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XSUNX INC
Form 10QSB
February 21, 2006

FORM 10-QSB
SECURITIES EXCHANGE COMMISSION
Washington, D.C. 20549

Quarterly Report under Section 13 or 15(d) of the Securities Exchange Act of 1934 For Quarterly Period Ended December 31, 2005

Transition Report under Section 13 or 15(d) of the Exchange Act 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 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 No

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes 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 20, 2006 the number of shares outstanding of the registrant's only class of common stock was 127,417,080.

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

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PART I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

XSUNX, INC.

(A DEVELOPMENT STAGE COMPANY)
FINANCIAL STATEMENTS

THREE-MONTHS ENDED DECEMBER 31, 2005

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(UNAUDITED)

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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, 2005, 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

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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.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2, conditions exist which raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are described in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/Jaspers + Hall, PC

Jaspers + Hall, PC
Denver, CO
February 13, 2006

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XSUNX, INC.
(A Development Stage Company)
BALANCE SHEETS
(Unaudited)

	December 2005

ASSETS:	
Current assets:	
Cash	\$ 1,27
Accounts Receivable	
Prepaid Expenses	30

Total current assets	1,58

Fixed assets:	

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Office Equipment	16

Total fixed assets	16

Other assets:	
Patents	2

Total other assets	2

TOTAL ASSETS	\$ 1,77
	=====
LIABILITIES AND STOCKHOLDERS' EQUITY:	
Current Liabilities:	
Accounts Payable	\$ 2
Accrued Expenses	6
Notes Payable	2,85

Total current liabilities	2,94

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; 123,917,080 shares issued and outstanding at December 31, 2005 and 123,876,633 shares issued and outstanding at September 30, 2005	4,00
Common Stock Warrants	2,15
Deficit accumulated during the development stage	(7,324)

Total stockholders' profit (deficit)	(1,169)

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 1,77
	=====

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XSUNX, INC.
(A Development Stage Company)
STATEMENT OF OPERATIONS
(Unaudited)

Three-Months Ended

Feb. 25, 19

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	December 31,		(Inception)
	2005	2004	December 2005
Revenue			
Service Income	\$ 8,000	\$ -	\$ -
Other Income	-	-	-
Total Revenue	8,000	-	-
Expenses:			
Abandoned Equipment	-	-	-
Advertising	349	1,860	-
Bank Charges	64	190	-
Conferences & Seminars	1,500	-	-
Consulting	-	-	1,340
Depreciation	-	-	200
Directors' Fees	-	-	100
Due Diligence	-	-	400
Equipment Rental	-	-	-
Filing Fees	-	-	-
Impairment loss	-	-	920
Insurance	-	-	-
Legal & Accounting	33,750	9,124	3200
Licenses & Fees	-	-	-
Loan Fees	213,000	-	3200
Meals & Entertainment	-	-	-
Miscellaneous	800	-	-
Office Expenses	1,473	1,405	200
Patent Fees	-	-	-
Postage & Shipping	458	174	-
Printing	2,943	39	100
Public Relations	33,352	7,189	2600

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Research & Development	274,603	98,897	90
Rent	2,250	1,500	2
Salaries	44,229	40,885	69
Subscription Reports	85		
Taxes	-	-	
Telephone	1,390	1,004	4
Transfer Agent Expense	-	1,759	1
Travel	4,860	961	7
Warrant Option Expense	951,250	-	2,15
	-----	-----	-----
Total Operating Expenses	1,566,356	164,987	7,26
	-----	-----	-----

See Accountants' Review Report
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XSUNX, INC.
(A Development Stage Company)
STATEMENT OF OPERATIONS
(Unaudited)

(continued)

	Three-Months Ended December 31,		Feb. 25, 19 (Inception) December 3 2005
	2005	2004	2005
	----	----	----
Other Income (Expense)			
Interest Expense	37,177	-	12
Interest Income	-	-	
Forgiveness of Debt	-	-	(59)
	-----	-----	-----
Total Other Income/Expense	37,177	-	6
	-----	-----	-----
Net (Loss)	\$ (1,595,533)	\$ (164,987)	\$ (7,324)
	=====	=====	=====

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Per Share Information:

Weighted average number of common shares outstanding	123,888,194 =====	114,036,102 =====
Net Loss per Common Share	\$ (0.01) =====	* =====

* Less than \$.01

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XSUNX, INC.
(A Development Stage Company)
STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)
December 31, 2005

(Unaudited)

	Treasury Stock		Common Stock		Co St Wa
	# of Shares	Amount	# of Shares	Amount	
Inception February 25, 1997	-	-	-	-	
Issuance of stock for cash 3/97	-	-	10,590	111,900	
Issuance of stock to Founders 3/97	-	-	14,110	-	
Issuance of stock for consolidation 4/97	-	-	445,000	312,106	
Issuance of stock for cash 8/97	-	-	2,900	58,000	
Issuance of stock for cash 9/97	-	-	2,390	47,800	
Net Loss for Year	-	-	-	-	

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Balance - September 30, 1997	-	-	474,990	529,806
Issuance of stock for services 11/97	-	-	1,500	30,000
Issuance of stock for cash 9/98	-	-	50,200	204,000
Consolidation stock cancelled 9/98	-	-	(60,000)	(50,000)
Net Loss for Year	-	-	-	-
Balance - September 30, 1998	-	-	466,690	713,806

See Accountants' Review Report
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XSUNX, INC.
(A Development Stage Company)
STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)
December 31, 2005

(Unaudited)

	Treasury Stock		Common Stock		Co St Wa
	# of Shares	Amount	# of Shares	Amount	
Issuance of stock for cash 10/98	-	-	21,233	159,367	
Issuance of stock for services 1/99	-	-	65,000	316,500	
Issuance of stock for cash 1/99	-	-	37,500	296,125	
Issuance of stock for cash 2/99	-	-	7,500	70,313	
Issuance of stock for cash 4/99	-	-	45,225	122,108	
Issuance of stock for services 6/99	-	-	70,000	147,000	
Issuance of stock for cash 9/99	-	-	40,000	69,200	
Net Loss for Year	-	-	-	-	
Balance - September 30, 1999	-	-	753,148	1,894,419	
Issuance of stock for cash 9/00	-	-	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	-	-	-	-	

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Balance - September 30, 2002	-	-	768,148	2,259,306
	-----	-----	-----	-----

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XSUNX, INC.
(A Development Stage Company)
STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)
December 31, 2005

(Unaudited)

	Treasury Stock		Common Stock		Co St Wa
	# of Shares	Amount	# of Shares	Amount	
Issuance of stock for Assets 7/03	-	-	70,000,000	3	
Issuance of stock for Cash 8/03	-	-	9,000,000	225,450	
Issuance of stock for Debt 9/03	-	-	115,000	121,828	
Issuance of stock for Accruals 9/03	-	-	115,000	89,939	
Issuance of stock for Services 9/03	-	-	31,300,000	125,200	
Net Loss for year	-	-	-	-	
	-----	-----	-----	-----	
Balance - September 30, 2003	-	-	111,298,148	2,821,726	
	-----	-----	-----	-----	
Issuance of stock for cash 3/04	-	-	181,750	21,071	
Issuance of stock for cash 4/04	-	-	217,450	22,598	
Issuance of stock for cash 5/04	-	-	254,956	34,669	
Issuance of stock for cash 6/04	-	-	694,649	96,306	
Issuance of stock for cash 7/04	-	-	157,649	21,421	
Issuance of stock for cash 8/04	-	-	57,000	5,133	
Issuance of stock for cash 9/04	-	-	1,174,500	81,472	
Issuance of Common Stock Warrants	-	-	-	-	1
Net Loss for Year	-	-	-	-	
	-----	-----	-----	-----	
Balance - September 30, 2004			114,036,102	3,104,396	1
			-----	-----	-----

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XSUNX, INC.
(A Development Stage Company)
STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)
December 31, 2005

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(Unaudited)

	Treasury Stock		Common Stock		Co St Wa
	# of Shares	Amount	# of Shares	Amount	
Issuance of stock for cash	-	-	5,919,537	471,068	
Issuance of stock for cash	-	-	300,500	20,067	
Issuance of stock for services	-	-	10,000	3,000	
Issuance of stock for services	-	-	300,000	24,000	
Issuance of stock for cash	-	-	527,000	40,260	
Issuance of stock for services	-	-	125,000	10,000	
Issuance of stock for services	-	-	114,469	13,827	
Issuance of stock for collateral	26,798,418	-	-	-	
Issuance of stock for loan inducement	-	-	2,544,031	310,117	
Net Loss for Year			-	-	
Balance - September 30, 2005	26,798,418	-	123,876,639	3,996,735	1
Issuance of stock for services	-	-	40,441	7,500	
Issuance of Common Stock Warrants	-	-	-	-	
Net Loss for Period	-	-	-	-	
Balance December 31, 2005	26,798,418	\$ -	123,917,080	\$4,004,235	\$ 2

All shares have been adjusted for the 1 for 20 reverse split.

See Accountants' Review Report
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XSUNX, INC.
(A Development Stage Company)
STATEMENT OF CASH FLOWS
(unaudited)

	Three-Months Ended December 31,	
	2005	2004
Cash Flows from Operating Activities:		
Net Loss	\$ (1,595,533)	\$ (164,88

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Issuance of Common Stock for Services	7,500	
Issuance of Common Stock for Loan Inducement	-	
Depreciation	-	
Adjustments to reconcile net loss to cash used in operating activities:		
(Increase) Accounts Receivable	(8,000)	
Decrease (Increase) in Prepaid Expense	(220,962)	
Increase (Decrease) in Accrued Expenses	19,780	(15,000)
Increase (Decrease) in Accounts Payable	(51,741)	(14,000)
	-----	-----
Net Cash Flows Used for Operating Activities	(1,848,956)	(179,000)
	-----	-----
Cash Flows from Investing Activities:		
Purchase of Equipment	-	
Purchase of Intangible Assets	-	
	-----	-----
Net Cash Flows Used for Investing Activities	-	
	-----	-----
Cash Flows from Financing Activities:		
Proceeds from Notes Payable	2,000,000	
Issuance of Common Stock Warrants	951,250	
Issuance of Common Stock	-	471,000
	-----	-----
Net Cash Flows Provided by Financing Activities	2,951,250	471,000
	-----	-----
Net Increase (Decrease) in Cash	1,102,294	291,900
	-----	-----
Cash and cash equivalents - Beginning of period	175,869	37,300
	-----	-----
Cash and cash equivalents - End of period	\$ 1,278,163	\$ 329,300
	=====	=====
Supplemental Disclosure of Cash Flow Information		
Cash Paid During the Year for:		
Interest	\$ -	\$ -
	=====	=====
Income Taxes	\$ -	\$ -
	=====	=====

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NON-CASH TRANSACTIONS

Common stock issued in exchange for services

\$ - \$
=====

See Accountants' Review Report
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XSUNX, INC.
(A Development Stage Company)
NOTES TO FINANCIAL STATEMENTS
December 31, 2005
(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, 2005 and the results of operations for the three-months ended December 31, 2005 and 2004 and for the period February 25, 1997 (inception) to December 31, 2005, and cash flows for the three-months ended December 31, 2005 and 2004 and the for the period February 25, 1997 (inception) to December 31, 2005. 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, 2005.

NOTE 2 - GOING CONCERN:

The Company's financial statements have been presented on the basis that it is a going concern, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business.

The Company is in the development stage and as of the period ending December 31, 2005, did not have any products for sale, and had not generated any revenue from sales or other operating activities. To date the Company's principal source of liquidity has been the private placement of equity securities and the issuance of notes payable. 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. The Company's ability to continue as a going concern is dependent upon its ability to develop additional sources of capital and ultimately, achieve profitable operations. The accompanying financial statements do not include any adjustments that might result from the outcome of these uncertainties.

The Company has made substantial investments this last year in the development of intellectual property assets as part of a business-restructuring plan. The purpose of these investments was to acquire patented solar electric glass technology. The Company believes that its patented solar electric technology has a number of marketing opportunities in the multi-billion dollar worldwide architectural glass markets.

XSUNX, INC.
(A Development Stage Company)
NOTES TO FINANCIAL STATEMENTS
December 31, 2005
(Unaudited)

NOTE 3 - EQUITY TRANSACTIONS:

Expanded License and Warrants

Expanded Use License stock warrant MVSSystems, Inc. - As consideration for the grant of an Expanded Use License on October 12, 2005, granting XsunX additional benefits for use of licensed technologies and patents, XsunX granted MVS a warrant (the "Expanded Use License Stock Warrant") for the purchase of up to Seven Million (7,000,000) shares of common stock of XsunX, the warrant will expire five (5) years after the date of the grant and is subject to the following vesting provisions:

- (1) The Expanded Use License Stock Warrant allowed for the vesting of one million (1,000,000) warrants on the effective date of the agreements.
- (2) Another one million (1,000,000) warrants will vest upon the satisfactory completion of a Phase 4 development program for the development of technologies licensed under the Expanded Use License.
- (3) The balance of five million (5,000,000) warrants will vest upon the date the technologies licensed within the Expanded Use License are licensed to a third party in a bona fide arms-length commercial setting.

In December 2005, 4,375,000 warrants were issued to Cornell Capital Partners, LP at \$.15 (3,125,000 warrants) and \$.05 (1,250,000 warrants) over market.

The total charged to expense was \$951,250 for these warrant issuances.

Issuance of Shares For Services

On or about December 5, 2005 the Company issued 40,441 shares of common stock to 1 consultant as compensation for three months of services that had been rendered to the company for a period prior to this quarter. The shares were valued at the average market price of the Company's common stock over the three month period of services which was \$0.18559 per share for a total compensated value of \$7,500.

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XSUNX, INC.
(A Development Stage Company)
NOTES TO FINANCIAL STATEMENTS
December 31, 2005
(Unaudited)

NOTE 4 - CONVERTIBLE DEBENTURES:

On December 12, 2005, XsunX, Inc. consummated a Securities Purchase Agreement dated December 12, 2005 with Cornell Capital Partners L.P. providing for the sale by the Company to Cornell of 10% secured convertible debentures in the aggregate principal amount of \$5,000,000 (the "Debentures") of which \$2,000,000 was advanced immediately as is included in convertible notes payable at December 31, 2005. The second installment of \$2,000,000 will be advanced immediately prior to the filing by the Company, with the Securities and Exchange Commission, of a Registration Statement. The last installment of \$1,000,000 will be advanced three days prior to the date the Registration Statement is declared effective by the Commission. The Debenture is convertible into shares of Common Stock at the option of the Holder at a conversion price per share equal to the lesser of \$0.38 or 95% of the lowest daily volume weighted average price of the Common Stock, as quoted by Bloomberg, LP, for the 30 trading days immediately preceding the date of conversion (the "Variable Market Price"). Unless waived by the Company, the Holders may not, together with their affiliates, convert more than an aggregate of \$350,000 in any 30-day period of principal amount of the Debentures at the Variable Market Price. Cornell has agreed not to short any of the shares of Common Stock.

On July 14, 2005, XSUNX, Inc. entered into a Secured Convertible Debenture agreement with Cornell Capital Partners, LP in the amount of \$400,000. The interest shall accrue on the outstanding principal balance hereof at an annual rate equal to twelve percent (12 %.) This Debenture shall be convertible into shares of Common Stock at the option of the Holder, with a conversion price in effect on any Conversion Date shall be equal to ten cents (\$.10), which may be adjusted pursuant to the other terms of this Debenture.

On August 16, 2005, XSUNX, Inc. received an additional \$450,000 from Cornell Capital Partners, LP with the same interest and conversion rights. The Debentures are secured by the assets of the Company and mature on the first anniversary of the date of issuance and bear interest at the annual rate of 12% in cash.

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

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

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

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

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Form 10-KSB filed by the Company and any Current Reports on Form 8-K filed by the Company.

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CURRENT OVERVIEW

XsunX, Inc. is developing Power Glass(TM) - an innovative thin film solar technology that is intended to allow glass windows to produce electricity from the power of the sun. This process for producing electricity is known as Photovoltaics. Photovoltaic ("PV") is the science of capturing and converting solar energy into electricity.

The Company is focusing its research and product development efforts on thin film PV devices in an effort to capitalize on what it perceives as cost and application diversity advantages to current rigid multi-crystalline silicon wafer technologies. The Company's thin film cell designs employ between .2 microns to 1.5 microns of material thickness as opposed to an approximate 400 microns of material thickness for multi-crystalline cell designs. This significant reduction in cell thickness and flexibility of the completed cell structure leads to the use of "thin film" terminology in describing the solar cell design.

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.

Building Integrated Photovoltaics or ("BIPV") allows photovoltaic material, in the form of photoelectric panels, to be incorporated into the design of building materials; thus, providing a new and smart way to integrate additional sources of power production into the operation of buildings. As the BIPV category of the photovoltaic industry is beginning its growth into the US, and worldwide markets, XsunX intends to positioned itself as one of the first companies dedicated to the large scale commercialization of BIPV through a combination of innovation and patented thin film designs and manufacturing techniques.

Through the successful commercial development of its Power Glass(R) film, a semi-transparent solar electric glazing process, the Company anticipates being able to take advantage opportunities to provide a commercially viable method for converting large areas of architectural glass into electrical power producing systems. Upon the completion of its commercialization process the Company anticipates the majority of revenues to be derived from the sale of its proprietary manufacturing systems and the licensing of its technologies.

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.

RESULTS OF OPERATIONS FOR THE THREE-MONTH PERIOD ENDED DECEMBER 31, 2005 COMPARED TO THE SAME PERIOD IN 2004

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The Company generated \$8,000 in revenues in the period ended December 31, 2005 as compared to \$0.0 for the same period in 2004.

The Company incurred operating expenses totaling \$1,566,359 for the three months ending December 31, 2005 compared to \$164,987 for the same period in 2004. Primary sources for the increase to operating expense of \$1,401,369 include: Research and Development expenses increased by \$175,706 to \$274,603 as compared to \$98,897 for the same period in 2004, Public Relations activity increased by \$26,163 to \$33,352 as compared to \$7,189 for the same period in 2004, Legal and Accounting expenses increased by \$24,626 to \$33,750 from \$9,124 in 2004. The increase in overall expenses included a one-time expense of \$420,000 associated with the grant of in-the-money warrants as consideration for the expansion of licensing and manufacturing rights associated with a technology sharing and license agreement granted to the Company. And, there was an additional one-time expense of \$531,250 from the grant of in-the-money warrants associated with the sale by the Company of 10% secured convertible debentures in the aggregate principal amount of \$5,000,000. The Company incurred additional one-time cash expenses for loan and structuring fees associated with the above referenced debenture totaling \$213,000. The \$1,566,359 operating expenses includes non-cash charges of \$7,500 for the issuance of unregistered stock for business development and advisory services in lieu of cash payment for services.

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The net loss for the three months ending December 31, 2005 was (\$1,595,533) as compared to a net loss of (\$164,889) for the same period 2004. The increase of \$1,430,644 in first quarter of this fiscal year includes (i) an increase in research and development expenditures of \$175,706 over the first quarter in the previous fiscal year which is anticipated to continue to increase for the foreseeable future as the Company furthers efforts to complete the commercial development of a licensable process for the manufacture of semi-transparent solar electric glazing technologies, (ii) an increase to General and Administrative expenses totaling \$61,413 representing the continued increase in costs associated with expansion of the Company's business plan, (iii) \$420,000 in expenses associated with the grant of in-the-money warrants as consideration for the expansion of licensing and manufacturing rights associated with a technology sharing and license agreement granted to the Company, (iv) \$744,250 in expenses associated with fees resulting from financing activities from the sale by the Company of a 10% secured convertible debenture in the aggregate principal amount of \$5,000,000 and, (v) \$37,177 for accrued interest expenses. These expenses in the first quarter of the current fiscal year were all incurred in preparing to commercialize a licensable process for the manufacture of semi-transparent solar electric glazing technologies.

The Company incurred net losses of (\$1,595,533) and (\$164,889) in the three-month period ended December 31, 2005 and 2004 respectively. The associated net loss per share was (\$.01) in the three-month period ended December 31, 2005 and nominal in the period in 2004. The Company expects the trend of losses to continue at an accelerated rate in future quarters until the Company is able to begin sales of significance of which there is no assurance.

LIQUIDITY AND CAPITAL RESOURCES

The Company had cash at December 31, 2005 of \$1,278,163 and prepaid expenses in the amount of \$300,964 as compared to cash of \$175,869 and prepaid expenses in the amount of \$79,984 as of September 30, 2005. The Company had a net working capital (deficit) of (\$1,355,163) as compared to a working capital (deficit) of (\$718,380) at September 30, 2005.

For the three-months ended December 31, 2005, the Company's capital

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needs have been met from the proceeds of the sale of secured convertible debentures made by the Company. In July 2005 the Company sold a 12% secured convertible debenture in the principal amount of \$850,000 and in December the Company sold a 10% secured convertible debenture in the aggregate principal amount of \$5,000,000 of which the Company had received \$2,000,000 as of December 31, 2005. The proceeds from the above sale of debentures were used primarily to fund the research and developments efforts and day-to-day operations of the Company and to pay the accrued liabilities associated with these operations.

We had, at December 31, 2005, cash and cash equivalents of \$1,587,109 and net working capital (deficit) of (\$1,355,163). We anticipate that there will not be sufficient cash generated from operations in the current year necessary to fund our current and anticipated cash requirements. The Company may engage in efforts to obtain additional financing from equity and debt placements.

CASH FLOWS

Cash flow used in operating activities during the three-month period ended, December 31, 2005, was (\$1,848,956) as compared to using (\$179,089) for the same period 2004. The increase of cash used in operations of \$1,669,867 included (i) an increase in research and development expenditures of \$175,706, (ii) an increase to General and Administrative expenses totaling \$61,413 representing the continued increase to costs associated with expansion of the Company's business plan, (iii) \$420,000 in expenses associated with the grant of in-the-money warrants as consideration for the expansion of licensing and manufacturing rights associated with a technology sharing and license agreement granted to the Company, (iv) \$744,250 in expenses associated with fees resulting from financing activities from the sale by the Company of 10% secured convertible debentures in the aggregate principal amount of \$5,000,000, (v) \$37,177 for accrued interest expenses and, (vi) non-cash charges of \$7,500 for the issuance of unregistered stock for business development and advisory services in lieu of cash payment for services. The value of the stock issued for services was determined by using the average of the last sale closing price as quoted on the OTCBB over the three month period the services were rendered.

The Company had net cash flows from financing activities of \$2,951,250, \$2,000,000 of which was from debentures sold and \$951,250 was charged as a cost for issuance of warrants.

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NEED FOR ADDITIONAL FINANCING

The Company anticipates that there will be insufficient cash generated from operations in the current year necessary to fund its anticipated cash requirements. The Company has incurred operating deficits since its reorganization in October 2003, which are expected to continue until its new business model is fully developed. Accordingly, the Company is dependent on raising additional capital necessary to meet the Company's cash needs for Research, Development, General and Administrative expenses including the costs of compliance with the continuing reporting requirements of the Securities Exchange Act of 1934.

The Company has been able to raise capital in a series of equity and debt offerings in the past and is actively pursuing additional financing in the form of loans or equity placements to cover on going cash needs. There can be no assurances that the Company will be able to obtain such additional financing, on terms acceptable to it and at the times required, or at all. Lack of capital may be a sufficient impediment to prevent it from accomplishing the goal of commercializing a licensable process for the manufacture of semi-transparent solar electric glazing technologies.

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The Company has registered on Form SB-2, effective February 9, 2006, 72,879,263 shares. The registration relates to the resale by the selling stockholders of up to 72,879,263 shares of our common stock. The selling stockholders may sell common stock from time to time in the principal market on which the stock is traded at the prevailing market price or in negotiated transactions. The total number of shares sold herewith includes the following shares owned by or to be issued to Cornell Capital Partners LP: (i) up to 9,520,000 shares issuable upon conversion of secured convertible debentures, including interest, at a fixed conversion price of \$0.10 per share; (ii) up to 50,000,000 shares issuable upon conversion of secured convertible debentures at a conversion price equal to the lesser of \$0.38 or 95% of the lowest daily volume weighted average price of our common stock for the 30 trading days immediately preceding the conversion date; (iii) 4,250,000 shares issuable upon the exercise of warrants at \$0.15 per share; (iv) 2,125,000 shares issuable upon the exercise of warrants at \$0.20 per share; (v) 3,125,000 shares of common stock issuable upon the exercise of warrants at \$0.45 per share; (vi) 1,250,000 shares of common stock issuable upon the exercise of warrants at \$0.55 per share; and (vii) 2,544,031 shares previously issued.

We are also including 65,232 shares owned by another shareholder.

This registration may allow conversion of \$5,850,000 in outstanding debentures to registered common shares and also registered shares to further allow exercise of 10,750,000 warrants for purchase of shares. Proceeds from warrant exercise, if any, will be received and used by Company.

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.

GOING CONCERN

The Company is in the development stage and as of the period ending December 31, 2005, did not have any products for sale, and had not generated any revenue from sales or other operating activities. To date the Company's principal source of liquidity has been the private placement of equity securities and the issuance of notes payable. 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.

Based on the foregoing and the Company's history of losses, the Company's financial statements for the six-month period ended December 31, 2005 include a going concern opinion from its outside auditors, which stated there "is substantial doubt" about our ability to continue operating as a "going concern."

Item 3. 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

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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

None.

Item 2. CHANGES IN SECURITIES

Expanded License and Warrants

Expanded Use License stock warrant MVSsystems, Inc. - As consideration for the grant of an Expanded Use License on October 12, 2005, granting XsunX additional benefits for use of licensed technologies and patents, XsunX granted MVS a warrant (the "Expanded Use License Stock Warrant") for the purchase of up to Seven Million (7,000,000) shares of common stock of XsunX, the warrant will expire five (5) years after the date of the grant and is subject to the following vesting provisions:

- (1) The Expanded Use License Stock Warrant allowed for the vesting of one million (1,000,000) warrants on the effective date of the agreements.
- (2) Another one million (1,000,000) warrants will vest upon the satisfactory completion of a Phase 4 development program for the development of technologies licensed under the Expanded Use License.
- (3) The balance of five million (5,000,000) warrants will vest upon the date the technologies licensed within the Expanded Use License are licensed to a third party in a bona fide arms-length commercial setting.

Funding Agreement

On December 12, 2005, XsunX, Inc. consummated a Securities Purchase Agreement dated December 12, 2005 with Cornell Capital Partners L.P. providing for the sale by the Company to Cornell of 10% secured convertible debentures in the aggregate principal amount of \$5,000,000 (the "Debentures") of which \$2,000,000 was advanced immediately. The second installment of \$2,000,000 will be advanced immediately prior to the filing by the Company, with the Securities and Exchange Commission, of a Registration Statement. The last installment of \$1,000,000 will be advanced three days prior to the date the Registration Statement is declared effective by the Commission. The Debenture is convertible into shares of Common Stock at the option of the Holder at a conversion price per share equal to the lesser of \$0.38 or 95% of the lowest daily volume weighted average price of the Common Stock, as quoted by Bloomberg, LP, for the 30 trading days immediately preceding the date of conversion (the "Variable Market Price"). Unless waived by the Company, the Holders may not, together with their affiliates, convert more than an aggregate of \$350,000 in any 30-day period of principal amount of the Debentures at the Variable Market Price. Cornell has agreed not to short any of the shares of Common Stock

Under the Purchase Agreement, the Company also issued to Cornell five-year warrants to purchase 3,125,000 and 1,250,000 shares of Common Stock at \$0.45 and \$0.55, respectively (collectively, the "Warrants").

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Termination of Distribution Agreement

In July 2005, in association with the sale of a Convertible 12% Secured Debenture, the Company entered into a Standby Equity Distribution Agreement (the "Distribution Agreement") with an investor providing for the sale and issuance of up to \$10,000,000 of Common Stock over a period of up to 24 months after the signing of the Distribution Agreement. The Company agreed to file a registration statement registering the Common Stock issuable upon sales under the Distribution Agreement and for the underlying shares associated with the sale of a Convertible 12% Secured Debenture. On August 17, 2005 the Company filed a registration statement with the U.S. Securities and Exchange Commission in relation to these agreements. On December 9, 2005 the Company and the investor agreed to the termination of the Distribution Agreement and withdrawal of the registration statement as part of a subsequent financing agreement, (see "Funding Agreement" above). No shares were sold under the Distribution Agreement prior to its termination.

Issuance of Shares For Services

On or about December 5, 2005 the Company issued 40,441 shares of common stock pursuant to Rule 144 of the Act to 1 consultant as compensation for three months of services that had been rendered to the company for the periods between July 7, 2005 and October 6, 2005. The shares were valued at the average market price of the Company's common stock over the three month period of services which was \$0.18559 per share for a total compensated value of \$7,500.00.

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:

31.1 Section 302 Sarbanes-Oxley Certification

32.1 Section 906 Sarbanes-Oxley Certification

B. Reports on Form 8-K:

Form 8-K Report filed on October 17, 2005.

Form 8-K Report filed on October 28, 2005.

Form 8-K Report filed on December 12, 2005.

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 21, 2006

XSUNX, INC.

By: /s/ Tom M. Djokovich

Tom M. Djokovich, Chief Executive
Officer, President, and acting Chief
Financial Officer

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

By: /s/ Tom M. Djokovich

Dated: February 21, 2006

Director, President, CEO and acting CFO