Film & Music Entertainment, Inc.
Form 10QSB
January 30, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-QSB

(Mark One)

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

For the quarterly period ended September 30, 2005

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from ___________ to ___________

0-51164

(Commission file number)

FILM AND MUSIC ENTERTAINMENT, INC.

(Exact name of small business issuer as specified in its charter)

Nevada	01-0802246
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

5670 Wilshire Blvd., Suite 1690, Los Angeles, California 90036

(Address of principal executive offices)

(323) 904-5200

(Issuer's telephone number)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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 []

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: As of November 1, 2005 - 125,170,398 shares of common stock

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes [ ] No [X]

Transitional Small Business Disclosure Format (check one):

Yes [ ]   No [X]

FILM AND MUSIC ENTERTAINMENT, INC.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Film and Music Entertainment, Inc. and Subsidiaries

Consolidated Balance Sheet

	September 30, 2005 (unaudited)
ASSETS	
CURRENT ASSETS	
Cash and cash equivalents	$ 502,474
Restricted cash	40,518
Loan receivable from Miracle Entertainment, Inc.	25,000
Other current assets (including amounts due from related party of $17,797)	190,067
Investment in equity securities	1,840,710
TOTAL CURRENT ASSETS	2,598,769
PROPERTY AND EQUIPMENT, net of accumulated depreciation of $15,307	82,768
REAL ESTATE INVESTMENTS	430,000

FILM COSTS	476,146
TOTAL ASSETS	$ 3,587,683

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES	
Accounts payable	$ 59,859
Accrued expenses (including amounts due from related party of $2,848)	68,040
Production advances	6,924
TOTAL CURRENT LIABILITIES	134,823
COMMITMENT AND CONTINGENCIES (Note 8)	-
STOCKHOLDER'S EQUITY	
Common stock, $0.001 par value; 250,000,000 shares authorized; 125,170,398 shares issued and outstanding	125,170
Additional paid-in capital	21,066,142
Accumulated deficit	(17,738,452)
TOTAL STOCKHOLDERS' EQUITY	3,452,860
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 3,587,683

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

Film and Music Entertainment, Inc. and Subsidiaries

Consolidated Statements of Operations

	Three Months Ended		Nine Mont
	September 30, 2005	September 30, 2004	September 30, 2005
	(unaudited)	(unaudited)	(unaudited)
REVENUE	$ -	$ -	$ 162,024

OPERATING EXPENSES			
Production costs	-	26,417	-
Advertising costs	108,366	-	279,845
Compensation expense	92,672	130,982	249,275
Consulting expense	16,241	2,000	39,875
General and administrative expenses	137,087	85,769	406,241
TOTAL OPERATING EXPENSES	354,366	245,168	975,236
LOSS FROM OPERATIONS	(354,366)	(245,168)	(813,212)
OTHER INCOME (EXPENSE)			
Other income	8,999	5,000	9,184
Investment income	6,921	11,079	17,125
Unrealized loss on marketable equity securities	166,942	-	145,537
Realized loss on sale of marketable equity securities	(33,636)	-	(62,852)
Gain on foreclosure of note receivable	-	-	50,000
Gain on disposition of real estate	-	-	208,500
TOTAL OTHER INCOME (EXPENSE)	149,226	16,079	367,494
LOSS BEFORE PROVISION FOR INCOME TAXES	(205,140)	(229,089)	(445,718)
PROVISION FOR INCOME TAXES	-	-	-
NET LOSS	$ (205,140)	$ (229,089)	$ (445,718)
NET LOSS PER SHARE - BASIC AND DILUTED	$ (0.00)	$ (0.00)	$ (0.00)
WEIGHTED AVERAGE SHARES OUTSTANDING - BASIC AND DILUTED	125,170,398	151,957,898	126,810,142

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

Film and Music Entertainment, Inc. and Subsidiaries

Consolidated Statement of Stockholders' Equity

(unaudited)

Additional

	Common Stock Shares	Common Stock Amount	Paid- in Capital	Accumu Defi
Balance, December 31, 2004	140,970,398	140,970	21,596,617	(17,29
Issuance of common stock for exercise of options	2,450,000	2,450	(1,225)	
Shares canceled in connection with non-payment on note receivable	(2,500,000)	(2,500)	(72,500)	
Shares canceled in connection with transfer of real estate investment to former owner	(15,750,000)	(15,750)	(456,750)	
Net loss	-	-	-	(44
Balance, June 30, 2005	125,170,398	$ 125,170	$ 21,066,142	$(17,73

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

Film and Music Entertainment, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

	Nine Months Ended September 30, 2005 (unaudited)	Nine Months Ended September 30, 2004 (unaudited)
CASH FLOW FROM OPERATING ACTIVITIES:		
Net loss	$ (445,718)	$ (601,660)
Adjustment to reconcile net loss to net cash used in operating activities:		
Depreciation expense	9,065	3,769
Common stock issued for services	-	3,700
Unrealized loss on marketable equity securities	(145,537)	-
Gain on disposition of real estate	(208,500)	-
Gain on foreclosure of note receivable	(50,000)	-
Purchase of marketable equity securities	(2,895,862)	-
Sale of marketable securities	1,860,638	-
Changes in operating assets and liabilities:		
Other current assets	(181,633)	(23,891)
Film costs	(401,146)	-

Accounts payable	(24,629)	18,804
Accrued expenses	(105,784)	147,239
Production advances	(35,398)	12,123
Net cash used in operating activities	(2,624,504)	(439,916)
CASH FLOW FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(52,680)	(32,065)
Increase in restricted cash	-	(40,518)
Investment in SMS Musicmaker Ltd.	-	(48,909)
Purchase of real estate	-	(373,001)
Net cash used in investing activities	(52,680)	(494,493)
CASH FLOW FROM FINANCING ACTIVITIES:		
Proceeds received from Miracle Entertainment	-	6,347
Proceeds from sale of common stock	-	5,000,000
Proceeds from exercise of options	-	625
Net cash provided by financing activities	-	5,006,972
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(2,677,184)	4,072,563
CASH AND CASH EQUIVALENTS, Beginning of period	3,179,658	112,079
CASH AND CASH EQUIVALENTS, End of period	$ 502,474	$ 4,184,642
SUPPLEMENTAL DISCLOSURES OF CASH FLOWS INFORMATION:		
Interest paid	$ 2,217	$ -
Income taxes paid	$ -	$ -

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

FILM AND MUSIC ENTERTAINMENT, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Note 1 - Basis of Presentation

The unaudited consolidated financial statements have been prepared by Film and Music Entertainment, Inc. (the "Company"), pursuant to the rules and regulations of the Securities and Exchange Commission. The information furnished herein reflects all adjustments (consisting of normal recurring accruals and adjustments) which are, in the opinion of management, necessary to fairly present the operating results for the respective periods. Certain information and footnote disclosures normally present in annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted pursuant to such rules and regulations. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and footnotes for the year ended December 31, 2004 included in the Company's Annual Report on Form 10SB. The results of the nine months ended September 30, 2005 are not necessarily indicative of the results to be expected for the full year ending December 31, 2005.

Stock Options

SFAS No. 123, "Accounting for Stock-Based Compensation," establishes and encourages the use of the fair value based method of accounting for stock-based compensation arrangements under which compensation cost is determined using the fair value of stock-based compensation determined as of the date of grant and is recognized over the periods in which the related services are rendered. The statement also permits companies to elect to continue using the current intrinsic value accounting method specified in Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," to account for stock-based compensation. The Company has elected to use the intrinsic value based method and has disclosed the pro forma effect of using the fair value based method to account for its stock-based compensation issued to employees. For options granted to employees where the exercise price is less than the fair value of the stock at the date of grant, the Company recognizes an expense in accordance with APB 25. For non-employee stock based compensation the Company recognizes an expense in accordance with SFAS No. 123 and values the equity securities based on the fair value of the security on the date of grant. For stock-based awards the value is based on the market value for the stock on the date of grant and if the stock has restrictions as to transferability a discount is provided for lack of tradability. Stock option awards are valued using the Black-Scholes option-pricing model.

The pro forma information regarding the effects on operations that is required by SFAS 123 and SFAS 148 are not presented since there is no pro forma expense to be shown for the three and nine months ended September 30, 2005 and 2004.

Note 2 - Loss Per Share

The Company reports earnings (loss) per share in accordance with SFAS No. 128, "Earnings per Share." Basic earnings (loss) per share is computed by dividing income (loss) available to common shareholders by the weighted average number of common shares available. Diluted earnings (loss) per share is computed similar to basic earnings (loss) per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential common shares had been issued and if the additional common shares were dilutive. Diluted earnings (loss) per share has not been presented since the effect of the assumed conversion of options and warrants to purchase common shares would have an anti-dilutive effect. At

September 30, 2005 there were 79,957,000 options outstanding that have been excluded from the computation of diluted net loss per share because the effect would have been anti-dilutive.

FILM AND MUSIC ENTERTAINMENT, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Note 3 - Investments in Marketable Equity Securities

The Company invests some of its excess cash in marketable equity securities. The marketable equity securities comprise of common stock of publicly traded companies. These investments are classified as trading securities as they are held principally for the purpose of selling in the near term. They are reported at fair value with unrealized gains and losses included in earnings. The fair value is determined by using the securities quoted market price as obtained from stock exchanges on which each securities trades.

Investment income, principally dividends, is recorded when earned. Realized capital gains and losses are calculated based on the cost of securities sold, which is determined by the "identified cost" method.

The unrealized gains/(losses) in the Company's portfolio of marketable equity securities as of September 30, 2005 is as follows:

Historical costs basis	$ 1,707,343
Unrealized gains	303,747
Unrealized losses	(170,380)
Fair value	$ 1,840,710

Note 4 - Loan Receivable from Miracle Entertainment, Inc.

As of December 31, 2003, Miracle Entertainment, Inc. owed the Company, $66,317. This amount was considered a short-term loan, non-interest bearing and unsecured. During June 2004, the Company executed a secured promissory note with Miracle Entertainment Inc. The repayment terms call for two equal payments of $25,000. The first payment is due April 15, 2005. The second payment is due December 15, 2005. The promissory note is non-interest bearing and is secured by 5,000,000 shares of the Company's stock. On April 15, 2005, Miracle did not make the required payment of $25,000; therefore the Company foreclosed on 2,500,000 shares of its common stock used to secure the loan. As a result of this foreclosure, the Company recognized a gain of $50,000 since the value of the 2,500,000 shares exceeded the required payment by $50,000. As of the September 30, 2005 the market value of the remaining shares of the Company's stock exceeded the remaining carrying value of the note of $25,000. Therefore, no write down of the note was deemed necessary.

Note 5 - Property and Equipment

The cost of property and equipment at September 30, 2005 consisted of the following:

	September 30, 2005
Computers	$ 3,330
Automobile	61,197
Furniture and fixtures	33,548
	98,075
Less accumulated depreciation	(15,307)
	$ 82,768

Depreciation expense for the nine months ended September 30, 2005 and 2004 was $9,065 and $3,769, respectively.

Note 6 - Real Estate Investments

On February 3, 2005, the Company entered into an agreement with a stockholder whereby the stockholder agreed to surrender to Company 15,750,000 shares of the Company's common stock owned by the stockholder and the Company agreed to give up any rights to a hypothecated money interest relating to certain real estate located in Cochise County, Arizona that the Company has recorded on its books at $264,000. The Company removed the real estate investment of $264,000 from its books and canceled 15,750,000 shares of its common stock valued at $0.03 per share or $472,500. The Company recognized a gain of $208,500 as a result of this transaction.

Note 7 - Stockholders' Equity

Common stock

During the nine months ended September 30, 2005, the Company has the following transactions in its common stock:

* canceled 15,750,000 shares of its common stock valued at $472,500 for a certain parcel of real estate;
* issued 2,450,000 share of its common stock for the exercise of stock options. The exercise price was paid by reducing

accrued expenses by $1,225; and
* canceled 2,500,000 shares of common stock valued at $75,000 that was used to secure a loan receivable.

Note 8 - Commitments and Contingencies

Litigation

In the ordinary course of business, the Company is generally subject to claims, complaints, and legal actions. At September 30, 2005, management believes that the Company is not a party to any action which would have a material impact on its financial condition, operations, or cash flows.

Miracle Entertainment, Inc. et. al v. Filmstar Releasing Corporation et. al., Los Angeles Superior Court, Case No. BC302233:

This is a complaint for unlawful conversion, breach of contract and fraud, commenced in September, 2003 by Miracle Entertainment, Inc., a company of which John Daly was Chairman, against a firm and several individuals who had previously contracted to raise funds for productions sponsored by Miracle Entertainment. A counter-claim was filed by the defendants in March, 2004, adding the Company as a defendant.

On May 2, 2005 a confidential Settlement Agreement and Mutual Release was executed between the Company and remaining litigants on terms acceptable to all the parties resulting in no liability and complete release of claims against the company.

Carol Lefko v. Film and Music Entertainment, Inc., Celebration Pictures, Inc., John Daly and Peter Beale, Los Angeles Superior Court, Case No. BC318753.

This is a complaint for breach of an alleged oral agreement commenced July 20, 2004 between the plaintiff and the defendants whereby the plaintiff would provide services as casting director of a film to be called "Host" and produced by Celebration Productions, Inc. which was added as a party to this lawsuit by amendment in February 2005. The plaintiff alleges that she performed the services but was not paid and is owed $12,000 for breach of contract plus $60,000 for "waiting time." The defendants have answered denying any liability, that no contract existed and that no services could have been rendered to the Company since the film never went into pre-production. The Company is informed and believes that Kevin Lewis and Peter Beale, in their individual capacity, were to be co-producers of the film "Host." Mr. Lewis was also to be the director of the film and that any agreement with plaintiff is between plaintiff and Mr. Lewis. The Company maintains that no contract exists between Ms. Lefko and either FAME or Celebration or both. The Company maintains that Ms. Lefko has never been employed by any of these entities, as indicated by Company records and that neither the Company nor Celebration Pictures, Inc. ever hired any casting director.

All the Defendants except Beale filed their general denial with affirmative defenses on September 1, 2004. Film And Music responded to plaintiff's first set of written discovery. The trial took place on July 13 and 14, 2005 and the court denied any liability on the part of the defendants to the plaintiff. The Company does not expect Ms. Lefko to appeal.

Sunset Towers Partnership v. First Miracle Group. Los Angeles Superior Court, Case No. SC072450.

This is a motion to amend a judgment entered against First Miracle Group by its former landlord in the amount of $300,000 to include Celebration Productions, Inc. and Film and Music Entertainment, Inc. Sunset Towers is claiming that Celebration and the Company are in fact successors in interest of Miracle Entertainment, Inc. and are therefore liable for the judgment.

The Company and Celebration have filed an opposition to the motion denying any theory that the Company and/or Celebration are successors-in-interest of First Miracle Group and/or Miracle Entertainment, Inc. in as much as only a portion of Miracle's assets were acquired by the Company and fair consideration in the amount of $3,000,000 worth of the Company's stock; that the Company and Miracle are separate, distinct publicly traded companies, with separate shareholders, boards, officers and businesses with the single exception that Mr. Daly was at the time of acquisition a Board member and officer of both companies; that neither the Company or Celebration had the opportunity to defend the litigation from which the judgment derived; and that neither the Company nor Celebration expressly assumed the liability of Miracles obligation under the judgment.

The motion was heard on May 17, 2005 and the Court denied the plaintiff's motion, finding on the evidence presented that Miracle Entertainment did not transfer all of its assets to the Company and that the Company was not the successor-in-interest of Miracle. On July 8, 2005 Sunset Towers filed a motion to appeal. The Company has no reason to believe an appeal will overturn the earlier findings in its favor.

Note 8 - Subsequent Events

The Company executed a Letter of Intent in January 2006 with 100% Entertainment and Red Hot Entertainment to produce low budget Science Fiction films in High Definition. The Letter calls for the Company to arrange 50% of the budget of the features for which the Company shall receive distribution fees world-wide along with 50% of the profits. The Company shall have mutual script and cast approval and in addition to the first feature, the Company has the option to co-produce an additional 10 films over four years.

FILM AND MUSIC ENTERTAINMENT, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

On December 15, 2005 the Company foreclosed on the security of 2,500,000 shares of the Company's common stock held as collateral against the balance of the note of $25,000. As of the December 15, 2005 the market value of the foreclosed upon shares of the Company's stock exceeded the remaining carrying value of the note of $25,000 by $275,000. Therefore, Company recognized a gain in this amount.

On November 23, 2005, the Company issued 2,450,000 share of its common stock for the exercise of stock options. The exercise price was paid by reducing accrued expenses by $1,225.

Item 2. Management's Discussion and Analysis or Plan of Operations

General

The following discussion of our financial condition and results of operations should be read in conjunction with (1) our interim unaudited consolidated financial statements for the nine months ended September 30, 2005 and 2004 and their explanatory notes included as part of this Form 10-QSB, and (2) our annual audited consolidated financial statements and explanatory notes for the years ended
December 31, 2004 and 2003 included on Form 10-SB filed with the Securities and Exchange Commission on August 4, 2005.

Overview

Film and Music Entertainment, Inc. is a holding company which, through its subsidiaries, develops, produces, sells and distributes films and associated entertainment.

Our wholly-owned Celebration Productions, Inc. subsidiary, provides comprehensive production services for filmed entertainment. Celebration Productions has provided production service relating to the development of the film "The Harder They Fall" and "The Disappeared" and production supervisory services to the films "Played" and "Moonpie". Revenue is recognized from productions as earned and such revenue will usually be partially from specific contractual fees and from contingent compensation paid as profits are earned. Our wholly-owned Celebration Pictures, Inc. provides sales and distribution services for North America for our and third party productions. In 2005, Celebration Pictures has been provided these services on two films, "The Aryan Couple" and "Waking Up Dead". Revenues are recognized in accordance with AICPA SOP 00-2. Our wholly-owned subsidiary, Celebration International Pictures, Ltd (BVI), provides sales and distribution services for the rest of the world excluding North America for our and third party productions. The Company ceased its sales and distribution efforts in "Waking Up Dead as of October 13, 2005 and has retained a lien against future earnings of the film for all money spent in the marketing of the film. The Company also has two non-operating subsidiaries, East Mojave Corporation and Myrob Properties, Inc., in which are held certain real estate assets of the company.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities.

On an ongoing basis, we evaluate our estimates, including those related to impairment of production costs, estimates of film revenue, any potential losses from pending litigation. 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 value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions; however, we believe that our estimates, including those for the above-described items, are reasonable.

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We capitalize films in development as capitalized film costs in accordance with AICPA SOP 00-2. These costs are transferred to film inventories at the point that the film is scheduled for production. On a quarterly basis we review each film in development and/or production as to whether the capitalized costs are in excess of their fair market value, and if so, we write off the excess and reflect the write-off in costs of revenue. If after three years in development a film has not been scheduled for production it is written off and reflected in the costs of revenue.

Under SOP 00-2 the costs of the film, including the capitalized costs, contingent compensation and residual costs (if any) are amortized and included in costs of revenue in the proportion the revenue for that period for the film bears to the estimated total revenue from all markets and territories under the individual-film-forecast-computation method. We review are estimates quarterly and they are revised if necessary. A revision will result in an increase or decrease to the percentage of amortization of the capitalized film costs relative to a previous period. Should the revision result in estimated revenues proving insufficient to cover the unamortized film costs remaining on that film, the difference will be written down to the fair market value based upon its then net present value.

Results of Operations

Nine Months Ended September 30, 2005 Compared to September 30, 2004.

We have received minimum revenue from operations to date. We believe that the main sources of our revenue will be revenues from domestic and foreign theatrical distribution, DVD and home video, pay-per-view, pay cable and basic cable distribution and free broadcast television. We have begun to receive income from foreign sales of the movie "The Aryan Couple" under our contract with AV Pictures Ltd. We anticipate this income will continue through next year. The film has generated a minimal amount of theatrical income in the US from festival showings in the first half of 2005. Management expects income from US theatrical revenues to increase substantially in the fourth quarter of this year as the film moves from festival showings to a wider release. Management also anticipates revenues to commence from "Waking Up Dead" in the fourth quarter of 2005.

Revenues: Revenue for the nine-month interim period ended September 30, 2005 was $162,024, as compared to $0 for the corresponding interim period in fiscal 2004.

Our revenues for the nine-months interim period ended September 30, 2005 were principally derived from the screening of The Aryan Couple, production services rendered by our Celebration Productions subsidiary and the proceeds of the sale of the distribution rights to the film "Tournament of Dreams".

We had no revenues for the nine months ended September 30, 2004 as the Company was in the process of solidifying contracts for productions.

Operating Expenses and loss from operations: Operating Expenses and loss from operations for the nine-month interim ended September 30, 2005 were $975,236 and $813,212, respectively, as compared to $624,830 and $624,830 for the corresponding interim period in fiscal 2004.

The decrease in production costs relates to the write-off of a production in of 2004. The increase in advertising cost relates to the increased advertising for The Aryan Couple during the first nine-months of 2005. The increase of in compensation expense is mainly attributable to payments for the services of John Daly, which were $0 for the period in 2004. The increase in general and administrative expense relates primarily to the increased costs relating to compliance and legal expense relating in the court cases in which the company was involved.

Other Income(Expense): Other Income(Expense) for the nine-months ended September 30, 2005 was $367,494 as compared with $23,170for the nine-months ended September 30, 2004. This increase was entirely due to a gain of $208,500 realized on the disposition of real estate to a stockholder in return for 15,750,000 shares of the Company's common stock and net gains (realized and unrealized) on our marketable securities portfolio of $82,685.

Three Months Ended September 30, 2005 Compared to September 30, 2004.

Revenues: Revenue for the three-month interim period ended September 30, 2005 was $0 as compared to $0 for the corresponding interim period in fiscal 2004.

Operating Expenses and loss from operations: Operating Expenses and loss from operations for the three-month interim ended September 30, 2005 were $354,366 and $354,366, respectively, as compared to $245,168 and $245,168 for the corresponding interim period in fiscal 2004.

The decrease in production costs relates to the write-off of a production in of 2004. The increase in advertising cost relates to the increased advertising for The Aryan Couple during the first three-months of 2005. The increase in general and administrative expense relates primarily to the increased costs relating to compliance and legal expense relating in the court cases in which the company was involved.

Other Income(Expense): Other Income(Expense) for the three-months ended September 30, 2005 was $149,226 as compared with $16,079 for the three-months ended September 30, 2004. This increase was principally due to net gains realized and unrealized) on our marketable securities portfolio of $133,306.

Three Months Ended September 30, 2005 Compared to September 30, 2004.

Revenues: Revenue for the three-month interim period ended September 30, 2005 was $0 as compared to $0 for the corresponding interim period in fiscal 2004.

Operating Expenses and loss from operations: Operating Expenses and loss from operations for the three-month interim ended September 30, 2005 were $354,366 and $354,366, respectively, as compared to $245,168 and $245,168 for the corresponding interim period in fiscal 2004.

The decrease in production costs relates to the write-off of a production in of 2004. The increase in advertising cost relates to the increased advertising for The Aryan Couple during the first three-months of 2005. The increase in general and administrative expense relates primarily to the increased costs

relating to compliance and legal expense relating in the court cases in which the company was involved.

Liquidity and Capital Resources

Historical Sources of Cash: For the period January 1, 2005 through September 30, 2005 we principally financed our operations through cash on hand derived from the sale of common shares for cash amounting $5,000,000 in April 2004.

Cash Position and Sources and Uses Of Cash: Our cash and cash equivalents position as of September 30, 2005 was $502,474 as compared to $3,179,658 as of December 31, 2004. The decrease in our cash and cash equivalents for the nine-month interim period ended September 30, 2005 was attributable to the net increase in equity securities of $1,035,224 resulting from the purchase and sale of $2,895,862 and $1,860,638, respectively.

Our operating activities used cash in the amount of $2,624,504 for the nine-month interim period ended September 30, 2005, as compared to $439,916 for the corresponding interim period in fiscal 2004. The $2,624,504 in cash used in operating activities for the nine-month interim period ended September 30, 2005 reflected our net loss of $445,718 for that period, adjustments for non-cash deductions, such as depreciation, unrealized gains and losses on equity securities and gain on the disposal of real estate and foreclosure of a note receivable. In addition, we purchased (net) $1,035,224 in equity securities which is a use of cash from operations and changes in other operating assets and liabilities resulted in use of cash of $748,590. The $439,916 of cash used in operating activities for the nine-month interim period ended September 30, 2004 reflected our net loss of $601,660 for that period and increased by changes in other operating assets and liabilities.

Capital Resources Going Forward: We have approximately $502,000 of cash on hand as of September 30, 2005 to fund our operations going forward. The Company also has on hand approximately $1,841,000 of marketable equity securities as of this date which the Company is holding as reserves for future operations. Our plan of operation for the twelve month period following the date of this quarterly report is for the Company and its subsidiaries to continue to develop, produce, sell and distribute motion pictures. The Company primarily uses third party investor funds for such activities; however the Company may provide limited funds for such activities where Management deems it prudent. We currently have budgeted approximately $1,100,000 in costs for the twelve month period following the date of this report, including approximately $200,000, in costs relating to the development, production, sales and distribution of films and $900,000 in general, sales and marketing expenses. The Company attempts to cash flow most costs relating to film production and distribution from third party direct investments. Occasionally, the Company may front certain costs to expedite a project to achieve certain goals. The Company attempts to structure any such expenditure so that they are recouped from any further funding in the specific project. If no such further finding occurs the Company may not be able to recoup these expenditures. To date, the Company has limited such expenditures as to be non-material.

Our assets are reasonably liquid with a substantial majority consisting of cash and cash equivalents, and investment securities. Both our total assets as well as the individual components as a percentage of total assets may vary significantly from period to period because of changes relating to production and distribution schedules, sales revenues, customer demand,

seasonal, economic and market conditions. Our total net assets at September 30, 2005 were $3,587,683 compared to $4,746,712 at December 31, 2004. The Company intends to increase employees by two in the first quarter of 2006; however, these additions should not substantially change its overhead structure. The only other current plans affecting overhead would be the costs associated with the addition of independent directors to the Board and D & O Insurance and an anticipated reduction in headquarters' lease expense as we intend to lease smaller premises at a lower rate when the current lease ends on March 1, 2006. With these additional expenses, the Company would still have sufficient cash, cash equivalents and liquidateable investment securities to cover operating expenses for the next 24 months.

We believe that cash generated by operations in conjunction with our available working capital will be sufficient to continue our business for the next twelve months. We believe that our capital structure is adequate for our current operations. We continually review our overall capital and funding needs to ensure that our capital base can support the estimated needs of the business. These reviews take into account current business needs as well as the Company's future capital requirements. Based upon these reviews, to take advantage of strong market conditions and to fully implement our expansion strategy, we believe that we may continue to increase our net capital by the proceeds of private sales of our securities. For more information on the cash flows of the Company, please see the statement of cash flows included in the Company's financial statements appearing elsewhere herein.

Should our costs and expenses prove to be greater than we currently anticipate, or should we change our current business plan in a manner that will increase or accelerate our anticipated costs and expenses, such as through an acquisition of new products, the depletion of our working capital would be accelerated. To the extent it become necessary to raise additional cash in the future as our current cash and working capital resources are depleted, we will seek to raise it through the sale of the equity securities owned by the Company, public or private sale of debt or equity securities, the procurement of advances on contracts or licenses, funding from joint-venture or strategic partners, debt financing or short-term loans, or a combination of the foregoing. We may also seek to satisfy indebtedness without any cash outlay through the private issuance of debt or equity securities. We currently do not have any binding commitments for, or readily available sources of, additional financing. We cannot give you any assurance that we will be able to secure the additional cash or working capital we may require to continue our operations in such circumstances.

Our anticipated costs described above are estimates based upon our current business plan. Our actual costs could vary materially from those estimated. Further, we could also change our current business plan resulting in a change in our anticipated costs. See the discussion concerning forward-looking statements.

To date we have financed our operations through the private placement of equity securities. On May 4, 2004 we completed a private placement of 50,000,000 shares of our Common Stock for a total consideration of $5,000,000. We have not employed any significant leverage or debt.

The Company has no plans to purchase any assets at this time. However, the Company constantly reviews industry opportunities to acquire income producing assets for possible acquisition.

Off-Balance Sheet Arrangements

There are no guarantees, commitments, lease and debt agreements or other agreements that could trigger adverse change in our credit rating, earnings, cash flows or stock price, including requirements to perform under standby agreements.

Subsequent Events

We executed a Letter of Intent in January 2006 with 100% Entertainment and Red Hot Entertainment to produce low budget Science Fiction films in High Definition. The Letter calls for us to arrange 50% of the budget of the features for which the Company shall receive distribution fees world-wide along with 50% of the profits. We shall have mutual script and cast approval and in addition to the first feature, we have the option to co-produce an additional 10 films over four years.

On December 15, 2005 we foreclosed on the security of 2,500,000 shares of our common stock held as collateral against the balance of the note of $25,000. As of the December 15, 2005 the market value of the foreclosed upon shares of our stock exceeded the remaining carrying value of the note of $25,000 by $275,000. Therefore, we recognized a gain in this amount.

On November 23, 2005, the we issued 2,450,000 share of our common stock for the exercise of stock options. The exercise price was paid by reducing accrued expenses by $1,225.

FORWARD-LOOKING STATEMENTS

Certain statements in this Quarterly Report on Form 10-QSB, as well as statements made by the company in periodic press releases, oral statements made by the company's officials to analysts and shareholders in the course of presentations about the company, constitute "forward-looking statements." All statements other than statements of historical facts included or incorporated by reference in this report, including, without limitation, statements regarding our future financial position, business strategy, budgets, projected costs and plans and objectives of management for future operations, are forward-looking statements. In addition, forward-looking statements generally can be identified by the use of forward-looking terminology such as "may," "will," "expect," "intend," "project," "estimate," "anticipate," "believe," or "continue" or the negative thereof or variations thereon or similar terminology. Although we believe that the expectations reflected in such forward-looking statements are reasonable, we cannot give any assurance that such expectations will prove to have been correct. Important factors that could cause actual results to differ materially from our expectations. All subsequent written and oral forward-looking statements attributable to us, or persons acting on our behalf, are expressly qualified in their entirety by the cautionary statements. We assume no duty to update or revise our forward-looking statements based on changes in internal estimates or expectations or otherwise.

Item 3. Controls and Procedures

As required by SEC rules, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures at the end of the period covered by this report. This evaluation was carried out under the supervision and with the participation of our management, including our principal executive officer and principal financial officer. Based on this evaluation, these officers have concluded that the design and operation of our disclosure controls and procedures are effective. There were no changes in our internal control over

financial reporting or in other factors that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Disclosure controls and procedures are our controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file under the Exchange Act is accumulated and communicated to our management, including principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Part II. OTHER INFORMATION

Item 1. Legal Proceedings

Miracle Entertainment, Inc. et. al v. Filmstar Releasing Corporation et. al., Los Angeles Superior Court, Case No. BC302233:

This is a complaint for unlawful conversion, breach of contract and fraud, commenced in September, 2003 by Miracle Entertainment, Inc., a company of which John Daly was Chairman, against a firm and several individuals who had previously contracted to raise funds for productions sponsored by Miracle Entertainment. A counter-claim was filed by the defendants in March, 2004, adding the Company as a defendant.

On May 2, 2005 a confidential Settlement Agreement and Mutual Release was executed between the Company and remaining litigants on terms acceptable to all the parties resulting in no liability and complete release of claims against the company.

Carol Lefko v. Film and Music Entertainment, Inc., Celebration Pictures, Inc., John Daly and Peter Beale, Los Angeles Superior Court, Case No. BC318753.

This is a complaint for breach of an alleged oral agreement commenced July 20, 2004 between the plaintiff and the defendants whereby the plaintiff would provide services as casting director of a film to be called "Host" and produced by Celebration Productions, Inc. which was added as a party to this lawsuit by amendment in February 2005. The plaintiff alleges that she performed the services but was not paid and is owed $12,000 for breach of contract plus $60,000 for "waiting time." The defendants have answered denying any liability, that no contract existed and that no services could have been rendered to the Company since the film never went into pre-production. The Company is informed and believes that Kevin Lewis and Peter Beale, in their individual capacity, were to be co-producers of the film "Host." Mr. Lewis was also to be the director of the film and that any agreement with plaintiff is between plaintiff and Mr. Lewis. The Company maintains that no contract exists between Ms. Lefko and either FAME or Celebration or both. The Company maintains that Ms. Lefko has never been employed by any of these entities, as indicated by Company records and that neither the Company nor Celebration Pictures, Inc. ever hired any casting director.

All the Defendants except Beale filed their general denial with affirmative defenses on September 1, 2004. Film And Music responded to plaintiff's first set of written discovery. The trial took place on July 13 and 14, 2005 and the court denied any

liability on the part of the defendants to the plaintiff. The Company does not expect Ms. Lefko to appeal.

Sunset Towers Partnership v. First Miracle Group. Los Angeles Superior Court, Case No. SC072450.

This is a motion to amend a judgment entered against First Miracle Group by its former landlord in the amount of $300,000 to include Celebration Productions, Inc. and Film and Music Entertainment, Inc. Sunset Towers is claiming that Celebration and the Company are in fact successors in interest of Miracle Entertainment, Inc. and are therefore liable for the judgment.

The Company and Celebration have filed an opposition to the motion denying any theory that the Company and/or Celebration are successors-in-interest of First Miracle Group and/or Miracle Entertainment, Inc. in as much as only a portion of Miracle's assets were acquired by the Company and fair consideration in the amount of $3,000,000 worth of the Company's stock; that the Company and Miracle are separate, distinct publicly traded companies, with separate shareholders, boards, officers and businesses with the single exception that Mr. Daly was at the time of acquisition a Board member and officer of both companies; that neither the Company or Celebration had the opportunity to defend the litigation from which the judgment derived; and that neither the Company nor Celebration expressly assumed the liability of Miracles obligation under the judgment.

The motion was heard on May 17, 2005 and the Court denied the plaintiff's motion, finding on the evidence presented that Miracle Entertainment did not transfer all of its assets to the Company and that the Company was not the successor-in-interest of Miracle. On July 8, 2005 Sunset Towers filed a motion to appeal. The Company has no reason to believe an appeal will overturn the earlier findings in its favor.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

Not applicable

Item 5. Other Information

Not applicable

Item 6. Exhibits

(a) Exhibits

Regulation S-B Number	Exhibit
31.1	Rule 13a-14(a) Certification of Chief Executive Officer

31.2	Rule 13a-14(a) Certification of Chief Financial Officer
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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.

FILM AND MUSIC ENTERTAINMENT, INC.

January 23, 2006 By: /s/ John Daly

John Daly
Chairman, President and CEO

January 23, 2006 By: /s/ Lawrence S. Lotman

Lawrence S. Lotman
Chief Financial Officer