NEW VISUAL CORP
Form 10QSB
September 14, 2005

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

FORM 10-QSB

|X| QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JULY 31, 2005

|_| TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM _________ TO

COMMISSION FILE NUMBER 0-21785

NEW VISUAL CORPORATION

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

UTAH	95-4545704
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification no.)
305 NE 102ND AVENUE, SUITE 105 PORTLAND, OREGON 97220	(503) 257-6700
(Address of principal executive offices, including zip code)	(Issuer's telephone number, including area code)

Check mark 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 [_]

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

The number of shares of the issuer's Common Stock, par value $.001 per share, outstanding as of September 12, 2005, was 161,256,489.

PART I - FINANCIAL INFORMATION

ITEM I - FINANCIAL STATEMENTS

FORM 10-QSB

NEW VISUAL CORPORATION

JULY 31, 2005

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NEW VISUAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEET
(UNAUDITED)

ASSETS

	July 31, 2005
Current Assets:	
Cash	$ 1,056,107
Other current assets	32,019
TOTAL CURRENT ASSETS	1,088,126
Property and equipment (net of accumulated depreciation of $164,146)	10,542
Technology license and capitalized software development fee	5,751,000
Deferred financing costs (net of accumulated amortization of $199,361)	807,555

Other assets	10,224
TOTAL ASSETS	$ 7,667,447

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:	
Convertible notes payable (net of debt discount of $21,167)	$ 838,829
Notes payable	2,196,976
Accounts payable and accrued expenses	1,178,439
TOTAL CURRENT LIABILITIES	4,214,244
Long-term portion of convertible notes payable (net of debt discount of $5,000)	25,375
Long-term portion of convertible debentures (net of debt discount of $3,347,344)	277,656
Long-term portion of notes payable	432,537
TOTAL LIABILITIES	4,949,812
Commitments, Contingencies and Other Matters	
Stockholders' Equity:	
Preferred stock - $0.01 par value; 15,000,000 shares authorized; Series A junior participating preferred stock; -0- shares issued and outstanding	--
Common stock - $0.001 par value; 500,000,000 shares authorized; 118,031,737 issued and outstanding	118,032
Additional paid-in capital	62,806,051
Unearned compensation	(155,682)
Accumulated deficit	(60,050,766)
TOTAL STOCKHOLDERS' EQUITY	2,717,635
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 7,667,447

See notes to condensed consolidated financial statements.

NEW VISUAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

For the Nine Months Ended
July 31,

	2005	2004
REVENUES	$ 26,558	$ 231,292
OPERATING EXPENSES:		
Cost of sales	11,945	115,665
Impairment of film in distribution	1,009,777	--
Research and development expenses (including stock based compensation of $296,667 and $0, respectively)	303,720	10,000
Selling, general and administrative expenses (including stock based compensation of $998,963 and $1,241,146, respectively)	2,460,145	2,749,317
TOTAL OPERATING EXPENSES	3,785,587	2,874,982
OPERATING LOSS	(3,759,029)	(2,643,690)
OTHER (INCOME) EXPENSES:		
Interest expense	1,183,318	595,478
Amortization of deferred financing costs	120,934	41,802
Amortization of unearned financing costs	--	99,933
Gain on sale of property and equipment	(20,000)	--
Gain on exchange of redeemable series B preferred stock into common stock	(55,814)	--
Gain on conversion of accrued expenses into convertible notes payable	(33,514)	--
Gain on forgiveness of liabilities	(99,369)	--
Other	5,008	(905)
TOTAL OTHER (INCOME) EXPENSES	1,100,563	736,308
NET LOSS	$ (4,859,592)	$ (3,379,998)
BASIC AND DILUTED NET LOSS PER COMMON STOCK	$ (.05)	$ (.04)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING	99,459,187	76,689,939

See notes to condensed consolidated financial statements.

NEW VISUAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

For the Three Months Ended
July 31,

	2005	2004
REVENUES	$ 10,360	$ 60,449
OPERATING EXPENSES:		
Cost of sales	--	29,451
Impairment of film in distribution	1,009,777	--
Research and development expenses (including stock based compensation of $296,667 and $0, respectively)	296,667	--
Selling, general and administrative expenses (including stock based compensation of $110,033 and $175,000, respectively)	888,811	561,059
TOTAL OPERATING EXPENSES	2,195,255	590,510
OPERATING LOSS	(2,184,895)	(530,061)
OTHER (INCOME) EXPENSES:		
Interest expense	543,672	411,075
Amortization of deferred financing costs	67,825	18,930
Amortization of unearned financing costs	--	5,224
Gain on forgiveness of liabilities	(99,369)	--
TOTAL OTHER (INCOME) EXPENSES	512,128	435,229
NET LOSS	$ (2,697,023)	$ (965,290)
BASIC AND DILUTED NET LOSS PER COMMON STOCK	$ (.02)	$ (.01)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING	111,616,151	78,719,909

See notes to condensed consolidated financial statements.

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NEW VISUAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
FOR THE NINE MONTHS ENDED JULY 31, 2005
(UNAUDITED)

Common Stock		Additional		
Shares	Amount	Paid-In Capital	Unearned Compensation	Accumula Defici

Balance at November 1, 2004	84,781,959	$ 84,782	$ 55,031,976	$ (164,500)	$(55,191
Issuance of common stock for cash	10,289,026	10,289	824,811	--	
Issuance of common stock under consulting agreements	2,837,500	2,838	339,162	(342,000)	
Issuance of common stock for services	5,073,015	5,073	309,594	(18,000)	
Issuance of common stock to key employees and directors	2,750,000	2,750	449,750	--	
Issuance of common stock for conversion of notes payable and convertible debentures	6,556,836	6,557	981,790	--	
Issuance of common stock for liquidated damages	639,998	640	95,360	--	
Issuance of common stock for below market issuance	29,457	29	4,979	--	
Issuance of common stock in payment of accounts payable and accrued expenses	422,783	423	71,488	--	
Issuance of common stock in exchange for surrender of convertible preferred stock	4,651,163	4,651	739,535	--	
Stock Options issued for professional services	--	--	165,869	(165,869)	
Warrants issued with convertible debentures	--	--	1,883,559	--	
Value assigned to beneficial conversion	--	--	1,616,441	--	
Warrants issued to placement agent	--	--	319,066	--	
Warrants issued for professional services	--	--	11,776	(11,776)	
Stock offering costs	--	--	(39,105)	--	
Amortization of unearned compensation expense	--	--	--	546,463	
Net loss	--	--	--	--	(4,859
Balance at July 31, 2005	118,031,737	$ 118,032	$ 62,806,051	$ (155,682)	$(60,050

See notes to condensed consolidated financial statements.

NEW VISUAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	For the Nine Months Ended July 31, 2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	$(4,859,592)	$(3,379,998)
Adjustments to reconcile net loss to net cash used in operating activities:		
Consulting fees and other compensatory elements of stock issuances	1,295,630	1,241,146
Issuance of common stock for below market issuance	5,008	--
Impairment of film in distribution	1,009,777	--
Amortization of unearned financing costs	--	99,933
Amortization of deferred financing costs	120,934	41,802
Amortization of film in production costs	11,945	115,665
Amortization on debt discount on notes	941,531	316,669
Depreciation	24,492	13,105
Gain on sale of property and equipment	(20,000)	--
Gain on exchange of redeemable series B preferred stock into common stock	(55,814)	--
Gain on conversion of accrued expenses into convertible notes payable	(33,514)	--
Gain on forgiveness of liabilities	(99,369)	--
Change in Assets (Increase) Decrease:		
Other current assets	(24,035)	1,673
Other assets	(2,790)	(399)
Change in Liabilities Increase(Decrease):		
Accounts payable and accrued expenses	(66,248)	219,951
NET CASH USED IN OPERATING ACTIVITIES	(1,752,045)	(1,330,453)
CASH USED IN INVESTING ACTIVITIES		
Acquisition of license	--	(95,000)
Acquisition of property and equipment	(11,161)	--
NET CASH USED IN INVESTING ACTIVITIES	(11,161)	(95,000)
CASH FLOWS FROM FINANCING ACTIVITIES		
Bank overdraft	--	45,636
Proceeds from issuance of common stock	835,100	379,500
Offering costs related to stock issuances	--	(14,075)
Proceeds from convertible debentures	3,500,000	1,350,000
Proceeds from note payable	--	12,000
Proceeds from convertible notes payable	300,000	--
Capitalized financing costs	(422,010)	(112,500)
Repayments of convertible debentures	--	(300,000)
Repayments of notes payable	(1,120,048)	--
Repayments of convertible notes payable	(401,540)	(250,000)
NET CASH PROVIDED BY FINANCING ACTIVITIES	2,691,502	1,110,561

INCREASE (DECREASE) IN CASH	928,296	(314,892)
CASH - BEGINNING	127,811	319,786
CASH - ENDING	$ 1,056,107	$ 4,894

See notes to condensed consolidated financial statements.

NEW VISUAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	For the Nine Months Ended July 31,	
	2005	2004
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$ 93,512	$ 8,940
NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Common stock issued for conversion of convertible debentures, notes payable and accrued interest	$ 988,347	$ 171,806
Common stock issued for extension of convertible notes payable	$ --	$ 15,992
Accounts payable and accrued expenses satisfied by issuance of common stock	$ 71,911	$ 130,011
Common stock issued for accrued liquidated damages	$ 96,000	$ --
Accounts payable and accrued expenses converted to notes payable	$ 439,162	$ --
Stock offering costs	$ 39,105	$ --
Value assigned to beneficial conversion in connection with issuance of convertible debentures	$ 1,616,441	$ 772,104
Value assigned to warrants issued to purchasers of convertible debentures	$ 1,883,559	$ 577,896
Value assigned to warrants issued to placement agent	$ 319,066	$ 138,713
Redeemable series B preferred stock exchanged		

into notes payable	$ 2,392,000	$ --
Redeemable series B preferred stock exchanged into common stock	$ 800,000	$ --

See notes to condensed consolidated financial statements.

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NEW VISUAL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1- PRINCIPLES OF CONSOLIDATION AND BUSINESS AND CONTINUED OPERATIONS

The condensed consolidated financial statements include the accounts of New Visual Corporation and its wholly owned operating subsidiaries, NV Entertainment, Inc. ("NV Entertainment") (including its 50% owned subsidiary Top Secret Productions, LLC), and NV Technology, Inc. (formerly New Wheel Technology, Inc.) ("New Wheel") (collectively, "New Visual" or the "Company"). All significant intercompany balances and transactions have been eliminated. The Company consolidates its 50% owned subsidiary Top Secret Productions, LLC due to the Company's control of management and financial matters of such entity.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the Unites States of America ("US GAAP"). In the opinion of management, the accompanying unaudited financial statements contain all adjustments, consisting only of those of a normal recurring nature, necessary for a fair presentation of the Company's financial position, results of operations and cash flows at the dates and for the periods indicated. These financial statements should be read in conjunction with the financial statements and notes related thereto included in the Annual Report on Form 10-KSB of the Company for the year ended October 31, 2004.

These results for the three months and nine months ended July 31, 2005 are not necessarily indicative of the results to be expected for the full fiscal year. The preparation of the consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

New Visual Corporation was incorporated under the laws of the State of Utah on December 5, 1985. In November of 1999, the Company began to focus its business activities on the development of new semiconductor technologies. Pursuant to such plan, in February of 2000, the Company acquired New Wheel. The Company's technology business has generated no revenues to date.

The Company operates in two business segments, the production of motion pictures, films and videos (Entertainment Segment) and development of new semiconductor technologies (Semiconductor Segment). The Company's Entertainment Segment is dependent on future revenues from the Company's film Step Into

Liquid. The Semiconductor Segment is dependent on the Company's ability to successfully commercialize its developed technology.

Through its subsidiary NV Entertainment the Company has operating revenues for its Entertainment Segment, but may continue to report operating losses for this segment. The Semiconductor Segment will have no operating revenues until successful commercialization of its developed technology, but will continue to incur substantial operating expenses, capitalized costs and operating losses.

GOING CONCERN

The accompanying condensed consolidated financial statements have been prepared assuming the Company will continue as a going concern. For the three months and nine months ended July 31, 2005, the Company incurred net losses of approximately $2,700,000 and $4,860,000, respectively, and as of July 31, 2005 had a working capital deficiency of approximately $3.1 million. In addition, management believes that the Company will continue to incur net losses and cash outflows from operating activities through at least the first half of 2006. These conditions raise substantial doubt about the Company's ability to continue as a going concern.

The Company's ability to continue operating as a going concern is substantially dependent on its ability to generate operating cash flow through the execution of its business plan or secure funding sufficient to provide for the working capital needs of its business. The financial statements do not include any adjustments relating to the recoverability and classification of recorded assets, or the amounts and classification of liabilities that might be necessary in the event the Company cannot continue in existence. There can be no assurance that management will be successful in implementing its business plan or that the successful implementation of such business plan will actually improve the Company's operating results. During the nine months ended July 31, 2005, the Company raised approximately $4,213,000 in net proceeds from the sale of its debt and equity securities.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

FILM IN DISTRIBUTION

Statement of Position 00-2, "Accounting by Producers or Distributors of Films" ("SOP-00-2") requires that film costs be capitalized and reported as a separate asset on the balance sheet. Film costs include all direct negative costs incurred in the production of a film, as well as allocations of production overhead and capitalized interest. Direct negative costs include cost of scenario, story, compensation of cast, directors, producers, writers, extras and staff, cost of set construction, wardrobe, accessories, sound synchronization, rental of facilities on location and post production costs. SOP-00-2 also requires that film costs be amortized and participation costs accrued, using the individual-film-forecast-method-computation method, which amortizes or accrues such costs in the same ratio that the current period actual revenue (numerator)

bears to the estimated remaining unrecognized ultimate revenue as of the beginning of the fiscal year (denominator). The Company makes certain estimates and judgments of its future gross revenue to be received for each film based on information received by its distributors, historical results and management's knowledge of the industry. Revenue and cost forecasts are continually reviewed by management and revised when warranted by changing conditions. A change to the estimate of gross revenues for an individual film may result in an increase or decrease to the percentage of amortization of capitalized film costs relative to a previous period.

In addition, SOP-00-2 also requires that if an event or change in circumstances indicates that an entity should assess whether the fair value of a film is less than its unamortized film costs, then an entity should determine the fair value of the film and write-off to the statement of operations the amount by which the unamortized capital costs exceeds the film's fair value. During July 2005, the Company performed its review, and it was determined that the unamortized film costs exceeded the Film's fair value. The conclusion was based upon information the Company received from the film's distributor relating to lower than expected sales. As a result of this review, the Company wrote-down the remaining carrying value attributed to its Film In Distribution to $0. This resulted in an impairment of $1,009,777 which is included in the condensed consolidated statement of operations for the three months ended July 31, 2005.

The Company commenced amortization of capitalized Film costs and accrued (expensed) participation costs when its film was released and it began to recognize revenue from the film.

REVENUE RECOGNITION

The Company recognizes film revenue from the distribution of its feature film and related products when earned and reasonably estimable in accordance with SOP 00-2 -- "Accounting by Producers or Distributors of Films." The following conditions must be met in order to recognize revenue in accordance with SOP 00-2:

- persuasive evidence of a sale or licensing arrangement with a customer exists;
- the film is complete and, in accordance with the terms of the arrangement, has been delivered or is available for immediate and unconditional delivery;
- the license period of the arrangement has begun and the customer can begin its exploitation, exhibition or sale;
- the arrangement fee is fixed or determinable; and
- collection of the arrangement fee is reasonably assured.

Under a rights agreement with Lions Gate Entertainment ("LGE"), the domestic distributor for its Film entitled Step Into Liquid, the Company shares with LGE in the profits of the Film after LGE recovers its marketing, distribution and other predefined costs and fees. The agreement provides for the payment of minimum guaranteed license fees, usually payable on delivery of the respective completed film, that are subject to further increase based on the actual distribution results in the respective territory.

RESEARCH AND DEVELOPMENT

Research and development costs are charged to expense as incurred. Amounts allocated to acquired-in-process research and development costs from business combinations are charged to earnings at the consummation of the acquisition.

NEW VISUAL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

CAPITALIZED SOFTWARE DEVELOPMENT COSTS

Capitalization of computer software development costs begins upon the establishment of technological feasibility. Technological feasibility for the Company's computer software is generally based upon achievement of a detail program design free of high-risk development issues and the completion of research and development on the product hardware in which it is to be used. The establishment of technological feasibility and the ongoing assessment of recoverability of capitalized computer software development costs require considerable judgment by management with respect to certain external factors, including, but not limited to, technological feasibility, anticipated future gross revenue, estimated economic life and changes in software and hardware technology.

Amortization of capitalized computer software development costs commences when the related products become available for general release to customers. Amortization is provided on a product-by-product basis. The annual amortization is the greater of the amount computed using (a) the ratio that current gross revenue for a product bears to the total of current and anticipated future gross revenue for that product, or (b) the straight-line method over the remaining estimated economic life of the product.

The Company periodically performs reviews of the recoverability of such capitalized software costs. At the time a determination is made that capitalized amounts are not recoverable based on the estimated cash flows to be generated from the applicable software, the capitalized costs of each software product is then valued at the lower of its remaining unamortized costs or net realizable value.

No assurance can be given that such technology will receive market acceptance. Accordingly it is possible that the carrying amount of the technology license may be reduced materially in the near future.

The Company has no amortization expense for the three months and nine months ended July 31, 2005 and 2004 for its capitalized software development costs.

SERIES B REDEEMABLE PREFERRED STOCK

Series B Redeemable Preferred Stock, which includes characteristics of both liabilities and equity, is classified as a long-term liability in accordance with the provisions of SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." In April 2005, the Series B Redeemable Preferred Stock was cancelled in exchange for the issuance of common stock and a promissory note. See Note 5 for further discussion.

LOSS PER COMMON SHARE

Basic loss per common share is computed based on weighted average shares outstanding and excludes any potential dilution. Diluted loss per share reflects the potential dilution from the exercise or conversion of all dilutive securities into common stock based on the average market price of common shares outstanding during the period. For the three months and nine months ended July 31, 2005 and 2004, no effect has been given to outstanding options, warrants or convertible debentures in the diluted computation, as their effect would be anti-dilutive.

NEW VISUAL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

STOCK-BASED COMPENSATION

The Company follows SFAS No. 123, "Accounting for Stock-Based Compensation." SFAS No. 123 establishes accounting and reporting standards for stock-based employee compensation plans. This statement allows companies to choose between the fair value-based method of accounting as defined in this statement and the intrinsic value-based method of accounting as prescribed by Accounting Principles Board Opinion No. 25 ("APB 25"), "Accounting for Stock Issued to Employees."

The Company has elected to continue to follow the accounting guidance provided by APB 25, as permitted for stock-based compensation relative to the Company's employees. Stock and options granted to other parties in connection with providing goods and services to the Company are accounted for under the fair value method as prescribed by SFAS 123.

In December 2002, the Financial Accounting Standard Board ("FASB") issued SFAS No. 148, "Accounting for Stock-Based Compensation -Transition and Disclosure - an Amendment of FASB Statement No. 123". This statement amends SFAS No. 123 to provide alternative methods of transition for a voluntary change to the fair value-based method of accounting for stock-based employee compensation. In addition, SFAS No.148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. SFAS No. 148 also requires that those effects be disclosed more prominently by specifying the form, content, and location of those disclosures.

	For the Nine Months Ended July 31,		For the Months July
	2005	2004	2005
Net loss, as reported	$(4,859,592)	$(3,379,998)	$(2,697,023)

Add: Stock-based employee compensation expense included in reported net loss	--	--	(20,915)
Less: Total stock-based employee compensation expense determined under the fair value-based method of all awards	(794,819)	(80,000)	(604,031)
Net loss, pro-forma	$(5,654,411)	$(3,459,998)	$(3,321,969)
Basic and Diluted Net Loss per Common Stock:			
As reported	$ (0.05)	$ (0.04)	$ (0.02)
Pro-forma	$ (0.06)	$ (0.04)	$ (0.03)

NEW VISUAL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 3 - FILM IN DISTRIBUTION

In April 2000, the Company entered into a joint venture production agreement to produce a feature length film ("Step Into Liquid") for theatrical distribution. The Company agreed to provide the funding for the production in the amount of up to $2,250,000 and, in exchange, received a 50% share in all net profits from worldwide distribution and merchandising, after receiving funds equal to its initial investment of up to $2,250,000. As of July 31, 2005 the Company has funded a net of $2,335,101 for completion of the film. The film is currently in foreign and DVD distribution. Based upon information received from the Company's film distributor in January 2005, the Company recorded an impairment charge of $977,799 during the three months ended October 31, 2004 which reduced the carrying value of its film in distribution to $1,021,722. The impairment charge was due to higher than expected distribution costs and lower than expected average retail selling price for the DVD. In addition, based upon information received from the Company's film distributor in July 2005, which indicated that sales were lower than expected, the Company recorded an impairment charge of $1,009,777 during the three months ended July 31, 2005 which reduced the carrying value of its film in distribution to $0.

The Company recognized revenues of $10,360 and $26,558 for the three months and nine months ended July 31, 2005, respectively. The Company recognized revenues of $60,449 and $231,292 for the three months and nine months ended July 31, 2004, respectively. The Company had amortization expense of zero and $11,945 for the three months and nine months ended July 31, 2005, respectively. The Company had amortization expense of $29,451 and $115,665 for the three months and nine months ended July 31, 2004, respectively.

NOTE 4 - DEFERRED FINANCING COST

At July 31, 2005, deferred financing cost consists of costs incurred and warrants issued in connection with the sale of $3,500,000 of 2005 Debentures, $1,350,000 of 7% convertible debentures and a promissory note.

Deferred financing cost	$1,006,916
Less: Accumulated amortization	(199,361)
Deferred Financing Cost, net	$807,555

Amortization of deferred financing cost for the three months and nine months ended July 31, 2005 was $67,825 and $120,934, respectively. Amortization of deferred financing cost for the three months and nine months ended July 31, 2004 was $18,930 and $41,802, respectively.

NOTE 5 - EXCHANGE AGREEMENT

In April 2005, the Company entered into an Exchange Agreement (the "Exchange Agreement") with Zaiq Technologies, Inc., ("Zaiq"), pursuant to which the Company issued 4,651,163 shares of common stock and a promissory note in the principal amount of $2,392,000 in exchange for the surrender by Zaiq of 3,192 shares of Series B Redeemable Preferred Stock. The Company issued the Series B Redeemable Preferred Stock to Zaiq pursuant to a Receivables Purchase and Stock Transfer Restriction Agreement dated as of April 17, 2002. These shares had an aggregate liquidation preference of $3,192,000, constituted all of the Series B Redeemable Preferred Stock issued and outstanding as of the date of the Exchange Agreement, and were cancelled upon the closing of the Exchange Agreement. The fair value of the common stock and promissory note on the closing date was determined to be less than the aggregate liquidation preference of the Series B Redeemable Preferred Stock and accordingly a gain of $55,814 was recognized during the three months ended April 30, 2005.

NEW VISUAL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 5 - EXCHANGE AGREEMENT (CONTINUED)

The Exchange Agreement provides that, subject to certain exceptions, if the Company, at any time prior to the payment in full of the amount due under the promissory note, issues common stock or securities convertible into or exercisable for shares of common stock at a price below the fair market value of the common stock or such securities (a "Below Market Issuance"), then the Company will issue to Zaiq additional shares of common stock in an amount that is determined in accordance with a formula that takes into consideration both the number of shares of common stock or other securities issued and the total consideration received by the Company in the Below Market Issuance. During the three months ended July 31, 2005, the Company issued 29,457 additional shares with a fair value of $5,008 to Zaiq as a result of a Below Market Issuance.

Under the terms of the agreements with Zaiq, a portion of the proceeds of any new financing consummated by the Company through the first anniversary of the agreement are to be applied to the prepayment of the note. See Note 8.

The conversion into common stock of the May 2005 debentures may require the Company to issue additional shares to Zaiq Technologies in the future in accordance with the anti-dilution provisions of the Exchange Agreement. Even if the Company determined that all of the shares issuable upon conversion of the debentures required anti-dilution adjustments, the resulting number of shares

that would be issuable to Zaiq Technologies would not be material in relation to the number of shares that are outstanding as of July 31, 2005.

NOTE 6 - CONVERTIBLE NOTES PAYABLE

The Company entered into several convertible promissory note agreements with various trusts and individuals. The Company agreed to repay the principal and an additional amount equal to 50% of the principal on all notes below except for one note for $10,000 which accrues interest at the rate of 9% per annum. The notes are due when the Company reaches certain milestones from the distribution of its motion picture. These notes may be converted at any time, in whole or in part, into that number of fully paid and non-assessable shares of common stock at conversion prices ranging from $.33 to $1.00.

In March 2005, the Company issued, in favor of the Company's executive vice president, a non-interest bearing convertible promissory note in the principal amount of $383,911. The convertible promissory note was issued in evidence of the Company's obligation for deferred compensation. In accordance with APB 21, imputed interest was calculated to arrive at the fair value of the convertible promissory note. The difference between the face amount and the present value upon issuance of the convertible promissory note is shown as a discount that is amortized over the life of the convertible promissory note.

Twelve notes with outstanding principal of $280,000 and accrued interest of $10,798 were repaid in May and June 2005 from the proceeds of the private placement of the 2005 Debentures further discussed in Note 7.

The outstanding notes are summarized in the table below:

	July 31, 2005
Note payable (1)	$ 122,000
Notes payable (ten notes) (2)	478,000
Note payable, 9% interest (3)	10,000
Note payable (4)	280,371
Total	890,371
Less: current portion of convertible notes payable	(859,996)
Long term portion of convertible notes payable	$ 30,375

NEW VISUAL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 6 - CONVERTIBLE NOTES PAYABLE (CONTINUED)

(1) Due when receipts received by the Company from the joint venture exceed $375,000.
(2) Due when receipts received by the Company from the joint venture exceed $2,250,000.
(3) Due when receipts received by the Company from the joint venture exceed

$750,000.

(4) In March 2005, the Company issued in favor of the Company's executive vice president, a non-interest bearing convertible promissory note in the principal amount of $383,911. The convertible promissory note is payable in monthly installments, on the first day of each month, beginning on April 1, 2005. Each month, the Company must pay to the executive vice president an amount not less than the monthly base salary paid to the Company's chief executive officer. However, if the Company determines in its sole discretion that it has the financial resources available, it may pay up to $20,833 per month. The Company made payments of $87,915 and 103,540 during the three months and nine months ended July 31, 2005, respectively. The convertible promissory note may be converted at the option of the holder, at any time, in whole or in part, into shares of common stock at a conversion price per share equal to the closing price of the common stock on the Over-the-Counter Bulletin Board on the date of conversion.

NOTE 7 - CONVERTIBLE DEBENTURES

2005 DEBENTURES

On May 26, 2005, the Company completed a private placement to certain individual and institutional investors of $3,500,000 in principal amount of its three-year 7% Senior Secured Convertible Debentures (the "2005 Debentures"). All principal is due and payable on May 26, 2008. Commencing on the earlier of (i) July 30, 2005 or (ii) the effective date of the Registration Statement (as defined below), the 2005 Debentures are convertible into shares of Common Stock at a conversion price equal to the lower of (x) 70% of the 5 day volume weighted average price of the Company's Common Stock immediately prior to conversion or (y) if the Company entered into certain financing transactions subsequent to the closing date, the lowest purchase price or conversion price applicable to that transaction. The Company received net proceeds of approximately $3.11 million, following repayment of offering related expenses. These offering related expenses were recorded as deferred financing costs and are being charged to interest expense over the three-year term of the 2005 Debentures.

The Company used a portion of those funds to repay the principal and accrued interest on notes payable and convertible notes payable (See Notes 6 and 8).

Interest on the 2005 Debentures accrues at the rate of 7% per annum and is payable on a bi-annual basis, commencing December 31, 2005, or on conversion and may be paid, at the option of the Company, either in cash or in shares of Common Stock. The Company may prepay the amounts outstanding on the 2005 Debentures by giving advance notice and paying an amount equal to 120% of the sum of (x) the principal being prepaid plus (y) the accrued interest thereon.

In connection with the issuance of the 2005 Debentures, the Company issued to the purchasers thereof warrants (the "Investor Warrants") to purchase shares of Common Stock, with warrants for 11,312,220 shares being exercisable through the last day of the month in which the first anniversary of the effective date of the Registration Statement occurs at a per share exercise price of $0.1547 and warrants for 22,624,430 shares being exercisable through the last day of the month in which the third anniversary of the effective date of the Registration Statement occurs at a per share exercise price of $0.3094.

Holders of the Investor Warrants, which become first exercisable on the earlier of (i) July 30, 2005 or (ii) the effective date of the Registration Statement, are entitled to exercise those warrants on a cashless basis following the first anniversary of issuance if the Registration Statement is not in effect at the time of exercise.

NEW VISUAL CORPORATION AND SUBSIDIARIES
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NOTE 7 - CONVERTIBLE DEBENTURES (CONTINUED)

The gross proceeds of $3,500,000 were allocated 46.18% or $1,616,441 to the 2005 Debentures and 53.82% or $1,883,559 to the Investor Warrants. The effective conversion price of the 2005 Debentures was below the market price of the Common Stock at the issuance date, which resulted in a beneficial conversion feature of $1,616,441. In accordance with EITF 00-27 the amount allocated to the beneficial conversion feature was limited to the net proceeds of the offering less the value allocated to the Investor Warrants issued to the purchasers. The beneficial conversion feature and value assigned to the Investor Warrants were recorded as debt discounts and are being accreted as interest expense through the maturity date of the related debenture.

In connection with the issuance of the 2005 Debentures, the Company also issued to a placement agent warrants to purchase up to 5,656,108 shares of Common Stock (the "Compensation Warrants") valued at $319,066. This amount was recorded as a deferred financing cost and is being charged to interest expense over the term of the 2005 Debentures. Warrants to purchase up to 2,262,443 shares are exercisable through the last day of the month in which the third anniversary of the effective date of the Registration Statement occurs at a per share exercise price of $0.3094. Warrants to purchase up to 2,262,443 shares are exercisable through the last day of the month in which the third anniversary of the closing occurs at a per share exercise price of $0.3094. Warrants to purchase up to 1,131,222 shares are exercisable through the last day of the month in which the first anniversary of the effective date of the Registration Statement occurs at a per share exercise price of $0.1547. The Compensation Warrants are otherwise exercisable on substantially the same terms and conditions as the Investor Warrants.

To secure the Company's obligations under the 2005 Debentures, the Company granted a security interest in substantially all of its assets, including without limitation, its intellectual property, in favor of the investors under the terms and conditions of a Security Interest Agreement dated as of the date of the 2005 Debentures. The security interest terminates upon the earlier of (i) the date on which less than one-third of the original principal amount of the 2005 Debentures issued on the closing date are outstanding or (ii) payment or satisfaction of all of the Company's obligations under the Loan Agreement.

A registration statement (the "Registration Statement") covering the Common Stock issuable upon conversion of the 2005 Debentures, the Investor Warrants and the Compensation Warrants referred to above was filed during July 2005 and subsequently declared effective on August 1, 2005.

As a result of obtaining the 2005 Debentures, 1,000,000 stock options granted to each of the Company's chief executive officer and executive vice president in April 2005 became fully vested and non-forfeitable, as discussed in Note 9.

The 2005 Debentures are summarized below:

	Principal Amount	Unamortized Debt Discount	Net carrying Value

Long term portion	$3,500,000	$ 3,289,234	$ 210,766

7% DEBENTURES

In December 2003, April 2004 and May 2004, the Company completed a private placement to certain private and institutional investors of $1,350,000 in principal amount of its three-year 7% Convertible Debentures (the "7% Debentures"). All principal is due and payable three years from the issuance date.

During the three months ended January 31, 2005, $199,450 of principal of 7% Debentures plus accrued interest of $12,264 were converted into 1,411,428 shares of the Common Stock. During the three months ended April 30, 2005, $383,050 of principal of 7% Debentures plus accrued interest of $28,212 were converted into 2,741,747 shares of Common Stock. During the three months ended July 31, 2005, $325,000 of principal of 7% Debentures plus accrued interest of $32,860 were converted into 2,385,804 shares of the Common Stock leaving a principal balance of $125,000.

NOTE 7 - CONVERTIBLE DEBENTURES (CONTINUED)

The 7% Debentures are summarized below:

	Principal Amount	Unamortized Debt Discount	Net carrying Value
Long term portion	$ 125,000	$ 58,110	$ 66,890

The remaining 7% Debentures outstanding at July 31, 2005 were originally issued in December 2003 and are due and payable in December 2006.

NOTE 8 - NOTES PAYABLE

The Company has the following notes payable outstanding at July 31, 2005:

Note payable (five individual notes with identical terms), unsecured, 6% interest, due on demand with three days notice	$ 256,886
Note payable, 10% interest, unsecured, due on demand with three days notice (1)	333,424
Note payable (2)	12,000
Note payable (3)	2,027,203
Total	$ 2,629,513
Less: current portion of notes payable	(2,196,976)
Long term portion of notes payable	$ 432,537

(1) Outstanding principal of $150,000 was paid in June 2005 from the proceeds of the private placement of the 2005 Debentures further discussed in Note

7.

(2) In March 2004, the Company entered into a loan agreement, pursuant to which the Company borrowed $12,000 from the lender. The loan is evidenced by an installment note issued by the Company to such lender. The principal amount of the loan and any accrued and unpaid interest at a rate of 5% were due and payable on July 26, 2004. On July 26, 2004, the lender agreed to extend payment and unpaid accrued interest until November 15, 2004. The lender has agreed to extend payment and unpaid interest until November 15, 2005.

(3) In April 2005, the Company issued its promissory note in connection with the cancellation of the Series B Redeemable Preferred Stock (see Note 5) which bears interest at the rate of 7% per annum compounded quarterly. The principal amount of the promissory note and interest accrued thereon is due and payable in four equal quarterly installments beginning on the first anniversary of the date of the promissory note. Unless an event of default has occurred and is continuing, the principal amount of the promissory note decreases by $797,333 on each of the six-month and twelve-month anniversaries of the date of the promissory note. The Company is required to pay to the holder 10% of the proceeds of any new financing consummated within 90 days of the date of the promissory note and 20% of the proceeds of any new financing consummated thereafter through the first anniversary of the promissory note in prepayment of the amount due under the promissory note. The Company has the right to prepay the outstanding principal amount of the promissory note and any accrued interest thereon in whole or in part without penalty or premium at any time. During the three months ended July 31, 2005, principal of $364,797 and interest of $27,983 were repaid from the proceeds of new financings to comply with the mandatory payment provisions of the promissory note.

In May and June 2005, three notes with outstanding principal of $605,251 and accrued interest of $43,931 were repaid from the proceeds of the private placement of the 2005 Debentures further discussed in Note 7.

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NEW VISUAL CORPORATION AND SUBSIDIARIES
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NOTE 9 - STOCKHOLDERS' EQUITY

COMMON STOCK ISSUANCES DURING THE NINE MONTHS ENDED JULY 31, 2005:

During the nine months ended July 31, 2005, the Company issued:

- 10,829,026 shares Common Stock to various investors for cash proceeds of $835,100;
- 5,073,015 shares of Common Stock for various services valued at $314,667;
- 422,783 shares of Common Stock in payment of accounts payable and accrued expenses of $71,911;
- 2,837,500 shares of Common Stock for consulting services valued at $342,000;
- 6,556,836 shares of Common Stock for converted promissory notes and accrued interest valued at $988,347;

- 639,998 shares of Common Stock as penalty for delayed filing/effectiveness of a registration statement valued at $96,000;
- 2,750,000 shares of Common Stock to various employees and directors valued at $452,500;
- 4,651,163 shares of Common Stock with a fair value of $744,186 in exchange for the surrender of Series B Redeemable Preferred Stock valued at $800,000. The Company recognized a gain of $55,814 on the transaction (See Note 5).
- 29,457 shares of Common Stock in connection with a Below Market Issuance valued at $5,008 (See Note 5).

OPTIONS GRANTED

In April 2005, the Company issued to each of its Chief Executive Officer and Executive Vice President, 1,000,000 shares of Common Stock, and performance based options to purchase 7,000,000 shares of restricted Common Stock at an exercise price of $0.17, which was equal to the closing price of the Common Stock on the Over-the-Counter Bulletin Board on the date of grant. Options to purchase 1,000,000 shares of restricted Common Stock vested upon the Company's consummation of the sales of the 2005 Debentures and options to purchase 6,000,000 shares of restricted Common Stock vest upon the Company's release of a beta version of its semiconductor technologies.

As the closing price of Common Stock at July 31, 2005 was below the exercise price of these options and therefore the intrinsic value was $0, previously recorded expense of $20,915 was reversed during the three months ended July 31, 2005.

OPTIONS EXPIRED, CANCELLED AND FORFEITED

During the nine months ended July 31, 2005, options to purchase 1,026,250 shares of Common Stock expired.

During the nine months ended July 31, 2005, options to purchase 2,325,000 shares of Common Stock were cancelled.

During the nine months ended July 31, 2005, options to purchase 925,000 shares of Common Stock were forfeited due to employee terminations.

WARRANTS EXPIRED

During the nine months ended July 31, 2005, warrants to purchase 800,000 shares of the Company's Common stock expired.

NOTE 10 - AMENDMENT TO DEVELOPMENT AND LICENSING AGREEMENT

The Company and Adaptive Networks, Inc. ("ANI") have, as of November 26, 2004, amended and restated their Development and License Agreement, dated as of April

17, 2002 (as so amended and restated the "Amended Agreement"). Under the Amended Agreement, the Company has accepted from ANI final delivery of the source code, the intellectual property rights related thereto and other materials related to certain technologies that were to be developed by ANI. Under the original Development and License Agreement entered into by the Company and ANI as of April 17, 2002, the Company acquired a worldwide, perpetual license to ANI's Powerstream technology, which provides the core technology for the Company's semiconductor technologies. The Company contemplates that HelloSoft, Inc. ("HelloSoft"), an independent software developer based in California, will provide certain development work necessary to the completion of the semiconductor chipset. The Company and HelloSoft are parties to a Services Agreement, dated as of March 31, 2004, under which HelloSoft provides continuing development services relating to the Company's semiconductor chipset.

Under the Amended Agreement, the Company and ANI's joint ownership rights will continue with respect to any improvements, developments, discoveries or other inventions that are developed under the agreement with HelloSoft.

In addition, under the Amended Agreement, ANI has agreed that the first $5 million of royalties otherwise payable by the Company to ANI thereunder from proceeds of the sale or license of the semiconductor technologies are to be offset by a credit in the same amount.

On July 26, 2005, the Company signed an amendment to its development agreement with HelloSoft that defines and prices the next two phases of the technology development. The Company will expend $445,000 on Phase II and $350,000 on Phase III. Half of Phase II, or $222,500, was paid to HelloSoft on July 26, 2005, in the form of restricted common stock issued at a discount of 25% to the closing price of common stock on that date, and the other $222,500 will be paid to them in cash when they complete Phase II. The restricted common stock issued to HelloSoft was valued at $296,667 and recorded as research and development expense. When HelloSoft commences Phase III, the Company will issue to them $175,000 worth of restricted common stock, and the other $175,000 will be paid to them in cash when they complete Phase III. Phase III will be deemed complete when HelloSoft releases the completed product in its beta form to the Company. The Company projects that this will occur in the fourth quarter of 2005.

NOTE 11 - COMMITMENTS AND CONTINGENCIES

NET LOSS PER SHARE

Securities that could potentially dilute basic earnings per share ("EPS") in the future that were not included in the computation of diluted EPS because to do so would have been anti-dilutive for the periods presented consist of the following:

2005 Debentures and accrued interest	74,569,774
Warrants to purchase common stock	50,812,757
Options to purchase common stock	16,893,750
Convertible notes payable and accrued interest	5,984,803
7% convertible debentures and accrued interest	931,690
Total as of July 31, 2005	149,192,774

Substantial issuance after July 31, 2005 through September 12, 2005:

Issuance of common stock for converted debentures and accrued interest	43,061,419
Issuance of common stock for liquidated damages	163,333

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NOTE 11 - COMMITMENTS AND CONTINGENCIES (CONTINUED)

LEGAL DISPUTES

During the quarter ended July 31, 2004, the Company was served with the following three summonses and complaints, each filed on July 30, 2004 in the Superior Court of California (San Diego County):

Each complaint relates to a convertible promissory note issued by us in December 2001 and payable, according to its terms, out of film distributions that we receive. Each complaint alleges, among other things: that we have failed to pay the amount due and owing under the convertible promissory note issued to the plaintiff despite demands for payment; that our management has acted to forestall payments to our creditors, including the plaintiff; and that we fraudulently induced the plaintiff to enter into the convertible promissory note.

The Company was served with the following additional summons and complaint, filed on July 30, 2004 in the Superior Court of California (San Diego County): Gerald Handler, Trustee of the Gerald and Judith Handler Trust and Trustee of the Handler Children Trust, and Wayne Lill Jr., Trustee of the Wayne Lill Trust dated 12-22-99 v. New Visual Corporation, New Visual Entertainment, Inc., Top Secret Productions, LLC and Does 1 through 20. The plaintiffs sought money damages in the aggregate of amount of $375,000, plus interest; an order avoiding alleged fraudulent transfers; an injunction against disposition of allegedly fraudulently transferred monies; the appointment of a receiver; a writ of attachment and imposition of a constructive trust.

According to their terms, each of the convertible promissory notes underlying these claims becomes due and payable upon our receipt of a specified amount of distributions from our Film and is payable out of those distributions that we have actually received. The convertible promissory notes underlying these claims were converted by the plaintiffs into shares of our common stock in March 2002.

The Company filed an answer to the complaints denying all allegations.

In July 2005 the legal proceedings were dismissed with prejudice upon the issuance in favor of the plaintiffs of an irrevocable letter of credit in the maximum amount of $300,000 by a non-related third party. The Company has no reimbursement obligation with respect to the letter of credit.

NEW VISUAL CORPORATION AND SUBSIDIARIES
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NOTE 12 - SEGMENT INFORMATION

Summarized financial information concerning the Company's reportable segments is shown in the following table:

For the nine months ended July 31, 2005:

	Telecommunications Business	Entertainment Business	Unallocable	Totals
Net Sales- domestic	$ --	$ 20,258	$ --	$ 20,258
Net Sales - foreign	$ --	$ 6,300	$ --	$ 6,300
Operating (Loss) Income	$ (5,999)	$(1,026,843)	$(2,726,187)	$(3,759,029)
Depreciation	$ 5,999	$ 18,493	$ --	$ 24,492
Total Identifiable Assets at July 31, 2005	$ 6,569,097	$ --	$ 1,098,350	$ 7,667,447

For the nine months ended July 31, 2004:

	Telecommunications Business	Entertainment Business	Unallocable	Totals
Net Sales - domestic	$ --	$ 74,382	$ --	$ 74,382
Net Sales - foreign	$ --	$ 156,910	$ --	$ 156,910
Operating (Loss) Income	$ (326,500)	$ 8,990	$(2,326,180)	$(2,643,690)
Depreciation	$ 2,829	$ 10,276	$ --	$ 13,105
Total Identifiable Assets at July 31, 2004	$ 5,923,761	$ 2,071,579	$ 23,788	$ 8,019,128

For the three months ended July 31, 2005:

	Telecommunications Business	Entertainment Business	Unallocable	Totals
Net Sales - domestic	$ --	$ 10,360	$ --	$ 10,360
Net Sales - foreign	$ --	$ --	$ --	$ --

Operating Income (Loss)	$ (4,100)	$(1,014,300)	$(1,166,495)	$(2,184,895)
Depreciation	$ 4,100	$ 13,297	$ --	$ 17,397
Total Identifiable Assets at July 31, 2005	$ 6,569,097	$ --	$ 1,098,350	$ 7,667,447

NEW VISUAL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 12 - SEGMENT INFORMATION (CONTINUED)

For the three months ended July 31, 2004:

	Telecommunications Business	Entertainment Business	Unallocable	Totals
Net Sales - domestic	$ --	$ --	$ --	$ --
Net Sales - foreign	$ --	$ 60,449	$ --	$ 60,449
Operating Income (Loss)	$ (153,939)	$ 4,558	$ (380,680)	$ (530,061)
Depreciation	$ 835	$ 3,487	$ --	$ 4,322
Total Identifiable Assets	$ 5,923,761	$ 2,071,579	$ 23,788	$ 8,019,128

NOTE 13 - SUBSEQUENT EVENTS

STOCK ISSUANCES

From August 1, 2005 to September 12, 2005 we issued securities as follows:

In August 2005, we issued:

(i) 163,333 shares of Common Stock for liquidated damages valued at $2,450.
(ii) 36,095,935 shares of Common Stock for converted debentures and interest valued at $1,036,625.

In September 2005, we issued 6,965,484 shares of Common Stock for converted debentures and interest valued at $179,613.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion in conjunction with our financial statements and the notes thereto included elsewhere herein.

CAUTION REGARDING FORWARD-LOOKING STATEMENTS

Throughout this quarterly report on Form 10-QSB, we make forward-looking statements that are based upon our current expectations, estimates and projections about our business and our industry, and that reflect our beliefs and assumptions based upon information available to us at the date of this report. In some cases, you can identify these statements by words such as "if," "may," "might," "will," "should," "expects," "plans," "anticipates," "believes," "estimates," "predicts," "potential," "continue," and other similar terms. These forward-looking statements include, among other things, projections of our future financial performance and our anticipated growth, descriptions of our strategies, our product and market development plans, the trends we anticipate in our business and the markets in which we operate, and the competitive nature and anticipated growth of those markets.

We caution readers that forward-looking statements are only predictions, based on our current expectations about future events. These forward-looking statements are not guarantees of future performance and are subject to risks, uncertainties and assumptions that are difficult to predict. Our actual results, performance or achievements could differ materially from those expressed or implied by the forward-looking statements. We caution readers not to rely on those forward-looking statements, which reflect management's analysis only as of the date of this quarterly report. We undertake no obligation to revise or update any forward-looking statement for any reason.

OVERVIEW

We are developing advanced transmission technology to enable data to be transmitted across copper telephone wire at speeds and over distances that exceed those offered by leading digital subscriber line (DSL) technology providers. We intend to market this novel technology to leading equipment makers in the telecommunications industry. Our technology is being designed to substantially increase the capacity of existing copper telephone networks, allowing telephone companies to provide enhanced video, data and voice services over the existing copper telecommunications infrastructure. The proprietary equipment, components and related technologies and semiconductor hardware and software products that we are designing, developing and testing will be referred to throughout this quarterly report as the "Semiconductor Technologies."

Through our wholly-owned subsidiary, NV Technology, we intend to design, develop, manufacture and license semiconductor hardware and software products based upon our Semiconductor Technologies. We believe that system-level products that use this set of technologies will have a significant advantage over existing system-level products that use existing broadband technologies, such as DSL, by providing faster transmission speed capability and by increasing the

transmission distance capability. We are currently in the process of completing the development of a commercial beta version of the chipset containing our Semiconductor Technologies for use and evaluation by prospective customers.

FILM. We have recognized revenues of approximately $694,000 from the feature-length documentary, STEP INTO LIQUID (the "Film") from its release through July 31, 2005. The Film has completed its domestic theater run grossing approximately $3.7 million in box office revenues, according to the Film's distributor. For the nine months ended July 31, 2005, the Company received revenue distributions in the aggregate amount of approximately $26,558. The Film is currently being distributed to foreign markets. The DVD was released domestically in April 2004 and the cable TV release occurred in October 2004. The broadcast television release is presently scheduled for summer 2005. The Film's foreign theatrical run began in Australia and New Zealand in January 2004 and will continue throughout 2005 in Japan, Brazil, Norway and Sweden. References to our business relating to the Film will sometimes be referred to in this quarterly report as our "Entertainment Business."

SEMICONDUCTOR TECHNOLOGIES. In December 2002, we completed the demonstration of the Semiconductor Technologies with a leading telephone company and a select target customer. In the demonstration, equipment enhanced by our Semiconductor Technologies achieved data speeds of 100 megabits per second. We believe that these results demonstrate the viability of delivering data intensive applications over existing telephone copper wiring infrastructure enhanced by our Semiconductor Technologies with limited significant service degradation and improved security and at a substantial savings from broadband solutions currently commercially available. No assurance can be provided that the results achieved in this demonstration can be reproduced or surpassed in the beta or commercial versions of our chipset or that, even if such results are reproduced or surpassed, that telephone equipment providers will include our chipset in their product offerings or ultimately deploy any product containing our chipset.

At the present time, we are working to complete a commercially deployable version of the chipset containing the Semiconductor Technologies. This process involves several steps. Initially, we will need to complete a beta version of the chipset of the Semiconductor Technologies for evaluation by potential customers and industry partners. We estimate we will complete this step in December 2005. We plan to present this beta version to a select base of potential customers and equipment providers for use in limited deployments. Once this stage is completed, we intend to complete a version that is more suitable to high volume, low cost production. We believe that the process of commercialization will entail extensive field testing and pilot deployments with selected telecommunications equipment providers to arrive at a commercially deployable version. The complexity of the Semiconductor Technologies could result in unforeseen delays or expense.

RESULTS OF OPERATIONS

COMPARISON OF THE THREE MONTHS AND NINE MONTHS ENDED JULY 31, 2005 AND THE THREE MONTHS AND NINE MONTHS ENDED JULY 31, 2004

REVENUES. Revenues for the three months and nine months ended July 31, 2005 were $10,360 and $26,558, respectively, and were attributable to our Entertainment Business. Revenues for the corresponding periods in 2004 were $60,449 and

$231,292, respectively, from our Entertainment Business.

COST OF SALES. Cost of sales for the three months and nine months ended July 31, 2005 were $0 and $11,945, respectively, and represent the amortization of film cost for the Film. Cost of sales for the corresponding periods in 2004 were $29,451 and $115,665, respectively. The decrease for the three months and nine months ended July 31, 2005 when compared with corresponding periods in 2004 was a result of lower revenues generated from the Film as cost of sales are directly related to the revenues recognized under SOP-00-2.

OPERATING EXPENSES. Operating expenses included research and development expenses in connection with the Semiconductor business, compensatory element of stock issuances, selling, general and administrative expenses, the costs of settlement of litigation, and the impairment of Film in Distribution. Total operating expenses increased by 272% to $2,195,255 for the three months ended July 31, 2005 from $590,510 for the three months ended July 31, 2004. This increase is primarily due to the impairment recorded on the Film in Distribution ($1,009,777), higher research and development expenses ($296,667), and higher selling, general and administrative expenses ($327,752). Selling, general and administrative expenses increased by 58% during the same period primarily as a result of commission payments for services in connection with the placement of the 2005 Debentures. Research and development expenses increased to $296,667 for the three months ended July 31, 2005 as we continue to use stock for compensation purposes in connection with our development agreement with HelloSoft.

Total operating expenses increased by 32% to $3,785,587 for the nine months ended July 31, 2005 from $2,874,982 for the nine months ended July 31, 2004. This increase is primarily due to the impairment recorded on the Film in Distribution ($1,009,777) and stock issued in connection with our development agreement with HelloSoft ($296,667), offset by reductions in selling, general and administrative expenses ($289,172). Selling, general and administrative expenses decreased 11% to $2,460,145 during the same period primarily due to a decrease in headcount in administrative personnel, including the elimination of executive level positions and lower compensation expense related to issuing stock for services.

OTHER (INCOME) EXPENSES. Other income for the three months and the nine months ended July 31, 2005 was attributable primarily to the gain on sale of property and equipment, gain on forgiveness of liabilities, and gain on exchange, including conversion of certain Company liabilities into the Company's Common Stock. Other expenses included primarily interest expense and amortization of deferred financing costs. Interest expense increased 32% and 99% for the three months and the nine months ended July 31, 2005 when compared with the same period in 2004 primarily as a result of the issuance of $3,500,000 principal amount of the 2005 Debentures in May 2005 and additional short-term financing obtained during fiscal year 2004, which remained outstanding during 2005. Increase in amortization of deferred financing costs by 258% and 189% for the three months and nine months ended July 31, 2005 when compared with the same period in 2004 was a result of higher amortization of the Compensation Warrants and other financing costs primarily related to the 2005 Debentures.

NET LOSS. For the three months ended July 31, 2005, the net loss increased $1,731,733 or 179% from $965,290 to $2,697,023 primarily due to the impairment recorded on the Film in Distribution ($1,009,777), higher research and

development expenses related to stock issuances ($296,667), higher selling, general and administrative expenses ($327,752), and higher interest costs, including amortization expenses ($181,492), offset by a gain on the forgiveness of liabilities ($99,369). For the nine months ended July 31, 2005, the net loss increased $1,479,594 or 44% from $3,379,998 to $4,859,592 primarily due to the impairment recorded on the Film in Distribution ($1,009,777), an increase in research and development expenses ($293,720), and higher interest costs, including amortization expenses ($666,972), offset by reductions in selling, general and administrative expenses ($289,172), cost of sales ($103,720), and other gains.

LIQUIDITY AND CAPITAL RESOURCES

Cash balances totaled $1,056,107 as of July 31, 2005 compared to $127,811 at October 31, 2004. As discussed below, in May 2005, the Company raised net proceeds of approximately $3.11 million from the private placement of certain of its securities.

Net cash used in operating activities was $1,752,045 for the nine months ended July 31, 2005 compared to $1,330,453 for the same period in 2004. The increase in cash used by operations is primarily attributable to a larger net loss during the nine months ended July 31, 2005 as compared to the nine months ended July 31, 2004 as well as changes in the outstanding balance of accounts payable and accrued expenses.

Net cash used in investing activities for the nine months ended July 31, 2005 was $11,161 compared to $95,000 for the nine months ended July 31, 2004. Net cash used in investing activities was primarily the result of the acquisition of property and equipment of $11,161 in 2005 and the acquisition of license of $95,000 in 2004.

Net cash provided by financing activities was $2,691,502 for the nine months ended July 31, 2005. This compares to $1,110,561 for the nine months ended July 31, 2004. Cash provided by financing activities during the first nine months of 2005 and 2004 primarily consisted of proceeds from issuance of Common Stock, proceeds from issuance of notes payable, convertible notes payable, and convertible debentures. The increase in cash provided by financing activities during the nine months ended July 31, 2005 as compared to the nine months ended July 31, 2004 is primarily due to the proceeds from the 2005 Debentures as discussed below, offset by the subsequent repayments of notes payable.

Since inception, we have funded our operations primarily through the sale of our Common Stock and debt securities. Our recent financings are discussed below.

In May 2005, we sold $3,500,000 aggregate principal amount of our senior secured 7% convertible debentures and warrants, receiving net proceeds of approximately $3.11 million after the payment of offering related fees and expenses (the "2005 Debentures").

In December 2004, we entered into a loan agreement with an institutional investor pursuant to which we borrowed $300,000. The outstanding principal and accrued interest on this loan was repaid in May 2005 from the proceeds of the 2005 Debentures.

In September 2004, we entered into a loan agreement with an institutional investor/stockholder pursuant to which we borrowed $250,000. The principal amount of the loan and any accrued and unpaid interest was originally due and payable on March 24, 2005 and was subsequently extended to May 31, 2005. The outstanding principal and accrued interest on this loan was repaid in May 2005 from the proceeds of the 2005 Debentures.

In December 2003, April 2004 and May 2004, we raised net proceeds of approximately $888,650 from the private placement to certain private and institutional investors of our three year 7% Convertible Debentures.

As of July 31, 2005, we had cash of $1,056,107. Although management believes funds on hand will enable us to meet our liquidity needs through December 31, 2005, we will require additional funds to continue to meet our liquidity needs and satisfy our current business plan. It is likely that we will need to raise additional funds to pay existing current liabilities as they come due, as well as to meet our operating requirements, prior to the receipt of revenues from our Semiconductor Technologies. Certain provisions of the 2005 Debentures may impair our ability to raise funds by selling our equity securities. For example, until the dollar amount of outstanding 2005 Debentures is 1/3 or less of $3.5 million, in most cases we cannot issue securities with a variable conversion or exercise price. In addition, until February 1, 2006, in most cases we cannot issue securities to an investor where the investor receives registration rights.

We may not be successful in our efforts to raise additional funds. Even if we are able to raise additional funds through the issuance of debt or other means, our cash needs could be heavier than anticipated in which case we could be forced to raise additional capital. Even after our product is ready to ship, we do not yet know what payment terms will be required by our customers or if our product will be successful. At the present time, we have no commitments for any additional financing, and there can be no assurance that, if needed, additional capital will be available to us on commercially acceptable terms or at all. Our auditors have included a "going concern" qualification in their auditors' report for the year ended October 31, 2004. Such a "going concern" qualification may make it more difficult for us to raise funds when needed.

Additional equity financings may be dilutive to holders of our Common Stock and debt financing, if available, may involve significant payment obligations and covenants that restrict how we operate our business.

IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

In April 2005, the Securities and Exchange Commission issued release number 33-8568, AMENDMENT TO RULE 4-01(A) OF REGULATION S-X REGARDING THE COMPLIANCE DATE FOR STATEMENT OF FINANCIAL ACCOUNTING STANDARDS NO. 123 (REVISED 2004), SHARE BASED PAYMENT. This release delays the date for compliance with Statement of Financial Accounting Standards No. 123 (Revised 2004), SHARE BASED PAYMENT ("Statement 123R") to the registrant's first interim or annual reporting period beginning on or after December 15, 2005. Statement 123R requires public entities to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award, and no longer allows companies to apply the intrinsic value based method of accounting for stock compensation described in Accounting Principles Board Opinion No. 25, ACCOUNTING FOR STOCK ISSUED TO EMPLOYEES. In accordance with this amendment, the Company will adopt SFAS No. 123R as of the beginning of the Company's interim reporting period that begins on February 1, 2006. The transitional provisions of SFAS 123R are not expected to have a material effect on the Company's consolidated financial position or results of operations as substantially all outstanding equity instruments are expected to vest on or prior to January 31, 2006. The Company will utilize the fair value method for any future instruments after the implementation date.

In June 2005, the Financial Accounting Standards Board published Statement of Financial Accounting Standards No. 154, ACCOUNTING CHANGES AND ERROR CORRECTIONS. SFAS 154 establishes new standards on accounting for changes in accounting principles. Pursuant to the new rules, all such changes must be accounted for by retrospective application to the financial statements of prior periods unless it is impracticable to do so. SFAS 154 completely replaces Accounting Principles Bulletin No. 20 and SFAS 3, though it carries forward the guidance in those pronouncements with respect to accounting for changes in estimates, changes in the reporting entity, and the correction of errors. The requirements in SFAS 154 are effective for accounting changes made in fiscal years beginning after December 15, 2005. The Company will apply these requirements to any accounting changes after the implementation date.

ITEM 3. CONTROLS AND PROCEDURES.

The Company, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the Company's "disclosure controls and procedures," as such term is defined in Rules 13a-15e promulgated under the Exchange Act as of this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer has concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report to provide reasonable assurance that material information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms.

Management is aware that there is a lack of segregation of duties at the Company due to the small number of employees dealing with general administrative and financial matters. This constitutes a significant deficiency in the internal controls. However, at this time management has decided that considering the employees involved, the control procedures in place, and the outsourcing of certain financial functions, the risks associated with such lack of segregation are low and the potential benefits of adding additional employees to clearly segregate duties do not justify the expenses associated with such increases. Management will periodically reevaluate this situation. If the volume of the business increases and sufficient capital is secured, it is the Company's intention to increase staffing to mitigate the current lack of segregation of duties within the general administrative and financial functions.

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems no evaluation of controls can provide absolute assurance that all control issues, if any, within a company have been detected. Such limitations include the fact that human judgment in decision-making can be faulty and that breakdowns in internal control can occur because of human failures, such as simple errors or mistakes or intentional circumvention of the established process.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

During the period covered by this quarterly report, the Company was a defendant in legal proceedings filed in July 2004 in the Superior Court of California, the details of which were previously disclosed in the Company's quarterly report on Form 10-QSB for the quarter ended April 30, 2005.

In May 2005, the Plaintiffs in the above proceeding withdrew with prejudice the complaints that they filed upon the issuance in their favor by a commercial bank of an irrevocable letter of credit in the maximum amount of $300,000. The letter of credit was commissioned by a non-related third party. The Company has no reimbursement obligation with respect to the letter of credit.

ITEM 2. UNREGISTERED SALES OF EQUITY IN SECURITIES AND USE OF PROCEEDS.

During the three months ended July 31, 2005, the Company issued unregistered securities as follows:

- issued 437,500 shares of Common Stock to various investors for aggregate cash proceeds of $35,000;
- issued 4,944,444 shares of Common Stock for services rendered that were valued at $296,667; and
- issued 29,457 shares of Common Stock in connection with a Below Market Issuance valued at $5,008.

All of the securities issued in the transactions described above were issued without registration under the Securities Act in reliance upon the exemption provided in Section 4(2) of the Securities Act. Appropriate legends were affixed to the share certificates issued in all of the above transactions. The Company believes the recipients were all "accredited investors" within the meaning of Rule 501(a) of Regulation D under the Securities Act, or had such knowledge and experience in financial and business matters as to be able to evaluate the merits and risks of an investment in its common stock. All recipients had adequate access, through their relationships with the Company and its officers and directors, to information about the Company. None of the transactions described above involved general solicitation or advertising.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

The Company submitted the following matters to a vote of its shareholders at its annual meeting, which was held July 27, 2005:

(a) The Company's shareholders were asked to vote for the election of Brad Ketch, Ray Willenberg, Jr., Thomas J. Cooper and Jack L. Peckham to the Board of Directors of the Company. The nominees were all elected pursuant to the following votes:

	FOR	WITHHELD
Election of Directors:		
Brad Ketch	67,162,797	1,499,953
Ray Willenberg, Jr.	66,945,996	1,716,754
Thomas J. Cooper	67,350,306	1,312,444
Jack L. Peckham	67,359,082	1,303,668

(b) The Company's shareholders were asked to ratify the selection of Marcum and

Kliegman LLP as the Company's independent auditors for the fiscal year ending October 31, 2005. The shareholders ratified the selection of the independent auditors by the following votes:

FOR	AGAINST	ABSTAIN
68,005,736	511,264	145,750

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) Exhibits:

10.1 Form of Securities Purchase Agreement dated as of May 26, 2005, among New Visual Corporation and certain investors (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K dated June 1, 2005 (the "June1, 2005 8-K").

10.2 Form of Registration Rights Agreement dated as of May 26, 2005, among New Visual Corporation and certain investors (incorporated by reference to Exhibit 10.2 of the June 1, 2005 8-K).

10.3 Security Interest Agreement dated as of May 26, 2005 among the Company, certain specified investors, as secured parties, and Krieger and Prager, as agent for the secured parties (incorporated by reference to Exhibit 10.3 of the June 1, 2005 8-K).

31. Rule 13a-14(a) / 15d-14(a) Certification

32. Section 1350 Certification

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.

NEW VISUAL CORPORATION

DATED: September 14, 2005

BY: /S/ BRAD KETCH

BRAD KETCH
PRESIDENT AND CHIEF EXECUTIVE OFFICER
(PRINCIPAL EXECUTIVE, FINANCIAL AND
ACCOUNTING OFFICER AND AUTHORIZED
SIGNATORY)

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