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XSUNX INC
Form 10-Q
February 14, 2007

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, 2006

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:

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 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to the filing requirements for at least the past 90 days. Yes [X] No []

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

As of February 14, 2006 the number of shares outstanding of the registrant's only class of common stock was 157,019,856.

Transitional Small Business Disclosure Format (check one): Yes [] No [X]

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PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

XSUNX

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(AN DEVELOPMENT STAGE COMPANY)
FINANCIAL STATEMENTS

THREE-MONTHS ENDED December 31, 2006
(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 December 31, 2006, and the related statements of operations, stockholders' equity (deficit), and cash flows for the three-month period 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.

/s/ Jaspers + Hall, PC
Jaspers + Hall, PC
Denver, CO
February 13, 2007

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	Unaudited December 2006
<hr/>	
ASSETS:	
Current assets:	
Cash	\$3,69
Prepaid Research and Development Expense	33
Prepaid Professional Expense	1
Prepaid Legal Expense	-----
Total current assets	4,04
<hr/>	
Fixed assets:	
Office Equipment	3
Research and Development Equipment	39
Leasehold Improvement	8
Total Fixed Assets	51
Less Depreciation	(11)
Total fixed assets	-----
<hr/>	
Other assets:	
Patents	4
Security Deposit	1,76
Marketable Prototype	-----
Total other assets	1,80
<hr/>	
TOTAL ASSETS	\$6,24
<hr/>	
LIABILITIES AND STOCKHOLDERS' EQUITY:	
Current Liabilities:	
Accounts Payable	\$ 55
Accrued Expenses	-----
Total current liabilities	56
<hr/>	
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; 26,798,418 issued and outstanding	
Common Stock, no par value; 500,000,000 shares authorized; 157,169,856 shares issued and outstanding at December 31, 2006 and September 30, 2006	13,29
Common Stock Warrants	2,15
Deficit accumulated during the development stage	(9,75)
Total stockholders' profit (deficit)	-----
<hr/>	

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TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY

\$6,24

See Accountants' Review Report

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

	Three-Months Ended December 31,		Feb. 25, 1997 (Inception) to December 31,
	2006	2005	2006
Revenue			
Service Income	\$ -	\$ 8,000	\$ 8,000
Other Income	-	-	-
Total Revenue	-	8,000	8,000
Expenses:			
Advertising	16,747	349	29,776
Bank Charges	25	64	2,932
Conferences & Seminars	9,271	1,500	20,538
Consulting	35,982	-	1,428,815
Depreciation	27,047	-	131,601
Directors' Fees	-	-	11,983
Due Diligence	-	-	45,832
Equipment Rental	-	-	1,733
Filing Fees	-	-	6,425
Impairment loss	-	-	924,642
Insurance	3,535	-	6,998
Legal & Accounting	77,418	33,750	513,320
Licenses & Fees	20	-	6,475
Loan Fees	-	213,000	741,834
Meals & Entertainment	-	-	4,119
Miscellaneous	2,135	800	7,822
Office Expenses	6,229	1,473	32,643
Patent Fees	1,181	-	2,469
Postage & Shipping	688	458	7,189
Printing	6,911	2,943	25,521
Public Relations	26,630	33,352	436,160
Research & Development	209,945	274,603	1,790,333
Rent	14,860	2,250	60,681
Salaries	140,615	44,229	1,071,026
Subscription Reports	10	85	3,765
Taxes	-	-	4,657
Telephone	7,162	1,390	59,784

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Transfer Agent Expense	283	-	20,648
Travel	29,829	4,860	145,819
Warrant Option Expense	-	951,250	2,151,250
	-----	-----	-----
Total Operating Expenses	616,523	1,566,356	9,696,790
	-----	-----	-----
Other Income (Expense)			
Interest Expense	-	37,177	247,363
Interest Income	(32,843)	-	(121,346)
Forgiveness of Debt	-	-	(59,773)
	-----	-----	-----
Total Other Income/Expense	(32,843)	37,177	66,244
	-----	-----	-----
Net (Loss)	\$ (583,680)	\$ (1,595,533)	\$ (9,755,034)
	=====	=====	=====
Per Share Information:			
Weighted average number of common shares outstanding	157,169,856	123,888,194	
	=====	=====	
Net Loss per Common Share	\$ (0.003)	\$ (0.013)	
	=====	=====	

See Accountants' Review Report

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

Indirect Method

	Three-Months Ended December 31,	
	2006	2005
	-----	-----
Cash Flows from Operating Activities:		
Net Loss	\$ (583,680)	\$ (1,595,533)
Issuance of Common Stock for Services	-	7,500
Issuance of Common Stock for Loan Inducement	-	-
Warrant Expense	-	-
Issuance of Stock for Interest	-	-
Depreciation	27,047	-
Depreciation Written Off Equipment	-	-
Adjustments to reconcile net loss to cash used in operating activities:		

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(Increase) Accounts Receivable	-	(8,000)
(Increase) Security Deposit	(1,700)	
(Increase) in Prepaid Expense	-	(220,900)
Increase in Accrued Expenses	449,880	19,700
(Decrease) in Accounts Payable	(476,153)	(51,700)
	-----	-----
Net Cash Flows Used for Operating Activities	(584,606)	(1,848,900)
	-----	-----
Cash Flows from Investing Activities:		
Purchase of Equipment	(28,360)	
Equipment Written Off	-	
Purchase of Intangible Assets	-	
	-----	-----
Net Cash Flows Used for Investing Activities	(28,360)	
	-----	-----
Cash Flows from Financing Activities:		
Proceeds from Notes Payable	-	2,000,000
Proceeds from Warrant Conversion	-	951,200
Proceeds from Debenture Conversion	-	
Issuance of Common Stock for cash	-	
	-----	-----
Net Cash Flows Provided by Financing Activities	-	2,951,200
	-----	-----
Net Increase (Decrease) in Cash	(612,966)	1,102,200
	-----	-----
Cash and cash equivalents - Beginning of period	4,305,105	175,800
	-----	-----
Cash and cash equivalents - End of period	\$ 3,692,139	\$ 1,278,100
	=====	=====
Supplemental Disclosure of Cash Flow Information		
Cash Paid During the Year for:		
Interest	\$ -	\$ -
	=====	=====
Income Taxes	\$ -	\$ -
	=====	=====
NON-CASH TRANSACTIONS		
Common stock issued in exchange for services	\$ -	\$ -
	=====	=====

See Accountants' Review Report

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XSUNX, INC.
(A Development Stage Company)
Statement of Stockholders' Equity (Deficit)
December 31, 2006

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(Unaudited)

	Treasury Stock		Common Stock		War
	# of Shares	Amount	# of Shares	Amount	
Inception February 25, 1997	-	-	-	-	
Issuance of stock for cash	-	-	15,880	217,700	
Issuance of stock to Founders	-	-	14,110	-	
Issuance of stock for consolidation	-	-	445,000	312,106	
Net Loss for Year	-	-	-	-	
Balance - September 30, 1997	-	-	474,990	529,806	
Issuance of stock for services	-	-	1,500	30,000	
Issuance of stock for cash	-	-	50,200	204,000	
Consolidation stock cancelled	-	-	(60,000)	(50,000)	
Net Loss for Year	-	-	-	-	
Balance - September 30, 1998	-	-	466,690	713,806	
Issuance of stock for cash	-	-	151,458	717,113	
Issuance of stock for services	-	-	135,000	463,500	
Net Loss for Year	-	-	-	-	
Balance - September 30, 1999	-	-	753,148	1,894,419	
Issuance of stock for cash	-	-	15,000	27,000	
Net Loss for year	-	-	-	-	
Balance - September 30, 2000	-	-	768,148	1,921,419	
Extinguishment of debt	-	-	-	337,887	
Net Loss for year	-	-	-	-	
Balance - September 30, 2001	-	-	768,148	2,259,306	
Net Loss for year	-	-	-	-	
Balance - September 30, 2002	-	-	768,148	2,259,306	
Issuance of stock for Assets	-	-	70,000,000	3	
Issuance of stock for Cash	-	-	9,000,000	225,450	
Issuance of stock for Debt	-	-	115,000	121,828	
Issuance of stock for Expenses	-	-	115,000	89,939	
Issuance of stock for Services	-	-	31,300,000	125,200	
Net Loss for year	-	-	-	-	
Balance - September 30, 2003	-	-	111,298,148	2,821,726	
Issuance of stock for cash	-	-	2,737,954	282,670	
Issuance of Common Stock Warrants	-	-	-	-	1,2
Net Loss for Year	-	-	-	-	
Balance - September 30, 2004	-	-	114,036,102	3,104,396	1,2

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XSUNX, INC.
 (A Development Stage Company)
 Statement of Stockholders' Equity (Deficit)
 December 31, 2006

(Unaudited)

	Treasury Stock		Common Stock		
	# of Shares	Amount	# of Shares	Amount	
Issuance of stock for cash	-	-	6,747,037	531,395	
Issuance of stock for services	-	-	3,093,500	360,944	
Issuance of stock for collateral	26,798,418	-	-	-	
Net Loss for Year			-	-	
Balance - September 30, 2005	26,798,418	-	123,876,639	3,996,735	1,2
Issuance of stock for services	-	-	72,366	31,500	
Issuance of Common Stock Warrants	-	-	-	-	9
Issuance of stock for debenture conversion	-	-	21,657,895	5,850,000	
Issuance of stock for interest expense	-	-	712,956	241,383	
Issuance of stock for warrant conversion	-	-	10,850,000	3,171,250	
Net Loss for Year	-	-	-	-	
Balance September 30, 2006	26,798,418	-	157,169,856	13,290,868	2,1
Net Loss for Period	-	-	-	-	
Balance - December 31, 2006	26,798,418	\$ -	157,169,856	\$13,290,868	\$2,1

See Accountants' Review Report

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XSUNX, INC.
 (A Development Stage Company)
 Notes to Financial Statements
 December 31, 2006
 (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 December 31, 2006 and the results of

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operations for the three-months ended December 31, 2006 and 2005 and for the period February 25, 1997 (inception) to December 31, 2006, and cash flows for the three-months ended December 31, 2006 and 2005 and for the period February 25, 1997 (inception) to December 31, 2006. 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, 2006.

Note 2 - Lease - Golden Suite:

As of July 1, 2006 a new lease was signed for the Golden Office in the amount of \$1,687.50 per month plus a fee of \$825.00 for utilities. This will increase to \$1,787.50 per month on 7/1/07 and \$1,790.00 per month on 7/1/08. The lease expires on 6/30/09.

Note 3 - Lease - Office Space California:

On November 1, 2006 a new lease was signed for additional space at the California office in the amount of \$1,330 per month plus fax and telephone access costs.

Note 4 - Subsequent Events:

Effective January 1, 2007, XSUNX, Inc. entered into two year Employment Agreements with the following individuals:

Joseph Grimes	Chief Operating Officer	\$150,000.00
Jeff Huitt	Chief Financial Officer	\$135,000.00
Robert Wendt	Vice President of Engineering	\$150,000.00
Kurt Laetz	Vice President of Global Sales	\$120,000.00

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XSUNX, INC.
(A Development Stage Company)
Notes to Financial Statements
December 31, 2006
(Unaudited)

Effective January 26, 2007, XSUNX, Inc. entered into a two year Consulting and Advisory Agreement with Dr. John Moore to become the Chairman of the Company's Scientific Advisory Board.

The company authorized employment incentive option grants to the following employees on January 26th 2007 at an exercise price per share of \$0.46 with a first vesting date of April 1, 2007:

Joseph Grimes	500,000 Option Shares
Jeff Huitt	500,000 Option Shares
Robert Wendt	500,000 Option Shares

The common vesting schedules for the above grantee's is:

- (a) The Option shall become exercisable in the amount of

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50,000 shares upon the First Vesting Date. Thereafter, the Option shall vest and become exercisable at the rate of 50,000 Shares per calendar quarter up to a total of 400,000 shares.

- (b) This Option shall become exercisable in the amount of 50,000 shares for each of the first two sales/licensure of an XsunX system

Kurt Laetz 250,000 Option Shares

The vesting schedule is:

- (b) The Option shall become exercisable in the amount of 15,000 shares upon the First Vesting Date. Thereafter, the Option shall vest and become exercisable at the rate of 15,000 Shares per calendar quarter.
- (c) During the second year of employment of Optionee by XsunX the Option will vest and become exercisable at the rate of 22,500 Shares per calendar quarter, or any apportioned amount thereof, during the term of the second year of employment by XsunX, Inc. of the Optionee.
- (d) This Option shall become exercisable in the amount of 50,000 shares for each of the first two sales/licensure of an XsunX system.

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XSUNX, INC.
(A Development Stage Company)
Notes to Financial Statements
December 31, 2006
(Unaudited)

The company authorized the issuance of an option grant on January 26, 2007 to a consultant in the amount of 150,000 option shares at an option exercise price of \$0.46 with a first vesting date of April 26, 2007 with following vesting schedule:

- (e) The Option shall become exercisable in the amount of 18,750 shares upon the First Vesting Date. Thereafter, the Option shall vest become exercisable at the rate of 18,750 Shares per calendar quarter, or any apportioned amount thereof, during the term of engagement by XsunX, Inc. of the Optionee.

On January 1, 2007, XSUNX, Inc. issued a secured, seven year, 10% note to Sencera, LLC in the amount up to \$1,500,000. Under the terms, the company provided Sencera, LLC with \$400,000 at the time of signing and \$137,500 per month for up to eight months. These funds are to be used to develop Technology and obtain licenses in agreement with the Technology Development and License Agreement between Sencera and XSUNX, Inc. also signed on January 1, 2007. The note may be converted into a membership interest in Sencera, LLP and an

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extension of the license for a period of three years. The security consists of the license rights, the ability to exercise the conversion and all other rights and remedies provided by law.

In December 2006 the Company entered into a settlement agreement with a service provider in which the service provider returned to the Company 150,000 of the 300,000 shares of common stock issued to the service provider in the period ended March 31, 2005. The shares were received and cancelled effective January 2007. As a result of the return and cancellation of these shares the Company will record a credit to expenses in the amount of \$12,000 and a debit to paid in capital of \$12,000 for the period ending March 31, 2007. The \$12,000 dollars represents one half of the monetary value expensed by the Company in the period in which the shares were issued.

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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 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:

- (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;

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- (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.

3

CURRENT OVERVIEW

XsunX develops and markets proprietary Thin Film Photovoltaic (TFPV) solar cell designs and core solar cell manufacturing systems, enabling licensees to manufacture TFPV solar devices on various substrates. We function as a strategic solar technology partner, supplying the advanced thin film solar cell manufacturing know-how and capabilities that will enable original equipment manufacturers ("OEM") customers to address the expanding market for thin film solar products.

The product of the Company's development efforts is intended to deliver two aspects of deliverable technologies in the form of an integrated solution providing, a) commercially scalable manufactured processes and equipment designed for the specific manufacture of the Company's thin film solar technologies, and, b) proprietary thin film solar cell designs that address new application opportunities in the growing field of Building Integrated Photovoltaics.

XsunX is positioning itself as a leading provider of TFPV device designs and core manufacturing products to an expanding global group of existing and new entrant solar product manufacturers. The company is working to establish an environment in which XsunX products and technologies are viewed as advanced core support infrastructure to manufacturers increasing their opportunities for success in servicing their regional solar markets. XsunX does not sell thin film solar materials directly to the consumer market.

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.

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Results of Operations for the Three-Month Period Ended December 31, 2006 Compared to the Same Period in 2005

The Company generated no revenues in the period ended December 31, 2006 as compared to \$8,000 for the same period in 2005.

The Company incurred operating expenses totaling \$616,523 for the three months ending December 31, 2006 compared to \$1,566,356 for the same period in 2005. Primary sources for the decrease to operating expense of \$949,833 include: Warrant Option Expenses decreased by \$951,250 to zero as compared to \$951,250 in the same period in 2005. Loan Fees decreased by \$213,000 to zero from \$213,000 during the same period in 2005. Research and Development expenses decreased by \$64,658 to \$209,945 as compared to \$274,603 for the same period in 2005, Legal and Accounting increased \$43,668 to \$77,418 as compared to \$33,750 for the same period in 2005. Salaries increased by \$96,386 to 140,615 from \$44,229 in the same period in 2005 as a result of the addition by the Company of three management level employees. The decrease in overall expenses was primarily attributable to the absence of a one-time expense of \$951,250 associated with the grant of in-the-money warrants from the sale by the Company of secured convertible debentures in the period ended December 31, 2005 not present in the three month period ending December 31, 2006. The \$616,523 operating expenses includes non-cash charges of \$27,047 for depreciation.

The net loss for the three months ending December 31, 2006 was (\$583,680) as compared to a net loss of (\$1,595,533) for the same period 2005. The decrease of \$1,011,853 includes (i) prior period one-time expenditures of \$951,250 associated with Warrant Option Expenses, (ii) a prior period one-time expenditure of \$213,000 associated with loan fees, partially offset by (iii) Salaries increased by \$96,386 and Legal and Accounting increased by 43,668

The Company incurred net losses of (\$583,680) and (\$1,595,533) in the three-month period ended December 31, 2006 and 2005 respectively. The associated net loss per share was nominal in the three-month period ended December 31, 2006 and 2005. 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.

4

Liquidity and Capital Resources

The Company had cash at December 31, 2006 of \$3,692,139 and prepaid expenses in the amount of \$349,117 as compared to cash of \$4,305,105 and prepaid expenses in the amount of \$394,117 as of September 30, 2006. The Company had a net working capital of \$3,478,830 as compared to a working capital of \$4,065,523 at September 30, 2006. Cash flow used in operating activities during the three-month period ended, December 31, 2006, was (\$584,606) as compared to using (\$1,848,956) for the same period 2005. The decrease of cash used in operations of \$1,264,350 included (i) the decrease in net loss resulting primarily from prior period one-time expenditures of \$951,250 associated with Warrant Option Expenses not incurred in the current period, (ii) a prior period one-time expenditure of \$213,000 associated with loan fees not incurred in the current period. This decrease in Net Loss was partially offset by (i) Salary increases of \$96,386 and Legal and Accounting increases of 43,668. The current period ending December 31, 2006 also included a non-cash depreciation expense of \$27,047 while there was no depreciation expense in the period ending December 31, 2005.

For the three-months ended December 31, 2006, 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 Debenture conversion and; (ii) the issuance

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of Common Stock for warrant conversion which both occurred in the fiscal year ended September 30, 2006.

We had, at December 31, 2006, cash and cash equivalents of \$4,041,256 and net working capital of \$3,478,830.

DEVELOPMENT STAGE COMPANY

The Company is in the development stage and as of the period ending December 31, 2006, did not have any significant revenues. We have begun marketing efforts and anticipate the sale of licenses in the 2007 period however the cash flow requirements associated with 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.

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

The Company's Chief Executive Officer and Chairman have evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this quarterly report and, based on this evaluation, have concluded that the disclosure controls and procedures are effective.

There have been no changes in the Company's internal control over financial reporting that occurred during the Company's first fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

On April 19th 2006, a service provider Office Radio Network filed a lawsuit in the District Court in Colorado alleging that it has been damaged due to refusal to allow it to sell its shares under Rule 144. The parties entered

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into a settlement in December 2006 providing for the return of 150,000 shares of the 300,000 shares issued to Office Radio Network, and the provisioning by Office Radio Network of an additional six months of service to the Company.

The Company is currently not aware of nor has any knowledge of any other 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 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 10KSB 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 prospectus 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."

RISKS RELATED TO OUR BUSINESS

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 December 31, 2006, we had an accumulated deficit of \$9,755,034. For the quarter ended December 31, 2006 and 2005, we incurred net losses of \$583,680 and \$1,595,533 respectively. 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 MAY NEED TO RAISE ADDITIONAL CAPITAL WHICH MAY NOT BE AVAILABLE ON ACCEPTABLE TERMS OR AT ALL

In the future, we may be required to raise additional funds, particularly if we are unable to generate positive cash flow as a result of our operations. There can be no assurance that financing will be available in amounts or on terms acceptable to us, if at all. The inability to obtain additional capital may reduce our ability to continue to conduct business operations. If we are unable to obtain additional financing, we will likely be required to curtail our research and development plans. Any additional equity financing may involve substantial dilution to our then existing shareholders.

WE MAY NOT BE ABLE TO SUCCESSFULLY COMMERCIALIZE OUR TECHNOLOGIES WHICH WOULD RESULT IN CONTINUED LOSSES AND MAY REQUIRE US TO CURTAIL OR CEASE OPERATIONS

As is the case with any new technology, we expect the development process to continue. We cannot assure that our engineering resources will be able to modify the product fast enough to meet market requirements. We can also not assure that

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our product will gain market acceptance and that we will be able to successfully commercialize the technologies. The failure to successfully commercialize the technologies would result in continued losses and may require us to curtail or cease operations

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OUR REVENUES ARE DEPENDENT UPON ACCEPTANCE OF OUR PRODUCTS BY LICENSEES; THE FAILURE OF WHICH WOULD CAUSE TO CURTAIL OR CEASE OPERATIONS

We believe that virtually all of our revenues will come from the licensing of our proprietary technologies to major manufacturers. We intend to offer non-exclusive licensing rights. As a result, we will continue to incur substantial operating losses until such time as we are able to generate revenues from licensing and service fees for our products through our distribution partners. There can be no assurance that businesses and customers will adopt our technology and products, or those businesses and prospective customers will agree to pay the licensing and service fees for our products. In the event that we are not able to significantly increase the number of customers that license our products, or if we are unable to charge the necessary license fees, our financial condition and results of operations will be materially and adversely affected.

IF WE LOSE KEY EMPLOYEES AND CONSULTANTS OR ARE UNABLE TO ATTRACT OR RETAIN QUALIFIED PERSONNEL, OUR BUSINESS COULD SUFFER.

Our success is highly dependent on our ability to attract and retain qualified scientific and management personnel. We are highly dependent on our management, including Mr. Tom Djokovich who has been critical to the development of our technologies and business. The loss of the services of Mr. Djokovich could have a material adverse effect on our operations. We do not have an employment agreement with Mr. Djokovich. Accordingly, there can be no assurance that he will remain associated with us. His efforts will be critical to us as we continue to develop our technology and as we transition from a development stage company to a company with commercialized products and services. If we were to lose Mr. Djokovich, or any other key employees or consultants, we may experience difficulties in competing effectively, developing our technology and implementing our business strategies.

THE LOSS OF STRATEGIC RELATIONSHIPS USED IN THE DEVELOPMENT OF OUR PRODUCTS AND TECHNOLOGY COULD IMPEDE OUR ABILITY TO COMPLETE OUR PRODUCT AND RESULT IN A MATERIAL ADVERSE EFFECT CAUSING THE BUSINESS TO SUFFER.

We have established a plan of operations under which a portion of our operations rely on strategic relationships with third parties, to provide general facilities, personnel, and expertise in research, development, 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 CANNOT GUARANTEE YOU THAT OUR PATENTS ARE BROAD ENOUGH TO PROVIDE ANY MEANINGFUL PROTECTION NOR CAN WE ASSURE YOU THAT ONE OF OUR COMPETITORS MAY NOT DEVELOP MORE EFFECTIVE TECHNOLOGIES, DESIGNS OR METHODS WITHOUT INFRINGING OUR INTELLECTUAL PROPERTY RIGHTS OR THAT ONE OF OUR COMPETITORS MIGHT NOT DESIGN AROUND OUR PROPRIETARY TECHNOLOGIES.

We have been granted, and exclusively own, three patents from the United States Patent and Trademark Office. We have also been granted a license to a patent and technology portfolio relating to photovoltaic technology design, manufacturing

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processes, and the development of technology. These patents and licenses may not protect us against our competitors, and patent litigation is very expensive. We may not have sufficient cash available to pursue any patent litigation to its conclusion because currently we do not generate revenues.

We cannot rely solely on our current patents to be successful. The standards that the U.S. Patent and Trademark Office and foreign patent offices use to grant patents, and the standards that U.S. and foreign courts use to interpret patents, are not the same and are not always applied predictably or uniformly and can change, particularly as new technologies develop. As such, the degree of patent protection obtained in the U.S. may differ substantially from that obtained in various foreign countries. In some instances, patents have been issued in the U.S. while substantially less or no protection has been obtained in Europe or other countries.

We cannot be certain of the level of protection, if any, that will be provided by our patents. If we attempt to enforce them and they are challenged in court where our competitors may raise defenses such as invalidity, unenforceability or possession of a valid license. In addition, the type and extent of any patent claims that may be issued to us in the future are uncertain. Our patents may not contain claims that will permit us to stop competitors from using similar technology.

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THE FOLLOWING RISKS RELATE PRINCIPALLY TO OUR COMMON STOCK AND ITS MARKET VALUE:

THERE IS A LIMITED MARKET FOR OUR COMMON STOCK WHICH MAY MAKE IT MORE DIFFICULT FOR YOU TO DISPOSE OF YOUR STOCK

Our common stock is quoted on the OTC Bulletin Board under the symbol "XSNX." There is a limited trading market for our common stock. Accordingly, there can be no assurance as to the liquidity of any markets that may develop for our common stock, the ability of holders of our common stock to sell our common stock, or the prices at which holders may be able to sell our common stock.

OUR STOCK PRICE MAY BE VOLATILE

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:

- o technological innovations or new products and services by us or our competitors;
- o additions or departures of key personnel;
- o sales of our common stock;
- o our ability to integrate operations, technology, products and services;
- o our ability to execute our business plan;
- o operating results below expectations;
- o loss of any strategic relationship;
- o industry developments;
- o economic and other external factors; and
- o 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 addition, the securities markets have from time to time experienced significant price and volume fluctuations that are unrelated to the operating

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performance of particular companies. These market fluctuations may also materially and adversely affect the market price of our common stock.

WE HAVE NOT PAID DIVIDENDS IN THE PAST AND DO NOT EXPECT TO PAY DIVIDENDS IN THE FUTURE. ANY RETURN ON INVESTMENT MAY BE LIMITED TO THE VALUE OF OUR COMMON STOCK

We have never paid cash dividends on our common stock and do not anticipate paying cash dividends in the foreseeable future. The payment of dividends on our common stock will depend on earnings, financial condition and other business and economic factors affecting it at such time as the board of directors may consider relevant. If we do not pay dividends, our common stock may be less valuable because a return on your investment will only occur if its stock price appreciates.

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Item 2. Changes in Securities

In December 2006 the Company entered into a settlement agreement with a service provider in which the service provider returned to the Company 150,000 of the 300,000 shares of common stock issued to the service provider in the period ended March 31, 2005. The shares were received and cancelled effective January 2007. As a result of the return and cancellation of these shares the Company will record a credit to expenses in the amount of \$12,000 and a debit to paid in capital of \$12,000 for the period ending March 31, 2007. The \$12,000 dollars represents one half of the monetary value expensed by the Company in the period in which the shares were issued.

In conjunction with the sale of convertible debentures in the amount of \$850,000 and \$5,000,000 in the fiscal periods ended December 31, 2005 and 2006 respectively, the Company issued and deposited into escrow 26,798,418 shares of Common Stock as part of a security structure for the above referenced obligations. As of September 30, 2006 the principal balance of the debentures had been reduced to \$0.0. Subsequently the holder of the debentures provided the Company with a notice of release of its security interests and returned the security shares to the Company for cancellation. On January 18, 2007 the above shares were cancelled on the Company's books.

Item 3. Defaults upon senior securities - None.

Item 4. Submission of matters to a vote of security holders - None.

Item 5. Other information - None

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

A. Exhibits:

32 Sarbanes-Oxley Certification

33 Sarbanes-Oxley Certification

B. Reports on Form 8-K:

None

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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.

Dated February 14, 2007

XSUNX, INC.

By: /s/ Tom M. Djokovich

Tom M. Djokovich, Chief
Executive Officer, President