month period ended June 30, 2004 due primarily to a decrease in the use, by SRC and its subsidiaries, of accounts receivable financing commonly referred to as factoring. Factoring, when utilized, has an annual interest rate in excess of 36%.

Grant income increased to \$300,000 for the three-month period ended June 30, 2005 from nil for the three-month period ended June 30, 2004 as the restrictions set forth in the grant have expired.

### Operating Loss

On a pre-tax basis, we had a net loss before income taxes of \$92,330 for the three-month period ended June 30, 2005 compared with a net loss before

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income taxes of \$751,112 for the three-month period ended June 30, 2004.

Our net loss for the three-month period ended June 30, 2005 was \$92,330 compared with a net loss of \$751,112 for the three-month period ended June 30, 2004. For the three-month period ended June 30, 2005, net loss per common share, basic and diluted, was \$0.01 per share. For the three-month period ended June 30, 2004, net loss per common share, basic and diluted, was \$0.07 per share.

Six-Month Period Ended June 30, 2005 Compared to the Six-Month Period  
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Ended June 30, 2004  
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### Revenues

Total revenues decreased to \$930,328 for the six-month period ended June 30, 2005 from \$1,533,260 for the six-month period ended June 30, 2004 primarily due to a decrease in the dollar amount of the contracts awarded to Connectivity and ECI.

Product sales income decreased to \$512,961 for the six-month period ended June 30, 2005 from \$893,400 for the six-month period ended June 30, 2004 primarily due to a decrease in the dollar amount of the contracts awarded to Connectivity.

Service fee income increased to \$352,414 for the six-month period ended June 30, 2005 from \$582,653 for the six-month period ended June 30, 2004 primarily due to a decrease in the dollar amount of the contracts awarded to ECI.

Internet related income increased to \$64,953 for the six-month period ended June 30, 2005 from \$57,207 for the six-month period ended June 30, 2004 as the operations of our subsidiary, CareerEngine, Inc. have stabilized although we have relatively small operations within the e-recruiting industry.

### Cost of Goods Sold

Costs of goods sold, which relates to product sales and related service fee income decreased to \$327,869 for the six-month period ended June 30, 2005 from \$785,315 for the six-month period ended June 30, 2004 due to the related decrease in revenues

### Other Expenses

Total other expenses decreased to \$992,811 for the six-month period ended June 30, 2005 from \$1,655,784 for the six-month period ended June 30, 2004 as the effect of certain cost reduction initiatives, including the reduction of our executive personnel, were instituted in the six-month period ended June 30, 2005 that were not instituted in the six month period ended June 30, 2004.

Advertising expenses modestly decreased to \$34,285 for the six-month period ended June 30, 2005 from \$36,928 for the six-month period ended June 30, 2004 as we decreased our attendance at industry trade shows. These expenditures relate to the acquired operations of USCL and SRC and its subsidiaries.

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Compensation and related costs decreased to \$401,287 for the six-month period ended June 30, 2005 from \$821,592 for the six-month period ended June 30, 2004 as we instituted certain payroll reduction initiatives in, primarily, the third quarter of 2004, including the reduction of our executive personnel.

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General and administrative expenses decreased to \$459,692 for the six-month period ended June 30, 2005 from \$663,299 for the six-month period ended June 30, 2004 due to the decreased cost and use of professional services in the operations of the Company.

Product development expenses decreased to nil for the six-month period ended June 30, 2005 from \$37,609 for the six-month period ended June 30, 2004 due to the cessation of certain initiatives commenced by USCL to develop products to meet our customers' future requirements.

Depreciation and amortization expenses modestly increased to \$97,547 for the six-month period ended June 30, 2005 from \$96,356 for the six-month period ended June 30, 2004.

### Other Items

Amortization of debt discount decreased to \$33,290 for the six-month period ended June 30, 2005 from \$149,784 for the six-month period ended June 30, 2004 due the combined effect of a decreased 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. The debt discount was fully amortized on April 30, 2005.

Interest expense decreased to \$134,125 for the six-month period ended June 30, 2005 from \$167,342 for the six-month period ended June 30, 2004 due primarily to a decrease in the use, by SRC and its subsidiaries, of accounts receivable financing commonly referred to as factoring. Factoring, when utilized, has an annual interest rate in excess of 36%.

Grant income increased to \$300,000 for the six-month period ended June 30, 2005 from nil for the six-month period ended June 30, 2004 as the restrictions set forth in the grant have expired.

### Operating Loss

On a pre-tax basis, we had a net loss before income taxes of \$257,676 for the six-month period ended June 30, 2005 compared with a net loss before income taxes of \$1,224,666 for the six-month period ended June 30, 2004.

Our net loss for the six-month period ended June 30, 2005 was \$257,676 compared with a net loss of \$1,224,666 for the six-month period ended June 30, 2004. For the six-month period ended June 30, 2005, net loss per common share, basic and diluted, was \$0.02 per share. For the six-month period ended June 30, 2004, net loss per common share, basic and diluted, was \$0.12 per share.

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### B. Liquidity and Capital Resources

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We have incurred substantial losses, sustained substantial cash outflows from operating activities and had a working capital deficit at June 30, 2005 and December 31, 2004. The above factors raise substantial doubt about our ability to continue as a going concern. Our continued existence depends on our ability to obtain additional equity and/or debt financing to fund our operations, financial obligations as they become due, and ultimately to achieve profitable operations. We are continuously in the process of raising additional financing and have initiated a cost reduction strategy. At June 30, 2005 and December 31, 2004 management believes that the working capital deficit, losses and negative cash flow will ultimately be improved by (i) cost reduction strategies initiated in January and June 2004, (ii) additional equity and debt financing activities, and (iii) a merger/acquisition transaction or a transaction of a similar nature in addition to those set forth in the financial statements.

On May 5, 2005, the Company received notice from the American Stock Exchange ("AMEX") Staff indicating that at December 31, 2004 it did not meet certain of AMEX's continuing listing standards, specifically its (i) Stockholders' Equity being less than \$6,000,000 (Section 1003(a)(iii) of the AMEX Company Guide) and (ii) financial condition has become so impaired that it appears questionable that it will be able to continue operations and/or meet its obligations as they mature (Section 1003(a)(iv) of the AMEX Company Guide). AMEX requested the Company to submit a plan that would demonstrate to AMEX the Company's ability to regain compliance (the "Plan"). On June 6, 2005 the Company submitted the Plan. On June 13, 2005, the Staff notified the Company that it had determined that the Plan did not make a reasonable demonstration of the Company's ability to regain compliance with the continued listing standards, as required by Section 1009 of the Company Guide and, as provided by Section 1009(d) thereof, the Staff has determined to proceed with the filing of an application with the Securities and Exchange Commission to strike the Company's common stock from listing and registration on AMEX. In accordance with Sections 1203 and 1009(d) of the Company Guide the Company had a limited right to appeal the Staff's determination at an oral hearing or one based on a written submission before a Listing Qualifications Panel. The Company requested, and was subsequently granted, an oral hearing on August 8, 2005 to appeal the Staff's determination. The Company is awaiting the decision of the Listing Qualifications Panel. The Company can give no assurance that its appeal will be successful. If the appeal is successful the Plan is subject to the approval and to periodic monitoring by AMEX. Assuming the Company achieves its scheduled financial milestones as determined by AMEX, the Company may have until November 5, 2005 to regain compliance with the continuing listing requirements. If the Company it does not achieve its scheduled financial milestones as determined by AMEX, the Company will lose its AMEX listing.

At June 30, 2005, our Stockholders' Equity was approximately \$5,661,000, our current assets were \$597,000, and our current liabilities were \$3,868,000 that

primarily included notes payable (\$1,850,000 due as of June 30, 2005) and related interest payable amounting to approximately \$2,097,000. No event of default has been declared by any holder thereof as of the date hereof. Management and the noteholders, who include certain of our directors,

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officers and an employee who is also a director, are currently renegotiating the terms of these notes. There is no assurance that we can obtain additional financing or achieve profitable operations or generate possible cash flow or that we can retain our listing. Our 2005 and 2004 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 ongoing concern uncertainty

On July 28, 2005, the Company signed an Agreement of Plan to Merge with Arrow Resources Development Ltd. ("Arrow"), a Bermuda registered company based in New York City, to merge operations subject to stockholder approval. The current stockholders and creditors of the Company. will retain 4% of the common stock of the Company, and the stockholders of Arrow, at Closing, will be issued 96% of the common stock of the Company, on a fully diluted basis. In connection therewith, the Company will issue 10,000,000 shares of its Series AAA Preferred Stock which will be automatically convertible into such number of shares of the Company's common Stock as shall equal 96% of the then number of outstanding shares if and when stockholder approval is obtained for such conversion.

Arrow is initiating the commercial development of timber resources and a eucalyptus plantation operation in Papua, New Guinea through Arrow Pacific Resources PNG Ltd. ("APR"), an affiliated company. Arrow has entered into a Marketing Agreement with APR to act as the publicly-listed management, financial and corporate operations arm for all of APR's timber activities in Papua, New Guinea.

APR has been granted licenses from the government of Papua, New Guinea for the development of plantation operations on more than 750,000 acres of land. The Marketing Agreement provides for Arrow to receive 10% of the gross sales generated by all plantation operations, from all resources and any and all derivative products (e.g. paper, pulp, chips).

The Agreement of Plan to Merge replaces the previous transaction announced on June 1, 2005, in which CNE Group's Board of Directors approved a spin-off to its stockholders of a recently formed subsidiary.

### Off-Balance Sheet Arrangements

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At June 30, 2005 and December 31, 2004, we had no off-balance sheet arrangements.

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### Operating Activities

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We utilized \$136,512 of cash in operating activities during the six-month period ended June 30, 2005. We had a net loss of \$257,676 during this period, which included an aggregate of \$199,837 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 accounts payable, accrued expenses, and deferred grant revenue, and a decrease in prepaid expenses and other assets.

We utilized \$853,961 of cash in operating activities during the six-month

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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.

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 in February 2004 from the sale of our Common Stock (see "Financing Activities" below), and restructured certain short-term credit arrangements into a \$300,000 note payable due in February 2005. Furthermore, in July through December 2004 we restructured and issued approximately \$450,000 of our debt securities. We are currently attempting to restructure the debt due April 30, 2005 amounting to \$1,600,000 with the holders thereof.

### Financing Activities

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On April 23, 2003, we completed a private financing pursuant to which we issued notes (the "Notes") in the aggregate principal amount of \$1,000,000, of which \$650,000 was to certain of our officers, and 4,165,800 ten year cashless Class B Warrants, each to purchase one share of our Common 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 equal 15% of our outstanding Common Stock on a fully-diluted basis. The Warrants are anti-dilutive until the Notes have been repaid. The due date of the Notes may be extended at our option for an additional year in consideration for the issuance of 10-year warrants to purchase 4% of our then outstanding Common Stock at \$0.50 per share. These Warrants would also be

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anti-dilutive until the Notes have been repaid. In addition, 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 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 then 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 (which we are currently negotiating an extension) 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 May 2005, we notified the Class B Warrant holders that, to satisfy the now 19% non-dilutive provisions of their Warrants, these Warrants are now exercisable for an additional of 1,122,100 shares of our

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Common Stock at approximately \$0.40 per share.

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, we sold 1,750,000 shares of our Common Stock at \$0.40 per share. The net proceeds of the transaction amounted to \$571,000.

On June 24, 2004 we repaid, in full, one of our outstanding lines of credit amounting to approximately \$146,000. On the same date we issued a secured note payable to an employee of one of our subsidiaries in the amount of \$150,000. This employee is also now one of our directors. The note is secured by the furniture and equipment of the subsidiary. The note bears interest at 10% per annum and the principal and all interest thereon was due on September 24, 2004. In consideration for extending the maturity date of the note to April 30, 2005 and deferring the payment of all accrued interest for the period June 24, 2004 through April 30, 2005, we issued the noteholder individual Warrants to purchase 101,000 shares of our Common Stock at \$0.28 per share. Management and the noteholder are currently renegotiating the terms of these notes.

In July and August 2004, we issued \$150,000 of our 24% Secured Notes due April 30, 2005 to the wife of our Chief Executive Officer who is also the holder of one of our 10% subordinated notes. Interest on the notes is payable quarterly in arrears. The notes are secured by (i) all the stock of SRC and USCL, and (ii) the pledge of Patent Nos. 6,060,979, 6,047,173 and 5,701,338 - all owned by us. On October 1, 2004, the holders of 100% of our 24% Secured Notes agreed to defer \$5,867 of interest due on such date to January 1, 2005 in consideration for our issuing to them 53,333 of our Class B Warrants, each to give the holder

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thereof the right to purchase one share of our Common Stock at \$0.33 per share. On January 1, 2005, the holders of 100% of our 24% Secured Notes agreed to defer \$9,200 of interest due on such date and further defer the interest that was due and deferred on October 1, 2004 \$5,867 to April 1, 2005 in consideration for our issuing to them 113,000 of our Class B Warrants, each to give the holder thereof the right to purchase one share of our Common Stock at \$0.40 per share. Management and the noteholders, which includes directors, and an officer of the Company, are currently renegotiating the terms of these notes.

In October 2004, we and USCL entered into a two-year Project Financing Agreement with an institutional lender relating to USCL's anticipated participation in the "Cellular Call Box Upgrade and Maintenance Service" projects for numerous Service Authority for Freeway Emergencies ("SAFE") programs within the state of California. We cannot assure you that we will participate in these projects or, if we do, to what extent such participation will be. This agreement provides us with finished goods and accounts receivable financing of up to \$2,000,000 relating to these potential aforementioned projects. The effective interest rate is approximately 3% per month on the outstanding balance of the amount receivables financed. The finished goods and accounts receivable to be financed, as well as all of our other assets not previously pledged, will secure the borrowings under this agreement.

In October, November and December 2004, we issued (i) \$150,000 of our 10% Convertible Subordinated Notes due June 30, 2005 and (ii) 945,000 of our



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Class C Cashless Warrants, each to give the holder thereof the right to purchase one share of our Common Stock at \$0.50 per share. The notes were sold to the wife of our Chief Executive Officer and other accredited investors and are convertible by the holder, at any time, into our Common Stock at \$0.50 per share. The warrants expire on April 30, 2013. Interest on the notes is due at maturity.

On or about April 1, 2005, two individuals, both of whom are adult children of our Chief Executive Officer, purchased 545,000 shares of our Series G Preferred Stock at a price of \$0.20 per share. The Series G Preferred Stock is non voting, has no liquidating preference over our Common Stock and each share is automatically convertible into two shares of our Common Stock when such conversion has been approved by our Common Stockholders.

On or about April 12, 2005, four individuals, three of whom are adult children or related thereto of our Chief Executive Officer, purchased 500,000 shares of our Series G Preferred Stock at a price of \$0.20 per share.

On or about April 20, 2005, an individual purchased 100,000 shares of the Company's Series G Preferred Stock at a price of \$0.20 per share.

On or about March 15, 2005, the Company borrowed \$25,000 from a lender evidenced by a secured convertible subordinated note due on September 15, 2005

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and bearing interest at the annual rate of 20% payable at maturity. The note was (i) secured by approximately \$42,000 in one of the Company's bank accounts; (ii) convertible into the Company's Common Stock at the rate of \$0.24 per share, subject to certain anti-dilution provisions; and (iii) subordinated to the Company's Senior Indebtedness as that term is defined therein. On June 10, 2005 the Company repaid this note in full. In addition, on or about April 15, 2005, the Company sold to this lender, for an aggregate purchase price of \$50,000, 333,333 shares of restricted Common Stock and three-year warrants to purchase an aggregate of 100,000 shares of Common Stock at \$0.50 per share, subject to appropriate anti-dilution provisions.

We are using the funds obtained from these financings for working capital. The financings were effected pursuant to the exemption from the registration provisions of the Securities Act of 1933 provided by Section 4(2) thereof.

For information relating to a merger transaction entered into on July 28, 2005 by the Company see Note F - Subsequent Event to the interim financial statements included with this filing.

We did not have any material commitments for capital expenditures as of June 30, 2005.

### C. Inflation -----

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

Item 3. Controls and Procedures

Our Chief Executive Officer and Chief Financial Officer 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 our 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.

We are a party to various vendor related litigations. Based on the opinion of management, we have accrued an estimated liability of approximately \$100,000.

Item 5. Other Information.

None

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

(a) Exhibits:

- 2.1 Agreement and Plan of Merger between CNE Group, Inc. and Arrow Development Resources Ltd. dated as of August 1, 2005
- 2.2 Series AAA Preferred Stock Purchase Agreement
- 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.

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(b) Reports on Form 8-K:

The Company filed a report on Form 8-K on May 26, 2005, a report on Form 8-K on June 17, 2005, a report on Form 8-K/A on June 23, 2005, and a report on Form 8-K on August 2, 2005.

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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

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

Date: August 12, 2005

/s/ Anthony S. Conigliaro

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Anthony S. Conigliaro, Vice President and  
Chief Financial Officer

Date: August 12, 2005

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