

XSUNX INC
Form 10-Q
February 17, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For The Quarterly Period Ended: December 31, 2014

Transition Report Pursuant to Section 13 or 15(d) of The Securities Exchange Act of 1934

For The Transition Period From _____ to _____

Commission File Number: 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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer Smaller reporting company

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Non-accelerated filer

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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

The number of shares of common stock issued and outstanding as of February 17, 2015 was 661,740,441.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements.

XSUNX, INC.
CONDENSED BALANCE SHEETS

	December 31, 2014 (Unaudited)	September 30, 2014
ASSETS		
CURRENT ASSETS		
Cash	\$99,352	\$50,838
Accounts receivable	8,148	-
Prepaid expenses	17,425	8,698
Total Current Assets	124,925	59,536
PROPERTY & EQUIPMENT		
Office & miscellaneous equipment	35,853	35,853
Machinery & equipment	64,538	64,538
	100,391	100,391
Less accumulated depreciation	(91,400)	(90,476)
Net Property & Equipment	8,991	9,915
TOTAL ASSETS	\$133,916	\$69,451
LIABILITIES AND SHAREHOLDERS' DEFICIT		
CURRENT LIABILITIES		
Accounts payable	\$181,833	\$128,528
Credit card payable	17,962	6,095
Accrued expenses	16,470	-
Accrued interest on notes payable	16,841	30,237
Deferred revenue	-	10,000
Derivative liability	423,699	546,280
Note Payable, related party	36,000	-
Convertible promissory notes, net of \$105,562 and \$76,401 in discounts	320,773	251,095
Total Current Liabilities	1,013,578	972,235
TOTAL LIABILITIES	1,013,578	972,235
SHAREHOLDERS' DEFICIT		
Preferred stock 50,000,000 shares authorized, shares issued and outstanding designated as follows:	50	50

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Preferred Stock Series A, \$0.01 par value, 10,000 authorized 5,000 shares issued and outstanding, respectively		
Common stock, no par value; 2,000,000,000 authorized common shares 591,400,069 and 591,400,069 shares issued and outstanding, respectively	31,014,990	31,014,990
Additional paid in capital	5,335,398	5,335,398
Paid in capital, common stock warrants	3,811,700	3,811,700
Accumulated deficit	(41,041,800)	(41,064,922)
TOTAL SHAREHOLDERS' DEFICIT	(879,662)	(902,784)
TOTAL LIABILITIES AND SHAREHOLDERS' DEFICIT	\$ 133,916	\$ 69,451

The accompanying notes are an integral part of these financial statements

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XSUNX, INC.
CONDENSED STATEMENTS OF OPERATIONS
(Unaudited)

	For The Three Months Ended	
	December 31, 2014	December 31, 2013
SALES	\$243,208	\$30,808
COST OF GOODS SOLD	201,052	29,791
GROSS PROFIT	42,156	1,017
OPERATING EXPENSES		
Selling, general and administrative expenses	134,408	138,728
Research and development	-	2,566
Depreciation and amortization expense	925	4,618
TOTAL OPERATING EXPENSES	135,333	145,912
LOSS FROM OPERATIONS BEFORE OTHER INCOME/(EXPENSES)	(93,177)	(144,895)
OTHER INCOME/(EXPENSES)		
Penalties	-	(226)
Gain/(Loss) on sale of asset	-	(4,423)
Loan and commitment fees	(22,080)	-
Gain/(Loss) on settlement of debt	-	(813,074)
Gain/(loss) on change in derivative liability	172,581	183,333
Interest expense	(34,202)	(277,420)
TOTAL OTHER INCOME/(EXPENSES)	116,299	(911,810)
NET INCOME (LOSS)	\$23,122	\$(1,056,705)
BASIC AND DILUTED INCOME (LOSS) PER SHARE	\$0.00	\$(0.00)
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING		
BASIC	591,400,069	488,925,399
DILUTED	736,943,734	488,925,399

The accompanying notes are an integral part of these financial statements

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XSUNX, INC.
 CONDENSED STATEMENT OF SHAREHOLDERS' DEFICIT
 (Unaudited)

	Preferred Stock		Common Stock		Additional Paid-in Capital	Stock Options/ Warrants Paid-in-Capital	Accumulated Deficit	Total
	Shares	Amount	Shares	Amount				
Balance at September 30, 2014	5,000	\$50	591,400,069	\$31,014,990	\$5,335,398	\$3,811,700	\$(41,064,922)	\$(902,784)
Net income for the three months ended December 31, 2014 (unaudited)	-	-	-	-	-	-	23,122	23,122
Balance at December 31, 2014 (unaudited)	5,000	\$50	591,400,069	\$31,014,990	\$5,335,398	\$3,811,700	\$(41,041,800)	\$(879,662)

The accompanying notes are an integral part of these financial statements

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XSUNX, INC.
CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)

	For the Three Months Ended	
	December 31,	December 31,
	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income (loss)	\$23,122	\$(1,056,705)
Adjustment to reconcile net income (loss) to net cash used in operating activities		
Depreciation & amortization	925	4,618
Common stock issued for services and other expenses	-	9,085
Convertible notes issued for prepaids	-	48,000
Commitment fees	22,080	-
(Gain)/loss on conversion and settlement of debt	-	813,074
(Gain)/loss on sale of asset	-	4,423
(Gain)/Loss on change in derivative liability	(172,581)	(183,333)
Amortization of debt discount and beneficial conversion feature recorded as interest expense	20,839	257,816
Change in Assets and Liabilities:		
(Increase) Decrease in:		
Accounts receivable	(8,148)	-
Prepaid expenses	(8,727)	(35,234)
Inventory	-	(14,652)
Other assets	-	2,500
Increase (Decrease) in:		
Accounts payable	65,171	3,262
Accrued expenses	29,833	10,250
Deferred revenue	(10,000)	-
NET CASH USED IN OPERATING ACTIVITIES	(37,486)	(136,896)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sale of assets	-	5,400
NET CASH PROVIDED BY INVESTING ACTIVITIES	-	5,400
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from note payable – Related party	36,000	-
Proceeds from convertible promissory notes	50,000	138,000
NET CASH PROVIDED BY FINANCING ACTIVITIES	86,000	138,000
NET INCREASE IN CASH	48,514	6,504
CASH, BEGINNING OF PERIOD	50,838	38,573

CASH, END OF PERIOD	\$99,352	\$45,077
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SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Interest paid	\$-	\$165
Taxes paid	\$-	\$-

SUPPLEMENTAL DISCLOSURES OF NON CASH TRANSACTIONS

Issuance of common stock upon conversion of debt	\$-	\$202,707
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The accompanying notes are an integral part of these financial statements

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XSUNX, INC.
NOTES TO THE CONDENSED FINANCIAL STATEMENTS – UNAUDITED
DECEMBER 31, 2014

1. Basis of Presentation

The accompanying unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all normal recurring adjustments considered necessary for a fair presentation have been included. Operating results for the three months ended December 31, 2014 are not necessarily indicative of the results that may be expected for the year ending September 30, 2015. For further information refer to the financial statements and footnotes thereto included in the Company's Form 10-K for the year ended September 30, 2014.

Going Concern

The accompanying unaudited financial statements have been prepared on a going concern basis of accounting, which contemplates continuity of operations, realization of assets and liabilities and commitments in the normal course of business. The accompanying financial statements do not reflect any adjustments that might result if the Company is unable to continue as a going concern. The Company does not generate significant revenue, and has negative cash flows from operations, which raise substantial doubt about the Company's ability to continue as a going concern. The ability of the Company to continue as a going concern and appropriateness of using the going concern basis is dependent upon, among other things, additional cash infusions. The Company has obtained funds from its shareholders since its inception through the period ended December 31, 2014. Management believes the existing shareholders and the prospective new investors will provide the additional cash needed to meet the Company's obligations as they become due, and will allow the development of its business.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

This summary of significant accounting policies of XsunX, Inc. is presented to assist in understanding the Company's financial statements. The financial statements and notes are representations of the Company's management, which is responsible for their integrity and objectivity. These accounting policies conform to accounting principles generally accepted in the United States of America and have been consistently applied in the preparation of the financial statements.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the accompanying financial statements. Significant estimates made in preparing these financial statements include the estimate of useful lives of property and equipment, the deferred tax valuation allowance, and the fair value of stock options. Actual results could differ from those estimates.

Cash and Cash Equivalents

For purposes of the statements of cash flows, cash and cash equivalents include cash in banks and money markets with an original maturity of three months or less.

Revenue Recognition

The Company recognizes revenue from contracts under the percentage of completion method of accounting after the contract reaches 10% completion, measured by the percentage of costs incurred to date to management's estimates of total anticipated costs for each contract. This method is used because management considers expended costs to be the

best available measure of progress on these contracts. No revenue is recognized until the percentage of completion reaches 10%. Contract costs include all direct materials, subcontractor costs, direct labor and those indirect costs related to contract performance, such as indirect labor, supplies, tools and repairs.

Stock-Based Compensation

Share-based Payment applies to transactions in which an entity exchanges its equity instruments for goods or services and also applies to liabilities an entity may incur for goods or services that are to follow a fair value of those equity instruments. We are required to follow a fair value approach using an option-pricing model, such as the Black Scholes option valuation model, at the date of a stock option grant. The deferred compensation calculated under the fair value method would then be amortized over the respective vesting period of the stock option. This has not had a material impact on our results of operations.

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XSUNX, INC.

NOTES TO THE CONDENSED FINANCIAL STATEMENTS – UNAUDITED
DECEMBER 31, 2014

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Basic and Diluted Net Income (Loss) per Share Calculations

Income (Loss) per Share dictates the calculation of basic earnings per share and diluted earnings per share. Basic earnings per share are computed by dividing income available to common shareholders by the weighted-average number of common shares available. Diluted earnings per share is computed similar to basic earnings per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential common shares had been issued and if the additional common shares were dilutive. The shares for employee options, and convertible notes were used in the calculation of the income per share.

Fair Value of Financial Instruments

Fair Value of Financial Instruments, requires disclosure of the fair value information, whether or not recognized in the balance sheet, where it is practicable to estimate that value. As of December 31, 2014, the balances reported for cash, prepaid expenses, accounts payable, accrued expenses approximate the fair value because of their short maturities.

We adopted ASC Topic 820 for financial instruments measured as fair value on a recurring basis. ASC Topic 820 defines fair value, established a framework for measuring fair value in accordance with accounting principles generally accepted in the United States and expands disclosures about fair value measurements.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC Topic 820 established a three-tier fair value hierarchy which prioritizes the inputs used in measuring fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). These tiers include:

- Level 1, defined as observable inputs such as quoted prices for identical instruments in active markets;
- Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable such as quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in markets that are not active; and
- Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions, such as valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

We measure certain financial instruments at fair value on a recurring basis. Assets and liabilities measured at fair value on a recurring basis are as follows at December 31, 2014:

Fair Value of Financial Instruments

	Total	(Level 1)	(Level 2)	(Level 3)
Assets	\$-	\$-	\$-	\$-
Total assets measured at fair value	\$-	\$-	\$-	\$-
Liabilities				

Derivative Liability	\$423,699	\$-	\$-	\$423,699
Convertible Promissory Notes, net of discount	320,773	-	-	320,773
Total liabilities measured at fair value	\$744,472	\$-	\$-	\$744,472

The following is a reconciliation of the derivative liability for which Level 3 inputs were used in determining the approximate fair value:

Beginning balance as of October 1, 2014	\$546,280
Fair value of derivative liabilities issued	50,000
Loss on change in derivative liability	(172,581)
Ending balance as of December 31, 2014	\$ 423,699

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XSUNX, INC.
NOTES TO THE CONDENSED FINANCIAL STATEMENTS – UNAUDITED
DECEMBER 31, 2014

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Research and Development

Research and development costs are expensed as incurred. Total research and development costs were \$0 and \$2,566 for the three months ended December 31, 2014, and 2013, respectively.

Recent Accounting Pronouncements

Management reviewed accounting pronouncements issued during the three months ended December 31, 2014, and no pronouncements were adopted during the period that would materially affect the financial statements.

3. CAPITAL STOCK

At December 31, 2014, the Company's authorized stock consisted of 2,000,000,000 shares of common stock, with no par value. The Company is also authorized to issue 50,000,000 shares of preferred stock with a par value of \$0.01 per share of which 10,000 shares have been designated as Series A Preferred Stock. The rights, preferences and privileges of the holders of the preferred stock are determined by the Board of Directors prior to issuance of such shares.

4. STOCK OPTIONS

On May 20, 2014, the Company adopted the 2014 XSUNX, Inc. Stock Option and Award Plan (the "Plan") to enable the Company to obtain and retain the services of the types of Employees, Consultants and Directors who will contribute to the Company's long range success and to provide incentives which are linked directly to increases in share value which will inure to the benefit of all stockholders of the Company. The 2007 Stock Option Plan is superseded by the newly adopted 2014 XSUNX, Inc. Stock Option and Award Plan. Options granted under the Plan may be either Incentive Options or Nonqualified Options and shall be administered by the Company's Board of Directors ("Board"). Each Option shall be exercisable to the nearest whole share, in installments or otherwise, as the respective Option agreements may provide.

Notwithstanding any other provision of the Plan or of any Option agreement, each Option shall expire on the date specified in the Option agreement.

A summary of the Company's stock option activity and related information follows:

	12/31/2014	
	Number of Options	Weighted average exercise price
Outstanding, beginning of the period	7,000,000	\$ 0.033
Granted	-	-
Exercised	-	-
Expired	-	-
Outstanding, end of the period	7,000,000	\$ 0.033
Exercisable at the end of the period	6,000,000	\$ 0.015
Weighted average fair value of		\$ -

options granted during the period

The weighted average remaining contractual life of options outstanding issued under the plan as of December 31, 2014 was as follows:

Exercisable Prices	Stock Options Outstanding	Stock Options Exercisable	Weighted Average Remaining Contractual Life (years)
\$ 0.014	500,000	500,000	0.36 years
\$ 0.100	1,000,000	-	0.80 years
\$ 0.014	4,000,000	4,000,000	1.22 years
\$ 0.045	1,500,000	1,500,000	2.03 years
	7,000,000	6,000,000	

We account for stock-based payment award forfeitures as they occur. The Company did not recognize stock-based compensation expense in the statement of operations during the three months ended December 31, 2014 and 2013, respectively.

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XSUNX, INC.
NOTES TO THE CONDENSED FINANCIAL STATEMENTS – UNAUDITED
DECEMBER 31, 2014

5. CONVERTIBLE PROMISSORY NOTES

On September 30, 2014, the amended note dated September 30, 2013 expired. On October 1, 2014, the Company and the Holder of the note entered into an extension of the note. The remaining principal balance of \$203,496, plus interest of \$48,839 was combined in the extended new note for a balance of \$252,335 as of December 31, 2014. No additional cash consideration was provided or exchanged. The maturity date of the note was extended to September 30, 2015. The note bears interest at 12% annum, and a conversion price of 60% of the lowest volume weighted average price (“VWAP”) occurring during the twenty trading days preceding any conversion date by Holder. The balance of the provisions remained substantially the same. As of December 31, 2014, the Company recognized interest expense of \$7,632, and commitment fees of \$22,080.

On April 25, 2014, the Company issued a 10% unsecured convertible promissory note (the “Note”) for the principal sum of up to \$100,000 plus accrued interest on any advanced principal funds. On April 28, 2014, and June 23, 2014 the lender advanced \$50,000 to the Company under the Note, for an aggregate outstanding balance of \$100,000. The Note matures eighteen months from each advance. The Note may be converted by the lender into shares of common stock of the Company at the lesser of \$.0125 per share or fifty percent (50%) of the three lowest trade prices of three separate trading days recorded in the twenty five (25) trading days prior to the conversion of any outstanding funded principal or accrued interest under the Note. The Company recorded debt discount of \$100,000 related to the conversion feature of the notes, along with derivative liabilities at inception. During the three months ended December 31, 2014, the Company recognized debt amortization as interest expense in the amount of \$17,085, with a remaining debt discount of \$59,317.

On November 20, 2014, the Company issued a 10% unsecured convertible promissory note (the “Note”) for the principal sum of up to \$400,000 plus accrued interest on any advanced principal funds. On November 20, 2014, the lender advanced \$50,000 to the Company under the Note, for an aggregate outstanding balance of \$50,000. The Note matures eighteen months from each advance. The Note may be converted by the lender into shares of common stock of the Company at the lesser of \$.0125 per share or fifty percent (50%) of the lowest trade price on any trade day following issuance of the Note, or the lowest effective price per share granted to any person or entity to acquire common stock after the issuance date of the Note, with the exception of the price per share offered to officers and directors of the Company. The Company recorded debt discount of \$50,000 related to the conversion feature of the notes, along with derivative liabilities at inception. During the three months ended December 31, 2014, the Company recognized debt amortization as interest expense in the amount of \$3,755, with a remaining debt discount of \$46,245.

Issuance of Convertible Promissory Notes for Services to Related Party

As of December 31, 2014, the aggregate remaining notes to two of the Board members issued in exchange for their retention as directors during the fiscal year ended September 30, 2014, had a remaining balance of \$24,000. The Promissory Notes can be converted into shares of common stock by the Holder for \$0.0045 per share. The Promissory Notes mature on October 1, 2015, and bore zero (0%) percent interest during the first 12 months from the date of issuance. Since the Promissory Notes were not paid in full by the Company, or converted by the Holder, on or before the October 1, 2014, a one-time interest charge of 10% was applied to the remaining principal sum of \$24,000. The Company recognized interest expense in the amount of \$2,400. So long as any shares issuable under a conversion are subject to transfer and sale restrictions imposed pursuant to SEC Rule 144 of the Rules promulgated under the Securities Act of 1933, the Company shall, upon written request by Holder, file Form S-8, if applicable, with the U.S. Securities and Exchange commission to register the underlying shares.

6. DERIVATIVE LIABILITIES

The convertible notes issued and described in Note 5 do not have fixed settlement provisions because their conversion prices are not fixed. The conversion features have been characterized as derivative liabilities to be re-measured at the end of every reporting period with the change in value reported in the statement of operations. At September 30, 2014, the outstanding fair value of the conversion feature of the convertible notes accounted as derivative liabilities amounted to \$546,280.

During the three months ended December 31, 2014, no notes were converted. Furthermore, during the three months ended December 31, 2014, the Company recognized derivative liabilities on new notes of \$50,000 and a gain of \$172,581 to account for the change in fair value of the derivative liabilities. At December 31, 2014, the fair value of the derivative liability was \$423,699.

For purpose of determining the fair market value of the derivative liability for the embedded conversion, the Company used Black Scholes option valuation model. The significant assumptions used in the Black Scholes valuation of the derivative are as follows:

Risk free interest rate	Between 0.10% and 0.67%
Stock volatility factor	Between 72.85% and 213.40%
Months to Maturity	1 year to 2 years
Expected dividend yield	None

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XSUNX, INC.
NOTES TO THE CONDENSED FINANCIAL STATEMENTS – UNAUDITED
DECEMBER 31, 2014

7. NOTE PAYABLE-RELATED PARTY

On August 5, 2014 the Company issued a 10% unsecured promissory note (the “Note”) in the aggregate principal amount of up to \$80,000 to a related party. During the three months ended December 31, 2014, the Company received two advances in the amount of \$6,000 and \$30,000. The principal use of the proceeds from any advance under the Note are intended to assist in the purchase of materials, and services for the commercial solar PV systems that we sell and install. Consideration advanced under the Note matures three months from each advance. During the three months ended December 31, 2014, the Company recognized interest expense of \$247.

8. SUBSEQUENT EVENTS

Management has evaluated subsequent events as of the financial statement date according to the requirements of ASC TOPIC 855 and has reported the following:

On January 29, 2015, the Company authorized the issuance of 25,252,017 shares of restricted common stock upon the conversion of \$75,335 of principal, and \$421 of accrued interest to the holder of a 12% convertible note. The securities above were offered and sold pursuant to an exemption from the registration requirements under Section 4(a) 2 of the Securities Act since among other things the transactions did not involve a public offering. On February 11, 2015 the Holder of this note notified the Company that they had sold, subject to the transfer provisions of the note, \$50,000 of the note principal balance and any accrued interest there on to a third party.

On February 4, 2015, the Company authorized the issuance of 28,820,406 shares of common stock upon the conversion of \$65,000 of principal, and \$4,649 of accrued interest to the holder of a 10% convertible note. The securities above were offered and sold pursuant to an exemption from the registration requirements under Section 4(a) 2 of the Securities Act since among other things the transactions did not involve a public offering.

On February 9, 2015 the Company, and a vendor for services related to the Company’s prior efforts to commercialize thin film technologies, elected to settle an outstanding account payable with a balance owed of \$108,172. Under the settlement agreement the parties agreed to settle the account for \$49,900 consisting of an initial payment of \$25,000, and the remaining balance within sixty days. The Company further agreed that should the Company fail to fully pay the agreed amount timely then the Company would not oppose to a judgment for any remaining unpaid account balance, and \$69,317 in accrued interest as a penalty.

On February 12, 2015, the Company authorized the issuance of 13,334,616 shares of common stock upon the conversion of the total \$50,000 of principal, and \$2,005 of accrued interest to the holder of a 12% convertible note. The securities above were offered and sold pursuant to an exemption from the registration requirements under Section 4(a) 2 of the Securities Act since among other things the transactions did not involve a public offering.

On February 12, 2015 the Company authorized the issuance of 2,933,333 shares of restricted common stock to Board member Dr. Michael Russak in exchange for his conversion of the remaining \$12,000 of principal, and \$1,200 of accrued interest of a convertible promissory note that had been issued on October 1, 2013 to each of four board members as a retention fee for services. Under the note the Company had agreed that so long as any shares issuable under a conversion are subject to transfer and sale restrictions imposed pursuant to SEC Rule 144 of the Rules promulgated under the Securities Act of 1933, the Company shall, upon written request by holder, file Form S-8, if applicable, with the U.S. Securities and Exchange commission to register the underlying shares.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

CAUTIONARY AND FORWARD LOOKING STATEMENTS

In addition to statements of historical fact, this Quarterly Report on Form 10-Q contains forward-looking statements. The presentation of future aspects of XsunX, Inc. ("XsunX", the "Company" or "issuer") found in these statements is subject to a number of risks and uncertainties that could cause actual results to differ materially from those reflected in such statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's analysis only as of the date hereof. Without limiting the generality of the foregoing, words such as "may", "will", "expect", "believe", "anticipate", "intend", or "could" or the negative variations thereof or comparable terminology are intended to identify forward-looking statements. Our actual results could differ materially from those anticipated by these forward-looking statements as a result of many factors, including those discussed under "Item 1A: Risk Factors" in the Company's Annual Report on Form 10-K.

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

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

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

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

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

on Form 8-K filed by the Company.

Management believes the summary data presented herein is a fair presentation of the Company's results of operations for the periods presented. Due to the Company's change in primary business focus 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 provides solar energy solutions that deliver significant bottom-line financial benefits to businesses. We specialize in the sale, design, and installation of commercial solar power systems. Our background and experience spans virtually all aspects of solar including technology assessment, design, and development.

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The Company has developed a highly skilled team of qualified engineering and specialty contractors with extensive commercial solar experience necessary to service the diverse conditions that can be encountered in commercial buildings. The company couples this superior design and delivery capability with factory direct pricing, and zero down financing options to provide exceptional solar power plant installations for our customers.

Our business development objectives are to capitalize on the increasing demand within the California commercial facilities markets for the installation of solar electric power systems. We see these efforts as a significant business development opportunity as management has the skillset associated with construction management, we have extensive experience associated with the design requirements associated with the delivery of solar power systems, and there is a market demand available for us to provide these services to.

Market for Solar Power

We believe that a significant demand for our commercial solar power energy solutions is developing, in part, as a result of following propositions:

- We provide the ability to control and predict future energy costs. Our customers invest in the ability to self-generate power to offset and/or eliminate the purchase of third party utility provided electric energy. These investments provide predictability and control of energy costs, and can significantly reduce overall energy costs while insulating clients from rising retail electricity prices.
- Maturity and dependability of solar technologies. The results and benefits from investments in commercial solar power systems have begun to produce long term statistical data. This historical performance data allows investment benefits for long term future operations to be accurately estimated. This provides customers greater reliance on future results, and the confidence to make investments.
- Rapid capital recovery of solar investments. Reports provided by U.S. Energy Department indicate that the installed price reductions for solar PV systems are driving record installation demand. These cost reductions for the major components that make up a solar power system allow us to provide per watt pricing that, coupled with tax and operating benefits, can often result in capital recovery within 3 to 4 years.

We have focused our operations and service toward commercial solar power sales, and we primarily serve customers in the greater Southern California markets.

Our Approach

We provide customers with a turn-key suite of services and products. Our customer relationship development begins with a financial analysis providing detailed estimated investment benefits and results over the first twenty five years of a solar power systems life span. Through this process we tailor our system designs to maximize the financial benefits and returns for each customer. Our strategy is to develop and deliver systems that can provide the client with the greatest benefits. We then focus on 100% customer satisfaction by consistently matching customer expectations with our performance, and the delivery of our systems.

The key elements of our approach include:

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Lead Generation. We market our services utilizing efforts that include wide area advertising in regional newspapers, door-to-door canvassing, list generation and target marketing, and customer referrals. Our sales development efforts work with prospective customers from initial interest through tailored proposals and, ultimately, signed contracts. We plan to grow our sales efforts and team while continually reviewing market trends, and the adoption of new approaches to engage more customers.

- Detailed Investment Analysis. We use information related to our customer's energy usage, costs, planned operations, and tax basis to determine optimal solar system and investment sizing. We combine this data and provide customers with 25 year investment projections that detail capital recovery expectations, system performance and energy savings, tax and operating benefits, and property re-sale value improvement estimates.
- Financing. We have established relationships with lenders and have been approved to offer their finance options to prospective customers. Through our lender association network we offer customers financing options that include commercial equipment loans, lease options, power purchase agreements (PPA's), PACE & HERO financing through property tax assessment, and we offer clients the option to apply utility incentives towards system purchase buy-downs thereby reducing up front out of pocket expenditures or the amount of capital financed.

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- **Design & Engineering.** To ensure accuracy we perform our site surveys directly and do not rely on third party services. We then finalize designs that will match proposed financial results, and work with a highly skilled team of qualified engineers with extensive commercial solar experience to ensure compliance with all codes, and best practices for the solar system operation.
- **Installation.** We make the installation process simple for our customers. Once we complete the design and engineering of a solar energy system, we obtain all necessary building permits. Then, as the general contractor and construction manager, we provide all materials and components and use highly qualified licensed specialty contractors with extensive commercial and solar experience to provide on-site assembly of solar systems, utility interconnections, and roofing or structural work. We manage and ensure local building department approvals, and arrange for interconnection to the power grid with the utility.
- **Monitoring, Maintenance, and Service.** We provide our customers with real-time facility wide monitoring of both solar energy generation and facility wide energy consumption. In addition to providing clients with a better understanding of their energy usage, and the opportunity to modify their usage to realize savings, these monitoring systems allow us to confirm the continuing proper operation of installed solar energy systems. We also service what we sell and provide customers with a single source for all system maintenance or warranty coordination and service.

Our Customers

Our customers, and key market, are owner occupied commercial facilities. We do not focus on specific industries or business type, but typically we have found manufacturing, storage, warehousing, agricultural, and single story commercial office space facilities offer greater opportunities for the placement of solar systems. While we can offer financing solutions for non-owner occupied facilities the greatest financial benefits can be realized by owner occupied commercial facilities.

We work to identify “best” candidates for our systems and we have found that facilities in excess of 3,000 square feet of roof area, and monthly utility costs in excess of \$350 provide the minimum practical entry point for our services. However, “best” candidates typically require a minimum of 29kW (kilowatt) in solar system sizing, and have monthly utility costs in excess of \$650. In the 2014 fiscal period we provided proposals for systems ranging in size from 16kW to 1.1MW (megawatt) with 30kW to 100kW providing the largest number of sales opportunities.

The diversity of our customer type presents us with a diverse scope of installation requirements. We routinely encounter installation applications that may require roof mounting, ground or post mounting, carport systems, and custom applications necessary to overcome physical site conditions.

As we work to expand our marketing and customer acquisition efforts we intend to seek sales opportunities for government facilities, and respond to proposal requests for utility scale solar power operations.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED DECEMBER 31, 2014 COMPARED TO THREE MONTHS ENDED DECEMBER 31, 2013.

Revenue and Cost of Sales:

The Company generated revenues in the three months ended December 31, 2014 and 2013 of \$243,208 and \$30,808 respectively. The increase in revenue during the three months ended December 31, 2014 was a result of our efforts in the sale of commercial solar PV systems. These efforts included market and advertisement testing, sales presentation development, the development of financing alternatives for clients, vetting of qualified subcontractors to provide specialty services, and product supply chain development. The costs of goods sold for the three months ended December 31, 2014 and 2013 was \$201,052 and \$29,791, respectively. The Company to date has had minimal revenue and cost of sales. Management expects to continue to generate revenues, and is working to increase sales as it matures the scope of the Company's capabilities and brand awareness.

Selling, General and Administrative Expenses:

Selling, General and Administrative (SG&A) expenses decreased by \$4,320 during the three months ended December 31, 2014 to \$134,408 as compared to \$138,728 for the three months ended December 31, 2013. The decrease in SG&A expenses was related primarily to an decrease in non-cash expense for outside services of \$12,000, with an overall increase in other SG&A expenses of \$7,680 resulting from the Company's change in business and other expenses during the Company's initial efforts in marketing and sales of commercial solar PV systems. Management expects SG&A expenses to increase in future periods as the Company continues to expand its marketing, sales, and service efforts.

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Research and Development:

Research and development decreased by \$2,566 during the three months ended December 31, 2014 to \$0 as compared to \$2,566 for the three months ended December 31, 2013. The decrease was primarily due to the elimination of research related employees used in the period. We anticipate this trend to continue as we do not have plans to devote resources towards additional testing, calibration, or enhancements to our CIGSolar® technology until such time that the market demand for thin film technologies warrants additional investments.

Other Income/(Expenses)

Other income and (expenses) increased by \$1,028,109 to \$116,299 for the three months ended December 31, 2014, compared to \$(911,810) for the three months ended December 31, 2013. The increase was the result of an increase in commitment fees of \$22,080 associated with extending a convertible note, with a decrease in amortization of debt discount in the amount of \$236,977, interest expense in the amount of \$6,242, penalties in the amount of \$226, loss in net change of fair value of the derivative instruments of \$802,321, which includes the loss on extinguishment of debt in the amount of \$813,074 and the net change in derivative of \$(10,752), and a loss on sale of assets in the amount of \$4,423. The decrease in other income and (expenses) was due to the Company entering into debt financing through the issuance of convertible promissory notes.

Net Loss:

For the three months ended December 31, 2014, our net income was \$23,122 as compared to a net loss of \$1,056,705 for the three months ended December 31, 2013. This decrease in net loss primarily stems from a decrease in other income (expenses) associated with the net change in loss on extinguishment of debt and a decrease in operating expenses, with an increase in gross profit due to the net gain on change in derivative. While management is working to increase sales and revenues as it matures the scope of the Company's capabilities and brand awareness for its commercial solar PV systems, the Company anticipates the trend of losses may continue in future periods until the Company can recognize sales of significance of which there is no assurance.

Liquidity and Capital Resources

We had a working capital deficit at December 31, 2014 of \$888,653, as compared to a working capital deficit of \$912,699 as of September 30, 2014. The decrease of \$24,046 in working capital deficit was the result of a decrease in derivative liability, with an increase in cash, prepaid expenses, accounts payable and other payables, accrued expenses, note payable and convertible notes.

Cash flow used by operating activities was \$37,486 for the three months ended December 31, 2014, as compared to cash flow used by operating activities of \$136,896 for the three months ended December 31, 2013. The decrease in cash flow used by operating activities was primarily due to a net change in non-cash expenses, prepaid expenses and deferred income, with an increase in accounts payable and accrued expenses.

Cash flow used by investing activities was for the three months ended December 31, 2014 and 2013 were \$0 and \$5,400, respectively. The net change in investing activities was primarily due to proceeds received of \$5,400 from the sale of certain assets in the prior period.

Cash provided by financing activities for the three months ended December 31, 2014 was \$86,000, as compared to \$138,000 for the three months ended December 31, 2013. Our capital needs have primarily been met from the proceeds of private placements, convertible notes, and initial revenues resulting from our change in business operations focused on the sale, design, and installation of Solar Photovoltaic (PV) Systems for commercial and

industrial real-estate in in the period.

Our financial statements as of December 31, 2014 have been prepared under the assumption that we will continue as a going concern as of December 31, 2014. Our independent registered public accounting firm has issued their report dated January 13, 2015, that included an explanatory paragraph expressing substantial doubt in our ability to continue as a going concern without additional capital becoming available. Our ability to continue as a going concern ultimately is dependent on our ability to generate a profit which is dependent upon our ability to obtain additional equity or debt financing, attain further operating efficiencies and, ultimately, to achieve profitable operations. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

For the three months ended December 31, 2014, the Company's capital needs have been met from the use of working capital provided by the proceeds of (i) the Company's working capital and (ii) the sale of debt proceeds totaling \$86,000, and (iii) revenues in the amount of \$243,208.

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Short Term

On a short-term basis, while our revenues have begun to develop under our new plan of operations we do not generate revenues sufficient to cover operations at this time. Based on prior history, we may continue to have insufficient revenue to satisfy current and recurring expenses and liabilities. For short term needs we may continue to be dependent on receipt, if any, of offering proceeds and the growth of our revenue.

Capital Resources

We have only common and preferred stock as our capital resources. We have no material commitments for capital expenditures within the next year, however as we work to market and make sales of our commercial solar PV system services, substantial capital may be needed to expand and pay for these activities.

Need for Additional Financing

We do not have capital sufficient to meet our cash needs. We will have to seek loans or equity placements to cover such cash needs. No commitments to provide additional funds have been made by our management or other stockholders. Accordingly, there can be no assurance that any additional funds will be available to us to allow it to cover our expenses as they may be incurred.

OFF-BALANCE SHEET ARRANGEMENTS

We do not have any off balance sheet arrangements that are reasonably likely to have a current or future effect on our financial condition, revenues, result of operations, liquidity or capital expenditures.

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.

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures designed to ensure that information required to be disclosed in reports filed under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our principal executive officer, principal financial officer, and principal operating officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

As required by SEC Rule 15d-15(e), our management, consisting of our Chief Executive Officer/Principal Accounting Officer carried out an evaluation, of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, our principal executive officer/ principal accounting officer, concluded that our disclosure controls and procedures were effective at a reasonable assurance level as of the end of

the period covered by this report.

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Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control structure and procedures over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f)) under the Exchange Act. The SEC 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. Our management conducted an assessment of the effectiveness of our internal control over financial reporting as of December 31, 2014 based on the framework set forth in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) that has been modified to more appropriately reflect the current limited operational scope of the Company as a Development Stage 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.

Based on that evaluation, our Chief Executive Officer/Principal Accounting Officer concluded that our internal control over financial reporting as of December 31, 2014 was effective. Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Changes in Internal Control over Financial Reporting

There have not been any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the three months ended December 31, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

None

Item 1A. Risk Factors

There are no material changes from the risk factors previously disclosed in the Registrant's Form 10-K filed with the Securities and Exchange Commission dated January 13, 2015.

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

Issuance of Convertible Promissory Notes

On November 20, 2014 the Company issued a 10% unsecured convertible promissory note (the "Note") for the principal sum of up to \$400,000 plus accrued interest on any advanced principal funds. The Company was advance \$50,000 upon issuance of the note. The Note matures eighteen months from each advance. The Note may be converted by the lender into shares of common stock of the Company at the lesser of \$.0125 per share or fifty percent (50%) of the lowest trade price on any trade day following issuance of the Note, or the lowest effective price per share granted to any person or entity to acquire common stock after the issuance date of the Note, with the exception of the price per share offered to officers and directors of the Company..

The securities above were offered and sold pursuant to an exemption from the registration requirements under Section 4(2) of the Securities Act of 1933, as amended (the "Securities Act") and Rule 506 of Regulation D promulgated thereunder since, among other things, the transactions did not involve a public offering and the securities were acquired for investment purposes only and not with a view to or for sale in connection with any distribution thereof.

Use of Proceeds from the Sale of Securities

The proceeds from the above sales of securities were and are being used primarily to fund efforts by the Company to expand operations to include the sale, design, and installation of solar electric PV systems, and in the day-to-day operations of the Company, and to pay the accrued liabilities associated with these operations.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mining and Safety Disclosures

None.

Item 5. Other information

On August 5, 2014 the Company issued a 10% promissory note (the "Note") in the aggregate principal amount of up to \$80,000 to a related party. The principal use of proceeds from any advance under the Note are intended to assist in the purchase of materials and services for the commercial solar PV systems that we sell and install. On November 12 and December 8, 2014, the lender advanced \$6,000 and \$30,000 dollars respectively to the Company under the note. Consideration advanced under the Note matures three months from each advance.

Effective October 1, 2014, the Company and the Holder of a 12% Exchange Note with a maturity date of September 30, 2014 entered into a Second Extension and Amendment Agreement (“Second Amendment Agreement”), under which the maturity date was extended to September 30, 2015 for the remaining principal, interest, and costs totaling \$252,335 at the time of the amendment.

Effective October 10, 2014, Joseph Grimes resigned as a director, and a consultant for the Company.

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Item 6. Exhibits

The following is a complete list of exhibits filed as part of this Form 10-Q. Exhibit numbers correspond to the numbers in the Exhibit Table of Item 601 of Regulation S-K.

Exhibit	Description
10.1	Form of Extension Agreement and Restated 12% Note used in connection with the exchange and 12 month extension to a promissory note that had become due September 30, 2014. (1)
10.2	Form of Convertible Promissory Note issued on April 25, 2014, used in connection with the sale of a 10% convertible promissory note in the amount of up to \$100,000. (2)
10.3	Form of Promissory Note issued on August 5, 2014, used in connection with establishing access to interim financing requirements for solar system installations in the amount of up to \$80,000. (3)
10.4	Form of Convertible 10% Promissory Note issued on November 20, 2014, used in connection with the sale of a convertible promissory note in an amount up to \$400,000. (4)
10.5	Form of Convertible Promissory Note issued to Board of Directors member Dr. Michael Russak dated October 1, 2013 used in conjunction of his conversion on February 12, 2015. (5)
31.1	<u>Certification of Chief Financial Officer and Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act (6)</u>
32.1	<u>Certification of Principal Executive and Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act (6)</u>
101.INS	XBRL Instance Document (6)
101.SCH	XBRL Taxonomy Extension Schema Document(6)
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document (6)
101.DEF	XBRL Taxonomy Extension Label Linkbase Document (6)
101.LAB	XBRL Taxonomy Extension Presentation Linkbase Document (6)
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document (6)

- (1) Incorporated by reference to exhibits included with the Company's Report on Form 8-K filed with the Securities and Exchange Commission dated October 16, 2014.
- (2) Incorporated by reference to exhibits included with the Company's Report on Form 10-Q filed with the Securities and Exchange Commission dated May 19, 2014.
- (3) Incorporated by reference to exhibits included with the Company's Report on Form 10-Q filed with the Securities and Exchange Commission dated August 18, 2014.
- (4) Incorporated by reference to exhibits included with the Company's Report on Form 8-K filed with the Securities and Exchange Commission dated November 26, 2014.
- (5) Incorporated by reference to exhibits included with the Company's Report on Form 8-K filed with the Securities and Exchange Commission dated November 12, 2013.
- (6) Filed Herewith

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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.

XSUNX, INC.

Dated: February 17, 2015

By:

/s/ Tom M. Djokovich
Tom M. Djokovich,
Principal Executive and Accounting Officer

