

XSUNX INC
Form 10-Q
February 17, 2009

FORM 10-Q

SECURITIES EXCHANGE COMMISSION
Washington, D.C. 20549

Quarterly Report under Section 13 or 15(d) of
The Securities Exchange Act of 1934

For Quarter Ended December 31, 2008

Commission file number: 000-29621

XSUNX, INC.
(Exact name of registrant as specified in its charter)

Colorado
(State of incorporation)

84-1384159
(I.R.S. Employer Identification No.)

65 Enterprise, Aliso Viejo, CA 92656
(Address of principal executive offices) (Zip Code)

Registrant's telephone number: (949) 330-8060

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

Title of each class: None Name of each exchange on which registered: N/A

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

Common Stock, no par value per share

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, during the preceding twelve (12) months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company filer.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

The number of shares of common stock issued and outstanding as of February 17, 2009 was 189,342,437.

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XSUNX, INC.
(A Development Stage Company)
Balance Sheets

| | December 31, 2008 (Unaudited) | September 30, 2008 |
|---|-------------------------------------|-----------------------|
| ASSETS: | | |
| Current assets: | | |
| Cash | \$ 1,555,240 | \$ 2,389,218 |
| Inventory Held for Sale | 1,417,000 | 1,417,000 |
| Prepaid Expenses | 38,084 | 11,986 |
| Total current assets | 3,010,324 | 3,818,204 |
| Fixed assets: | | |
| Office & Misc. Equipment | 51,708 | 50,010 |
| Research and Development Equipment | 469,382 | 435,910 |
| Leasehold Improvements | 89,825 | 89,825 |
| Total Fixed Assets | 610,915 | 575,745 |
| Less: Accumulated Depreciation | (336,611) | (299,559) |
| Net fixed assets | 274,304 | 276,186 |
| Other assets: | | |
| Manufacturing Equipment in Progress | 9,341,349 | 5,824,630 |
| Security Deposit | 5,815 | 5,815 |
| Total other assets | 9,347,164 | 5,830,445 |
| TOTAL ASSETS | \$ 12,631,792 | \$ 9,924,835 |
| LIABILITIES AND STOCKHOLDERS' EQUITY: | | |
| Current Liabilities: | | |
| Accounts Payable | \$ 3,700,989 | \$ 465,953 |
| Accrued Expenses | 54,239 | 30,957 |
| Total current liabilities | 3,755,228 | 496,910 |
| Stockholders' Equity: | | |
| Preferred Stock, par value \$0.01 per share; 50,000,000 shares authorized; no shares issued and outstanding | - | - |
| Common Stock, no par value; 500,000,000 shares authorized; 189,342,437 shares issued and outstanding at December 31, 2008 and 186,292,437 shares issued and outstanding at September 30, 2008 | 23,224,369 | 22,613,369 |
| Paid in Capital - Common Stock Warrants | 2,718,662 | 2,641,412 |
| Additional Paid in Capital | 5,248,213 | 5,248,213 |
| (Deficit) accumulated during the development stage | (22,314,680) | (21,075,069) |
| Total stockholders' equity | 8,876,564 | 9,427,925 |

| | | |
|--|---------------|--------------|
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 12,631,792 | \$ 9,924,835 |
|--|---------------|--------------|

The Accompanying Notes are an Integral Part of These Financial Statements

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XSUNX, INC.
(A Development Stage Company)
Statements of Operations
(UNAUDITED)

| | Three Months Ended | | Feb. 25, 1997 |
|--|-----------------------|---------------------|--|
| | December 31, | 2007 | (Inception) to December 31, 2008 |
| | 2008 | | 2008 |
| Revenue | | | |
| Service Income | \$ - | \$ - | \$ 14,880 |
| Total Revenue | - | - | 14,880 |
| Expenses: | | | |
| Selling, General and Administrative Expense | 1,121,135 | 448,899 | 12,402,235 |
| Depreciation | 37,052 | 41,708 | 472,165 |
| Option / Warrant Expense | 77,250 | 168,322 | 2,992,852 |
| Total Operating Expenses | 1,235,437 | 658,929 | 15,867,252 |
| Other (Income) Expense | | | |
| Interest Expense | - | 395 | 91,293 |
| Interest Income | (3,416) | (58,588) | (443,466) |
| Legal Settlement | - | - | (1,100,000) |
| Loan Fees | - | - | 7,001,990 |
| Impairment of Asset | - | - | 1,204,459 |
| Other - Non Operating | 7,590 | - | 12,805 |
| Forgiveness of Debt | - | - | (304,773) |
| Total Other (Income) Expense | 4,174 | (58,193) | 6,462,308 |
| Net (Loss) | \$ (1,239,611) | \$ (600,736) | \$ (22,314,680) |
| Per Share Information: | | | |
| Basic and Diluted | | | |
| Weighted average number of common shares outstanding | 188,404,937 | 164,724,263 | |
| Net (Loss) per Common Share | \$ (0.01) | \$ (0.00) | |

The Accompanying Notes are an Integral Part of These Financial Statements

XSUNX, INC.
(A Development Stage Company)
Statements of Operations
(UNAUDITED)

| | Treasury Stock | | Common Stock | | Additional Paid in Capital | Paid In Capital Options & Warrants | (Deficit) Accumulated During the Development Stage | Totals | |
|---|----------------|--------|--------------|----------|----------------------------------|---|--|--------|-------------|
| | Shares | Amount | Shares | Amount | | | | | |
| Inception February 25, 1997 | - | \$ - | - | \$ - | - | \$ - | - | \$ - | - |
| Issuance of stock for cash | - | - | 15,880 | 217,700 | - | - | - | - | 217,700 |
| Issuance of stock to Founders | - | - | 14,110 | - | - | - | - | - | - |
| Issuance of stock for consolidation | - | - | 445,000 | 312,106 | - | - | - | - | 312,106 |
| Net Loss | - | - | - | - | - | - | (193,973) | - | (193,973) |
| Balance - September 30, 1997 | - | - | 474,990 | 529,806 | - | - | (193,973) | - | 335,834 |
| Issuance of stock for services | - | - | 1,500 | 30,000 | - | - | - | - | 30,000 |
| Issuance of stock for cash | - | - | 50,200 | 204,000 | - | - | - | - | 204,000 |
| Consolidation stock cancelled | - | - | (60,000) | (50,000) | - | - | - | - | (50,000) |
| Net Loss | - | - | - | - | - | - | (799,451) | - | (799,451) |
| Balance - September 30, 1998 | - | - | 466,690 | 713,806 | - | - | (993,424) | - | (279,618) |
| Issuance of stock for cash | - | - | 151,458 | 717,113 | - | - | - | - | 717,113 |
| Issuance of stock for services | - | - | 135,000 | 463,500 | - | - | - | - | 463,500 |
| Net Loss | - | - | - | - | - | - | (1,482,017) | - | (1,482,017) |

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| | | | | | | | | |
|---|---|---|-------------|-----------|---|---------|-------------|-------------|
| Balance - September 30, 1999 | - | - | 753,148 | 1,894,419 | - | - | (2,475,441) | (581,022) |
| Issuance of stock for cash | - | - | 15,000 | 27,000 | - | - | - | 27,000 |
| Net Loss | - | - | - | - | - | - | (118,369) | (118,369) |
| Balance - September 30, 2000 | - | - | 768,148 | 1,921,419 | - | - | (2,593,810) | (672,391) |
| Extinguishment of debt | - | - | - | 337,887 | - | - | - | 337,887 |
| Net Loss | - | - | - | - | - | - | (32,402) | (32,402) |
| Balance - September 30, 2001 | - | - | 768,148 | 2,259,306 | - | - | (2,626,212) | (366,906) |
| Net Loss | - | - | - | - | - | - | (47,297) | (47,297) |
| Balance - September 30, 2002 | - | - | 768,148 | 2,259,306 | - | - | (2,673,509) | (414,203) |
| Issuance of stock for Assets | - | - | 70,000,000 | 3 | - | - | - | 3 |
| Issuance of stock for Cash | - | - | 9,000,000 | 225,450 | - | - | - | 225,450 |
| Issuance of stock for Debt | - | - | 115,000 | 121,828 | - | - | - | 121,828 |
| Issuance of stock for Expenses | - | - | 115,000 | 89,939 | - | - | - | 89,939 |
| Issuance of stock for Services | - | - | 31,300,000 | 125,200 | - | - | - | 125,200 |
| Net Loss | - | - | - | - | - | - | (145,868) | (145,868) |
| Balance - September 30, 2003 | - | - | 111,298,148 | 2,821,726 | - | - | (2,819,377) | 2,350 |
| Issuance of stock for cash | - | - | 2,737,954 | 282,670 | - | - | - | 282,670 |
| Issuance of Common Stock Warrants | - | - | - | - | - | 825,000 | 375,000 | 1,200,000 |
| Net Loss | - | - | - | - | - | - | (1,509,068) | (1,509,068) |

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| | | | | | | | | |
|--|------------|---|-------------|------------|-----------|-----------|--------------|-------------|
| Balance - September 30, 2004 | | | 114,036,102 | 3,104,396 | - | 825,000 | (3,953,445) | (24,049) |
| Issuance of stock for cash | - | - | 6,747,037 | 531,395 | - | - | - | 531,395 |
| Issuance of stock for services | - | - | 3,093,500 | 360,945 | - | 180,000 | - | 540,945 |
| Issuance of stock for debenture conversion | - | - | - | - | 400,000 | - | - | 400,000 |
| Issuance of Common Stock Warrants | 26,798,418 | - | - | - | - | - | - | - |
| Net Loss | - | - | - | - | - | - | (1,980,838) | (1,980,838) |
| Balance - September 30, 2005 | 26,798,418 | - | 123,876,639 | 3,996,735 | 400,000 | 1,005,000 | (5,934,283) | (532,548) |
| Issuance of stock for services | - | - | 72,366 | 31,500 | - | - | - | 31,500 |
| Issuance of Common Stock Warrants | - | - | - | - | - | 996,250 | - | 996,250 |
| Issuance of stock for debenture conversion | - | - | 21,657,895 | 5,850,000 | 5,685,573 | - | - | 11,535,573 |
| Issuance of stock for interest expense | - | - | 712,956 | 241,383 | - | - | - | 241,383 |
| Issuance of stock for warrant conversion | - | - | 10,850,000 | 3,171,250 | - | - | - | 3,171,250 |
| Net Loss | - | - | - | - | - | - | (9,112,988) | (9,112,988) |
| Balance September 30, 2006 | 26,798,418 | - | 157,169,856 | 13,290,869 | 6,085,573 | 2,001,250 | (15,047,271) | 6,330,420 |
| Cancellation of Stock for Services Returned | - | - | (150,000) | (150,000) | 150,000 | - | - | - |

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| | | | | | | | | |
|--|--------------|------|-------------|---------------|--------------|--------------|-----------------|--------------|
| Release of Security Collateral | (26,798,418) | - | - | - | - | - | - | - |
| Issuance of Stock for Warrants - Jim Bentley | - | - | 900,000 | 285,000 | (150,000) | - | - | 135,000 |
| Issuance of Common Stock Warrants | - | - | - | - | - | 772,315 | - | 772,315 |
| Net Loss | - | - | - | - | - | - | (1,968,846) | (1,968,846) |
| Balance September 30, 2007 | - | - | 157,919,856 | 13,425,869 | 6,085,573 | 2,773,565 | (17,016,117) | 5,268,889 |
| Fusion Equity Stock Purchase | - | - | 15,347,581 | 5,200,000 | - | - | - | 5,200,000 |
| Commitment Fees | - | - | 3,500,000 | 1,190,000 | (1,190,000) | - | - | - |
| Cumorah Capital Stock Purchase | - | - | 8,650,000 | 2,500,000 | - | - | - | 2,500,000 |
| Wharton Settlement | - | - | 875,000 | 297,500 | (397,500) | - | - | (100,000) |
| MVS Warrant Cancellation | - | - | - | - | 805,440 | (805,440) | - | - |
| Option and Warrant | - | - | - | - | (55,300) | 673,287 | - | 617,987 |
| Net Loss | - | - | - | - | - | - | (4,058,952) | (4,058,952) |
| Balance September 30, 2008 | - | - | 186,292,437 | 22,613,369 | 5,248,213 | 2,641,412 | (21,075,069) | 9,427,925 |
| Fusion Equity Stock Purchase | - | - | 3,000,000 | 600,000 | - | - | - | 600,000 |
| Issuance of stock for services | - | - | 50,000 | 11,000 | - | - | - | 11,000 |
| Option and Warrant | - | - | - | - | - | 77,250 | - | 77,250 |
| Net Loss | - | - | - | - | - | - | (1,239,611) | (1,239,611) |
| Balance December 31, 2008 (Unaudited) | - | \$ - | 189,342,437 | \$ 23,224,369 | \$ 5,248,213 | \$ 2,718,662 | \$ (22,314,680) | \$ 8,876,564 |

The Accompanying Notes are an Integral Part of These Financial Statements

XSUNX, INC.
(A Development Stage Company)
Statements of Operations
(UNAUDITED)

| | Three Months Ended December 31, | | Feb. 25, 1997 (Inception) to December 31, 2008 |
|---|------------------------------------|------------------|---|
| | 2008 | 2007 | |
| Cash Flows from Operating Activities: | | | |
| Net (Loss) | \$ (1,239,611) | \$ (600,736) | \$ (22,314,680) |
| Issuance of Common Stock for Interest | - | - | 241,383 |
| Issuance of Common Stock for Services | 11,000 | - | 1,599,251 |
| Amortization of Cornell financing warrants, commitment fees and beneficial conversion | - | - | 5,685,573 |
| Option / Warrant Expense | 77,250 | 168,322 | 2,992,852 |
| Asset Impairment | - | - | 1,204,459 |
| Depreciation | 37,052 | 41,708 | 472,165 |
| Adjustments to reconcile net loss to cash used in operating activities: | | | |
| (Increase) in Inventory Held for Sale | - | - | (1,417,000) |
| (Increase) in Prepaid Expense | (26,098) | 12,895 | (38,084) |
| Decrease in Other Assets | - | - | (5,815) |
| Increase (Decrease) in Accounts Payable | 3,235,035 | (20,756) | 5,307,277 |
| Increase (Decrease) in Accrued Expenses | 23,282 | (12,932) | 54,239 |
| Net Cash Flows Provided by (Used in) Operating Activities | 2,117,910 | (411,499) | (6,218,380) |
| Cash Flows from Investing Activities: | | | |
| Purchase of Fixed Assets | (35,170) | (102,112) | (610,915) |
| Purchase of Marketable Prototype and Patent | - | - | (1,780,394) |
| Purchase of Manufacturing Equipment and Facilities - In process | (3,516,719) | (37,737) | (9,341,349) |
| Payments on Note Receivable | - | - | (1,500,000) |
| Receipts on Note Receivable | - | - | 1,500,000 |
| Net Cash Flows (Used in) Investing Activities | (3,551,889) | (139,849) | (11,732,658) |
| Cash Flows from Financing Activities: | | | |
| Proceeds from Warrant Conversion | - | - | 3,306,250 |
| Proceeds from Debentures | - | - | 5,850,000 |
| Net Proceeds from Sale of Common Stock | 600,000 | 970,000 | 10,350,028 |
| Net Cash Flows Provided by Financing Activities | 600,000 | 970,000 | 19,506,278 |
| Net Increase (Decrease) in Cash | (833,979) | 418,652 | 1,555,240 |

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| | | | |
|--|--------------|--------------|--------------|
| Cash and cash equivalents - Beginning of period | 2,389,218 | 1,768,616 | - |
| Cash and cash equivalents - End of period | \$ 1,555,240 | \$ 2,187,268 | \$ 1,555,240 |
| Supplemental Disclosure of Cash Flow Information | | | |
| Cash Paid During the Period for: | | | |
| Interest | \$ - | \$ 395 | \$ 119,617 |
| Income Taxes | \$ - | \$ - | \$ - |

The Accompanying Notes are an Integral Part of These Financial Statements

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XSUNX, INC.
(A Development Stage Company)
Notes to Financial Statements
December 31, 2008
(Unaudited)

Note 1 — Presentation of Interim Information:

The unaudited interim consolidated financial statements of the Company included herein have been prepared in accordance with generally accepted accounting principles for interim financial information and in accordance with the instructions for Form 10-Q under Article 8.03 of Regulation S-X. These statements do not include all of the information and notes to the financial statements required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included.

Operating results for the three month period ended December 31, 2008, are not necessarily indicative of the results that may be expected for the year ending September 30, 2009. The unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the fiscal year ended September 30, 2008, included in the Company's Annual Report on Form 10-K, as filed with Securities and Exchange Commission.

Note 2 — Going Concern:

We are a development stage company and, to date, have not generated any significant revenues. The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate our continuation as a going concern. Net loss for the period ended December 31, 2008 was \$1,239,611. In addition, the Company has an accumulated deficit of \$22,314,680 since inception.

The items discussed above raise substantial doubt about our ability to continue as a going concern. We cannot assure you that we can achieve or sustain profitability in the future. Our operations are subject to the risks and competition inherent in the establishment of a business enterprise. There can be no assurance that future operations will be profitable. Revenues and profits, if any, will depend upon various factors, including whether our product development can be completed, whether our products will achieve market acceptance and whether we obtain additional financing. We may not achieve our business objectives and the failure to achieve such goals would have a material adverse impact on us.

The Company is currently working to transition from the development stage to the implementation phase and as of the period ended December 31, 2008, did not have any significant revenues. The transition to revenue recognition may exceed cash generated from operations in the current and future periods. We have in the past experienced substantial losses and negative cash flow from operations and have required financing, including equity and debt financing, in order to pursue the commercialization of products based on our technologies. We expect that we will continue to need significant financing to operate our business, including capital expenditures to install our planned production capacity. The Company needs to raise additional capital to complete its operational plan.

Note 3 — Common Stock Transactions:

The authorized common stock of the Company was established at 500,000,000 shares with no par value.

Financing

In a placement of the Company's common stock pursuant to an S-1 Registration declared effective by the U.S. Securities and Exchange Commission on April 10, 2008, the Company has sold 3,000,000 shares of common stock at a price of \$0.20 each, for total proceeds of \$600,000 to Fusion Capital Fund II, LLC during the three months ending December 31, 2008.

Pursuant to the S-1 Registration Statement declared effective by the SEC on April 10, 2008, the Company has sold to Fusion Capital Fund II, LLC through December 31, 2008, approximately 18,347,581 shares for a total investment of \$5,800,000. These shares were sold at various pricing between \$0.405 and \$0.20 per share. Including 3,500,000 shares issued to Fusion as financing commitment shares leaving 18,152,419 registered shares available for future sales pursuant to the effective S-1 Registration Statement.

Issuance of Shares for Services

In November 2008, the Company issued 50,000 shares of its restricted common stock in connection with a services agreement to provide marketing and financing service to the Company. The shares were valued at \$0.22 per share, the share price on the date the agreement was reached. The agreement ended on December 31, 2008.

Employee Incentive Option Grants

During the period ended December 31, 2008, and in connection with the Company's policy to incentivize employees whose contribution is deemed to influence the Company's efforts to prepare, install, and operate solar module manufacturing capabilities, the Company authorized employment incentive option grants to the following employees at an exercise price per share of \$0.36. The options have a 5 year exercise terms and vest in the amount of 1/3 of the total grant on an annual basis from the date of hire and subject to continued employment with the Company:

| Name | Date of Grant | Amount | Type of Grant | Exercise Price | Term |
|-----------------|------------------|---------|---------------|----------------|-------|
| Vanessa Watkins | October 10, 2008 | 115,000 | Incentive | \$0.36 | 5 yr. |
| Tyler Anderson | October 10, 2008 | 100,000 | Incentive | \$0.36 | 5 yr. |
| Yang Zhuang | October 29, 2008 | 20,000 | Incentive | \$0.36 | 5 yr. |

Note 4 - Stock-Based Compensation:

The Company follows SFAS No. 123(R), ("Share-Based Payment" (SFAS No. 123(R))). This statement requires that all stock-based compensation be recognized as an expense in the financial statements and that such cost be measured at the fair value of the grant. This statement was adopted using the modified prospective method of application, which requires us to recognize compensation expense on a prospective basis. Therefore, prior period financial statements have not been restated. Under this method, in addition to reflecting compensation expense for new share-based grants, expense is also recognized to reflect the remaining service period of grants that had been included in pro-forma disclosures in prior periods.

XsunX records the fair value of stock-based compensation grants as an expense. In order to determine the fair value of stock options on the date of grant, XsunX applies the Black-Scholes option-pricing model. Inherent in this model are assumptions related to expected stock-price volatility, option life, risk-free interest rate and dividend yield. While the risk-free interest rate and dividend yield are less subjective assumptions, typically based on factual data derived from public sources, the expected stock-price volatility and option life assumptions require a greater level of judgment.

XsunX uses an expected stock-price volatility assumption that is based on historical implied volatilities of the underlying stock which is obtained from public data sources. With regard to the weighted-average option life assumption, XsunX considers the exercise behavior of past grants and models the pattern of aggregate exercises. Patterns are determined on specific criteria of the aggregate pool of optionees.

Forfeiture rates are based on the Company's historical data and future estimates for stock option forfeitures. There are 10,180,332 options and warrants issued of which 7,454,707 are vested. The exercise price range for the Company's options and warrants are \$0.15 to \$1.69. The weighted average remaining life of the option and warrant grants range from 2.7 years to 4.3 years. We have based our expected volatility on the historical performance of our stock adjusted for extreme period of volatility that resulted from unusual events. The range of volatility for our options and warrants is 53% to 122% based on the specific grant. The risk free interest rate used in our calculation was 3.54%. Total net stock-based compensation expense is attributable to the granting of and the remaining requisite service periods of stock options previously granted. We have recorded \$77,251 of option and warrant expense in the quarter ended December 31, 2008 relating to current period vesting of historically granted stock options.

Note 5 — Notes, Commitments, and Contingencies:

Contractual Obligations as of the period ended December 31, 2008, are shown in the following table -

Contractual Obligations

| | Total | Less than 1 Year | 1 - 3 Years | Thereafter |
|-------------------------|---------------|---------------------|----------------|------------|
| Operating Lease(1) | \$ 1,865,007 | \$ 662,713 | \$ 1,202,294 | \$ — |
| Purchase Obligations(2) | 32,814,587 | 32,814,587 | — | — |
| To | \$ 34,679,594 | \$ 33,477,300 | \$ 1,202,294 | \$ — |

(1) Operating Lease Obligations consist of the lease on the Company's Manufacturing facility in Wood Village, OR and an Administrative facility in Golden, CO.

(2) Represents the total contractual purchase obligations represented by purchase orders for manufacturing equipment. The total obligations under these agreements is \$38,264,635 of which, \$5,450,048 has been paid on the obligations. Future scheduled payments are tied to progress made on the delivery of the associated equipment. There is an additional \$3,124,857 of accounts payable currently due on these obligations. The timing of these payments may vary due to the progress actually made by the vendors.

The estimated contract cost in item (2) above may be higher or lower based on final costs. The Company has not booked any contingency for cost overruns.

Note 6 — Subsequent Events:

On December 23, 2008, the Company received a comment letter from the SEC stating that due to the revocation of our previous auditors' registration to practice before the PCAOB, the Company could no longer include the audit reports of such prior auditor in the Company's SEC filings. As a result, the Company was required to perform an audit

not only for the fiscal year ended September 30, 2008, but also for fiscal years 2007 and 2006.

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While the Company made every effort to complete the required audits of the previous three (3) fiscal years, the Company was unable to complete such work to timely file its Annual Report on Form 10-K by December 30, 2008. As a result, on December 31, 2008 the Company's trading stock symbol was modified and an "e" was appended so that the trading symbol appeared as "XSNXE.OB" for failure to timely file its Annual Report on Form 10-K. The Company was granted a thirty (30) day grace period to comply with certain rules enforced by the Financial Industry Regulatory Authority (FINRA).

The Company continued through the grace period to complete the required audits however the Company was unable to file its Annual Report until February 2, 2009. As a result, commencing on February 3, 2009, the Company's common stock was disqualified for quotation on the OTCBB. On February 2, 2009, a qualified market maker member of FINRA prepared and submitted forms to initiate the processes necessary to resume our quotation on the OTCBB. On February 5, 2009, the Company satisfied all requirements and received approval to resume quotation on the OTCBB.

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

CAUTIONARY AND FORWARD LOOKING STATEMENTS

In addition to statements of historical fact, this Quarterly Report on Form 10-Q contains forward-looking statements. The presentation of future aspects of XsunX, Inc. ("XsunX", the "Company" or "issuer") found in these statements is subject to a number of risks and uncertainties that could cause actual results to differ materially from those reflected in such statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's analysis only as of the date hereof. Without limiting the generality of the foregoing, words such as "may", "will", "expect", "believe", "anticipate", "intend", or "could" or the negative variations thereof or comparable terminology are intended to identify forward-looking statements.

These forward-looking statements are subject to numerous assumptions, risks and uncertainties that may cause XsunX's actual results to be materially different from any future results expressed or implied by XsunX in those statements. Important facts that could prevent XsunX from achieving any stated goals include, but are not limited to, the following:

Some of these risks might include, but are not limited to, the following:

- (a) volatility or decline of the Company's stock price;
- (b) potential fluctuation in quarterly results;
- (c) failure of the Company to earn revenues or profits;
- (d) inadequate capital to continue or expand its business, inability to raise additional capital or financing to implement its business plans;
- (e) failure to commercialize its technology or to make sales;
- (f) rapid and significant changes in markets;
- (g) litigation with or legal claims and allegations by outside parties;
- (h) insufficient revenues to cover operating costs.

There is no assurance that the Company will be profitable, the Company may not be able to successfully develop, manage or market its products and services, the Company may not be able to attract or retain qualified executives and technology personnel, the Company's products and services may become obsolete, government regulation may hinder the Company's business, additional dilution in outstanding stock ownership may be incurred due to the issuance of more shares, warrants and stock options, or the exercise of warrants and stock options, and other risks inherent in the Company's businesses.

The Company undertakes no obligation to publicly revise these forward-looking statements to reflect events or circumstances that arise after the date hereof. Readers should carefully review the factors described in other documents the Company files from time to time with the Securities and Exchange Commission, including the Quarterly Reports on Form 10-Q and Annual Reports on Form 10-K filed by the Company and any Current Reports on Form 8-K filed by the Company.

Management believes the summary data presented herein is a fair presentation of the Company's results of operations for the periods presented. Due to the Company's change in primary business focus in October 2003 and new business opportunities these historical results may not necessarily be indicative of results to be expected for any future period. As such, future results of the Company may differ significantly from previous periods.

Business Overview

XsunX, Inc. is a thin-film photovoltaic ("TFPV") company which utilizes amorphous silicon ("a-Si"), a mature semiconductor technology, as the core solar energy absorber used to convert sunlight into electricity in the design and manufacture of its solar modules. We believe that the design of our proprietary manufacturing system, and solar module, coupled with our choice of assembly materials may allow us to enjoy production costs of approximately \$1.27 per watt within our first full year of solar module production.

We are currently developing the infrastructure to manufacture high performance TFPV solar modules to address growth in demand for solar modules within the electrical power production markets, and to satisfy contractual commitments for the sale and delivery of our solar modules in 2009 and 2010. To accomplish this we are executing a plan to build a thin film amorphous silicon solar module manufacturing facility located in the Portland Oregon, USA area. We are working to complete the installation of our base production infrastructure and develop initial production capacities to 25 MW in 2009, and then scale through system optimization to approximately 33 MW within the first full year of manufacturing operations. Subject to available financing we plan to expand production capacities through replication, growing production capacities to over 100 MW as rapidly as possible.

Upon completion and operation of our initial manufacturing system we anticipate that our per watt production costs will decrease over the next several years of operation as we work to further optimize solar module output per line, validate and then utilize newer and less costly packaging materials, increase the sellable watts per solar module, expand production capacities, and leverage economies of scale to better absorb certain fixed costs. Our goal is to drive our per watt solar module production costs to or below \$1.00 per watt as rapidly as possible, a price point that may allow us to offer a solar electricity production solution that can generate electricity on a non-subsidized basis at a cost equal to the price of retail electricity within certain domestic and foreign markets conducive to solar power production.

We have designed a TFPV solar module which we believe will deliver an average of approximately 127.5 peak watts. To produce solar modules in commercial quantities, our system design processes multiple 100cm X 160cm glass substrates simultaneously within a proprietary semiconductor manufacturing system which employs the design of a high-throughput, automated and continuous process. We believe that the design of our TFPV module and manufacturing system can deliver per watt costs significantly less than those of traditional crystalline silicon solar module manufacturers, and allow us to market TFPV modules that will be highly competitive with other thin film offerings.

While we receive interest in the use of our solar module in a broad range of applications, our business strategy is to deliver thin film solar products that meet the performance needs of the large solar farm and utility scale installation market. Our target customers represent a range of developers that may own and operate solar power plants or sell turnkey solar power plants to end-users that include government facilities, public and private utility companies, operators of commercial warehouse, office and industrial buildings, and financial investors that are looking to operate

large scale solar power plant projects.

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Products

Solar Modules

We have designed a TFPV solar module, the ASI-120, which we believe will deliver an average of approximately 127.5 peak watts. In designing our solar module, the XsunX ASI-120 module, we interviewed solar systems integrators and developed a design that we believe provides a module delivering high power output relative to other thin films. In doing so, we believe our modules strike a competitive balance between silicon wafer modules and other thin film modules.

Our design utilizes two separate (tandem) solar cell layers of amorphous silicon deposited on to a glass substrate. Two solar cell layers are used to broaden the visible spectrum of sunlight utilized by the module which in turn can increase the amount of absorbed and converted solar energy within our modules. After the tandem cell layers, conductive wiring, and weatherproofing encapsulant are applied we bond a second tempered sheet of glass to the module assembly. Based on previous experimental and limited commercial use of our thin film deposition recipes, we anticipate the finished solar module to produce 7.9% frame to frame efficiency delivering approximately 127.5 peak watts of direct current "DC" power. We believe that we may be able to improve conversion efficiencies through the use of derivative forms of amorphous and other proprietary cell structures.

We anticipate that we can present the superior per-rated-watt-performance of amorphous in "real world" operating conditions as a competitive strength over the factory-rated performance of various other solar technologies. We believe these factors will influence the purchasing decision process of large solar power farms and utility size installations.

Phased Production Build Out and Planned Capacities

At present, and for the foreseeable future, the majority of our operations development efforts will focus on establishing and expanding facilities necessary to manufacture our TFPV solar modules for commercial sale.

During the period ended December 31, 2008 we engaged in simultaneous efforts to prepare manufacturing facilities to house our module assembly line, design engineering and the placement of orders for manufacturing line components, monitor and management of component assembly efforts, material vendor negotiations and selection, and continued product design evaluation.

Planned Completion and Capacity Expansion

Barring assembly delays and/or any delays in securing necessary working capital, we anticipate completing the assembly of our initial 25MW manufacturing line and commencing manufacturing operations in 2009. We plan to scale manufacturing capacities through system optimization to approximately 33 MW within the first full year of production. Subject to available financing, we plan to expand production capacities through replication, growing production capacities to over 100 MW as rapidly as possible.

RESULTS OF OPERATIONS FOR THE THREE-MONTH PERIOD ENDED DECEMBER 31, 2008 COMPARED TO THE SAME PERIOD IN 2007

Revenue:

The Company generated no revenues in the period ended December 31, 2008 and 2007. Additionally, there was no associated cost of sales.

Operating Expenses:

Operating Expenses for the three month period ended December 31, 2008 totaled \$1,235,437. This represents an increase of \$576,508 as compared to the same period in 2007 which totaled \$658,929. The increase in operating expenses between the periods is primarily attributable to increased consulting expenses relating to the planning and preparation for our manufacturing facility, increased legal fees associated with the conclusion of several matters, an increase in rent expense for the manufacturing facility in Oregon, an increase in sales and property taxes related to equipment in Colorado and property taxes in Oregon., and higher wages and salaries cost. These increased costs were partially offset by reductions in travel expense and option and warrant expenses. A comparative analysis of the period to period performance is provided below.

Option and Warrant Expenses:

Option and Warrant expense for the three month period ending December 31, 2008 was \$77,250 as compared to \$168,322 during the same period in 2007. This reduction of \$91,072 was related primarily to the vesting of current options and the cancellation of options that had vesting expenses in previous periods.

Salaries and Wages:

Salaries and wages for the three month period ended December 31, 2008 were \$380,209 as compared to \$235,516 during the same period in 2007. The increase of \$144,693 was driven by an increase to salaries related to retention of key employees and the addition of new employee's necessary for the launch of our plans to build and establish thin film solar module manufacturing infrastructure. There were nine full time employees at December 31, 2008 as compared to seven full time employees at December 31, 2007.

Professional Services:

Public relations and marketing expense for the three month period ended December 31, 2008 totaled \$97,365 as compared to \$68,674 during this same period in 2007. The increase of \$28,691 represents an increased utilization of public relations services to work towards establishing brand awareness during the period.

Consulting expenses for the three month period ended December 31, 2008 totaled \$58,477 as compared to \$30,986 during the same period in 2007, an increase of \$27,491. This increase is largely due to higher utilization of consulting services associated with the planning and preparation for our manufacturing facility and for the payment of board of director fees as well as the hiring of a contract HR manager to facilitate hiring in Oregon.

Legal and accounting fees for the three month period ended December 31, 2008 totaled \$124,840 as compared to \$10,328 during the same period in 2007. This represents an increase of \$114,512 largely driven by increased expenditures for legal services related to equipment and materials contract review and the efforts to defend claims by a third party for payment of fees for claimed services and higher audit fees related to the re-audit of the September 30, 2006 and 2007 financial statements.

Travel and Entertainment:

Expenses for travel and entertainment were \$29,838 for the three month period ended December 31, 2008. This compared to \$31,953 for the same period in 2007. This decrease of \$2,115 was largely flat period over period.

The net loss for the three months ended December 31, 2008 was \$(1,239,611) as compared to a net loss of (\$600,736) for the same period 2007. The increased net loss of \$638,875 includes (i) The operating expense changes discussed above, (ii) and a decrease in interest income of \$55,173 relating to the repayment of the Sencera note and associated

interest income.

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The associated net loss per share was \$(0.01) for the three month period ended December 31, 2008 and less than \$(0.01) for the same period in 2007. The Company anticipates the trend of losses to continue in future quarters until the Company can recognize sales of significance of which there is no assurance.

LIQUIDITY AND CAPITAL RESOURCES

The Company had cash at December 31, 2008 of \$1,555,240, and inventory of \$1,417,000 and \$38,084 of pre-paid expenses as compared to cash of \$2,389,218, restated inventory from production prototype machine of \$1,417,000 and prepaid expenses in the amount of \$11,986 as of September 30, 2008. The Company had a net working capital deficit of \$744,904 as compared to a net working capital of \$3,321,294 at September 30, 2008. Cash flow used in operating activities during the three-month period ended, December 31, 2008, was \$2,117,910 as compared to a use of cash of \$(411,499) for the same period 2007. The change in operating cash flow resulted from a significant increase in accounts payables related to primarily to Oregon manufacturing facilities of \$3,124,857.

Contractual Obligations as of the period ended December 31, 2008 are shown in the following table -

Contractual Obligations

| | Total | Less than 1 Year | 1 - 3 Years | Thereafter |
|-------------------------|---------------|---------------------|----------------|------------|
| Operating Lease(1) | \$ 1,865,007 | \$ 662,713 | \$ 1,202,294 | \$ — |
| Purchase Obligations(2) | 32,814,587 | 32,814,587 | — | — |
| To | \$ 34,679,594 | \$ 33,477,300 | \$ 1,202,294 | \$ — |

(1) Operating Lease Obligations consist of the lease on the Company's Manufacturing facility in Wood Village, OR and an Administrative facility in Golden, CO.

(2) Represents the total contractual purchase obligations represented by purchase orders for manufacturing equipment. The total obligations under these agreements is \$38,264,635 of which, \$5,450,048 has been paid on the obligations. Future scheduled payments are tied to progress made on the delivery of the associated equipment. There is an additional \$3,124,857 of accounts payable currently due on these obligations. The timing of these payments may vary due to the progress actually made by the vendors.

The estimated contract cost in item (2) above may be higher or lower based on final costs. The Company has not booked any contingency for cost overruns.

For the three months ended December 31, 2008, the Company's capital needs have been met from the use of working capital provided by the proceeds of (i) the Company's working capital and (ii) an additional \$600,000 cash from the issuance of common stock to Fusion Capital.

DEVELOPMENT STAGE COMPANY

The Company is currently working to transition from the development stage to the implementation phase and as of the period ended December 31, 2008, did not have any significant revenues. The transition to revenue recognition may exceed cash generated from operations in the current and future periods. We have in the past experienced substantial losses and negative cash flow from operations and have required financing, including equity and debt financing, in order to pursue the commercialization of products based on our technologies. We expect that we will continue to need significant financing to operate our business, including capital expenditures to install our planned production capacity. Although the Company entered into a financing arrangement with Fusion Capital Fund II, LLC pursuant to which the Company has the right over a 25-month period to receive \$80,000 every two business days under such

financing arrangement unless our stock price equals or exceeds \$0.30, in which case we can sell greater amounts to Fusion Capital as the price of our common stock increases, Fusion Capital shall not have the right or the obligation to purchase any shares of our common stock on any business day that the market price of our common stock is less than \$0.20. As of February 12, 2009, the Company's stock was trading at approximately \$0.16 and therefore, the Company is not presently able to draw down on this financing arrangement. Furthermore, there can be no assurance that additional financing will be available or that the terms of such additional financing, if available, will be acceptable to us. If additional financing is not available or not available on terms acceptable to us, our ability to fund our operations, develop and install or expand our manufacturing operations and sales network, maintain our research and development efforts or otherwise respond to competitive pressures may be significantly impaired. We could also be forced to curtail our business operations, reduce our investments, decrease or eliminate capital expenditures and delay the execution of its business plan, including, without limitation, the installation of our planned production in Oregon, which would have a material adverse affect on our business.

While we have been able to raise capital in a series of equity and debt offerings in the past there can be no assurances that we will be able to obtain such additional financing, on terms acceptable to us and at the times required, or at all.

Irrespective of whether the Company's cash assets prove to be inadequate to meet the Company's operational needs, the Company might seek to compensate providers of services by issuances of stock in lieu of cash.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We do not have any market risk sensitive instruments. Since all operations are in U.S. dollar denominated accounts, we do not have foreign currency risk. Our operating costs are reported in U.S. dollars.

The Company does not invest in term financial products or instruments or derivatives involving risk other than money market accounts, which fluctuate with interest rates at market.

Item 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures and internal controls to ensure that information required to be disclosed in the Company's filings under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Our Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this report. The evaluation included certain control areas in which we have made, and are continuing to make, changes to improve and enhance controls. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, our disclosure controls and procedures were effective, and we have discovered no material weakness.

Changes in Internal Control over Financial Reporting

There have not been any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during our fourth fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

In the ordinary conduct of our business, we are subject to periodic lawsuits, investigations and claims, including, but not limited to, routine employment matters. Although we cannot predict with certainty the ultimate resolution of lawsuits, investigations and claims asserted against us, we are currently not aware of nor have any knowledge of any legal proceedings or claims that we believe will have, individually or in the aggregate, a material adverse affect on our business, financial condition or operating results.

Item 1A. Risk Factors

An investment in our common stock involves a high degree of risk. You should carefully consider the following risk factors, as well as the other information in this Quarterly Report on Form 10-Q, in evaluating XsunX and our business. If any of the following risks occur, our business, financial condition and results of operations could be materially and adversely affected. Accordingly, the trading price of our common stock could decline and you may lose all or part of your investment in our common stock. The risks and uncertainties described below are not the only ones we face. Additional risks that we currently do not know about or that we currently believe to be immaterial may also impair our business operations.

We Have Not Generated Any Significant Revenues And Our Financial Statements Raise Substantial Doubt About Our Ability to Continue As A Going Concern

We are a development stage company and, to date, have not generated any significant revenues. The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate our continuation as a going concern. Net loss for the periods ended December 31, 2008 and 2007 was \$1,239,611 and \$600,736, respectively. Net cash provided by operations was \$2,117,910 and net cash used in operations was \$(411,499) for the periods ended December 31, 2008 and 2007, respectively. From inception through December 31, 2008, we had an accumulated deficit of \$22,314,680.

The items discussed above raise substantial doubt about our ability to continue as a going concern. We cannot assure you that we can achieve or sustain profitability in the future. Our operations are subject to the risks and competition inherent in the establishment of a business enterprise. There can be no assurance that future operations will be profitable. Revenues and profits, if any, will depend upon various factors, including whether our product development can be completed, whether our products will achieve market acceptance and whether we obtain additional financing. We may not achieve our business objectives and the failure to achieve such goals would have a materially adverse impact on us.

We will require significant financing in order to execute our operating plan and continue as a going concern. We cannot predict whether this additional financing, if available, will be in the form of equity, debt, or another form. We may not be able to obtain the necessary additional capital on a timely basis, on acceptable terms, or at all. In any of these events, we may be unable to implement our current plans for expansion, repay our debt obligations as they become due or respond to competitive pressures, any of which circumstances would have a material adverse effect on our business, prospects, financial condition and results of operations. The financial statements do not include any adjustments relating to the recoverability and reclassification of recorded asset amounts or amounts and reclassification of liabilities that might be necessary, should we be unable to continue as a going concern.

Should financing sources fail to materialize, management would seek alternate funding sources such as the sale of common and/or preferred stock, the issuance of debt, or the sale of our marketable assets.

In the event that these financing sources do not materialize, or that we are unsuccessful in increasing our revenues and profits, we will be forced to further reduce our costs, may be unable to repay our debt obligations as they become due, or respond to competitive pressures, any of which circumstances would have a material adverse effect on our business, prospects, financial condition and results of operations. Additionally, if these funding sources or increased revenues and profits do not materialize, and we are unable to secure additional financing, we could be forced to reduce or cease our business operations.

We will need to obtain significant additional financing to continue to operate our business, including significant capital expenditures to complete the installation of our initial 25MW per annum production capacity, and financing may be unavailable or available only on disadvantageous terms which could cause the Company to curtail its business operations and delay the execution of its business plan

We have in the past experienced substantial losses and negative cash flow from operations and have required financing, including equity and debt financing, in order to pursue the commercialization of products based on our technologies. We expect that we will continue to need significant financing to operate our business, including capital expenditures to install our planned production capacity. Although the Company entered into a financing arrangement with Fusion Capital Fund II, LLC pursuant to which the Company has the right over a 25-month period to receive \$80,000 every two business days under such financing arrangement unless our stock price equals or exceeds \$0.30, in which case we can sell greater amounts to Fusion Capital as the price of our common stock increases, Fusion Capital shall not have the right or the obligation to purchase any shares of our common stock on any business day that the market price of our common stock is less than \$0.20. As of February 12, 2009, the Company's stock was trading at approximately \$0.16 and therefore, the Company is not presently able to draw down on this financing arrangement. Furthermore, there can be no assurance that additional financing will be available or that the terms of such additional financing, if available, will be acceptable to us. If additional financing is not available or not available on terms acceptable to us, our ability to fund our operations, develop and install or expand our manufacturing operations and sales network, maintain our research and development efforts or otherwise respond to competitive pressures may be significantly impaired. We could also be forced to curtail our business operations, reduce our investments, decrease or eliminate capital expenditures and delay the execution of its business plan, including, without limitation, the installation of our planned production in Oregon, which would have a material adverse affect on our business.

We May Be Required To Raise Additional Financing By Issuing New Securities With Terms Or Rights Superior To Those Of Our Shares Of Common Stock, Which Could Adversely Affect The Market Price Of Our Shares Of Common Stock and Our Business

We may require additional financing to fund future operations, including expansion in current and new markets, development and acquisition, capital costs and the costs of any necessary implementation of technological innovations or alternative technologies. We may not be able to obtain financing on favorable terms, if at all. If we raise additional funds by issuing equity securities, the percentage ownership of our current stockholders will be reduced, and the holders of the new equity securities may have rights superior to those of the holders of shares of common stock, which could adversely affect the market price and the voting power of shares of our common stock. If we raise additional funds by issuing debt securities, the holders of these debt securities would similarly have some rights senior to those of the holders of shares of common stock, and the terms of these debt securities could impose restrictions on operations and create a significant interest expense for us which could have a materially adverse affect on our business.

We are working to establish our manufacturing capacity for TFPV products in order to meet anticipated demand, and our revenues and profits may decrease if we are unable to successfully complete our initial 25MW of manufacturing capacity and then sell our TFPV products at volumes to match our available production capacity.

We are working to establish initial manufacturing capacity of 25MW per annum and plan to expand manufacturing capacity to 100MW per annum as rapidly as possible. This plan includes adding a new facility in Oregon. We will be installing and testing the equipment for this manufacturing facility internally and through third parties. We may experience delays, additional or unexpected costs and other adverse events in connection with our projects, including those associated with the equipment we purchase from third parties. Additionally, there can be no assurance that market demand will absorb our manufacturing capacity or that our marketing capabilities will be successful. As a result, we may not be able to realize revenues and profits based upon the expected capacity, or we may experience

delays or reductions in these revenues and profits, and our business could be materially adversely affected.

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If future products based on our technologies cannot be developed for manufacture and sold commercially or our products become obsolete or noncompetitive, we may be unable to recover our investments or achieve profitability which will have a materially adverse affect on our business

There can be no assurance that such research and development efforts will be successful or that we will be able to develop commercial applications for our products and technologies. Further, the areas in which we are developing technologies and products are characterized by rapid and significant technological change. Rapid technological development may result in our products becoming obsolete or noncompetitive. If future products based on our technologies cannot be developed for manufacture and sold commercially or our products become obsolete or noncompetitive, we may be unable to recover our investments or achieve profitability. In addition, the commercialization schedule may be delayed if we experience delays in meeting development goals, if products based on our technologies exhibit technical defects, or if we are unable to meet cost or performance goals. In this event, potential purchasers of products based on our technologies may choose alternative technologies and any delays could allow potential competitors to gain market advantages.

There is no assurance that the market will accept our products once commercial-scale manufacturing has been achieved which could have an adverse affect on our business

There can be no assurance that products based on our technologies will be perceived as being superior to existing products or new products being developed by competing companies or that such products will otherwise be accepted by consumers. The market prices for products based on our technologies may exceed the prices of competitive products based on existing technologies or new products based on technologies currently under development by competitors. There can be no assurance that the prices of products based on our technologies will be perceived by consumers as cost-effective or that the prices of such products will be competitive with existing products or with other new products or technologies. If consumers do not accept products based on our technologies, we may be unable to recover our investments or achieve profitability.

Other companies, many of which have greater resources than we have, may develop competing products or technologies which cause products based on our technologies to become noncompetitive which could have an adverse affect on our business

We will be competing with firms, both domestic and foreign, that perform research and development, as well as firms that manufacture and sell solar products. In addition, we expect additional potential competitors to enter the markets for solar products in the future. Some of these current and potential competitors are among the largest industrial companies in the world with longer operating histories, greater name recognition, access to larger customer bases, well-established business organizations and product lines and significantly greater resources and research and development staff and facilities. There can be no assurance that one or more such companies will not succeed in developing technologies or products that will become available for commercial sale prior to our products, that will have performance superior to products based on our technologies or that would otherwise render our products noncompetitive. If we fail to compete successfully, our business would suffer and we may lose or be unable to gain market share.

The loss of strategic relationships used in the development of our products and the systems and components to our planned 25MW manufacturing system could impede our ability to complete our product and/or our initial manufacturing system and have a material adverse affect on our business

We have established a plan of operations under which a portion of our operations rely on strategic relationships with third parties, to provide systems design, assembly and support. A loss of any of our third party relationships for any reason could cause us to experience difficulties in implementing our business strategy. There can be no assurance that we could establish other relationships of adequate expertise in a timely manner or at all.

We may suffer the loss of key personnel or may be unable to attract and retain qualified personnel to maintain and expand our business which could have a material adverse affect on our business

Our success is highly dependent on the continued services of a limited number of skilled managers, scientists and technicians. The loss of any of these individuals could have a material adverse effect on us. In addition, our success will depend upon, among other factors, the recruitment and retention of additional highly skilled and experienced management and technical personnel. There can be no assurance that we will be able to retain existing employees or to attract and retain additional personnel on acceptable terms given the competition for such personnel in industrial, academic and nonprofit research sectors.

Higher raw material costs could negatively impact our cost of goods and our ability to successfully develop our products and technologies which could have a material adverse affect on our business

Higher costs for certain raw materials and commodities, principally glass, resin-based polymers and industrial gases, as well as higher energy costs, could negatively impact our cost of operations. While we have developed strategies to mitigate or partially offset the impact of higher raw material, commodity and energy costs, there can be no assurances such measures will be successful. In addition, no assurances can be given that the magnitude and duration of these cost increases or any future cost increases will not have a larger adverse impact on our profitability and consolidated financial position than currently anticipated. As part of our planned research and development activities, we are attempting to reduce costs through improved automation and substitution strategies. There can be no assurances that we will succeed in these future cost-reduction efforts, which may be essential for the continued development of our competitive presence.

Standards For Compliance With Section 404 Of The Sarbanes-Oxley Act Of 2002 Are Uncertain, And If We Fail To Comply In A Timely Manner, Our Business Could Be Harmed And Our Stock Price Could Decline

Rules adopted by the SEC, pursuant to Section 404 of the Sarbanes-Oxley Act of 2002 require annual assessment of our internal control over financial reporting, and attestation of our assessment by our independent registered public accountants. The standards that must be met for management to assess the internal control over financial reporting as effective are new and complex, and require significant documentation, testing and possible remediation to meet the detailed standards and will impose significant additional expenses on us. We may encounter problems or delays in completing activities necessary to make an assessment of our internal control over financial reporting. In addition, the attestation process by our independent registered public accountants is new and we may encounter problems or delays in completing the implementation of any requested improvements and receiving an attestation of our assessment by our independent registered public accountants. If we cannot assess our internal control over financial reporting as effective, or our independent registered public accountants are unable to provide an unqualified attestation report on such assessment, investor confidence and share value may be negatively impacted.

Our Common Stock Is Considered A “Penny Stock” And As A Result, Related Broker-Dealer Requirements Affect Its Trading And Liquidity.

Our common stock is considered to be a “penny stock” since it meets one or more of the definitions in Rules 15g-2 through 15g-6 promulgated under Section 15(g) of the Exchange Act. These include but are not limited to the following: (i) the common stock trades at a price less than \$5.00 per share; (ii) the common stock is not traded on a “recognized” national exchange; (iii) the common stock is not quoted on the NASDAQ Stock Market, or (iv) the common stock is issued by a company with average revenues of less than \$6.0 million for the past three (3) years. The principal result or effect of being designated a “penny stock” is that securities broker-dealers cannot recommend our Common Stock to investors, thus hampering its liquidity.

Section 15(g) and Rule 15g-2 require broker-dealers dealing in penny stocks to provide potential investors with documentation disclosing the risks of penny stocks and to obtain a manually signed and dated written receipt of the documents before effecting any transaction in a penny stock for the investor’s account. Potential investors in our Common Stock are urged to obtain and read such disclosure carefully before purchasing any of our shares.

Moreover, Rule 15g-9 requires broker-dealers in penny stocks to approve the account of any investor for transactions in such stocks before selling any penny stock to that investor. This procedure requires the broker-dealer to (i) obtain from the investor information concerning his or her financial situation, investment experience and investment objectives; (ii) reasonably determine, based on that information, that transactions in penny stocks are suitable for the investor and that the investor has sufficient knowledge and experience as to be reasonably capable of evaluating the risks of penny stock transactions; (iii) provide the investor with a written statement setting forth the basis on which the

broker-dealer made the determination in (ii) above; and (iv) receive a signed and dated copy of such statement from the investor, confirming that it accurately reflects the investor's financial situation, investment experience and investment objectives.

The Trading Market In our Common Stock Is Limited And May Cause Volatility In The Market Price.

Our common stock is currently traded on a limited basis on the OTCBB. The OTCBB provides significantly less liquidity than the NASDAQ Stock Market and the other national markets. Quotes for stocks included on the OTCBB are not listed in the financial sections of newspapers as are those for the NASDAQ Stock Market. Therefore, prices for securities traded solely on the OTCBB may be difficult to obtain.

The quotation of our common stock on the OTCBB does not assure that a meaningful, consistent and liquid trading market currently exists, and in recent years such market has experienced extreme price and volume fluctuations that have particularly affected the market prices of many smaller companies like us. Thus, the market price for our common stock is subject to volatility and holders of common stock may be unable to resell their shares at or near their original purchase price or at any price. In the absence of an active trading market:

- ινῶεστορσ μαψ ηᾶπε διφιχιυλιτψ βυψινγ ανδ σελλιινγ ορ οβταιινγ μαρκετ θυοτατιονσ;
 - μαρκετ πισιβιλιτψ φορ ουρ χομμον στοχκ μαψ βε λιμιτεδ; ανδ
- α λαχκ οφ πισιβιλιτψ φορ ουρ χομμον στοχκ μαψ ηᾶπε α δεπρεσσιῶε εφφεχτ ον τηε μαρκετ φορ ουρ χομμον στοχκ.

Due to the low price of the securities, many brokerage firms may not be willing to effect transactions in the securities. Even if a purchaser finds a broker willing to effect a transaction in these securities, the combination of brokerage commissions, state transfer taxes, if any, and any other selling costs may exceed the selling price. Further, many lending institutions will not permit the use of such securities as collateral for any loans. Such restrictions could have a materially adverse affect on our business.

We May Have Difficulty Raising Necessary Capital To Fund Operations As A Result Of Market Price Volatility For Our Shares Of Common Stock.

The market price of our common stock is likely to be highly volatile and could fluctuate widely in price in response to various factors, many of which are beyond our control, including:

- technological innovations or new products and services by us or our competitors;
 - additions or departures of key personnel;
 - sales of our common stock;
- our ability to integrate operations, technology, products and services;
 - our ability to execute our business plan;
 - operating results below expectations;
 - loss of any strategic relationship;
 - industry developments;
- economic and other external factors; and

- period-to-period fluctuations in our financial results.

Because we have a limited operating history with limited revenues to date, you may consider any one of these factors to be material. Our stock price may fluctuate widely as a result of any of the above listed factors. In recent years, the securities markets in the United States have experienced a high level of price and volume volatility, and the market price of securities of many companies have experienced wide fluctuations that have not necessarily been related to the operations, performances, underlying asset values or prospects of such companies. For these reasons, our shares of common stock can also be expected to be subject to volatility resulting from purely market forces over which we will have no control. If our business development plans are successful, we may require additional financing to continue to develop and exploit existing and new technologies and to expand into new markets. The exploitation of our technologies may, therefore, be dependent upon our ability to obtain financing through debt and equity or other means.

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

In November 2008, the Company issued 50,000 shares of its restricted common stock in connection with a services agreement to provide marketing and financing service to the Company. The shares were issued in a transaction exempt from registration pursuant to Section 4(2) of the Securities Act.

Item 3. Defaults Upon Senior Securities

None.

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

None.

Item 5. Other information

OTCBB Qualification

On December 23, 2008, the Company received a comment letter from the SEC stating that due to the revocation of our previous auditors' registration to practice before the PCAOB, the Company could no longer include the audit reports of such prior auditor in the Company's SEC filings. As a result, the Company was required to perform an audit not only for fiscal year ended September 30, 2008 but also for fiscal years 2007 and 2006.

While the Company made every effort to complete the required audits of the previous three (3) fiscal years, the Company was unable to complete such work to timely file its Annual Report on Form 10-K by December 30, 2008. As a result, on December 31, 2008 the Company's trading stock symbol was modified and an "e" was appended so that the trading symbol appeared as "XSNXE.OB" for failure to timely file its Annual Report on Form 10-K. The Company was granted a thirty (30) day grace period to comply with certain rules enforced by the Financial Industry Regulatory Authority (FINRA).

The Company continued through the grace period to complete the required audits however the Company was unable to file its Annual Report until February 2, 2009. As a result, commencing on February 3, 2009, the Company's common stock was disqualified for quotation on the OTCBB. On February 2, 2009, a qualified market maker member of FINRA prepared and submitted forms to initiate the processes necessary to resume our quotation on the OTCBB. On February 5, 2009, the Company received approval to resume quotation on the OTCBB.

Financing

In a placement of the Company's common stock pursuant to an S-1 Registration declared effective by the Securities and Exchange Commission on April 10, 2008, the Company has sold to Fusion Capital Fund II, LLC during the three months ending December 31, 2008 3,000,000 shares of common stock for total proceeds of \$600,000. These shares were sold at a price of \$0.20 each.

Pursuant to the S-1 Registration Statement declared effective by the SEC on April 10, 2008, the Company has sold to Fusion Capital Fund II, LLC through December 31, 2008, approximately 18,347,581 shares for a total investment of \$5,800,000. These shares were sold at various pricing between \$0.405 and \$0.20 per share. Including 3,500,000 shares issued to Fusion as financing commitment shares this leaves 18,152,419 registered shares available for future sales pursuant to the effective S-1 Registration Statement.

Marketable Prototype Dispute

In November 2008, XsunX received a notice from MVSystems, Inc. asserting that XsunX was in material default of the terms of a Separation Agreement between the parties dated May 30, 2008. XsunX disputes the assertion and as of the date of this report no related litigation is pending, and MVSystems has not asserted any related monetary damages. The claim relates to a production prototype machine built under the terms of an Expanded Use License Agreement dated October 12, 2005 between XsunX and MVSystems, Inc. Under the terms of the Expanded Use License Agreement the parties had agreed to build the machine to prove technology for intended resale and split any associated profits from the sale of the machine 50/50. This production machine was never brought operational due to the failure to meet contractual requirements of the machine by MVSystems, and XsunX has never taken possession of the machine. Under the terms of the May 2008 Separations Agreement MVSystems continues to have possession of the machine and subject to the Separations Agreement has undertaken efforts to sell the machine for the parties benefit. Under the notice of material default provided to XsunX MVSystems has claimed that a sale of the machine has occurred to XsunX and that state sales tax in the amount of approximately \$60,000 is due. XsunX disputes this claim and the parties have each petitioned the State of Colorado for a final determination on this matter. As of the date of this report the Company has not received determination or notice from the State of Colorado.

Change in Registered Public Accountant

The PCAOB revoked the registration of our former independent registered public accounting firm, Jaspers + Hall, PC on or about October 21, 2008. After receiving notice of such revocation, the Company's Board of Directors dismissed Jaspers + Hall, PC effective October 31, 2008 and engaged Stark Winter Schenkein & Co., LLP ("SWSC") to serve as the Company's new independent registered public accounting firm effective as of November 3, 2008 as set forth in the Company's Current Report on Form 8-K as filed with the SEC on November 6, 2008.

| EXHIBIT | DESCRIPTION | LOCATION |
|---------|--|-------------------|
| 31.1 | Certifications of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Certification Act of 2002 | Provided herewith |
| 31.2 | Certifications of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Certification Act of 2002 | Provided herewith |
| 32.1 | Certification Pursuant To 18 U.S.C. Section 1350, As Adopted Pursuant To Section 906 of the Sarbanes-Oxley Certification Act Of 2002 | Provided herewith |
| 32.2 | Certification Pursuant To 18 U.S.C. Section 1350, As Adopted Pursuant To Section 906 of the Sarbanes-Oxley Certification Act Of 2002 | Provided herewith |

SIGNATURES

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

XSUNX, INC.

Dated: February 17, 2009

By: /s/ Tom M. Djokovich
Tom M. Djokovich,
President, Principal Executive Officer

Dated: February 17, 2009

By: /s/ Jeff Huitt
Jeff Huitt
Chief Financial Officer and Principal Financial and
Accounting Officer