

XSUNX INC
Form 10-K/A
January 14, 2014

UNITED STATES
SECURITIES EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K /A
Amendment No. 1

ANNUAL REPORT PURSUANT TO
THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended September 30, 2013

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.)

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65 Enterprise, Aliso Viejo, CA 92656

(Address of Principal Executive Offices) (Zip Code)

(949) 330-8060

(Registrant's Telephone Number)

Securities registered pursuant to Section 12(b) of the Act: Title of each class: **None**

Name of Each Exchange on which Registered: **N/A**

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

Title of each class: **Common Stock, no par value per share**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes NO

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

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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.

Yes NO

Check if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

(Check one):

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

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

Yes NO

As of March 31, 2013, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was approximately \$5,610,354 million based on the closing price as reported on the OTCBB.

As of January 14, 2014, there were 519,821,256 shares of the registrant's company common voting stock outstanding.

Explanatory Note

The purpose of this Amendment No. 1 (the "Amendment") to the registrant's Annual Report on Form 10-K for the year ended September 30, 2013, filed with the Securities and Exchange Commission on January 14, 2014 (the "Original Form 10-K Filing Date"), is solely to furnish the following exhibits which were inadvertently filed as part of the main Form 10-K Report and excluded from the exhibit list;

Exhibit 31.1 Sarbanes Oxley Certification

Exhibit 32.1 Sarbanes Oxley Certification

In addition, in connection with the filing of this Amendment and pursuant to Rule 12b-15 of the Securities Exchange Act of 1934, as amended, the certifications of our principal executive officer and principal financial officer are attached as exhibits to the Amendment.

Except as set forth above, we have not modified or updated disclosures presented in the Original Form 10-K filing to reflect events or developments that have occurred after the date of the Original Filing. Among other things, forward-looking statements made in the Original Filing have not been revised to reflect events, results or developments that have occurred or facts that have become known to us after the date of the Original Filing (other than as discussed above), and such forward-looking statements should be read in their historical context. Accordingly, this Amendment should be read in conjunction with our filings made with the SEC subsequent to the filing of the Original Filing. This Amendment No. 1 to the Form 10-K speaks as of the original filing date of the Form 10-K and does not contain any other changes.

TABLE OF CONTENTS

	Page
PART I	
Item 1. Business	4
Item 1A. Risk Factors	10
Item 1B. Unresolved Staff Comments	17
Item 2. Properties	18
Item 3. Legal Proceedings	18
Item 4. Mine Safety Disclosures	18
PART II	
Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	
Item 6. Selected Financial Data	21
Item 7. Management's Discussion and Analysis or Plan of Operations	21
Item 7A. Quantitative and Qualitative Disclosures About Market Risk	25
Item 8. Financial Statements and Supplementary Data	26
Item 9. Changes in and Disagreements on Accounting and Financial Disclosure	26
Item 9A. Controls and Procedures	26
Item 9B. Other Information	27
PART III	
Item 10. Directors, Executive Officers, and Corporate Governance	28
Item 11. Executive Compensation	30
Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	33

Item 13. Certain Relationships and Related Transactions, and Director Independence	34
Item 14. Principal Accounting Fees and Services	35

PART IV

Item 15. Exhibits, Financial Statement Schedules	36
Financial Statements	39
Signatures	57

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the Securities Exchange Act of 1934, as amended (the Exchange Act) and the Securities Act of 1933, as amended (the Securities Act) which are subject to risks, uncertainties and assumptions that are difficult to predict. All statements in this Annual Report on Form 10-K, other than statements of historical fact, are forward-looking statements. These forward-looking statements are made pursuant to safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The forward-looking statements include statements, among other things, concerning our business strategy, including anticipated trends and developments in and management plans for, our business and the markets in which we operate; future financial results, operating results, revenues, gross margin, operating expenses, products, projected costs and capital expenditures; research and development programs; sales and marketing initiatives; and competition. In some cases, you can identify these statements by forward-looking words, such as estimate , expect , anticipate , project , plan , intend , believe , forecast , foresee , likely , may , should , goal , target and continue , the negative or plural of these words and other comparable terminology.

The forward-looking statements are only predictions based on our current expectations and our projections about future events. All forward-looking statements included in this Annual Report on Form 10-K are based upon information available to us as of the filing date of this Annual Report on Form 10-K. You should not place undue reliance on these forward-looking statements. We undertake no obligation to update any of these forward-looking statements for any reason. These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance, or achievements to differ materially from those expressed or implied by these statements. These factors include the matters discussed in the section entitled Item 1A: Risk Factors and elsewhere in this Form 10-K. You should carefully consider the risks and uncertainties described under this section.

For further information about these and other risks, uncertainties and factors, please review the disclosure included in this report under Item 1A Risk Factors.

PART I

Item 1. Business.

In this Report, we use the terms Company, XsunX, we, us, and our, unless otherwise indicated, or the context otherwise requires, to refer to XsunX, Inc.

Organization

XsunX, Inc. (XsunX, the Company or the issuer) is a Colorado corporation formerly known as Sun River Mining Inc. (Sun River). The Company was originally incorporated in Colorado on February 25, 1997. Effective September 24, 2003, the Company completed a plan of reorganization and changed its name, to XsunX, Inc.

Business Overview

XsunX focuses on providing solar energy solutions that provide the greatest bottom-line financial benefits to businesses. Our background and experience spans virtually all aspects of solar including technology assessment, design, and development.

Our business development efforts for the majority of the year ended September 30, 2013, centered on the development and marketing of a licensable low cost entry point solution for the manufacture of Copper Indium Gallium Selenide (CIGS) thin film solar cells which we call CIGSolar®.

During the period we completed the assembly of a thin film solar cell co-evaporation system central to the design of our CIGSolar® technology, and worked to calibrate the system, make adjustments to its new design as testing results warranted, and marketed the benefits of the technology to potential licensees. Such potential licensees consisted primarily of companies working to establish vertically integrated solar module manufacturing operations to service emerging demand in developing economies and regions.

In September 2013, in response to what the Company foresees as increasing demand within the commercial real-estate markets in California for the installation of solar electric photovoltaic (PV) systems, we began to prepare our operations to diversify and include services for the sale, design, and installation of solar electric PV systems. We intend to operate as a licensed contractor in California providing such services.

Initially, we plan to complete the preparation for the sale and delivery of solar PV system design and installation services in the first quarter of fiscal 2014, and begin to market to commercial and industrial business and facility owners in the California market.

We see this as a significant business development opportunity as management has the skillset associated with construction management, the licensing qualifications necessary for us to qualify as a licensed contractor in California, we have extensive experience associated with PV technologies and the design requirements associated with the delivery of a solar PV system, and there is a market demand available for us to provide these services to. We plan to focus a large portion of operations on the rapid development and market acceptance for our solar electric PV systems design and installation services.

Solar Industry Segments, Technology, and Pricing Trends

The solar industry, in general, is comprised of four primary segments consisting of:

Equipment suppliers for the manufacture of photovoltaic (PV) solar cells and solar module assembly;

Manufacturers who produce solar cells and assemble solar modules;

Balance of solar PV system component suppliers who provide the materials and technologies for the assembly and operation of the end-user installed solar PV system, and;

Licensed providers of solar PV system design and installation services to end-users.

PV Industry Manufacturing by Technology Type, Capacity, and Trends

According to a September 2013 report by Bloomberg New Energy Finance, total solar module production and installations in 2013 are projected to be approximately 37 Giga Watts (GW). Technologies produced by PV type were approximately 60% Poly-silicon, 30% Mono-silicon, 4% thin film Cadmium Telluride, 2% thin film Copper Indium Gallium Selenide (CIGS), and 4% all others.

Silicon solar cells and modules comprise the super majority of PV production at approximately 90% market share, and according to an October 2013 report by NDP Solarbuzz, are anticipated to remain the dominant technology and to increase market share in 2014 while thin film technology production is expected to continue to lose market share, declining from a collective 9.4% in 2013 to 8.9% in 2014.

Controlled capital spending across the manufacturing supply chain of these PV technologies is expected to continue to follow proportionally to meet increasing product demand. Spending on capital equipment is therefore expected to remain selective as manufacturers continue to leverage installed capacities to extract maximum economies. This tactic is consistent with the highly cautious approach to investing in or transitioning next-generation technologies from the research lab to mass production by solar cell and solar module manufacturers.

Industry Pricing and Growth Trends

According to reports by the U.S. Solar Energy Industries Association (SEIA) solar module costs in the second quarter of calendar 2013 were down by 60% compared to the first quarter of 2011. Due to an increase in demand for solar modules, and a continued consolidation of the supply chain, this trend of steep average selling price (ASP) decline for solar modules has begun to stabilize and quarter over quarter blended solar module per watt (W) pricing has increased by 3% from \$0.68/W in the second quarter of calendar 2013 to \$0.70/W in the third quarter calendar 2013.

Reports provided by U.S. Energy Department (USDE) indicate that the installed price reductions for solar PV systems that are driving record installation demand are primarily attributable to the steep reductions noted above in the price of solar modules. The USDE reports that from 2008 to 2012, annual average module prices on the global market fell by \$2.60/W, representing about 80% of the total decline in solar PV system installed pricing over that period.

While solar PV system installed costs have continued to decline the rebates and other forms of cash incentives for residential and commercial PV systems that are offered by state agencies and utilities in many U.S. regions have also declined. According to reports by the USDE over the period of 2011 to 2012, median cash incentives from state and utility programs fell by \$0.40/W to \$0.60/W, depending on PV system size. Still, with the installed costs for solar PV systems at all-time lows, and utility provided electric costs at all-time highs, reports by the SEIA indicate that as much as 20% of installations have forgone state and utility incentives in the first half of 2013.

Meanwhile, other sources of financial support for solar PV projects such as the 30% federal investment tax credit under Section 48(a)(3) of the Internal Revenue Code, or the Federal ITC, for the installation of certain solar power facilities until December 31, 2016, and depreciation tax incentives, can be coupled with state and utility incentives to provide significant cash value offsets to the installed costs for solar PV systems.

Together, the steep reductions to the installed per watt costs for solar PV systems and continued cash and tax incentives have created favorable market trends for the purchase and installation of residential and commercial solar PV systems. Specifically, California's PV installation market has seen continued strong growth. A report by the SEIA indicates that the second calendar quarter of 2013 ranks as the strongest second quarter in the state's history, with installations up 78% in the residential market and 26% in the non-residential market year-over-year.

For residential and non-residential projects, an enabling sales incentive for solar PV system developers has been higher retail rates for electricity and the ability for customers to use net metering (NEM) to offset up to 100% of their typical energy consumption costs, coupled with the federal 30% Investment Tax Credit, and accelerated depreciation for systems purchased by businesses.

Sales, Marketing and Planned Operations

CIGSolar® Thin Film Systems Licensing and Sales

We have through September 2013 devoted the majority of our resources to the development of a low cost solution for the manufacture of Copper Indium Gallium Selenide (CIGS) thin film solar cells which we call CIGSolar®. Our target market and customer for this technology are manufacturers who produce solar cells and assemble solar modules.

During the 2012 and 2013 all manufacturers of thin film solar technologies that had previously enjoyed significant per watt price advantages have seen this advantage erode and as a result there has been a continued significant reduction to the number of companies that produce or intended to produce thin film solar products in the 2013 calendar period as compared to the same period ended 2012 and 2011. This is consistent with reports by the U.S. Solar Energy Industries Association (SEIA) indicating that silicon solar modules are anticipated to remain the dominant technology and increase market share in 2014 while thin film technology production is expected to continue to lose market share, declining from a collective 9.4% in 2013 to 8.9% in 2014.

In response to these trends, we have worked to re-focus marketing efforts into developing economic regions where the modular design of our technology can allow for significantly reduced initial start-up costs. However, challenges we face in these new markets are associated with the need for our target customers to gain government and financial support necessary to execute business plans. We anticipate that this may continue to pose a challenge to us through 2014 and is consistent with an October 2013 report by NDP Solarbuzz indicating that investments in new thin-film manufacturing equipment declined to an eight-year low during 2013, but are forecast to increase in 2015, as existing suppliers and new entrants into the market plan to add capacity.

We intend to continue to market our multi-chamber CIGSolar® thermal co-evaporation technology and system to third parties, however we do not anticipate devoting substantial resources towards additional testing, calibration, or enhancements to the system until such time that we either enter into a sales agreement for the technology or the market demand for thin film technologies warrants additional investments.

Planned Solar PV System Design and Installation Services

While the market conditions for increased capital expenditures for thin film solar cell manufacturing technology continue to resolve we anticipate, and market reports substantiate, that demand for solar electric PV systems servicing commercial and industrial properties will increase and provide us with significant business development opportunities servicing the California commercial real-estate market, which ranks as the largest in the United States according to reports by the SEIA.

We plan to complete the preparation for the sale and delivery of solar PV system design and installation services in the first quarter of fiscal 2014, and begin to market to commercial and industrial business and facility owners in the California market.

We see this as a significant business development opportunity as management has the skillset associated with construction management, the licensing qualifications necessary for us to qualify as a licensed contractor in California, we have extensive experience associated with PV technologies and the design requirements associated with the delivery of a solar PV system, and there is a market demand available for us to provide these services to.

We plan to focus a large portion of operations on the rapid development and market acceptance for our solar electric PV systems design and installation services. We believe that these efforts may provide us with the fastest path to revenue generation and the ability to reduce future dependency on the sale of debt or equity to fund operations.

At this time we do not plan to manufacture CIGS solar modules for use in the solar PV systems that we market and install. The current configuration of our CIGSolar® evaporation systems have been established for marketing demonstration and development purposes, which is consistent with our licensing sales model for this technology.

Solar PV System Operations and Supply

We plan to purchase major components such as solar panels, inverters, and solar module mounting hardware directly from multiple manufacturers. We intend to establish direct factory purchasing relationships when possible. We plan to select these suppliers and components based on cost, reliability, warranty coverage, ease of installation, application design, technology advantages, and enter into contractual arrangements with major suppliers that define the general terms and conditions of our purchases, including warranties, product specifications, delivery and other customary terms.

Additionally, to compete favorably we plan to establish relationships with lenders through which we can offer financing of the systems we design and install as an alternative cash management solution for our target customers, and a sales inducement to purchase systems.

For the foreseeable future we anticipate that we will purchase the systems components for each project on an as-needed basis from the suppliers at the then-prevailing prices pursuant to purchase orders issued under any contractual arrangements we may have in place. Due to the volatility of component pricing we do not anticipate any supplier arrangements that will contain long-term pricing or volume commitments. Should our sales efforts, volume, and market conditions warrant we may in the future elect to make purchase commitments to ensure sufficient supply of components. We plan to purchase solar panels containing cells manufactured outside of China, and accordingly we do not anticipate to be adversely impacted by any U.S. government imposed tariffs on solar cells manufactured in China.

Our intent is to provide complete solar PV project design, management of engineering, facility preparations, installation of systems, repair or restoration to all affected areas resulting from the installation process, and any ongoing maintenance agreements as may be sold. To accomplish this we intend to use the services of licensed service professionals in each of the representative trades or specialties necessary. Additionally, we intend to provide qualified staff to supervise project operations, inspections, and system start up and energizing. We plan to also develop in-house installation and general assembly of systems capabilities through the addition of qualified staff.

Competitive Solar Industry Conditions

In the fiscal year ended September 30, 2013, over developed production capacities for silicon solar cells, which have existed for several years, continued to create highly competitive conditions for solar modules and the components and technologies used in their manufacture. According to reports by the U.S. Solar Energy Industries Association (SEIA) these competitive conditions have resulted in extensive price reductions of approximately 60% between calendar Q1 2011 and calendar Q2 2013 for solar products incorporating the use of silicon solar cells. These market sales price reductions have significantly affected operating margins at the solar module manufacturer level, and restructured the project planning process and selection of installed solar technologies at the solar PV systems project developer level.

All manufacturers of thin film solar technologies that had previously enjoyed significant per watt price advantages have seen this advantage erode and as a result there has been a continued significant reduction to the number of companies that produce or intended to produce thin film solar products in the 2013 calendar period as compared to the same period ended 2012 and 2011. This is consistent with reports by the U.S. Solar Energy Industries Association

(SEIA) indicating that silicon solar modules are anticipated to remain the dominant technology and increase market share in 2014 while thin film technology production is expected to continue to lose market share, declining from a collective 9.4% in 2013 to 8.9% in 2014.

Controlled capital spending across the manufacturing supply chain of both silicon and thin film PV technologies is, at best, expected to continue to follow proportionally to meet increasing product demand. Manufacturers, while interested in maintaining the ability to supply growth in market demand, do not want to re-create the abundant over supply conditions that created significant average selling price per watt reductions in the 2011 and 2012 periods.

Spending on capital equipment is therefore expected to remain selective as manufacturers continue to leverage installed capacities to extract maximum economies. This tactic is consistent with the highly cautious approach to investing in or transitioning next-generation technologies from the research lab to mass production by solar cell and solar module manufacturers. This trend has significantly reduced the pool of our potential customers in developed markets and our ability to produce sales associated with our CIGSolar® technology.

We anticipate that this trend will pose a challenge to us through 2014 and is consistent with an October 2013 report by NDP Solarbuzz indicating that investments in new thin-film manufacturing equipment declined to an eight-year low during 2013, but are forecast to increase in 2015, as existing suppliers and new entrants into the market plan to add capacity.

Company Response to Market Conditions

In response to the trends noted above, of reduced and cautious commitment to capital expenditures on new production capacity or new technologies in developed markets we have worked to re-focus marketing efforts into developing economic regions where the modular design of our technology can allow for significantly reduced initial start-up costs. However, challenges we face in these new markets are associated with the need for our target customers to gain government and financial support necessary to execute business plans.

We intend to continue to market our multi-chamber CIGSolar® thermal co-evaporation technology and system to third parties, but we do not anticipate devoting substantial resources towards additional testing, calibration, or enhancements to the system until such time that we either enter into a sales agreement for the technology or the market demand for thin film technologies warrants additional investments.

Conversely, the demand for, and installations of, solar PV systems has continued to increase with overall global installations of solar electricity projects projected to approach 37 giga watts in the calendar year ending 2013, an approximate 20% increase from 2012 according to reports by the SEIA. Together, the steep reductions to the installed per watt costs for solar PV systems, and continued cash and tax incentives, have created favorable market trends for the purchase and installation of residential and commercial solar PV systems. Specifically, California's PV installation market has seen continued strong growth. The reports by the SEIA indicated that the second quarter 2013 ranks as the strongest second quarter in the state's history, with installations up 78% in the residential market and 26% in the non-residential market year-over-year.

In response to these expanding opportunities for the sale of solar electric PV systems to the end user market we plan to complete the preparation for the sale and delivery of solar PV system design and installation services in the first quarter of fiscal 2014, and begin to market to commercial and industrial business and facility owners in the California market. We see this as a significant business development opportunity and we plan to focus a large portion of operations on the rapid development and market acceptance for our solar electric PV systems design and installation services.

Competition and Positioning of Our Services

As we enter the solar PV design and installation market we believe that our primary competitors will be the traditional utilities that supply energy to our target customers who are owners and operators of businesses and commercial real-estate properties. We will compete with these traditional utilities primarily based on current price, predictability of future price, and the financial cost incentives and ease by which customers can switch to electricity generated by solar PV energy systems we market. We believe that upon completion of the development of our plans we will compete favorably with regional utilities based on these factors in the areas we service.

When offering our solar PV system design and installation services we will compete with companies that provide products and services in distinct segments of the solar energy value chain. Some of the current competitors in the solar energy system installation market include American Solar Electric, Inc., Petersen Dean, Inc., Real Goods Solar, Inc., REC Solar, Inc., Verengo, Inc., Chevron Corporation, and SunPower Corporation along with many smaller local solar system companies.

We believe that upon completion of the preparation for the delivery of these new services we can compete favorably with these companies. Our plan is to focus primarily on the commercial systems market and provide extensive services in which we work with clients to establish the ideal solar PV system design through comprehensive financial analysis to determine the best return on system investment for each client. We then design, install, and service all aspects providing a single point of contact and accountability for the entire system installation and product group that we offer clients.

As an example, a customer with extensive power costs would like to mitigate long term power costs through the addition of on-site solar PV electrical generation. However, the application of solar to anyone of their existing facilities could require structure rehabilitation or modifications to allow for the solar installation. This type of project requires that the client either identify and manage numerous service and trade providers, or that they retain a licensed general contractor capable of design and rehabilitation analysis from a cost benefit standpoint, management of the engineering and permitting process, structural, soils, and facilities corrective work, and installation of the solar PV systems. Our management provides the skillset associated with construction management, the licensing qualifications necessary for us to qualify and operate as a licensed contractor in California, and we have extensive experience associated with PV technologies and the design requirements associated with the delivery of a solar PV systems.

We anticipate that while the above example may not be indicative of all projects, the ability to offer extensive or integrated services may allow us to compete outside of the typical cost per watt only analysis while also providing for significant differentiation and additional sources of sales and revenue streams.

Intellectual Property

The following is an outline of certain patents and technologies we are developing, have acquired, or licensed:

The Company has worked to develop a hybrid manufacturing solution to produce high performance Copper Indium Gallium (di) Selenide (CIGS) thin film solar cells. Our system and processing technology, which we call CIGSolar®, focuses on the mass production of individual thin-film CIGS solar cells that match silicon solar cell dimensions and can be offered as a non-toxic, high-efficiency and lowest-cost alternative to the use of silicon solar cells.

The Company is developing a manufacturing solution to produce high performance Copper Indium Gallium Selenide (CIGS) thin film solar cells. Our system and processing technology, which we call CIGSolar®, focuses on the mass production of individual thin-film CIGS solar cells that match silicon solar cell dimensions and can be offered as a lowest-cost alternative to the use of silicon solar cells. We have designed a proprietary system for a process known as co-evaporation used in the manufacture of the solar absorbing material CIGS. Certain key features related to this system we believe may qualify for patent protection. In July 2012 we filed three (3) claims related to our thermal effusion source installation design. We have been advised by the USPTO that first action and review of this application will occur approximately fifteen (15) months from our initial filing or on or about October 2013. As we may continue to refine our designs and process technologies we may elect to abandon, modify, or file additional applications, and we may seek to enforce our claims through filing of utility patents.

In September 2003, the Company was assigned the rights to three patents as part of an Asset Purchase Agreement with Xoptix Inc., a California corporation. The patents acquired were No. 6,180,871 for Transparent Solar Cell and Method of Fabrication (Device), granted on January 30, 2001; No. 6,320,117 for Transparent Solar Cell and Method of Fabrication (Method of Fabrication), granted on November 20, 2001; and No. 6,509,204 for Transparent Solar Cell and Method of Fabrication (formed with a Schottky barrier diode and method of its manufacture), granted on January 21, 2003. We do not currently employ nor envision the use of the above named patents in the development or commercialization of our CIGSolar® technology. Because of technological and business developments within the solar industry, we believe that these patents no longer provide business opportunities for the Company to pursue.

On July 10, 2012, the United States Patent and Trademark Office issued a certificate of registration No. 4,172,218 granting the Company a trademark for the use of CIGSolar .

As we may continue to develop new technologies or business methods, we may actively seek patent protection for certain aspects related to methods and apparatus we develop. We can give no assurance that any such patent(s) will be granted for any process and manufacturing technology that we may develop individually or in conjunction with third parties.

We rely on trademark and copyright law, trade secret protection and confidentiality or license agreements with our employees, customers, partners and others to protect our proprietary rights. We have not been subject to any intellectual property claims.

Government Contracts

There are no government contracts as of the fiscal year ended September 30, 2013.

Compliance with Environmental Laws and Regulations

The operations of the Company are subject to local, state and federal laws and regulations governing environmental quality and pollution control. Compliance with these regulations by the Company has required that, when necessary, we retain the use of consulting firms to assist in the engineering and design of systems related to equipment operations, management of industrial gas storage and delivery systems, and occupancy fire and safety construction standards to deal with emergency conditions. We do not anticipate that these costs will have a material effect on the Company's operations or competitive position, and the cost of such compliance has not been material to date. The Company is unable to assess or predict at this time what effect additional regulations or legislation could have on its activities.

Employees and Consultants

As of the fiscal year ended September 30, 2013, we had three employees including Mr. Tom Djokovich who is the President and CEO. This represents no change to the same period ended 2012. To compensate our need for scientific and technical productivity the Company also relies on qualified consultants to perform specific functions that otherwise would require an employee. As we expand our business developments efforts to include solar PV system design and installations we will need to add staff to adequately respond to sales inquiries, project management, and general labor as warranted. We consider relations with our employees and consultants to be good.

Available Information

Our website address is www.xsunx.com. We make available on our website access to our Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports that we have filed with the U.S. Securities and Exchange Commission (SEC). The information found on our website is not part of this or any other report we file with, or furnish to, the SEC.

Item 1A. Risk Factors

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

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

We are a development stage company and, to date, have not generated any significant revenues. The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate our continuation as a going concern. Net loss for the years ended September 30, 2013 and 2012 was \$(2,522,382) and \$(1,555,194), respectively. Net cash used for operations was \$(441,718) and \$(379,240) for the years ended September 30, 2013 and 2012, respectively. At September 30, 2013, we had a working capital deficit of \$(889,448). From inception through September 30, 2013, we had an accumulated deficit of \$(39,115,035) at September 30, 2013.

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

We expect that we will need to obtain additional financing to continue to operate our business, including expenditures to expand operations for the sales, design, and installation of solar PV systems, and to continue to complete the commercialization of marketable thin film manufacturing technologies. This financing may be unavailable or available only on disadvantageous terms which could cause the use to curtail our business operations and delay the execution of our business plan.

We have in the past experienced substantial losses and negative cash flow from operations and have required financing, including equity and debt financing, in order to pursue the commercialization of products based on our technologies. We expect that we will continue to need significant financing to operate our business. Furthermore, there can be no assurance that additional financing will be available or that the terms of such additional financing, if available, will be acceptable to us. If additional financing is not available or not available on terms acceptable to us, our ability to fund our operations, successfully expand operations to include the sales, design, and installation of solar PV systems, complete the sales or development of marketable technologies, products, or services, develop a sales network, or otherwise respond to competitive pressures may be significantly impaired. We could also be forced to curtail our business operations, reduce our investments, decrease or eliminate capital expenditures and delay the execution of any portion or all of our business plans, including, without limitation, all aspects of our operations, which would have a material adverse effect on our business.

We may be required to raise additional financing by issuing new securities with terms or rights superior to those of our shares of common stock, which could adversely affect the market price of our shares of common stock and our business.

We will require additional financing to fund future operations, including expansion in current and new markets, development and acquisition, capital costs and the costs of any necessary implementation of technological innovations or alternative technologies. We may not be able to obtain financing on favorable terms, if at all. If we raise additional funds by issuing equity securities, the percentage ownership of our current stockholders will be reduced, and the holders of the new equity securities may have rights superior to those of the holders of shares of common stock, which could adversely affect the market price and the voting power of shares of our common stock. If we raise additional funds by issuing debt securities, which we have relied on significantly during the year ended September 30, 2013, the holders of these debt securities could have some rights senior to those of the holders of shares of common stock, and the terms of these debt securities could impose restrictions on operations and create a significant interest and derivative expenses for us which could have a materially adverse effect on our business.

As we enter the solar PV system sales, design, and installation market existing electric utility industry regulations, and changes to regulations, may present technical, regulatory and economic barriers to the purchase and use of solar energy systems that may significantly reduce demand for the solar energy systems we design and market.

Federal, state and local government regulations and policies concerning the electric utility industry, and internal policies and regulations promulgated by electric utilities, heavily influence the market for electricity generation products and services. These regulations and policies often relate to electricity pricing and the interconnection of customer-owned electricity generation. In the United States, governments and utilities continuously modify these regulations and policies. These regulations and policies could deter customers from purchasing renewable energy, including solar energy systems. This could result in a significant reduction in the potential demand for our solar energy systems. For example, utilities commonly charge fees to larger, industrial customers for disconnecting from the electric grid or for having the capacity to use power from the electric grid for back-up purposes. These fees could increase our target customers' cost to use our systems and make them less desirable, thereby harming our future business, prospects, financial condition and results of operations.

In addition, any changes to government or internal utility regulations and policies that favor electric utilities could reduce our competitiveness and cause a significant reduction in demand for our products and services. For example, certain jurisdictions have proposed imposing a new charge that would disproportionately impact solar energy system customers who utilize net metering, either of which would increase the cost of energy to those customers and could reduce demand for our solar energy systems. Any similar government or utility policies adopted in the future could reduce demand for our products and services and adversely impact our growth.

As we enter the solar PV system sales, design, and installation market we rely on net metering and related policies to offer competitive pricing to our target customers in our key market of California.

California has a regulatory policy known as net energy metering, or net metering. Net metering typically allows our target customers to interconnect their on-site solar energy systems to the utility grid and offset their utility electricity purchases by receiving a bill credit at the utility's retail rate for energy generated by their solar energy system in excess of electric load that is exported to the grid. At the end of the billing period, the customer simply pays for the net energy used or receives a credit at the retail rate if more energy is produced than consumed. Our ability to sell solar energy systems or the benefits of the electricity they generate may be adversely impacted by the failure to expand existing limits on the amount of net metering, or the imposition of new charges that only or disproportionately impact customers that utilize net metering. Our ability to sell solar energy systems or the benefits of the electricity they generate may also be adversely impacted by the unavailability of expedited or simplified interconnection for grid-tied solar energy systems or any limitation on the number of customer interconnections or amount of solar energy that utilities are required to allow in their service territory or some part of the grid.

Limits on net metering, interconnection of solar energy systems and other operational policies in our key market could limit the number of solar energy systems installed there. For example, California utilities are currently required to

provide net metering to their customers until the total generating capacity of net metered systems exceeds 5% of the utilities' aggregate customer peak demand. This cap on net metering in California was increased to 5% in 2010 as utilities neared the prior cap of 2.5%. New California legislation passed in October 2013 establishes a process and timeline for developing a new program with no participation cap that would apply after the current cap of 5% is reached. If the current net metering caps in California, are reached, or if the amounts of credit that customers receive for net metering are significantly reduced, our target customers will be unable to recognize the current cost savings associated with net metering. We anticipate that we will substantially rely on net metering to establish competitive pricing for our solar PV system sales with our prospective customers. The absence of net metering for customer acquisition would greatly limit demand and our ability to effectively market our solar energy system benefits.

As we enter the solar PV system sales, design, and installation market these business operations will depend on the availability of rebates, tax credits and other financial incentives. The expiration, elimination or reduction of these rebates, credits and incentives would adversely impact our planned business expansion.

U.S. federal, state and local government bodies provide incentives to end users, distributors, system integrators and manufacturers of solar energy systems to promote solar electricity in the form of rebates, tax credits and other financial incentives such as system performance payments and payments for renewable energy credits associated with renewable energy generation. We will rely on these governmental rebates, tax credits and other financial incentives to market the low cost operating and investment benefits of solar PV systems to our target customers. However, these incentives may expire on a particular date, end when the allocated funding is exhausted, or be reduced or terminated as solar energy adoption rates increase. Certain reductions or terminations could occur without warning.

The federal government currently offers a 30% investment tax credit under Section 48(a)(3) of the Internal Revenue Code, or the Federal ITC, for the installation of certain solar power facilities until December 31, 2016. This credit is due to adjust to 10% in 2017. Reductions in, or eliminations or expirations of, governmental incentives could adversely impact our future results of operations and our ability to offer solar PV systems as a competitive alternative to utility provided electricity.

A material drop in the retail price of utility-generated electricity or electricity from other sources would harm our business development efforts as we enter the solar PV system sales, design, and installation market and cause a material adverse effect to our future financial condition and results of operations.

Our target customer's decision to invest in renewable energy through us will be primarily driven by their desire to pay less for electricity. The customer's decision may also be affected by the cost of other renewable energy sources. Decreases in the retail prices of electricity from the utilities or from other renewable energy sources would harm our ability to offer competitive alternatives and could harm our business. The price of electricity from utilities could decrease as a result of any number of market conditions including:

the construction of a significant number of new power generation plants, including nuclear, coal, natural gas or renewable energy technologies, and ;

a reduction in the price of natural gas as a result of new drilling techniques or a relaxation of associated regulatory standards.

A reduction in utility electricity prices would make the investment by our target customers into the solar PV systems that we design and install less economically attractive. In addition, a shift in the timing of peak rates for utility-generated electricity to a time of day when solar energy generation is less efficient could make our solar energy system offerings less competitive and reduce demand for our products and services. If the retail price of energy available from utilities were to decrease due to any of these reasons, or others, we would be at a competitive disadvantage, we may be unable to attract customers and our growth would be limited.

A material drop in the retail price of utility-generated electricity would particularly adversely impact our ability to attract commercial customers which represent our target customer base.

We anticipate that commercial customers will comprise a significant portion of our business, and the commercial market for energy is particularly sensitive to price changes. Typically, commercial customers pay less for energy from utilities than residential customers. Any future decline in the retail rate of energy for commercial entities could have a significant impact on our ability to attract commercial customers. We may be unable to offer solar energy systems for the commercial market that produce electricity at rates that are competitive with the price of retail electricity on a

non-subsidized basis. If this were to occur, we would be at a competitive disadvantage to other energy providers and may be unable to attract new commercial customers, and our future business operations would be harmed.

Rising interest rates could adversely impact all aspects of our current and planned business operations.

Changes in interest rates could have an adverse impact on our business by increasing the cost of capital for our target customers. For example rising interest rates may negatively impact our ability to provide financing sources on favorable terms to facilitate our customers' purchase of our solar PV systems.

As we enter the solar PV system sales, design, and installation market we will act as the licensed general contractor for our customers and will be subject to risks associated with construction, cost overruns, delays, regulatory compliance and other contingencies, any of which could have a material adverse effect on our business and results of operations.

We intend to and are required to operate as a licensed contractor in every region we intend to service, and we will be responsible for every customer installation. For our commercial solar PV system projects, we intend to be the general contractor and construction manager, and we will typically rely on licensed subcontractors representing specialty trades such as electrical, roofing, and carpentry to install the commercial systems we sell. We may be liable to customers for any damage we cause to their facility, belongings or property during the installation of our systems. For example, we will frequently penetrate our customers' roofs during the installation process and may incur liability for the failure to adequately weatherproof such penetrations following the completion of construction. In addition, any shortages that may occur of skilled subcontractor labor for our commercial projects could significantly delay a project or otherwise increase our costs. Because our profit on a particular installation will be based in part on assumptions as to the cost of such project, cost overruns, delays or other execution issues may cause us to not achieve our expected margins or cover our costs for that project.

In addition, the installation of solar energy systems and the evaluation and modification of buildings that may be necessary as part of our business is subject to oversight and regulation in accordance with national, state and local laws and ordinances relating to building codes, safety, environmental protection, utility interconnection and metering, and related matters. Any new government regulations or utility policies pertaining to the systems we design and install may result in significant additional expenses to us and our future customers and, as a result, could cause a significant reduction in demand for our systems and services.

Compliance with occupational safety and health requirements and best practices can be costly, and noncompliance with such requirements may result in potentially significant monetary penalties, operational delays and adverse publicity.

The installation of solar energy systems will require our employees and any subcontractors that we engage to work at heights with complicated and potentially dangerous electrical systems. The evaluation and modification of buildings that may be necessary as part of our business may require our employees to work in locations that may contain potentially dangerous levels of asbestos, lead or mold. Our operations are subject to regulation under the U.S. Occupational Safety and Health Act, or OSHA, and equivalent state laws. Changes to OSHA requirements, or stricter interpretation or enforcement of existing laws or regulations, could result in increased costs. If we fail to comply with applicable OSHA regulations, even if no work-related serious injury or death occurs, we may be subject to civil or criminal enforcement and be required to pay substantial penalties, incur significant capital expenditures, or suspend or limit operations.

As we enter the solar PV system sales, design, and installation market future problems with product quality or performance may cause us to incur warranty expenses or performance guarantee expenses, and may damage our market reputation and cause our financial results to decline.

Solar energy system warranties are lengthy. Customers in our target market of California who purchase solar energy systems that we have designed and installed will be covered by a warranty of up to 10 years in duration for material and workmanship. We may also make extended warranties available at an additional cost to customers. In addition, we will provide a pass-through of the module mounting, inverter and panel manufacturers' warranties to our customers, which generally range from 5 to 25 years. One or more of these third-party manufacturers could cease operations and no longer honor a stated warranty leaving us to fulfill these potential obligations to our customers.

As we enter the solar PV system installation market we will have a limited operating history of the solar energy systems we design and install. We will be required to make assumptions and apply judgments regarding a number of factors, including our anticipated rate of warranty claims, and the durability, performance and reliability of our solar energy systems. We initially intend to make these assumptions based on the historic performance of similar systems or on accelerated life cycle testing of the third party materials and components used in the assembly of the systems we sell. Our assumptions could prove to be materially different from the actual performance of our systems, causing us to incur substantial expense to repair or replace defective solar energy systems in the future. Any widespread product

failures or operating deficiencies may damage our market reputation and adversely impact our future financial results.

If products and technologies that we market or products based on technologies we are developing cannot be developed for manufacture and sold commercially or our products or the products we market become obsolete or noncompetitive, we may be unable to recover our investments or achieve profitability which will have a materially adverse effect on our business.

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

There is no assurance that the market will accept the products that we offer or have developed once development has been completed which could have an adverse effect on our business.

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

There is no assurance that the market will accept our planned efforts to offer design, engineering, and installation services for solar electric PV systems which could have an adverse effect on our business.

The market for sales and installation of solar electric PV systems is highly competitive with limited barriers to entry by potential competitors. There can be no assurance that the products and services we will offer will be perceived as being superior or a better value to other similar products and services offered by competing companies or that such products will otherwise be accepted by consumers. If consumers do not accept our design, engineering, and installations services at the pricing we offer we may be unable to recover our investments, make sales of any significance, or achieve profitability.

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

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

There continues to be a few thin film companies that produce thin film solar products such as First Solar and Solar Frontier, and a limited number of others, compared to previous periods, are currently working to develop and commercialize thin film manufacturing methods. Given the benefit of time, investment, and advances in manufacturing technologies any of these competing technologies may achieve manufacturing costs per watt lower than cost per watt to manufacture technologies developed by us. However, while these risks do exist the Company believes that the more prevalent and greater risk posing both the Company, and the thin film market, will continue to be further and prolonged market price reductions from manufacturers of silicon solar technologies. The majority of the companies within the silicon industry have greater resources to devote to research, development, manufacturing and marketing than we do.

The loss of strategic relationships used in provisioning the products that comprise the solar PV systems that we intend to offer, and strategic relationships used in any future development of our thin film manufacturing technologies and products could impede our ability to offer competitive solar PV system products or further the development of our products and have a material adverse effect on our business.

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

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

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

We may not be successful in protecting our intellectual property and proprietary rights and may be required to expend significant amounts of money and time in attempting to protect these rights. If we are unable to protect our intellectual property and proprietary rights, our competitive position in the market could suffer.

Our current intellectual property consists of patent applications, trade secrets, and trade dress. Our success depends in part on our ability to create and maintain intellectual property to differentiate our services, how we provision our services, the ability to obtain patents as either business processes or technology development mature, and maintain adequate protection of our other intellectual property for our technologies and products in the U.S. and in other countries. The laws of some foreign countries do not protect proprietary rights to the same extent as do the laws of the U.S., and many companies have encountered significant problems in protecting their proprietary rights in these foreign countries. These problems may be caused by, among other factors, a lack of rules and methods for defending intellectual property rights. Also, the costs associated with the development of intellectual property rights can be significant and we may not be able to pursue rights initially in any region that we operate in and that may pose competitive challenges to us.

Our future commercial success may require us not to infringe on patents and proprietary rights of third parties, or breach any licenses or other agreements that we have entered into with respect to the products that we market, our technologies, products and businesses. The enforceability of patent positions cannot be predicted with certainty. We have in the past applied for patents covering certain aspects of the technology we have developed and we may elect to file additional patents, if any, as we deem appropriate. Patents, if issued, may be challenged, invalidated or circumvented. There can be no assurance that no other relevant patents have been issued that could block our ability to obtain patents or to operate as we would like. Others may develop similar technologies or may duplicate technologies developed by us.

We are not currently a party to any litigation with respect to any of our patent positions or trade secrets. However, if we become involved in litigation or interference proceedings declared by the United States Patent and Trademark Office, or other intellectual property proceedings outside of the U.S., we might have to spend significant amounts of money to defend our intellectual property rights. If any of our competitors file patent applications or obtain patents that claim inventions or other rights also claimed by us, we may have to participate in interference proceedings declared by the relevant patent regulatory agency to determine priority of invention and our right to a patent of these inventions in the U.S. Even if the outcome is favorable, such proceedings might result in substantial costs to us, including, significant legal fees and other expenses, diversion of management time and disruption of our business. Even if successful on priority grounds, an interference proceeding may result in loss of claims based on patentability grounds raised in the interference proceeding. Uncertainties resulting from initiation and continuation of any patent or related litigation also might harm our ability to continue our research or to bring products to market.

An adverse ruling arising out of any intellectual property dispute, including an adverse decision as to the priority of our inventions would undercut or invalidate our intellectual property position. An adverse ruling also could subject us to significant liability for damages, prevent us from using certain processes or products, or require us to enter into royalty or licensing agreements with third parties. Furthermore, necessary licenses may not be available to us on satisfactory terms, or at all.

Confidentiality agreements with employees and others may not adequately prevent disclosure of trade secrets and other proprietary information.

To protect our proprietary business methods, technologies and processes, we rely on trade secret protection and we have also sought formal legal devices such as patents. Although we have taken security measures to protect our trade secrets and other proprietary information, these measures may not provide adequate protection for such information. Our policy is to execute confidentiality and proprietary information agreements with each of our employees and consultants upon the commencement of an employment or consulting arrangement with us. These agreements generally require that all confidential information developed by the individual or made known to the individual by us during the course of the individual's relationship with us be kept confidential and not be disclosed to third parties. These agreements also generally provide that technology conceived by the individual in the course of rendering services to us shall be our exclusive property. Even though these agreements are in place there can be no assurances that that trade secrets and proprietary information will not be disclosed, that others will not independently develop substantially equivalent proprietary information and techniques or otherwise gain access to our trade secrets, or that we can fully protect our trade secrets and proprietary information. Violations by others of our confidentiality agreements and the loss of employees who have specialized knowledge and expertise could harm our competitive position and cause our sales and operating results to decline as a result of increased competition. Costly and time-consuming litigation might be necessary to enforce and determine the scope of our proprietary rights, and failure to obtain or maintain trade secret protection might adversely affect our ability to continue our research or bring products to market.

Downturns in general economic conditions could adversely affect our ability to attract customers and our potential for future profitability.

Downturns in general economic conditions can cause fluctuations in demand for any products we may offer, product prices, volumes and margins. Economic conditions may at any time not be favorable to our industry. A decline in the demand for our products and services or a shift to lower-margin products due to deteriorating economic conditions could adversely affect sales of our intended products and our profitability and could also result in impairments of certain of our assets.

Market demand and finished product pricing conditions could adversely affect the demand for our technology or the products and services we may offer, our competitive position, and collectively our ability to commercialize our technology and any potential for future profitability.

We believe that a risk posing both the Company, and the thin film solar product market, will continue to be further and prolonged market price reductions from manufacturers of silicon solar technologies. While the primary cause for price reductions appears to be over supply which has also caused significant losses for many manufacturers the trend of oversupply may continue for the foreseeable future. Many of the companies within the silicon industry have greater resources to devote to research, development, manufacturing and marketing than we do. These factors will cause a decline in interest in our technologies and pose significant threats to our ability to successfully attract customers and commercialize our technologies.

Standards for compliance with section 404 of The Sarbanes-Oxley Act Of 2002 are subject to change, and if we fail to comply in a timely manner, our business could be harmed and our stock price could decline.

This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this annual report. The standards that must be met for management to assess the internal control over financial reporting as effective are new and complex, and require significant documentation, testing and possible remediation to meet the detailed standards and will impose significant additional expenses on us. We may encounter problems or delays in completing activities necessary to make an assessment of our internal control over financial reporting. If we cannot assess our internal control over financial reporting as effective, investor confidence and share value may be negatively impacted.

Our common stock is considered a Penny Stock and as a result, related broker-dealer requirements affect its trading and liquidity.

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

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

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

The trading market in our common stock is limited and may cause volatility in the market price.

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

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

investors may have difficulty buying and selling or obtaining market quotations;

market visibility for our common stock may be limited; and

a lack of visibility for our common stock may have a depressive effect on the market for our common stock.

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

We may have difficulty raising necessary capital to fund operations as a result of market price volatility for our shares of common stock.

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

technological innovations or new products and services by us or our competitors;

additions or departures of key personnel;