XSUNX INC
Form 10-Q
August 11, 2008

**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 June 30, 2008**

*Commission file number: 000-29621*

**XSUNX, INC.**

(Exact name of registrant as specified in its charter)

| Colorado | 84-1384159 |
| --- | --- |
| (State of incorporation) | (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:**

Title of each class: None

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. Yesx No o

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

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

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

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yesx No o

The number of shares of common stock issued and outstanding as of August 11, 2008 was 182,334,829.

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XSUNX
(A DEVELOPMENT STAGE COMPANY)
FINANCIAL STATEMENTS
June 30, 2008
(UNAUDITED)

***JASPERS + HALL, PC***
*CERTIFIED PUBLIC ACCOUNTANTS*

***9175 E. Kenyon Avenue, Suite 100***
***Denver, CO 80237***
***303-796-0099***

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors
XSUNX, INC.
Aliso Viejo, CA

We have reviewed the accompanying balance sheet of XSUNX, INC. (a development stage company) as of June 30, 2008, and the related statements of operations, stockholders' equity (deficit), and cash flows for the three-month and nine-month periods then ended. These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with standards of the Public Company Accounting Oversight Board (United States). The review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the consolidated financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements for them to be in conformity with accounting principles generally accepted in the United States.

Jaspers + Hall, PC
Denver, CO
August 11, 2008

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

| | | (Unaudited) June 30, 2008 | | (Audited) September 30, 2007 |
|---|---|---|---|---|
| **ASSETS:** | | | | |
| Current assets: | | | | |
| Cash | $ | 4,577,784 | $ | 1,773,748 |
| Inventory Held for Sale - Marketable Prototype | | 1,632,625 | $ | 1,720,875 |
| Prepaid Expenses | | | | 54,377 |
| Total current assets | | 6,210,409 | | 3,549,000 |
| | | | | |
| Fixed assets: | | | | |
| Office & Misc. Equipment | | 41,016 | | 39,437 |
| Research and Development Equipment | | 635,435 | | 532,795 |
| Leasehold Improvement | | 89,825 | | 89,825 |
| Oregon Manufacturing Progress Payment & Other | | 2,356,671 | | - |
| Total Fixed Assets | | 3,122,947 | | 662,057 |
| Less Depreciation | | (219,406) | | (118,064) |
| Total fixed assets | | 2,903,541 | | 543,993 |
| | | | | |
| Other assets: | | | | |
| Patents/Trade Marks | | | | - |
| Security Deposit | | 5,815 | | 5,815 |
| Accrued Interest Receivable | | | | 143,452 |
| Note Receivable | | | | 1,500,000 |
| | | | | |
| Total other assets | | 5,815 | | 1,649,267 |
| | | | | |
| **TOTAL ASSETS** | $ | 9,119,765 | $ | 5,742,260 |
| | | | | |
| **LIABILITIES AND STOCKHOLDERS' EQUITY:** | | | | |
| **Current Liabilities:** | | | | |
| Accounts Payable | $ | 5,227 | $ | 259,652 |
| Accrued Expenses | | 143,255 | | 53,036 |
| Total current liabilities | | 148,482 | | 312,688 |
| | | | | |
| **Stockholders' Equity:** | | | | |
| Preferred Stock, par value $0.01 per share; 50,000,000 shares authorized; no shares issued and outstanding | | | | |
| Treasury Stock, no par value; no shares where issued or outstanding | | | | |
| Common Stock, no par value; 500,000,000 shares authorized; 180,036,091 shares issued and outstanding at June 30, 2008 and 157,919,856 shares were issued and outstanding at September 30, 2007 | | 21,574,429 | | 13,563,869 |
| Paid in Capital - Common Stock Warrants & Fees | | 2,832,658 | | 2,326,553 |
| Deferred Stock Compensation | | (1,690,120) | | |
| Deficit accumulated during the development stage | | (13,745,684) | | (10,460,850) |
| Total stockholders' profit (deficit) | | 8,971,283 | | 5,429,572 |

| | | | | |
|---|---|---|---|---|
| **TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY** | $ | 9,119,765 | $ | 5,742,260 |

**See Accountants' Review Report**

**XSUNX, INC.**
**(A Development Stage Company)**
**Statement of Operations**
**(Unaudited)**

| | Three Months Ended June 30, 2008 | Three Months Ended June 30, 2007 | Nine Months Ended June 30, 2008 | Nine Months Ended June 30, 2007 | Feb. 25, 1997 (Inception) to June 30, 2008 |
|---|---|---|---|---|---|
| **Revenue** | | | | | |
| Service Income | $ - | | | $ 6,880 | $ 14,880 |
| Other Income | | | | | - |
| | | | | | |
| Total Revenue | - | - | - | 6,880 | 14,880 |
| | | | | | |
| **Expenses:** | | | | | |
| Advertising | 8,000 | 1,780 | 16,254 | 45,250 | 76,856 |
| Bank Charges | 1,715 | 663 | 2,902 | 892 | 6,782 |
| Conferences & Seminars | 825 | 1,125 | 4,609 | 10,495 | 30,601 |
| Consulting | 127,274 | 59,462 | 263,502 | 102,004 | 1,777,657 |
| Depreciation | 23,893 | 16,826 | 47,523 | 60,587 | 229,325 |
| Directors' Fees | | | | | 11,983 |
| Due Diligence | | | | | 45,832 |
| Dues and Subscriptions | | | | | - |
| Equipment Rental | | | | | 1,733 |
| Filing Fees | 1,011 | 1,079 | 2,053 | 3,576 | 10,663 |
| Impairment loss | | | | | 923,834 |
| Insurance | 6,023 | 14,085 | 40,764 | 48,670 | 111,082 |
| Legal & Accounting | 168,939 | 84,501 | 241,399 | 194,078 | 981,712 |
| Licenses & Fees | 75,000 | 20 | 75,643 | 90 | 82,188 |
| Commitment and Loan Fees | | | | | 741,834 |
| Meals & Entertainment | | | | | 4,119 |
| Miscellaneous | | 1,170 | 100 | 1,198 | 7,478 |
| Office Expenses | 9,626 | 3,239 | 16,587 | 14,673 | 58,100 |
| Patent Fees | 2,640 | | 2,640 | | 5,109 |
| Postage & Shipping | 2,749 | 2,857 | 5,616 | 5,555 | 20,444 |
| Printing | 12,611 | 396 | 23,297 | 6,778 | 51,767 |
| Public Relations | 107,798 | 24,660 | 311,459 | 51,960 | 799,053 |
| Recruitment Expenses | 2,038 | 29,806 | 3,441 | 29,806 | 50,505 |
| Research & Development | (234,242) | 15,313 | (69,994) | 326,550 | 1,937,381 |
| Rent | 20,233 | 19,764 | 59,111 | 50,114 | 171,635 |
| Salaries | 316,813 | 220,736 | 835,999 | 578,616 | 2,596,885 |
| Subscription Reports | | 6,093 | | 6,093 | 9,858 |
| Taxes | 27 | 1,003 | 2,496 | 1,507 | 11,332 |
| Telephone | 9,481 | 5,543 | 21,608 | 17,831 | 96,530 |
| Transfer Agent Expense | 889 | 150 | 1,321 | 533 | 21,254 |
| Travel, Meals & Entertainment | 74,361 | 52,718 | 143,560 | 128,299 | 418,053 |
| Utilities | 1,183 | 3,815 | 6,718 | 3,815 | 14,822 |
| Abandoned Equipment | | | | | 808 |

| | | | | | |
|---|---|---|---|---|---|
| Option / Warrant Expense | | | 1,308,865 | 364 | 3,785,418 |
| **Total Operating Expenses** | 738,887 | 566,804 | 3,367,473 | 1,689,334 | 15,092,633 |
| **Other (Income) Expense** | | | | | |
| Interest Income | (52,006) | (71,820) | (83,693) | (156,589) | 197,344 |
| Interest Expense | 262 | 651 | 1,054 | (156,589) | (369,640) |
| Legal Settlement | | | | | (1,100,000) |
| Other | | | | | - |
| Forgiveness of Debt | | | | | (59,773) |
| | | | | | - |
| **Total Other Income/Expense** | (51,744) | (71,169) | (82,639) | (313,178) | (1,332,069) |
| **Net (Loss)** | $ (687,143) | $ (495,635) | $ (3,284,834) | $ (1,369,276) | $ (13,745,684) |
| **Per Share Information:** | | | | | |
| Basic | | | | | |
| Weighted average number of common shares outstanding | 176,107,775 | 157,169,856 | 173,085,015 | 156,505,367 | |
| **Net Loss per Common Share** | $ (0.004) | $ (0.003) | $ (0.02) | $ (0.009) | |

**See Accountants' Review Report**

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**XSUNX, INC.**
**(A Development Stage Company)**
**Statement of Stockholders' Equity (Deficit)**
**June 30, 2007**
**(Unaudited)**

| | Treasury Stock | | Common Stock | | Paid in Capital Common Stock Warrants | Deficit Accumulated During the Exploration Stage | Deferred Stock Compensation | Totals |
|---|---|---|---|---|---|---|---|---|
| | # of Shares | Amount | # of 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 for Year | - | - | - | - | - | (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 for Year | - | - | - | - | - | (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 for Year | - | - | - | - | - | (1,482,017) | | (1,482,017) |
| 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 for year | - | - | - | - | - | (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 for year | - | - | - | - | - | (32,402) | | (32,402) |
| Balance - September 30, 2001 | - | - | 768,148 | 2,259,306 | - | (2,626,212) | - | (366,906) |
| Net Loss for year | - | - | - | - | - | (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 for year | - | - | - | - | - | (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 | - | - | - | - | 1,200,000 | - | - | 1,200,000 |
| Net Loss for Year | - | - | - | - | - | (1,509,068) | | (1,509,068) |
| Balance - September 30, 2004 | | | 114,036,102 | 3,104,396 | 1,200,000 | (4,328,445) | - | (24,049) |
| Issuance of stock for cash | - | - | 6,747,037 | 531,395 | - | - | - | 531,395 |
| Issuance of stock for services | - | - | 3,093,500 | 360,945 | - | - | - | 360,945 |
| Issuance of stock for collateral | 26,798,418 | - | - | - | - | - | - | - |
| Net Loss for Year | | | - | - | - | (1,400,839) | | (1,400,839) |
| Balance - September 30, 2005 | 26,798,418 | - | 123,876,639 | 3,996,735 | 1,200,000 | (5,729,284) | - | (532,549) |
| Issuance of stock for services | - | - | 72,366 | 31,500 | - | - | - | 31,500 |
| Issuance of Common Stock Warrants | - | - | - | - | 951,250 | - | - | 951,250 |
| Issuance of stock for debenture conversion | - | - | 21,657,895 | 5,850,000 | | | | 5,850,000 |
| 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 for Year | - | - | - | - | - | (3,441,940) | | (3,441,940) |
| Balance September 30, 2006 | 26,798,418 | - | 157,169,856 | 13,290,869 | 2,151,250 | (9,171,354) | - | 6,270,765 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Cancelation of Stock for Services Returned | | | (150,000) | (12,000) | | | | (12,000) |
| Release of Security Collateral | (26,798,418) | | | | | | | |
| Issuance of Stock for Warrants - Jim Bentley | | | 900,000 | 285,000 | (150,000) | | | 135,000 |
| Stock Option / Warrant Expense | | | | | 325,303 | | | 325,303 |
| Net Loss for Year | | | | | | (1,289,497) | | (1,289,497) |
| | | | | | | | | |
| Balance September 30, 2007 | - | $ - | 157,919,856 | $ 13,563,869 | $ 2,326,553 | $ (10,460,850) | $ - | 5,429,572 |
| | | | | | | | | |
| Issuance of Stock for Cash | | | 3,333,332 | 1,000,000 | | | | 1,000,000 |
| Issuance of Common Stock for Services | | | 3,500,000 | 1,105,300 | 1,308,865 | | | 2,414,165 |
| Deferred Stock Compensation | | | | | | | (1,135,300) | (1,135,300) |
| Net Loss for the Period | | | | | | (1,796,632) | | (1,796,632) |
| | | | | | | | | |
| Balance December 31, 2007 | - | $ - | 164,753,188 | $ 15,669,169 | $ 3,635,418 | $ (12,257,482) | $ (1,135,300) | 5,911,805 |
| | | | | | | | | |
| Issuance of Stock for Cash | | | 8,650,000 | 2,500,000 | | | | 2,500,000 |
| Issuance of Common Stock for Services | | | | | | | | - |
| Deferred Stock Compensation | | | | | | | | - |
| Deferred Stock Compensation | | | | | | | (20,000) | (20,000) |
| Net Loss for the Period | | | | | | (801,059) | | (801,059) |
| | | | | | | | | |
| Balance March 31, 2008 | - | $ - | 173,403,188 | $ 18,169,169 | $ 3,635,418 | $ (13,058,541) | $ (1,155,300) | 7,590,746 |
| | | | | | | | | |
| | | | 5,757,903 | 2,200,000 | | | | 2,200,000 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Issuance of Stock for Cash | | | | | | | | |
| Issuance of Common Stock for Services | | | 875,000 | 402,500 | | | (402,500) | - |
| Deferred Stock Compensation | | | | | | | | |
| Deferred Stock Compensation | | | | 802,760 | (802,760) | | (132,320) | (132,320) |
| Net Loss for the Period | | | | | | (687,143) | | (687,143) |
| Balance June 30, 2008 | - | $ - | 180,036,091 | $ 21,574,429 | $ 2,832,658 | $ (13,745,684) | $ (1,690,120) | $ 8,971,283 |

**See Accountants' Review Report**

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**XSUNX, INC.**
**(A Development Stage Company)**
**Statement of Cash Flows**
**(Unaudited)**

| | Nine Months Ended June 30, 2008 | Nine Months Ended June 30, 2007 | Feb. 25, 1997 (Inception) to June 30, 2008 |
|---|---|---|---|
| **Cash Flows from Operating Activities:** | | | |
| Net Loss | $ (3,284,834) | $ (1,526,880) | $ (13,745,684) |
| | | | |
| Issuance of Common Stock for Services | | (12,000) | 1,336,998 |
| Issuance of Common Stock for Commitment Fee | | | 310,117 |
| Option / Warrant Expense | 1,308,865 | | 3,785,418 |
| Issuance of Stock for Interest | | | 241,383 |
| Depreciation | 101,342 | 60,587 | 219,406 |
| Inventory | 88,250 | | (1,632,625) |
| | | | |
| Adjustments to reconcile net loss to cash used in operating activities: | | | - |
| (Increase) in Deferred Financing Costs | | | - |
| (Increase) Accounts Receivable | | | - |
| (Increase) Security Deposit | - | (3,200) | (5,815) |
| (Increase) in Prepaid Expense | 54,377 | 29,664 | - |
| (Decrease) in Accounts Payable | (254,425) | (84,242) | 5,227 |
| Increase (Decrease) in Accrued Liabilities | 90,219 | 31,812 | 143,255 |
| Net Cash Flows Used for Operating Activities | (1,896,206) | (1,504,259) | (9,342,320) |
| | | | |
| **Cash Flows from Investing Activities:** | | | |
| Purchase of Fixed Assets | (2,460,890) | (143,538) | (3,122,947) |
| Note Receivable | 1,500,000 | (1,225,000) | - |
| Accrued Interest earned | 143,452 | (68,493) | - |
| Net Cash Flows Used for Investing Activities | (817,438) | (1,437,031) | (3,122,947) |
| | | | |
| **Cash Flows from Financing Activities:** | | | |
| Proceeds from Warrant Conversion | | | 3,171,250 |
| Proceeds from Debenture Conversion | | | 5,000,000 |
| Issuance of Common Stock for Warrants | | | 135,000 |
| Deferred Stock Compensation | (182,320) | | (282,320) |
| Issuance of Common Stock for Cash | 5,700,000 | | 9,019,121 |
| | | | - |
| | | | |
| Net Cash Flows Provided by Financing Activities | 5,517,680 | - | 17,043,051 |
| | | | |
| Net Increase (Decrease) in Cash | 2,804,036 | (2,941,290) | 4,577,784 |
| | | | |
| Cash and cash equivalents - Beginning of period | 1,773,748 | 4,305,105 | - |

| | | | | | | |
|---|---|---|---|---|---|---|
| **Cash and cash equivalents - End of period** | $ | 4,577,784 | $ | 1,363,815 | $ | 4,577,784 |
| | | | | | | |
| **Supplemental Disclosure of Cash Flow Information** | | | | | | |
| Cash Paid During the Period: | | | | | | |
| Interest | $ | 262 | $ | 1,054 | $ | 73,200 |
| Income Taxes | $ | - | $ | - | $ | - |
| | | | | | | |
| **NON-CASH TRANSACTIONS** | | | | | | |
| Common stock issued (returned) in exchange for services | | | $ | (12,000) | $ | 1,336,998 |
| Conversion of debt for Stock | | | | | $ | - |
| Common Stock Issued for Commitment Fee | | | | | $ | 364,417 |
| Common Stock Issued for Interest | | | | | $ | 241,383 |

**See Accountants' Review Report**

XSUNX, INC.
(A Development Stage Company
Notes to Financial Statements
June 30, 2008
Unaudited)

Note 1 - Presentation of Interim Information:

In the opinion of the management of XSUNX, Inc., the accompanying unaudited financial statements include all normal adjustments considered necessary to present fairly the financial position as of June 30, 2008 and the results of operations for the three and nine months ended June 30, 2008 and 2007 and for the period February 25, 1997 (inception) to June 30, 2008, and cash flows for the nine-months ended June 30, 2008 and 2007 and the for the period February 25, 1997 (inception) to June 30, 2008. Interim results are not necessarily indicative of results for a full year.

The financial statements and notes are presented as permitted by Form 10-Q, and do not contain certain information included in the Company's audited financial statements and notes for the fiscal year ended September 30, 2007.

Note 2 – Facility Leases :

Golden, Colorado Facility Lease

On July 1, 2006 the Company entered into a three year lease for office and research facilities located at 500 Corporate Circle, Golden Colorado. First year lease rate was $1,687.50 per month. This increased to $1,738 per month on July 1, 2007 and will increase to $1,790.00 per month on July 1, 2008. The lease expires on June 30, 2009.

On May 30, 2008 the Company and MVSystems, Inc. ("MVS"), a vendor previously performing research and technology development services for XsunX, entered into a Sublease Agreement providing for the sublease by MVS of the rear warehouse and assembly floor area of the Company's facilities located in Golden Colorado. The Company will continue to occupy the front or office portions of the facility. Under the agreement MVS will pay for utilities necessary to operate and demonstrate a PECVD system in its marketing efforts of the system. Subject to various acceleration clauses contained in the sublease, the sublease terminates on or before May 31, 2009.

Oregon Manufacturing Facilities Lease

On April 1, 2008, XsunX entered into a sub-lease agreement for approximately ninety thousand (90,000) square feet of manufacturing facility located at 23365 NE Halsey Street, Wood Village, Oregon, U.S.A.. On July 15, 2008, the sub-lease commenced and XsunX took possession of the facility. The purpose of the lease agreement was to establish facilities necessary for the installation and operation of the Company's planned thin film solar module manufacturing operations. The lease agreement requires that XsunX post a security deposit letter of credit in the amount of $106,000 which has been delivered, and a second letter of credit in an amount to be determined for 125% of the value for the removal of any improvements performed to the structure by XsunX.

The term of the lease agreement with the sub-landlord provides for XsunX occupancy through July 31, 2011. Thereafter, should XsunX elect to continue to occupy the premises, XsunX will be required to have established continued lease arrangements with the master landlord. Specific term and lease payment schedule is as follows:

| Each Month During The Time Period: | Monthly Basic Rent Payable With Respect To Each Month During The Subject Time Period: |
|---|---|
| Commencement Date to July 31, 2009 | $53,000.00 |

| | |
|---|---|
| August 1, 2009 to July 31, 2010 | $54,060.00 |
| August 1, 2010 to July 31, 2011 | $55,141.20 |

Note 3 - Note Receivable Paid and Cancelled:

On June 13, 2008, the Company and Sencera, LLC (“Sencera”), a company that XsunX had previously lent $1,500,000 dollars to in exchange for certain license rights to patent-pending technologies yet to be developed for applicability in thin film solar cell manufacturing, entered into a Separation Agreement (the “Agreement”). The Agreement terminated all previous agreements and obligations between the parties, released all potential claims related to the previous agreements, and provided for the accelerated re-payment to XsunX of the outstanding principal balance of $1,500,000 and accrued interest of approximately $173,251. Upon receipt of the full $1,673,251 payment the Company cancelled the note.

Note 4 - Legal:

Wharton Capital Settlement

On December 7, 2007, XsunX, Inc. (the “Company”) filed an action for breach of contract and declaratory relief in the Superior Court of Orange County, California, against Wharton Capital Partners, Ltd, Wharton Capital Markets LLC, and Capitoline Financial Group LLC. The XsunX Action was brought to seek a court determination that the Company did not owe any fees to the above defendants by reason of a $21 million dollar financing transaction with Fusion Capital Fund II, LLC (“Fusion”). In on or about February 2008 the XsunX Action was removed to the U.S. District Court for the Southern District of New York.

On January 3, 2008, Wharton Capital Partners, Ltd, and Wharton Capital Markets LLC, (“Wharton”) filed an action in the U.S. District Court for the Southern District of New York against the Company pursuant to which Wharton sought fees in an amount equal to seven percent (7%) of the gross proceeds received by the Company under a financing agreement between Fusion Capital Fund II, LLC and the Company.

On May 30, 2008 XsunX and Wharton entered into a Settlement Agreement. Under the Settlement Agreement XsunX has agreed to provide Wharton with eight hundred and seventy five thousand (875,000) shares of its common stock. Subject to the fulfillment of the requirements of Rule 144 of the Securities Act of 1933, Wharton has agreed not to sell or transfer no more than two hundred and fifty thousand (250,000) shares monthly. The Company has also agreed to a one hundred thousand dollar ($100,000) cash payment to be paid in four (4) monthly installments of $25,000 each. As of the date of this filing the remaining balance of the cash payment due Wharton was $25,000. Within five business days after XsunX has made the final payment to Wharton, the parties will file a joint motion, pursuant to Federal Rule of Civil Procedure 41(a)(1)(A)(ii), to dismiss both the New York Action and the California Action with prejudice. Each of the parties has unconditionally and irrevocably released, waived, and forever discharged each other from claims related to the XsunX Action and the Wharton Action.

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Note 5 - Marketable Production Machine:

XsunX had previously contracted MVSystems, Inc. (“MVS”) to built a first run prototype production machine (“Machine”) for the purpose of proofing and demonstrating certain thin film solar cell manufacturing technology. In June 2008 the Company commenced efforts to market and sell the Machine. As a result, the Company reclassified the net book value of the asset which was $1,632,625 ($1,765,000 original cost less accumulated depreciation of $132,375) from total other assets to inventory. The Company re-classified this asset for prior periods in the current financial statement, net of accumulated depreciation for comparability. There is no salvage value estimated for this equipment as we believe that the machine will be sold prior to the end of its useful life. Accumulated depreciation for this asset is included with all other accumulated depreciation in the accumulated depreciation line in fixed assets section of the balance sheet.

Upon the successful sale of the Machine, the Company and MVS have agreed that if the sale proceeds are greater than $1,765,000.00, exclusive of sales tax, import duties and packaging and shipping costs, such proceeds will be allocated and disbursed 50% to XsunX and 50% to MVS from such amount as may be left after payment, in the following order and to the extent sale proceeds remain available, of $1,412,000 to XsunX, $353,000 to MVS, MVS’s costs of sale, and one-half (1/2) of XsunX’s rental payments made for the premises housing the Machine; or (b) if the sale proceeds are less than $1,765,000.00, exclusive of sales tax, import duties and packaging and shipping costs, such proceeds will be allocated and disbursed approximately 80% to XsunX and approximately 20% to MVS.

Note 6 - Stock-Based Compensation:

Effective September 30, 2007, XsunX adopted SFAS No. 123(R), (“Share-Based Payment” (SFAS No. 123(R)). This statement replaces SFAS No. 123, “Accounting for Stock-Based Compensation” (SFAS No. 123) and supersedes APB No. 25. SFAS No. 123(R) 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.

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Note 6 - Stock-Based Compensation - Continued:

Forfeiture rates are based on the Company's historical data and future estimates for stock option forfeitures. There are 9,705,332 options and warrants issued of which 3,448,781 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 86 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. There were no additional option or warrant expense booked in the quarter ended June 30, 2008.

Note 7 - Oregon Factory Equipment Progress Payments:

During the three months ending June 30, 2008, the Company made a series of progress payments to suppliers of manufacturing equipment for our Oregon facility in the amount of $1,832,196 bringing the total of these progress payments to $2,332,196. These payments are reflected as progress payments on the balance sheet and as the equipment is delivered will be reclassified as manufacturing equipment.

Note 8 - Sale of Shares

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 June 30, 2008 5,757,903 shares of common stock at variable pricing between $0.36 to $0.405 raising aggregate proceeds of $2,200.000. Subsequent to June 30, 2008 the Company has sold an additional 2,298,738 shares of common stock at variable pricing between $0.321 and $0.38 raising aggregate proceeds of $800,000.00. As of August 1, 2008 25,110,027 shares remain available for sale to Fusion under S-1 Registration.

Note 9 – Technology Service and License Agreements

MVSystems, Inc. Separation Agreements

On May 30, 2008 the Company and MVSystems, Inc. ("MVS"), a vendor previously performing research and technology development services for XsunX and from which XsunX had licensed certain patented and patent-pending technologies, and the MVS principal officer Dr. Arun Madan ("Madan") entered into a Separation and Mutual Release Agreement, Non-Exclusive License and Cross License Agreement, and Sublease Agreement (together, the "Contracts"). The Contracts terminated all previous agreements and obligations between the parties, released all claims related to the previous agreements, provided for the continued licensure of technologies and patents, terminated all warrants provided by the Company to MVS under previous agreements for certain license rights and special services, and provided for the sublease of certain portions of the Company's Golden Colorado facility to MVS.

The Separation and Mutual Release Agreement provided for the termination of all existing agreements between the parties including all warrant grants provided to MVS and Madan for the purchase by MVS and Madan of up to 14,000,000 shares of the Company's common stock with exercise prices ranging from $.15 to $.25 cents. The agreement further defined the efforts required by MVS to market for sale a first run production prototype multi-chamber plasma enhanced chemical vapor deposition (“PECVD) system built for the Company by MVS, and the distribution of the proceeds between the Company and MVS from the sale of the PECVD system. The agreement discharges the parties from any further obligations stemming from any previous agreement between the parties, and with the exception of any claims that might arise from the performance under the Contracts, released the parties and forever discharges each other from claims related to all previous agreements between the parties.

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MVSystems, Inc. Separation Agreements – Continued:

The Non-Exclusive License and Cross License Agreement provides XsunX a worldwide, non-exclusive, royalty-free, irrevocable, fully-paid up right and license, with the right to sublicense the following patents and patent application and any reissues, re-examinations, divisionals, continuations and extensions thereof: (a) U.S. Patent No. 6,488,777 B2; (b) U.S. Patent No. 6,258,408 B1; and (c) U.S. Patent App. No. 10/905,545 (Pub. No. US 2005/0150542 A1) (together, the "Patents"). The license limits XsunX to the use of the Patents for the development by XsunX of commercial-grade (*i.e.*, web width 30 cms or more and nominal output exceeding 1 megawatt/year based on 1 shift operation) semi-transparent (greater than 5% transparency) and opaque solar cells, photovoltaic technologies, solar cell panels and methods of manufacture. The agreement further provides that MVS will continue to be the exclusive owner of the Patents and grants XsunX exclusive ownership of any improvements made by XsunX to the licensed Patents.

The Non-Exclusive License and Cross License Agreement provides MVS a worldwide, non-exclusive, royalty-free, irrevocable, fully-paid up right and license, with the right to sublicense the derivative works produced by the parties under the various phased technology development programs between September 17, 2004 and May 30, 2008. The agreement further provides that XsunX will continue to be the exclusive owner of the derivative works and grants MVS exclusive ownership of any improvements made by MVS to the licensed derivative works.

Under the Contracts the Company and MVS have also entered into a Sublease Agreement providing for the sublease by MVS of the rear warehouse and assembly floor area of the Company's facilities located in Golden Colorado. The Company will continue to occupy the front or office portions of the facility. Under the agreement MVS will pay for utilities necessary to operate and demonstrate the PECVD system in its marketing efforts of the system. Subject to various acceleration clauses contained in the sublease, the sublease terminates on or before May 31, 2009.

Sencera, LLC Separation Agreement

On June 13, 2008, the Company and Sencera, LLC ("Sencera), a company that XsunX had previously lent $1,500,000 dollars to in exchange for certain license rights to patent-pending technologies yet to be developed for applicability in thin film solar cell manufacturing, entered into a Separation Agreement (the "Agreement"). The Agreement terminated all previous agreements and obligations between the parties, releases all claims related to the previous agreements, and provided for the accelerated re-payment of $1,673,251 in principal and accrued interest to XsunX by Sencera under a secured, seven year, 10% Promissory Note and Loan Agreement (the "Loan") between the Company and Sencera dated January 1, 2007.

The Loan was made by XsunX in conjunction with a Technology License and Development Agreement between the parties, also dated January 1, 2007, providing XsunX with limited licensing rights to plasma deposition technologies for possible future use by XsunX in solar product manufacturing technologies. Use of the licensed plasma technology by XsunX in any of its planned or future processes or products was subject to completion of development by Sencera, LLC, under a phased development plan, substantiation by XsunX of intended performance criteria as specified under the agreements and Phase II development objectives, and determination of commercial application suitability by XsunX.

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Sencera, LLC Separation Agreement – Continued:

Review of the Sencera project reports by the Company's scientific staff and an on-site review of the report data with Sencera concluded, in the opinion of XsunX, that a licensable process, or the basis for a licensable process, had not been developed that would be capable of, or that indicated the potential for, producing silicon materials at deposition rates expected to produce thin film solar cells at costs of less than $1 dollar USD per watt. The Company elected to negotiate an accelerated re-payment of the Loan after these determinations were made.

Note 10 - Subsequent Events:

Effective August 1, 2008, the Company's Board of Directors adopted a resolution by unanimous written consent appointing Joseph Grimes as a new director to the Company's board. Mr. Grimes will continue to also serve as the Company's Chief Operating Officer, duties he has performed since April 2006. Mr. Grimes is 51 years old.

Mr. Joseph Grimes professional resume is as follows;

In addition to Mr. Grimes two years of executive management experience as XsunX's Chief Operating Officer Mr. Grimes brings to XsunX more than eight additional years of direct experience in thin-film technology and manufacturing operations while employed by Applied Magnetics Corporation from 1985 to 1993 where he acted as manager for thin-film prototype assemblies. From 1993 until its sale to Envisage Technology Corporation in 2005 Mr. Grimes was co-founder, president, and CEO of ISERA Group, a developer of logistical resource optimization and complex scheduling systems servicing the defense, aerospace, and medical industries. Mr. Grimes holds a Bachelor's degree in business economics and environmental studies, and a Masters in computer modeling and operation research applications, both from the University of California at Santa Barbara.

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

**CAUTIONARY AND FORWARD LOOKING STATEMENTS**

In addition to statements of historical fact, this 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.

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**CURRENT OVERVIEW**

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 is a development stage company with no significant sources of revenue to date. We are a thin-film photovoltaic ("TFPV") company that intends to grow its business by manufacturing TFPV amorphous solar modules and selling them into what we believe is a high growth solar market opportunity. Our decision to pursue this strategy is based on our three years of research in the design and use of technologies for the manufacture of TFPV solar cells utilizing amorphous silicon. During this time we have developed the technical capabilities, qualified core staff, and market understanding that we believe will be necessary to establish product manufacturing infrastructure and take our product to market.

We have designed a 125 peak watt TFPV solar module utilizing glass substrates and a proprietary semiconductor manufacturing system which employs the design of a high-throughput, automated, continuous process to produce solar modules in commercial quantities. We believe that these key processes 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.

Driving our solar module manufacturing plan is what we believe to be the ability to capitalize on long term growth in solar spurred by increasing electrical energy costs and demand. Large markets are developing for commercial operators of private solar farms, utilities meeting green mandates, government subsidized installations, and operators of large commercial and industrial properties. These projects represent large installations typically approaching 1MW or more.

While we believe that the market conditions are excellent for all producers of solar products, we intend to deliver thin film solar products that provide extra value in performance and cost.

**Products**

***Solar Modules***

In designing our ASI-120 watt module, we interviewed solar systems integrators and developed a design that we believe provides for a module delivering high power output (relative to other thin films), and size and framing that would allow for the use of many existing mounting systems.

We plan to deposit two separate solar cell layers of amorphous silicon on to a one meter by one point six meter size (1m x 1.6m) glass substrate. This is to increase the amount of absorbed and converted solar energy in our modules. 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 125 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.

**Planned Manufacturing Capacities**

In the 2008 calendar year, we anticipate completing the assembly and installation of a small production research and development system and initiating construction of our first full scale 25 MW system. Barring assembly delays, we anticipate completing the assembly of our first 25MW line in March 2009. Near the end of the 2008 calendar year, we plan to launch the build-out of the first of three additional 25 MW systems necessary to eventually bring our capacity to 100 MW. Barring assembly delays and/or any delays in securing the necessary expansion capital, we anticipate completing the assembly of the first of these additional lines in November 2009, the second in January 2010, and the final 25 MW in March 2010. We intend to use the balance of the 2010 year to continue to work to improve system utilization, add shifts, and increase module yields to bring our production to peak capacities of 100 MW or more of annualized solar module production. To complete each new production line, we plan to use a systematic replication process that is designed to enable us to add production lines rapidly and efficiently, and achieve operating metrics that are comparable to the performance of our initial 25 MW system.

**Sales and Marketing**

***Target Market***

Our primary target market for our TFPV solar modules will be applications for On-Grid (facilities tied to conventional power distribution infrastructure) application of 1MW in size and above. Typical applications and buyers would include:

- Solar Farms
- Government Agencies (DOD)
  - Bureau of Land Management
  - Department of Defense
- Power Purchase Agreements
  - Renewable Ventures
- Utility Companies
  - Meeting Green Mandates
- Large Commercial Installations

***Sales & Distribution***

In anticipation of commercial production, we have developed a pre-sales reservation program, based upon the solar module manufacturing industry's policy of pre-selling manufacturing capacity to system installers and large users of solar. This is intended to aid in building a sales channel, loading that channel with customers interested in purchasing our future module production, and developing brand presence and recognition as early as possible. The program enables qualified, interested parties to specify the amount of solar module capacity they anticipate purchasing at favorable per watt pricing. As of the date of this report, we have signed reservation agreements with five (5) solar system integrators indicating interest in over 145 MW of production in calendar 2009, 2010 and 2011. Our agreements provide for the payment of a 5% deposit based on the 2009 calendar year purchase commitment either prior to, or not later than, 30 days after the delivery by XsunX to the reserving party of commercial samples for evaluation. The information in this paragraph is designed to summarize the general terms of the pre-sales reservation program and market opportunities. It is not intended to provide guidance about our future operating results, including revenues or profitability.

**RESULTS OF OPERATIONS FOR THE THREE-MONTH PERIOD ENDED JUNE 30, 2008 COMPARED TO THE SAME PERIOD IN 2007**

Revenue:

The Company generated no revenues in the period ended June 30, 2008 as compared to zero during the same period in 2007. Additionally, there was no associated cost of sales.

Operating Expenses:

Operating Expenses for the three month period ended June 30, 2008 totaled $738,887. This represents an increase of $172,083 as compared to the same period in 2007 which totaled $566,804. 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 contract negotiations, an economic enterprise zone application payment, higher public relations expenditures and higher wages and salaries cost. These increased costs were partially offset by reductions in R&D expense associated with a settlement with a research services provider MVSystems, Inc.. 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 June 30, 2008 were $0 and were the same as compared to the same period in 2007.

Salaries and Wages:

Salaries and wages for the three month period ended June 30, 2008 were $316,813 as compared to $220,736 during the same period in 2007. The increase of $96,077 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.

Research and Development:

Research and Development expense for the three month period ended June 30, 2008 were $(234,242) a reduction of $249,555 resulting from accrued R&D expenses that were no longer payable due to the terms of an agreement with MVSystems, Inc. in which the balance of accounts payable to MVSystems, Inc. under R&D expenses was reduced to zero. This total compared to $15,313 for the same period in 2007.

Professional Services:

Public relations and marketing expense for the three month period ended June 30, 2008 totaled $107,798 as compared to $24,660 during this same period in 2007. The increase of $83,138 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 June 30, 2008 totaled $127,274 as compared to $59,462 during the same period in 2007, an increase of $67,812. This increase is largely due to higher utilization of consulting services associated with the planning and preparation for our manufacturing facility.

Legal and accounting fees for the three month period ended June 30, 2008 totaled $168,939 as compared to $84,501 during the same period in 2007. This represents an increase of $84,438 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.

Travel and Entertainment:

Expenses for travel and entertainment were $74,361 for the three month period ended June 30, 2008. This compared to $52,718 for the same period in 2007. This increase of $21,643 was driven by increased business development trips to monitor progress on the Oregon manufacturing facility an at vendor facilities.

The net loss for the three months ended June 30, 2008 was $(687,143) as compared to a net loss of ($495,635) for the same period 2007. The increased net loss of $191,508 includes (i) The operating expense changes discussed above, (ii) and a decrease in interest income of $19,814 resulting from the investment of cash balances in interest bearing accounts.

Non-cash expenses included in the above is depreciation of $23,893.

The Company incurred a net loss of $(687,143) and net loss of ($495,635) in the three-month period ended June 30, 2008 and 2007 respectively. The associated net loss per share was $(0.004) for the three month period ended June 30, 2008 and $(0.003) 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.

**RESULTS OF OPERATIONS FOR THE NINE-MONTH PERIOD ENDED JUNE 30, 2008 COMPARED TO THE SAME PERIOD IN 2007**

Revenue:

The Company generated no revenues in the period ended June 30, 2008 as compared to $6,880 revenue in the same period in 2007. Additionally, there was no associated cost of sales.

Operating Expenses:

Operating Expenses for the nine month period ended June 30, 2008 totaled $3,367,473. This represents an increase of $1,678,139 as compared to the same period in 2007 which totaled $1,689,334. The increase was primarily due to none cash warrant and option expenses of $1,308,865 and an increase to operational expenses primarily attributable to the Company’s efforts to establish manufacturing facilities and to commercialize its technologies. A comparative analysis of the period to period performance is provided below.

Option and Warrant Expenses:

Option and Warrant expense for the nine month period ending June 30, 2008 were $1,308,865 and were higher by $1,308,501 from the same period in 2007 which were $364. This increase is due to additional options and warrants issued by the company under its 2007 Stock Option Plan and the implementation of SFAS No. 123(R), (“Share-Based Payment” (SFAS No. 123(R)). This statement replaces SFAS No. 123, “Accounting for Stock-Based Compensation” (SFAS No. 123).

Salaries and Wages:

Salaries and wages for the nine month period ended June 30, 2008 were $835,999 as compared to $578,616 during the same period in 2007. The increase of $257,383 was driven by an increase to salaries related to retention of key employees and the addition of employees necessary for the launch of our plans to build and establish thin film solar module manufacturing infrastructure.

Research and Development:

Research and Development expense for the nine month period ended June 30, 2008 totaled $(69,994) a reduction to expense of $(396,544) as compared to $326,550 for the same period in 2007, resulting from accrued R&D expenses that were no longer payable due to the terms of an agreement with MVSystems, Inc. in which the balance of accounts payable to MVSystems, Inc. under R&D expenses was reduced to zero.

Professional Services:

Public relations and marketing expense for the nine month period ended June 30, 2008 totaled $311,459 as compared to $51,960 during this same period in 2007. The increase of $259,499 represents an increased utilization of public relations services to work towards establishing brand awareness during the period.

Consulting expenses for the nine month period ended June 30, 2008 totaled $263,502 as compared to $102,044 during the same period in 2007, an increase of $161,498. This increase is largely due to higher utilization of consulting services associated with the planning and preparation for our manufacturing facility.

Legal and accounting fees for the nine month period ended June 30, 2008 totaled $241,399 as compared to $194,078 during the same period in 2007. This represents an increase of $47,321 largely driven by separation agreement and settlement legal work.

Travel and Entertainment:

Expenses for travel and entertainment were $143,560 for the nine month period ended June 30, 2008. This compared to $128,299 for the same period in 2007. The increase of $15,261 was driven by increased business development trips to monitor progress on the Oregon manufacturing facility an at vendor facilities.

The net loss for the nine months ended June 30, 2008 was ($3,284,334) as compared to a net loss of ($1,369,276) for the same period 2007. The increased net loss of $1,915,558 includes (i) The operating expense changes discussed above including non-cash expenses associated with the issuance of Options and Warrants of $1,308,501, (ii) and a decrease in interest income of $72,896 resulting from the investment of cash balances in interest bearing accounts.

The Company incurred net losses of ($3,284,334) and ($1,369,276) in the nine-month period ended June 30, 2008 and 2007 respectively. The associated net loss per share was $(0.02) for the nine month period ended June 30, 2008 and $(0.009) 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 June 30, 2008 of $4,577,784, and inventory of $1,632,625and no pre-paid expenses as compared to cash of $1,773,748, restated inventory from production prototype machine net of depreciation of $1,720,875 and prepaid expenses in the amount of $54,377 as of September 30, 2007. The Company had a net working capital of $6,061,927 as compared to a net working capital of $3,236,312 at September 30, 2007. Cash flow used in operating activities during the six-month period ended, June 30, 2008, was ($1,896,206) as compared to a use of cash of ($1,504,259) for the same period 2007. The increase in cash used in operations of $391,947 included (i) increased non-cash expense relating to option and warrant expenses of $1,308,865, (ii) the operation changes discussed above and (iii)offset by the reduced accounts payable resulting from an agreement for the reduction of liabilities with a research services provider MVSystems, Inc. The current period ended June 30, 2008 also included a non-cash depreciation expense of $101,342 compared to $60,587 in the same period in 2007.

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Contractual Obligations are shown in the following table -

| **Contractual Obligations** | **Payments Due by Period** | | | | |
|---|---|---|---|---|---|
| | **Total** | **Less than 1 Year** | **1 - 3 Years** | **3 - 5 Years** | **More than 5 Years** |
| Long Term Obligations | — | — | — | — | — |
| Capital Lease | — | — | — | — | — |
| Operating Lease(1) | 185,419 | 70,015 | 115,404 | — | — |
| Purchase Obligations(2) | 31,616,603 | 31,616,603 | — | — | — |
| Other Long Term Liabilities Reflected on the Registrant's Balance Sheet Under GAAP | — | | | | |
| To | 31,802,022 | 31,686,618 | 115,404 | — | — |

(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 $33,948,800 of which, $2,332,197 has been paid on the obligations. Future scheduled payments are tied to progress made on the delivery of the associated equipment. 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 nine-months ended June 30, 2008, the Company's capital needs have been met from the use of working capital provided by the proceeds of (i) the issuance of common stock for cash raising gross proceeds of $5,700,000 which occurred in the nine-months ended June 30, 2008, $285,000 from the issuance of stock warrants and $1,673,251 from the early repayment of principal and associated interest from the Sencera Note and other historical financings which occurred in the fiscal year ended September 30, 2007.

At June 30, 2008, we had cash and cash equivalents of $4,577,784 and net working capital of $6,061,927.

**DEVELOPMENT STAGE COMPANY**

The Company is currently working to transition from the development stage to the implementation phase and as of the period ended June 30, 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 may seek to obtain additional financing from equity and/or debt placements. As such, the Company's ability to secure additional financing on a timely basis is critical to its ability to stay in business and to pursue planned operational activities.

On November 1, 2007, XsunX signed a $21 million common stock purchase agreement with Fusion Capital Fund II, LLC, an Illinois limited liability Company ("Fusion Capital"). Upon signing the agreement, XsunX received $1,000,000 from Fusion Capital as an initial purchase under the $21 million commitment in exchange for 3,333,332 shares of our common stock. The shares were issued in a transaction exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. Concurrently with entering into the common stock purchase agreement, we entered into a registration rights agreement with Fusion Capital. Under the registration rights agreement, we agreed to file a registration statement related to the transaction with the U.S. Securities & Exchange Commission ("SEC") covering the shares that have been issued or may be issued to Fusion Capital under the common stock purchase agreement. After the SEC declared effective the registration statement related to the transaction, which occurred on April 10, 2008, we have the right over a 25-month period to sell our shares of common stock to Fusion Capital, from time to time, in amounts up to $1 million per sale, depending on certain conditions as set forth in the agreement, up to the full aggregate commitment of $21 million.

The Company has the right over a 25-month period to receive $80,000 every two business days under the Purchase Agreement with Fusion Capital 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.

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***

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 Securities Exchange Act of 1934, as amended (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. 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.

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.

**Internal Control over Financial Reporting**

The Securities and Exchange Commission rule making for the Sarbanes-Oxley Act of 2002 Section 404 requires that a company's internal controls over financial reporting be based upon a recognized internal control framework. The Company has an internal control frame work based on COSO Internal Control - Integrated Framework that has been modified to more appropriately reflect the current limited operational scope of the company as a Development Stage, smaller public company. The Company used the COSO guide - The Internal Control over Financial Reporting - Guidance for Smaller Public Companies to implement the Company’s internal control framework. Additionally, the limited scope of operations of the Company means that traditional separation of duties controls are not used by the Company as a result of the limited staffing within the Company. The Company relies on alternative procedures to overcome this non-material control weakness.

During the second half of the Company's fiscal year ending September 30, 2008 management will continue revising the Company's internal and controls procedure document basing this revision upon additional guidance for implementing the model framework created by the Committee of Sponsoring Organizations of the Treadway Commission (or "COSO") as is appropriate to our operations and operations of smaller public entities. This framework is entitled Internal Control-Integrated Framework. The COSO Framework, which is the common shortened title, was published in 1992 and has been updated, and we believe will satisfy the Securities and Exchange Commission requirements of Section 404 of the Sarbanes-Oxley Act of 2002. As the Company expands operations, we intend to add additional staff to implement separation of duties controls as well.

As of June 30, 2008, the Company’s board of directors had three outside directors and did not have an audit committee. The board of directors will appoint committees as necessary, including an audit committee.

**Changes in Internal Control over Financial Reporting**

Except as noted above, 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 first 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.**

Wharton Capital Settlement

On December 7, 2007, XsunX, Inc. (the “Company”) filed an action for breach of contract and declaratory relief in the Superior Court of Orange County, California, against Wharton Capital Partners, Ltd, Wharton Capital Markets LLC, and Capitoline Financial Group LLC. The XsunX Action was brought to seek a court determination that the Company did not owe any fees to the above defendants by reason of a $21 million dollar financing transaction with Fusion Capital Fund II, LLC (“Fusion”). In on or about February 2008 the XsunX Action was removed to the U.S. District Court for the Southern District of New York.

On January 3, 2008, Wharton Capital Partners, Ltd, and Wharton Capital Markets LLC, (“Wharton”) filed an action in the U.S. District Court for the Southern District of New York against the Company pursuant to which Wharton sought fees in an amount equal to seven percent (7%) of the gross proceeds received by the Company under a financing agreement between Fusion Capital Fund II, LLC and the Company.

On May 30, 2008 XsunX and Wharton entered into a Settlement Agreement. Under the Settlement Agreement XsunX has agreed to provide Wharton with eight hundred and seventy five thousand (875,000) shares of its common stock. Subject to the fulfillment of the requirements of Rule 144 of the Securities Act of 1933, Wharton has agreed not to sell or transfer no more than two hundred and fifty thousand (250,000) shares monthly. The Company has also agreed to a one hundred thousand dollar ($100,000) cash payment to be paid in four (4) monthly installments of $25,000 each.

Within five business days after XsunX has made the final payment to Wharton, the parties will file a joint motion, pursuant to Federal Rule of Civil Procedure 41(a)(1)(A)(ii), to dismiss both the New York Action and the California Action with prejudice. Each of the parties has unconditionally and irrevocably released, waived, and forever discharged each other from claims related to the XsunX Action and the Wharton Action.

**Item 1A. Risk Factors**

An investment in our shares involves a high degree of risk. Before making an investment decision, you should carefully consider all of the risks described on this Form 10-Q and Annual Reports on Form 10-K and Form 10-KSB previously filed by the Company and any Current Reports on Form 8-K filed by the Company. If any of the risks discussed in these reports actually occur, our business, financial condition and results of operations could be materially and adversely affected. If this were to happen, the price of our shares could decline significantly and you may lose all or a part of your investment. The risk factors described below are not the only ones that may affect us. Our forward-looking statements in this report are subject to the following risks and uncertainties. Our actual results could differ materially from those anticipated by our forward-looking statements as a result of the risk factors below. See "Cautionary and Forward-Looking Statements."

***We have not generated any significant revenues and may never achieve profitability.***

We are a development stage company and, to date, have not generated any significant revenues. From inception through June 30, 2008, we had an accumulated deficit of $13,745,684. 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, and if it will achieve market acceptance. We may not achieve our business objectives and the failure to achieve such goals would have an adverse impact on us.

***We expect that we will need to obtain significant additional financing to continue to operate our business, including significant capital expenditures to install our initial 25MW per annum production capacity, and financing may be unavailable or available only on disadvantageous terms.***

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.

On November 1, 2007, XsunX signed a common stock Purchase Agreement with Fusion Capital Fund II, LLC, an Illinois limited liability Company (“Fusion Capital”) providing for the sale of up to $21 million of common stock to Fusion. Upon signing the agreement, XsunX received $1,000,000 from Fusion Capital as an initial purchase under the $21 million commitment in exchange for 3,333,332 shares of our common stock. The shares were issued in a transaction exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. Concurrently with entering into the common stock purchase agreement, we entered into a registration rights agreement with Fusion Capital. On January 18, 2008, XsunX, Inc. filed a Form S-1 with the Securities and Exchange Commission seeking to register 48,650,000 shares related to our financing agreements with Fusion Capital Fund II, LLC and Cumorah Capital. The registration was declared effective by the Securities and Exchange Commission on April 10, 2008.

The Company has the right over a 25-month period to receive $80,000 every two business days under the Purchase Agreement with Fusion Capital 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 mark