ENOVA SYSTEMS INC
Form 10-Q/A
May 02, 2014

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

FORM 10-Q/A

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ending September 30, 2013

or

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____________ to ______________

Commission file no. 1-33001

ENOVA SYSTEMS, INC.
(Exact name of registrant as specified in its charter)

California	95-3056150
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

2945 Columbia Street, Torrance, California 90503
(Address of principal executive offices, including zip code)

(650) 346-4770
(Registrant's telephone number, including area code)

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 periods that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	[ ]	Accelerated filer	[ ]
Non-accelerated filer	[ ]	Smaller reporting company	[X]

(Do not check if a smaller reporting company)

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

As of March 31, 2014 , there were 64,520,195 shares of common stock outstanding.

Explanatory Note

This Amendment No. 1 on Form 10Q/A (this "Amendment") amends the Quarterly Report on Form 10-Q of Enova Systems, Inc. (the "Company") for the quarter ended September 30, 2013, originally filed with the Securities and Exchange Commission on November 19, 2013 ("Original Filing").

The Original Filing was not reviewed by the Company's Registered Independent Accounting Firm. This Amendment of the financial statements and accompanying Management's Discussion for the three and nine months ended September 30, 2013 was reviewed by the Company's Registered Independent Public Accounting Firm. In addition, the Amendment reflects an assessment by the Company's management to increase the reserve for obsolete inventory by approximately $1,000,000, which resulted in a decrease in the stockholders' deficit from approximately minus $3.7 million to approximately minus $4.7 million.

Pursuant to Rule 406T of Regulation ST, the Interactive Data Files attached as Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus of Section 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities Act of 1934, as amended, and otherwise are not subject to liability under those Sections.

ENOVA SYSTEMS, INC.

INDEX

PART I — FINANCIAL INFORMATION	Page
Item 1. Financial Statements (Unaudited)	1
Balance Sheets as of September 30, 2013 and December 31, 2012	1
Statements of Operations for the Three and Nine Months Ended September 30, 2013 and 2012	2
Statements of Cash Flows for the Nine Months Ended September 30, 2013 and 2012	3
Condensed Notes to Financial Statements	4
Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations	12
Item 3. Quantitative and Qualitative Disclosure About Market Risk	20
Item 4. Controls and Procedures	20
PART II — OTHER INFORMATION	
Item 1. Legal Proceedings	22
Item 1A. Risk Factors	23
Item 2. Unregistered Sales of Equity and Use of Proceeds	23
Item 3. Defaults upon Senior Securities	23
Item 4. Mine Safety Disclosures	23
Item 5. Other Information	23
Item 6. Exhibits	23
Signatures	24

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ENOVA SYSTEMS, INC.
BALANCE SHEETS

	September 30, 2013	December 31, 2012 (audited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ -	$ 57,000
Accounts receivable, net	136,000	208,000
Inventories and supplies, net	871,000	2,203,000
Prepaid expenses and other current assets	87,000	242,000
Total current assets	1,094,000	2,710,000
Long term accounts receivable	18,000	38,000
Property and equipment, net	95,000	307,000
Total assets	$ 1,207,000	$ 3,055,000
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Bank overdraft	$ 2,000	$ -
Accounts payable	643,000	558,000
Loans from employees	19,000	-
Deferred revenues	213,000	118,000
Accrued payroll and related expenses	162,000	98,000
Accrued loss for litigation settlement	2,014,000	2,014,000
Other accrued liabilities	217,000	255,000
Current portion of notes payable	56,000	66,000
Total current liabilities	3,326,000	3,109,000
Accrued interest payable	1,380,000	1,318,000
Notes payable, net of current portion	1,241,000	1,262,000
Total liabilities	5,947,000	5,689,000
Stockholders' deficit:		
Series A convertible preferred stock — no par value, 30,000,000 shares authorized; 0 shares issued and outstanding; liquidating preference at $0.60 per share as of September 30, 2013 and December 31, 2012	-	-
Series B convertible preferred stock — no par value, 5,000,000 shares authorized; 546,000 shares issued and outstanding; liquidating preference at $2 per share as of September 30, 2013 and December 31, 2012	1,094,000	1,094,000
Common Stock to be issued	528,000	528,000
Common Stock — no par value, 750,000,000 shares authorized; 44,520,000 shares issued and outstanding as of September 30, 2013 and December 31, 2012	145,512,000	145,512,000
Additional paid-in capital	9,589,000	9,579,000
Accumulated deficit	(161,463, 000)	(159,347,000)
Total stockholders' deficit	(4 ,740,000)	(2,634,000)
Total liabilities and stockholders' deficit	$ 1,207,000	$ 3,055,000

See accompanying condensed notes to these financial statements.

-1-

Table of Contents

ENOVA SYSTEMS, INC.

STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended September 30		Nine Months Ended September 30	
	2013	2012	2013	2012
Revenues	$ 140,000	$ 152,000	$ 425,000	$ 1,055,000
Cost of revenues	1,179,000	140,000	1,660,000	1,722,000
Gross income (loss)	(1,039,000)	12,000	(1,235,000)	(667,000)
Operating expenses				
Research and development	-	1,000	-	805,000
Selling, general & administrative	216,000	731,000	754,000	3,129,000
Total operating expenses	216,000	732,000	754,000	3,934,000
Operating loss	(1,255,000)	(720,000)	(1,989,000)	(3,881,000)
Other income and (expense)				
Interest and other income (expense)	(115,000)	(29,000)	(127,000)	(150,000)
Total other income and (expense)	(115,000)	(29,000)	(127,000)	(150,000)
Net loss	$ (1,370,000)	$ (749,000)	$ (2,116,000)	$ (4,751,000)
Basic and diluted loss per share	$ (0.03)	$ (0.02)	$ (0.05)	$ (0.11)
Weighted average number of common shares outstanding	44,520,000	44,520,000	44,520,000	43,757,000

See accompanying condensed notes to these financial statements.

Table of Contents

ENOVA SYSTEMS, INC.
STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended September 30	
	2013	2012
Net loss	$ (2,116,000)	$ (4,751,000)
Adjustments to reconcile net loss to net cash used in operating activities:		
Reserve for doubtful accounts	(46,000)	197,000
Inventory reserve	1,207,000	945,000
Depreciation and amortization	114,000	351,000
Loss on disposal of fixed assets	4,000	-
Loss on asset impairment	45,000	68,000
Stock option expense	10,000	169,000
(Increase) decrease in:		
Accounts receivable	118,000	240,000
Inventory and supplies	125,000	231,000
Prepaid expenses and other current assets	155,000	94,000
Long term receivables	20,000	6,000
Increase (decrease) in:		
Accounts payable	85,000	(121,000)
Loans from employees	19,000	-
Deferred revenues	95,000	(302,000)
Accrued payroll and related expense	64,000	(163,000)
Other accrued liabilities	(38,000)	(112,000)
Accrued interest payable	62,000	61,000
Net cash used in operating activities	(77,000)	(3,087,000)
Cash flows from investing activities:		
Proceeds from the sale of fixed assets	29,000	-
Purchases of property and equipment	-	(16,000)
Net cash provided by (used) in investing activities	29,000	(16,000)
Cash flows from financing activities:		
Proceeds from bank overdraft	2,000	-
Payment on notes payable	(11,000)	(17,000)
Net proceeds from the issuance of common stock	-	132,000
Net cash provided by (used in) financing activities	(9,000)	115,000
Net decrease in cash and cash equivalents	(57,000)	(2,988,000)
Cash and cash equivalents, beginning of period	57,000	3,096,000
Cash and cash equivalents, end of period	$ -	$ 108,000
Supplemental disclosure of cash flow information:		
Interest paid	$ 1,000	$ 4,000
Supplemental disclosure of non cash investing and financing:		
Shares issued for services	$ -	$ 62,000

See accompanying condensed notes to these financial statements.

-3-

Table of Contents

ENOVA SYSTEMS, INC.
CONDENSED NOTES TO FINANCIAL STATEMENTS
(Unaudited)

1. Description of the Company and its Business

Enova Systems, Inc., ("Enova", "We" or "the Company"), a California corporation, was incorporated in July 1976, and trades on the OTCQB under the trading symbol "ENVS" and on the London Stock Exchange under the symbol "ENV" or "ENVS". The Company believes it has been a globally recognized leader as a supplier of efficient, environmentally-friendly digital power components and systems products, in conjunction with associated engineering services. The Company's core competencies are focused on the commercialization of power management and conversion systems for mobile and stationary applications.

THE DISCUSSION SET FORTH BELOW AND ELSEWHERE IN THIS 10-Q IS QUALIFIED IN ITS ENTIRETY BY THE FOLLOWING: ENOVA REMAINS INSOLVENT AND OWES IN EXCESS OF $4.5 MILLION IN THE AGGREGATE TO ITS TWO PRINCIPAL CREDITORS, THE CREDIT MANAGERS ASSOCIATION AND ARENS CONTROLS COMPANY, L.L.C. ("ARENS"). WITHOUT IMMEDIATE ADDITIONAL FINANCING OR COLLECTION OF RECEIVABLES, THE COMPANY WILL NEED TO CEASE OPERATIONS. THE COMPANY CURRENTLY HAS NO VISIBILITY AS TO EITHER ADDITIONAL FINANCING OR THE COLLECTION OF RECEIVABLES. SPECIFICALLY, WITHOUT A MUTUALLY ACCEPTABLE SETTLEMENT OF THE ARENS JUDGMENT ARISING OUT OF ARENS CONTROLS COMPANY, L.L.C. v. ENOVA SYSTEMS, INC., CASE NO. 13-1102 (7TH CIRCUIT) IN THE AMOUNT OF $2.0 MILLION, THE COMPANY DOES NOT CURRENTLY BELIEVE IT HAS ANY ALTERNATIVE OTHER THAN TO CEASE OPERATIONS. THE COMPANY CURRENTLY EMPLOYS ONLY TWO PERSONNEL, JOHN MICEK, THE COMPANY'S CEO, CFO AND SECRETARY, AND ONE ADDITIONAL INDIVIDUAL IN THE FINANCE DEPARTMENT.

ON SEPTEMBER 24, 2013, THE COMPANY ENTERED INTO A SETTLEMENT AGREEMENT AND MUTUAL RELEASE WITH ARENS PROVIDING A PERIOD OF 120 DAYS TO SETTLE THE JUDGMENT FOR THE AMOUNT OF $300,000. THE COMPANY WAS NOT ABLE TO MAKE THE PAYMENT BY THE DUE DATE OF JANURY 22, 2014. THEREFORE, THE JUDGMENT AGAINST THE COMPANY CAN BE ENFORCED WITHOUT FURTHER NOTICE.

2. Summary of Significant Accounting Policies

Basis of Presentation — Interim Financial Statements

The financial information as of and for the three and nine months ended September 30, 2013 and 2012 is unaudited but includes all adjustments (consisting only of normal recurring adjustments) that the Company considers necessary for a fair statement of its financial position at such dates and the operating results and cash flows for those periods. The year-end balance sheet data was derived from audited financial statements, and certain information and note disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to SEC rules or regulations; however, the Company believes the disclosures made are adequate to make the information presented not misleading.

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although management believes these estimates and assumptions are adequate, actual results could differ from the estimates and assumptions used.

The results of operations for the interim periods presented are not necessarily indicative of the results of operations to be expected for the year. These interim financial statements should be read in conjunction with the audited financial statements for the year ended December 31, 2012, which are included in the Company’s Annual Report on Form 10-K for the year then ended.

Table of Contents

Liquidity and Going Concern

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. However, historically the Company has experienced significant recurring net losses and operating cash flow deficits. The Company’s ability to continue as a going concern is dependent on many factors, including among others, its ability to raise additional funding, and its ability to successfully restructure operations to lower manufacturing costs and reduce operating expenses.

To date, the Company has incurred recurring net losses and negative cash flows from operations. At September 30, 2013, the Company had an accumulated deficit of approximately $161.5 million, cash and cash equivalents of negative $2,000, working capital of approximately negative $2.2 million and shareholders’ deficit of approximately $4.7 million. Until the Company can generate significant cash from its operations, the Company expects to continue to fund its operations with existing cash resources, proceeds from one or more private placement agreements, as well as potentially through debt financing or the sale of equity securities. However, the Company may not be successful in obtaining additional funding. In addition, the Company cannot be sure that its existing cash and investment resources will be adequate or that additional financing will be available when needed or that, if available, financing will be obtained on terms favorable to the Company or its stockholders.

Our operations will require us to make necessary investments in human and production resources, regulatory compliance, as well as sales and marketing efforts. We do not currently have adequate internal liquidity to meet these objectives in the long term. On June 21, 2012, we reported in a Form 8-K filing that, as part of cost cutting measures in response to our decrease in revenue amid continued delays in industry adoption of EV technology resulting from ongoing battery cost and reliability concerns, in excess of 80% of our workforce left our Company, including the resignation of members of our senior management. We continue to evaluate strategic partnering opportunities and other external sources of liquidity, including the public and private financial markets and strategic partners. As a result of having insufficient funds, the Company has delayed all of its product development. Failure to obtain adequate financing also will adversely affect the Company’s ability to continue in business. If the Company raises additional funds by issuing equity securities, substantial dilution to existing stockholders would likely result. If the Company raises additional funds by incurring debt financing, the terms of the debt may involve significant cash payment obligations, as well as covenants and specific financial ratios that may restrict its ability to operate its business.

The Company continues to pursue other options to raise additional capital to fund its operations; however, there can be no assurance that we can successfully raise additional funds through the capital markets.

As of September 30, 2013, the Company had approximately negative $2,000 in cash and cash equivalents and does not anticipate that its anticipated receivables collections will be sufficient to meet its projected operating requirements through December 2013 to continue operations and market trading.

Significant Accounting Policies

The accounting and reporting policies of the Company conform to US GAAP. There have been no significant changes in the Company's significant accounting policies during the three months ended September 30, 2013 compared to what was previously disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

Revenue Recognition

The Company manufactures proprietary products and other products based on design specifications provided by its customers. The Company recognizes revenue only when all of the following criteria have been met:

- Persuasive Evidence of an Arrangement — The Company documents all terms of an arrangement in a written contract signed by the customer prior to recognizing revenue.

- Delivery Has Occurred or Services Have Been Rendered — The Company performs all services or delivers all products prior to recognizing revenue. Professional consulting and engineering services are considered to be performed when the services are complete. Equipment is considered delivered upon delivery to a customer's designated location. In certain instances, the customer elects to take title upon shipment.

- The Fee for the Arrangement is Fixed or Determinable — Prior to recognizing revenue, a customer's fee is either fixed or determinable under the terms of the written contract. Fees for professional consulting services, engineering services and equipment sales are fixed under the terms of the written contract. The customer's fee is negotiated at the outset of the arrangement and is not subject to refund or adjustment during the initial term of the arrangement.

- Collectability is Reasonably Assured — The Company determines that collectability is reasonably assured prior to recognizing revenue. Collectability is assessed on a customer-by-customer basis based on criteria outlined by management. New customers are subject to a credit review process which evaluates the customer's financial position and ultimately its ability to pay. The Company does not enter into arrangements unless collectability is reasonably assured at the outset. Existing customers are subject to ongoing credit evaluations based on payment history and other factors. If it is determined during the arrangement that collectability is not reasonably assured, revenue is recognized on a cash basis. Amounts received upfront for engineering or development fees under multiple-element arrangements are deferred and recognized over the period of committed services or performance, if such arrangements require the Company to provide on-going services or performance. All amounts received under collaborative research agreements or research and development contracts are nonrefundable, regardless of the success of the underlying research.

The Company recognizes revenue from milestone payments over the remaining minimum period of performance obligations.

The Company also recognizes engineering and construction contract revenues using the percentage-of-completion method, based primarily on contract costs incurred to date compared with total estimated contract costs. Customer-furnished materials, labor, and equipment, and in certain cases subcontractor materials, labor, and equipment, are included in revenues and cost of revenues when management believes that the company is responsible for the ultimate acceptability of the project. Contracts are segmented between types of services, such as engineering and construction, and accordingly, revenue and gross margin related to each activity is recognized as those separate services are rendered.

Changes to total estimated contract costs or losses, if any, are recognized in the period in which they are determined. Claims against customers are recognized as revenue upon settlement. Revenues recognized in excess of amounts received are classified as current assets. Amounts billed to clients in excess of revenues recognized to date are classified as current liabilities on contracts.

Changes in project performance and conditions, estimated profitability, and final contract settlements may result in future revisions to engineering and development contract costs and revenue.

These accounting policies were applied consistently for all periods presented. Our operating results would be affected if other alternatives were used. Information about the impact on our operating results is included in the footnotes to our financial statements.

Several other factors related to the Company may have a significant impact on our operating results from year to year. For example, the accounting rules governing the timing of revenue recognition related to product contracts are complex and it can be difficult to estimate when we will recognize revenue generated by a given transaction. Factors such as acceptance of services provided, payment terms, creditworthiness of the customer, and timing of delivery or acceptance of our products often cause revenues related to sales generated in one period to be deferred and recognized in later periods. For arrangements in which services revenue is deferred, related direct and incremental costs may also be deferred.

Deferred Revenues

The Company recognizes revenues as earned. Amounts billed in advance of the period in which service is rendered are recorded as a liability under deferred revenues. When the Company enters into production and development contracts with customers, an evaluation is made to ascertain the specific revenue generating activities of each contract and establishes the units of accounting for each activity. Revenue on these units of accounting is not recognized until a) there is persuasive evidence of the existence of a contract, b) the service has been rendered and delivery has occurred, c) there is a fixed and determinable price, and d) collectability is reasonable assured.

Table of Contents

Warranty Costs

The Company provides product warranties for specific product lines and accrues for estimated future warranty costs in the period in which revenue is recognized. Our products are generally warranted to be free of defects in materials and workmanship for a period of 12 to 24 months from the date of installation, subject to standard limitations for equipment that has been altered by other than Enova Systems personnel and equipment which has been subject to negligent use. Warranty provisions are based on past experience of product returns, number of units repaired and our historical warranty incidence over the past twenty-four month period. The warranty liability is evaluated on an ongoing basis for adequacy and may be adjusted as additional information regarding expected warranty costs becomes known.

Stock Based Compensation

We measure the compensation cost for stock-based awards classified as equity at their fair value on the date of grant and recognize compensation expense over the service period for awards expected to vest, net of estimated forfeitures.

Accounting Changes and Recent Accounting Pronouncements

Certain accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company's financial position, results of operations and cash flows.

3. Inventory

Inventory, consisting of materials, labor and manufacturing overhead, is stated at the lower of cost (first-in, first-out) or market and consisted of the following at:

		September 30, 2013		December 31, 2012
Raw materials	$	3,144,000	$	3,988,000
Work in progress		222,000		2,000
Finished goods		472,000		587,000
Reserve for obsolescence		(2,967,000)		(2,374,000)
Total	$	871,000	$	2,203,000

In the nine months ended September 30, 2013, the Company exchanged excess inventory with an original book value totaling $830,000 as settlement for vendor payables. Inventory reserve charged to operations amounted to $1,207,000 and $945,000 for the nine months ended September 30, 2013 and 2012, respectively. Inventory valuation adjustments and other inventory write-offs amounted to $699,000 and $161,000 for the nine months ended September 30, 2013 and 2012, respectively.

4. Property and Equipment

Property and equipment consisted of the following at:

		September 30, 2013		December 31, 2012
Computers and software	$	59,000	$	580,000
Machinery and equipment		251,000		535,000
Furniture and office equipment		86,000		87,000

Demonstration vehicles and buses		423,000		675,000
Leasehold improvements		-		1,327,000
		819,000		3,204,000
Less accumulated depreciation and amortization		(724,000)		(2,897,000)
Total	$	95,000	$	307,000

Table of Contents

Depreciation and amortization expense was $114,000 and $351,000 for the nine months ended September 30, 2013 and 2012, respectively, and within those total expenses, the amortization of leasehold improvements was $22,000 and $196,000 for the nine months ended September 30, 2013 and 2012, respectively. Depreciation and amortization expense was $23,000 and $113,000 for the three months ended September 30, 2013 and 2012, respectively, and within those total expenses, the amortization of leasehold improvements was $0 and $65,000 for the three months ended September 30, 2013 and 2012, respectively.

For the nine months ended September 30, 2013, fixed assets with an original book value of $272,000 were exchanged in settlement of vendor payables, two vehicles were sold and one vehicle was repossessed. In addition, three vehicles were repossessed in October. For the three months ended September 30, 2013, the Company recorded a loss on the impairment of fixed assets of $65,000 for the three vehicles repossessed in October. For the nine months ended September 30, 2013, the Company recorded proceeds from the sale of fixed assets of $29,000, a loss on the impairment of fixed assets of $65,000 and a loss on the disposal of fixed assets of $4,000, and an impairment loss of $68,000 for the three and nine months ended September 30, 2012. In addition, the Company's headquarters lease expired on January 31, 2013, which resulted in a decrease in gross leasehold improvements in the amount of $1,327,000 and a net book value of zero.

5. Other Accrued Liabilities

Other accrued liabilities consisted of the following at:

	September 30, 2013	December 31, 2012
Accrued inventory received	$ 10,000	$ 14,000
Accrued professional services	86,000	45,000
Accrued warranty	96,000	117,000
Other	25,000	79,000
Total	$ 217,000	$ 255,000

Accrued warranty consisted of the following activities during the nine months ended September 30:

	2013	2012
Balance at beginning of year	$ 117,000	$ 227,000
Accruals for warranties issued during the period	96,000	94,000
Warranty claims	(117,000)	(216,000)
Balance at end of quarter	$ 96,000	$ 105,000

Accrued warranty consisted of the following activities during the three months ended September 30:

	2013	2012
Balance at beginning of quarter	$ 111,000	$ 140,000
Accruals for warranties issued during the period	39,000	14,000
Warranty claims	(54,000)	(49,000)
Balance at end of quarter	$ 96,000	$ 105,000

Table of Contents

6. Notes Payable, Long-Term Debt and Other Financing

Notes payable consisted of the following at:

	September 30, 2013	December 31, 2012
Secured note payable to Credit Managers Association of California, bearing interest at prime plus 3% (6.25% as of September 30, 2013), and is adjusted annually in April through maturity. Principal and unpaid interest due in April 2016. A sinking fund escrow may be funded with 10% of future equity financing, as defined in the Agreement	$ 1,238,000	$ 1,238,000
Secured note payable to a Coca Cola Enterprises in the original amount of $40,000, bearing interest at 10% per annum. Principal and unpaid interest due on demand	40,000	40,000
Secured note payable to a financial institution in the original amount of $38,000, bearing interest at 8.25% per annum, payable in 60 equal monthly installments of principal and interest through February 19, 2014	5,000	11,000
Secured note payable to a financial institution in the original amount of $19,000, bearing interest at 10.50% per annum, payable in 60 equal monthly installments of principal and interest through August 25, 2014	5,000	8,000
Secured note payable to a financial institution in the original amount of $26,000, bearing interest at 7.91% per annum, payable in 60 equal monthly installments of principal and interest through April 9, 2015	9,000	14,000
Secured note payable to a financial institution in the original amount of $25,000, bearing interest at 7.24% per annum, payable in 60 equal monthly installments of principal and interest through March 10, 2016	-	17,000
	1,297,000	1,328,000
Less current portion of notes payable	(56,000)	(66,000)
Notes payable, net of current portion	$ 1,241,000	$ 1,262,000

As of September 30, 2013 and December 31, 2012, the balance of long term interest payable amounted to $1,380,000 and $1,318,000, respectively, of which the Credit Managers Association of California note amounted to $1,344,000 and $1,286,000, respectively. Interest expense on notes payable amounted to $64,000 and $65,000 during the nine months ended September 30, 2013 and 2012, respectively. Interest expense on notes payable amounted to $21,000 and $24,000 during the three months ended September 30, 2013 and 20112, respectively. In June 2013, the vehicle that secured the note payable due March 10, 2016 was repossessed by the secured lender. The Company was invoiced by the lender for $8,000 for final settlement.

7. Deferred Revenues

The Company had deferred $213,000 and $118,000 in revenue related to production and development contracts at September 30, 2013 and December 31, 2012, respectively. The Company's management is attempting to obtain funding to complete the orders in the second quarter of 2014.

8. Stockholders' Equity

On April 23, 2012, the Company entered into a $6,600,000 purchase agreement with Lincoln Park Capital Fund pursuant to which the Company has the right to sell to Lincoln Park up to $6,600,000 in shares of the Company's common stock, and on April 24, 2012, the Company entered into another purchase agreement with Lincoln Park Capital Fund pursuant to which the Company has the right to sell to Lincoln Park up to $3,400,000 in shares of the

Company's common stock, subject to certain limitations. We received proceeds of $132,000, net of financing costs of $152,000, under the $3,400,000 Purchase Agreement and issued a total of 1,754,974 shares of common stock in the second quarter of 2012. As consideration for its commitment to purchase common stock under the $3,400,000 Purchase Agreement, the Company issued to Lincoln Park 281,030 shares of common stock. Access to funding under the facility is dependent upon our shares being listed on a national exchange, and as our shares were delisted from the NYSE Amex exchange on October 31, 2012, the Company can no longer raise funds from the facility.

Table of Contents

9. Stock Options

Stock Option Program Description

As of September 30, 2013, the Company had two equity compensation plans, the 1996 Stock Option Plan (the "1996 Plan") and the 2006 equity compensation plan (the "2006 Plan"). The 1996 Plan has expired for the purposes of issuing new grants. However, the 1996 Plan will continue to govern awards previously granted under that plan. The 2006 Plan has been approved by the Company's shareholders. Equity compensation grants are designed to reward employees and executives for their long term contributions to the Company and to provide incentives for them to remain with the Company. The number and frequency of equity compensation grants are based on competitive practices, operating results of the company, and government regulations.

The maximum number of shares issuable over the term of the 1996 Plan was limited to 65 million shares (without giving effect to subsequent stock splits). Options granted under the 1996 Plan typically have an exercise price of 100% of the fair market value of the underlying stock on the grant date and expire no later than ten years from the grant date. On August 27, 2013, the Board of Directors of Enova Systems approved amendments to Enova's 2006 Equity Compensation Plan (a) to increase the number of shares authorized for issuance from 3,000,000 shares to 9,000,000 shares and (b) to increase the number of shares of common stock that may be issued to an individual in any calendar year from 500,000 shares to 5,000,000 shares. Of the 9,000,000 shares reserved for issuance under the amended 2006 Plan, of which 4,400,000 and 270,000 were granted in the nine months ended September 30, 2013 and 2012, respectively, and 3,711,000 shares were available for grant as of September 30, 2013. Options granted under the 2006 Plan have terms of between three and ten years and generally vest and become fully exercisable from one to three years from the date of grant or vest according to the price performance of our shares.

Stock-based compensation expense related to stock options was $6,000 and $166,000 for the nine months ended September 30, 2013 and 2012, respectively. As of September 30, 2013, the total compensation cost related to non-vested awards not yet recognized is $48,000. The remaining period over which the future compensation cost is expected to be recognized is 32 months.

The following table summarizes information about stock options outstanding and exercisable at September 30, 2013:

	Number of Share Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term in Years	Aggregate Intrinsic Value(1)
Outstanding at December 31, 2012	810,000	$ 0.64	4.06	$ —
Granted	4,400,000	$ 0.02	2.91	$ —
Exercised	—	$ —	—	$ —
Forfeited or Cancelled	—	$ —	—	$ —
Outstanding at September 30, 2013	5,210,000	$ 0.12	2.97	$ —
Exercisable at September 30, 2013	650,000	$ 0.78	3.54	$ —
Vested and expected to vest (2)	5,210,000	$ 0.12	2.97	$ —

(1) Aggregate intrinsic value represents the value of the closing price per share of our common stock on the last trading day of the fiscal period in excess of the exercise price multiplied by the number of options outstanding or exercisable, except for the "Exercised" line, which uses the closing price on the date exercised.
(2) Number of shares includes options vested and those expected to vest net of estimated forfeitures.

The exercise prices of the options outstanding at September 30, 2013 ranged from $0.07 to $4.35. The weighted average grant-date fair value of options granted during the nine months ended September 30, 2013 and 2012 was $0.02 and $0.05, respectively. The Company's policy is to issue shares from its authorized shares upon the exercise of stock options.

Table of Contents

Unvested share activity for the nine months ended September 30, 2013 is summarized below:

	Unvested Number of Options		Weighted Average Grant Date Fair Value
Unvested balance at December 31, 2012	236,000	$	0.04
Granted	4,400,000	$	0.02
Vested	(76,000)	$	0.11
Forfeited	—	$	—
Unvested balance at September 30, 2013	4,560,000	$	0.02

The fair values of all stock options granted during the nine months ended September 30, 2013 and 2012 were estimated on the date of grant using the Black-Scholes option-pricing model with the following range of assumptions:

	For the nine months ended			
	September 30, 2013		September 30, 2012	
Expected life (in years)	2		6.5	
Average risk-free interest rate	1.66	%	1.66	%
Expected volatility	111	%	108	%
Expected dividend yield	0	%	0	%
Forfeiture rate	3	%	3	%

The estimated fair value of grants of stock options to nonemployees of the Company is charged to expense in the financial statements. These options vest in the same manner as the employee options granted under each of the option plans as described above.

10. Warrants

In December 2011, the Company completed a private equity placement of 11,250,000 shares of common stock for $1,245,000 together with warrants to purchase up to 11,250,000 shares of common stock to a group of 17 shareholders (the “Low-Beer Managed Accounts”). The warrants are exercisable for a period of five years and exercisable at a price of $0.22 per share. The warrants further provide that if, for a twenty consecutive trading day period, the average of the closing price quoted on the OTCQB market is greater than or equal to $0.44 per share, with at least an average of 10,000 shares traded per day, then, on the 10th calendar day following written notice from the Company, any outstanding warrants will be deemed automatically exercised pursuant to the cashless/net exercise provisions under the warrants.

The following is a summary of changes to outstanding warrants for the nine months ended September 30, 2013:

	Number of Share Options		Weighted Average Exercise Price	Weighted Average Remaining Contractual Life
Outstanding at December 31, 2012	11,250,000	$	0.22	4.00
Granted	—	$	—	—
Exercised	—	$	—	—

Forfeited or Cancelled	—	$	—	—
Outstanding at September 30, 2013	11,250,000	$	0.22	3.25
Exercisable at September 30, 2013	11,250,000	$	0.22	3.25

Table of Contents

11. Concentrations

The Company's trade receivables are concentrated with a few customers. The Company performs credit evaluations on its customers' financial condition and generally requires no collateral from its customers. Concentrations of credit risk, with respect to accounts receivable, exist to the extent of amounts presented in the financial statements. Two customers represented 62% and 38%, respectively, of gross accounts receivable at September 30, 2013, and two customers represented 61% and 39%, respectively, of gross accounts receivable at December 31, 2012.

The Company's revenues are concentrated with few customers. For the three and nine months ended September 30, 2013, two customers represented 63% and 32% of gross revenues and two customers represented 76% and 19% of gross revenues, respectively. For the three and nine months ended September 30, 2012, two customers represented 65% and 31% of gross revenues and two customers represented 66% and 21% of gross revenues, respectively.

12. Subsequent Events

The Company has evaluated subsequent events and has determined that other than noted below, there were no subsequent events to recognize or disclose in these financial statements.

On February 23, 2014, Enova Systems, Inc, entered into Subscription Agreements with various offshore investors to sell approximately GBP 150,000 in gross proceeds by a private subscription of 19,999,998 common shares to be newly issued on the Alternative Investment Market of the London Stock Exchange (the "AIM Exchange"). The common shares were issued at a price of 0.0075 pence (approximately US$0.01per share) to certain eligible offshore investors (the "Subscription"). In connection with the Subscription, Enova entered into an Agreement for the Provision of Receiving Agent Services (the "Agreement") with Daniel Stewart & Company PLC (UK) for receiving agent services. Daniel Stewart presently serves as the Nominated Adviser for the listing of Enova's common shares on the AIM Exchange. The newly issued common shares for the Subscription were issued in three tranches of approximately GBP 50,000 each.

Daniel Stewart received an introducing agent's fee of 10% of the aggregate funds raised pursuant to the subscription in addition to reimbursement of expenses. Factoring in the commission, legal and other expenses of the offering, Enova received approximately US$223,000 in net proceeds.

The offer and sale of the shares were made pursuant to Regulation S under the Securities Act of 1933, as amended (the "Securities Act"). Among other things, each investor purchasing shares of Enova's common stock in the offering represented that the investor is not a United States person as defined in Regulation S. In addition, neither Enova nor the receiving agent conducted any selling efforts directed at the United States in connection with the offering. All shares of common stock issued in the offering included a restrictive legend indicating that the shares were issued pursuant to Regulation S under the Securities Act and are deemed to be "restricted securities." As a result, the purchasers of such shares will not be able to resell the shares unless in accordance with Regulation S, pursuant to a registration statement, or upon reliance of an applicable exemption from registration under the Securities Act. The shares to be sold pursuant to the Subscription Agreements were not registered under the Securities Act, and there is no obligation on the part of Enova to so register such shares.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Quarterly Report on Form 10-Q contains statements indicating expectations about future performance and other forward-looking statements that involve risks and uncertainties. We usually use words such as "may," "will," "should," "expect," "plan," "anticipate," "believe," "estimate," "predict," "future," "intend," "potential," or "continue" or the negative

or similar expressions to identify forward-looking statements. These statements appear throughout this Quarterly Report on Form 10-Q and are statements regarding our current intent, belief or expectation, primarily with respect to our operations and related industry developments. Examples of these statements include, but are not limited to, statements regarding the following: our future operating expenses, our future losses, our future expenditures for research and development and the sufficiency of our cash resources. You should not place undue reliance on these forward-looking statements, which apply only as of the date of this Quarterly Report on Form 10-Q. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including the risks faced by us and described in our Annual Report on Form 10-K for the year ended December 31, 2012, as updated by the disclosure contained in Item 1A of Part II of this Form 10-Q.

Table of Contents

The following discussion and analysis should be read in conjunction with the unaudited interim financial statements and notes thereto included in Part I, Item 1 of this Quarterly Report on Form 10-Q and with the financial statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended December 31, 2012.

Overview

Enova believes it has been a leader in the development, design and production of proprietary, power train systems and related components for electric and hybrid electric buses and medium and heavy duty commercial vehicles. Electric drive systems are comprised of an electric motor, electronics control unit and a gear unit which power a vehicle. Hybrid electric systems, which are similar to pure electric drive systems, contain an internal combustion engine in addition to the electric motor, and may eliminate external recharging of the battery system. A hydrogen fuel cell based system is similar to a hybrid system, except that instead of an internal combustion engine, a fuel cell is utilized as the power source. A fuel cell is a system which combines hydrogen and oxygen in a chemical process to produce electricity.

A fundamental element of Enova's strategy has been to develop and produce advanced proprietary software and hardware for applications in these alternative power markets. Our focus has been on powertrain systems including digital power conversion, power management and system integration, focusing chiefly on vehicle power generation. Specifically, we have developed, designed and produce drive systems and related components for electric, hybrid electric and fuel cell powered vehicles in both the new and retrofit markets. We also perform internal research and development ("R&D") and funded third party R&D to augment our product development and support our customers.

Our product development strategy is to design and introduce to market successively advanced products, each based on our core technical competencies. In each of our product/market segments, we provide products and services to leverage our core competencies in digital power management, power conversion and system integration. We believe that the underlying technical requirements shared among the market segments will allow us to more quickly transition from one emerging market to the next, with the goal of capturing early market share.

Enova's primary market focus has been centered on aligning ourselves with key customers and integrating with original equipment manufacturers ("OEMs") in our target markets. We believe that alliances will result in the latest technology being implemented and customer requirements being met, with an optimized level of additional time and expense. Provided we generate necessary resources, we will continue to work refining both our market strategy and our product line to maintain our edge in power management and conversion systems for vehicle applications.

Our website, www.enovasystems.com, contains up-to-date information on our company, our products, programs and current events. Our website is a prime focal point for current and prospective customers, investors and other affiliated parties seeking additional information on our business.

Table of Contents

Enova has incurred significant operating losses in the past. As of September 30, 2013, we had an accumulated deficit of approximately $ 161.5 million, working capital of approximately negative $2.2 million and shareholders' deficit of approximately $ 4.7 million. As reported in our Form 8-K filing on June 21, 2012, due to continued delays in industry adoption of EV technology, the Company's revenues continue to significantly decrease. As part of cost cutting measures, we implemented a reduction in our workforce whereby in excess of 80% of our employees left the Company. We continue to evaluate strategic opportunities to leverage resources and assist with operations. We expect to incur additional operating losses until we re-position the company in order to achieve a level of product sales sufficient to cover our operating and other expenses. As of September 30, 2013, the Company had approximately negative $2,000 in cash and cash equivalents and we do not anticipate that our anticipated receivables collections will be sufficient to meet projected operating requirements through the end of 2013 to continue operations and market trading.

Customer Highlights

FIRST AUTO WORKS (FAW) - Enova continues to supply FAW drive systems for their hybrid buses. Since the 2008 Olympics in Beijing, Enova Systems and First Auto Works have deployed over 500 vehicles utilizing Enova's pre-transmission hybrid drive system components. First Auto Works is one of China's largest vehicle producers, manufacturing in excess of 1,000,000 vehicles annually.

SMITH ELECTRIC VEHICLES (SEV) – Enova continues to be SEV's supplier of drive systems. SEV is a leader in the all EV market in North America and Europe.

Technology Highlights

OMNI INVERTER. Power-source and motor design agnostic, Enova's new Omni-series inverter/vehicle controller offers increased flexibility and ease-of-integration. With plug-and-play connectivity, it is compatible with a wide range of vehicle drive systems and motors, and can be configured for HEV, PHEV and EV applications. The inverter is fully production validated.

OMNI CHARGER. Our Omni-series 10kW on-board battery charger for plug-in hybrid-electric and all-electric vehicles is a CAN control based unit that offers increased flexibility, ease-of-integration and compatibility with a wide range of vehicle platforms.

Enova has delayed further introduction of the Omni Inverter and Charger with customers due to the reduction in our workforce and current financial resource constraints. Provided additional resources are obtained, we anticipate continuing development and marketing of these two products, which we believe can gain broad market acceptance.

Critical Accounting Policies

In the ordinary course of business, the Company has made a number of estimates and assumptions relating to the reporting of results of operations and financial condition in the preparation of its financial statements in conformity with accounting principles generally accepted in the United States of America. The Company constantly re-evaluates these significant factors and makes adjustments where facts and circumstances dictate. Estimates and assumptions include, but are not limited to, customer receivables, inventories, equity investments, fixed asset lives, contingencies and litigation. There have been no material changes in estimates or assumptions compared to our most recent Annual Report for the fiscal year ended December 31, 2012.

-14-

Table of Contents

The following represents a summary of our critical accounting policies, defined as those policies that we believe: (a) are the most important to the portrayal of our financial condition and results of operations and (b) involve inherently uncertain issues which require management's most difficult, subjective or complex judgments.

Cash and cash equivalents — Cash consists of currency held at reputable financial institutions.

Inventory — Inventories are priced at the lower of cost or market utilizing first-in, first-out ("FIFO") cost flow assumption. We maintain a perpetual inventory system and continuously record the quantity on-hand and standard cost for each product, including purchased components, subassemblies and finished goods. We maintain the integrity of perpetual inventory records through periodic physical counts of quantities on hand. Finished goods are reported as inventories until the point of transfer to the customer. Generally, title transfer is documented in the terms of sale.

Inventory reserve — We maintain an allowance against inventory for the potential future obsolescence or excess inventory. A substantial decrease in expected demand for our products, or decreases in our selling prices could lead to excess or overvalued inventories and could require us to substantially increase our allowance for excess inventory. If future customer demand or market conditions are less favorable than our projections, additional inventory write-downs may be required, and would be reflected in cost of revenues in the period the revision is made.

Allowance for doubtful accounts — We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. The assessment of the ultimate realization of accounts receivable including the current credit-worthiness of each customer is subject to a considerable degree to the judgment of our management. If the financial condition of the Company's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Stock-based Compensation — The Company measures and recognizes compensation expense for all share-based payment awards made to employees and directors, including employee stock options based on the estimated fair values at the date of grant. The compensation expense is recognized over the requisite service period.

Revenue recognition — Effective January 1, 2011, we adopted the provisions of Accounting Standards Update, or ASU, 2009-13, Multiple-Deliverable Revenue Arrangements, or ASU 2009-13, which is included within the Codification as Revenue Recognition-Multiple Element Arrangements, on a prospective basis. Under the provisions of ASU 2009-13, we no longer rely on objective and reliable evidence of the fair value of the elements in a revenue arrangement in order to separate a deliverable into a separate unit of accounting, and the use of the residual method has been eliminated. We instead use a selling price hierarchy for determining the selling price of a deliverable, which is used to determine the allocation of consideration to each unit of accounting under an arrangement. The selling price used for each deliverable will be based on vendor-specific objective evidence, if available, third-party evidence if vendor-specific objective evidence is not available or estimated selling price if neither vendor-specific objective evidence nor third-party evidence is available. As of September 30, 2012, we had not applied the provisions of ASU 2009-13 to any of our revenue arrangements as we had not entered into any new, or materially modified any of our existing, revenue arrangements since our adoption of ASU 2009-13. Therefore, there was no material impact on our financial position or results of operations from adopting ASU 2009-13. However, the provisions of ASU 2009-13 could have a material impact on the revenue recognized from any collaboration agreements that we enter into in future periods.

We generally recognize revenue at the time of shipment when title and risk of loss have passed to the customer, persuasive evidence of an arrangement exists, performance of our obligation is complete, our price to the buyer is fixed or determinable, and we are reasonably assured of collection. If a loss is anticipated on any contract, a provision for the entire loss is made immediately. Determination of these criteria, in some cases, requires management's judgment. Should changes in conditions cause management to determine that these criteria are not met for certain

future transactions, revenue for any reporting period could be adversely affected.

Table of Contents

The Company also recognizes engineering and construction contract revenues using the percentage-of-completion method, based primarily on contract costs incurred to date compared with total estimated contract costs. Customer-furnished materials, labor, and equipment, and in certain cases subcontractor materials, labor, and equipment, are included in revenues and cost of revenues when management believes that the company is responsible for the ultimate acceptability of the project. Contracts are segmented between types of services, such as engineering and construction, and accordingly, gross margin related to each activity is recognized as those separate services are rendered.

These accounting policies were applied consistently for all periods presented. Our operating results would be affected if other alternatives were used. Information about the impact on our operating results is included in the footnotes to our financial statements.

Several other factors related to the Company may have a significant impact on our operating results from year to year. For example, the accounting rules governing the timing of revenue recognition related to product contracts are complex and it can be difficult to estimate when we will recognize revenue generated by a given transaction. Factors such as acceptance of services provided, payment terms, creditworthiness of the customer, and timing of delivery or acceptance of our products often cause revenues related to sales generated in one period to be deferred and recognized in later periods. For arrangements in which services revenue is deferred, related direct and incremental costs may also be deferred.

RESULTS OF OPERATIONS

Three and Nine Months Ended September 30, 2013 compared to Three and Nine Months Ended September 30, 2012

Third Quarter of Fiscal 2013 vs. Third Quarter of Fiscal 2012

	Three Months Ended September 30,			As a % of Revenues September 30,	
	2013	2012	% Change	2013	2012
Revenues	$ 140,000	$ 152,000	-8%	100%	100%
Cost of revenues	1,179,000	140,000	742%	842%	92 %
Gross loss	(1,039,000)	12,000	-8758%	-742%	8%
Operating expenses					
Research and development	-	1,000	-100%	0%	1%
Selling, general & administrative	216,000	731,000	-70%	154%	481%
Total operating expenses	216,000	732,000	-70%	154%	482%
Operating loss	(1,255,000)	(720,000)	-74%	-896%	-474%
Other income (expense)					
Interest and other income (expense)	(115,000)	(29,000)	297%	-82%	-19%
Total other income (expense)	(115,000)	(29,000)	297%	-82%	-19%
Net loss	$ (1,370,000)	$ (749,000)	-83%	-979%	-493%

First Nine Months of Fiscal 2013 vs. First Nine Months of Fiscal 2012

	Nine Months Ended September 30,			As a % of Revenues September 30,	
	2013	2012	% Change	2013	2012

Revenues	$ 425,000	$ 1,055,000	-60%	100%	100%
Cost of revenues	1,660,000	1,722,000	-4%	391%	163%
Gross loss	(1,235, 000)	(667,000)	-85%	-291%	-63%
Operating expenses					
Research and development	-	805,000	-100%	0%	76%
Selling, general & administrative	754,000	3,129,000	-76%	177%	297%
Total operating expenses	754,000	3,934,000	-81%	177%	373%
Operating loss	(1,989,000)	(4,601,000)	-57%	-468%	-436%
Other income (expense)					
Interest and other income (expense)	(127,000)	(150,000)	-15%	-30%	-14%
Total other income (expense)	(127,000)	(150,000)	-15%	-30%	-14%
Net loss	$ (2,116,000)	$ (4,751,000)	-55%	-498%	-450%

Table of Contents

The sum of the amounts and percentages may not equal the totals for the period due to the effects of rounding.

Computations of percentage change period over period are based upon our results, as rounded and presented herein.

Revenues. Revenues in the current year were negatively affected by capacity constraints to pursue new business due to our restructuring in June 2012. We believe the industry is affected by continued uncertainty over battery performance and non-recoverable engineering costs associated with battery development. As a result, OEM and other customers have delayed major all-electric vehicle marketing initiatives, resulting in decreased demand for our systems. The decrease in revenue for the three and nine months ended September 30, 2013 compared to the same period in 2012 was mainly due to a decrease in deliveries to our core customer base in Asia. Revenues in the first three and nine months of 2013 were mainly attributed to continued shipments to First Auto Works in China and the Smith Electric Vehicles in the U.S. We will have fluctuations in revenue from quarter to quarter. Although we have seen some indications from customers to support future revenue, there can be no assurance there will be continuing demand for our products and services.

Cost of Revenues. Cost of revenues consists of component and material costs, direct labor costs, integration costs and overhead related to manufacturing our products as well as inventory valuation reserve amounts. Cost of revenues for the three months ended September 30, 2013 increased primarily due to an increase in the inventory reserve. Cost of revenues for the nine months ended September 30, 2013 decreased primarily due to the decrease in revenue compared to the same period in the prior year and, in addition, we recorded a charge of approximately $1,207,000 and $945,000 during the first nine months of 2013 and 2012, respectively, to increase our inventory obsolescence reserve after management updated its estimate of the realizable value of inventory as of those dates.

Gross Loss. The decrease in gross loss for the three months ended September 30, 2013 compared to the same period in the prior year is primarily attributable to the recording of an increase in the inventory obsolescence reserve in the three months ending September 30, 2013. The decrease in gross loss for the nine months ending September 30, 2013 is primarily due to reduced revenue in that period.

Research and Development (“R&D”). R&D costs decreased for the three and nine months ended September 30, 2013 compared to the same periods in the prior year as our engineering staff was reduced in June 2012 due to the Company’s lack of financial resources. As a result, the Company’s development of its next generation Omni-series motor control unit and 10kW charger was put on hold at the end of the second quarter of 2012.

Selling, General, and Administrative Expenses (“S, G & A”). S, G & A is comprised of activities in the executive, finance, marketing, field service and quality departments’ compensation as well as related payroll benefits, and non-cash charges for depreciation and options expense. The decrease in S, G & A for the three and nine months ended September 30, 2013 compared to the same period in the prior year is attributable to the resignation of approximately 80% of the Company’s workforce from June 2012 and other cost savings measures. We continually monitor S, G & A in light of our business outlook and are taking steps to control these costs.

Interest and Other Income (Expense). The interest and other income (expense) for the three months ended September 30, 2013 increased and for the nine months ended September 30, 2013 decreased compared to the same period in the prior year primarily due to the timing of recording fixed asset impairment charges.

Net Loss. The decrease in the net loss for the three and nine months ended September 30, 2013 compared to the same period in the prior year was mainly due to the reduction in our workforce in the second quarter of 2012 which resulted in lower operating costs.

Comparability of Quarterly Results. Our quarterly results have fluctuated in the past and we believe they will continue to do so in the future. Certain factors that could affect our quarterly operating results are described in Part I, Item 1A-Risk Factors contained in our Form 10-K for 2012, as updated by the disclosure contained in Item 1A of Part II of this Form 10-Q. Due to these and other factors, we believe that quarter-to-quarter comparisons of our results of operations are not meaningful indicators of future performance.

Table of Contents

LIQUIDITY AND CAPITAL RESOURCES

We have experienced losses primarily attributable to research, development, marketing and other costs associated with our strategic plan as an international developer and supplier of electric drive and power management systems and components. Historically cash flows from operations have not been sufficient to meet our obligations and we have had to raise funds through several financing transactions. At least until we reach breakeven volume in sales and develop and/or acquire the capability to manufacture and sell our products profitably, we will need to continue to rely on cash from external financing sources. Our operations during the three months ended September 30, 2013 were financed from working capital reserves.

On June 30, 2010, the Company entered into a secured a revolving credit facility with a financial institution for $200,000 which was secured by a $200,000 certificate of deposit. The interest rate on a drawdown from the facility is the certificate of deposit rate plus 1.25% with interest payable monthly and the principal due at maturity. The financial institution also renewed the $200,000 irrevocable letter of credit for the full amount of the credit facility in favor of Sunshine Distribution LP, with respect to the lease of the Company's corporate headquarters at 1560 West 190th Street, Torrance, California. During the fourth quarter of 2012, the irrevocable letter of credit was fully drawn down by Sunshine Distribution L.P. in order to pay rent on our corporate headquarters, and the certificate of deposit was fully utilized to fund draws on the secured facility. Therefore, the facility was fully drawn and expired on December 31, 2012.

Net cash used in operating activities was $77,000 for the nine months ended September 30, 2013, a decrease of $3,010,000 compared to $3,087,000 for the nine months ended September 30, 2012. Operating cash used in the first nine months of 2013 decreased compared to the prior year period primarily due to over 80% of our workforce leaving the Company in June 2012 that decreased our ongoing operational costs in the current year. Non-cash items include expense for stock-based compensation, depreciation and amortization and other losses. These non-cash items decreased by $1,320,000 for the nine months ended September 30, 2013 as compared to the same period in the prior year primarily a decrease in the inventory reserve charges and in the current year period and lower depreciation expense in 2013 due to the end of the lease at our former headquarters in January 2013. The decrease in net loss was primarily due to a decrease in administrative and R&D expenses related to over 80% of our workforce leaving the Company in June 2012 and our restricting other administrative expenditures to conserve cash resources. As of September 30, 2013, the Company had negative $2,000 of cash and cash equivalents compared to $57,000 as of December 31, 2012.

Net cash provided by investing activities was $29,000 for the nine months ended September 30, 2013 compared to net cash used of $16,000 for the nine months ended September 30, 2012. The Company recorded net proceeds of $29,000 from the sale of vehicles in 2013 and, subsequent to the reduction in our work force in the second quarter of 2012, halted further capital expenditures.

Net cash used in financing activities was $9,000 for the nine months ended September 30, 2013, a decrease of $124,000 compared to net cash from financing activities of $115,000 for the nine months ended September 30, 2012. The decrease was primarily attributable to proceeds of $132,000 from the issuance of Common Stock during second quarter of 2012 from the Lincoln Park facility, as explained in Note 8 – Stockholders' Equity to the financial statements included in Item 1 of this Form 10-Q.

Net accounts receivable decreased by $72,000, or 35%, to $136,000 at September 30, 2013 compared to a balance of $208,000 at December 31, 2012. The decrease in the receivable balance was primarily due to collections of receivables due. As of September 30, 2013 and December 31, 2012, the Company maintained a reserve for doubtful accounts receivable of $268,000 and 313,000, respectively, primarily related to financial instability at a major customer.

Net inventory and supplies decreased by $1,332,000 , or 14%, to $871,000 at September 30, 2013 compared to a balance of $2,203,000 at December 31, 2012. The decrease resulted from net inventory activity including receipts totaling $305,000, consumption of $430,000 and an inventory reserve charge of $1,207,000 .

Prepaid expenses and other current assets decreased by $155,000, or 64%, to $95,000 at September 30, 2013 compared to a balance of $242,000 at December 31, 2012. The decrease was primarily due to a decrease in deposits to vendors in support of a customer purchase orders and decreases in prepaid rent and insurance in the first half of 2013.

Table of Contents

Long term accounts receivable decreased by $2,000 , or 53% , to $18,000 at September 30, 2013 compared to a balance of $38,000 at December 31, 2012. The decrease is primarily due to reclassification of amounts that will be due within one year to current accounts receivable. The Company agreed to defer collection of certain accounts receivable as requested by a customer for the term of the Company's warranty guarantee. Due to its financial condition, the Company is not servicing warranty claims with the customer, which could delay collection of the receivable. Therefore, management has determined to reserve the short-tem portion recorded in accounts receivables.

Property and equipment, net of depreciation, decreased by $212,000, or 69%, to $95,000 at September 30, 2013 compared to a balance of $307,000 at December 31, 2012. The decrease is primarily due to depreciation expense of $114,000 and a loss on disposed and impaired assets of $69,000.

Accounts payable increased by $85,000, or 15%, to $643,000 at September 30, 2013 compared to a balance of $558,000 at December 31, 2012. The increase was primarily due to inventory purchases made in the second quarter of 2013 in support of a customer order and payment deferrals due to the financial condition of the Company.

Loans from employees increased by $19,000, or 100%, to $19,000 at September 30, 2013 compared to a balance of $0 at December 31, 2012. Due the financial condition of the company, employees loaned funds to the Company to pay for certain necessary administrative costs.

Deferred revenues increased by $95,000, or 81%, to $213,000 at September 30, 2013 compared to a balance of $118,000 at December 31, 2012. The Company's management is attempting to obtain funding to complete the orders in the second quarter of 2014.

Accrued payroll and related expenses increased by $64,000, or 65%, to $162,000 at September 30, 2013 compared to a balance of $98,000 at December 31, 2012. The increase was primarily due to an increase in unpaid compensation in the second and third quarters of 2013 resulting from the financial condition of the Company.

Accrued loss for litigation settlement was unchanged at September 30, 2013 compared to the balance at December 31, 2012. As disclosed in Item 1. Legal Proceedings, on December 12, 2012, a judgment was entered in favor of Arens Controls Company, L.L.C. by the United States District Court Northern District of Illinois in the amount of $2,014,169 in the case of Arens Controls Company, L.L.C. v. Enova Systems, Inc. See Item 1 of Part II of this report on Form 10-Q.

Other accrued liabilities decreased by $35,000, or 14%, to $220,000 at September 30, 2013 compared to a balance of $255,000 at December 31, 2012. The decrease was primarily due to a decrease in the accrual for professional services incurred in the first nine months of 2013.

Accrued interest payable increased by $62,000, or 5%, to $1,380,000 at September 30, 2013 compared to a balance of $1,318,000 at December 31, 2012. The increase was due to interest related to our debt instruments, primarily the interest on the secured note payable in the amount of $1,344,000 to the Credit Managers Association of California.

Going concern

To date, the Company has incurred recurring net losses and negative cash flows from operations. At September 30, 2013, the Company had an accumulated deficit of approximately $ 161.5 million, working capital of approximately negative $2.2 million and shareholders' deficit of approximately $ 4.7 million. Until the Company can generate significant cash from its operations, the Company expects to continue to fund its operations with existing working capital, proceeds from one or more private placement agreements, as well as potentially through debt financing or the sale of equity securities. However, the Company may not be successful in obtaining additional funding. In addition,

the Company cannot be sure that its existing cash and investment resources will be adequate or that additional financing will be available when needed or that, if available, financing will be obtained on terms favorable to the Company or its shareholders.

Table of Contents

Our operations will require us to make necessary investments in human and production resources, regulatory compliance, as well as sales and marketing efforts. We do not currently have adequate internal liquidity to meet these objectives in the long term. On June 21, 2012, we reported in a Form 8-K filing that, as part of cost cutting measures in response to our decrease in revenue amid continued delays in industry adoption of EV technology resulting from ongoing battery cost and reliability concerns, in excess of 80% of our workforce left our Company, including the resignation of members of our senior management. We continue to evaluate strategic partnering opportunities and other external sources of liquidity, including the public and private financial markets and strategic partners. Having insufficient funds has required the Company to eliminate its product development, and may result in relinquishing rights to product candidates at an earlier stage of development or negotiate less favorable terms than it would otherwise choose. Failure to obtain adequate financing also will adversely affect the Company’s ability to continue in business. If the Company raises additional funds by issuing equity securities, substantial dilution to existing stockholders would likely result. If the Company raises additional funds by incurring debt financing, the terms of the debt may involve significant cash payment obligations, as well as covenants and specific financial ratios that may restrict its ability to operate its business.

As of September 30, 2013, the Company had approximately negative $2,000 in cash and cash equivalents and we do not anticipate that our existing anticipated receivables collections will be sufficient to meet projected operating requirements through the end of 2013 to continue operations and market trading.

Judgment entered in Arens Controls Litigation

On December 12, 2012, a judgment was entered by the United States District Court Northern District of Illinois in favor of Arens Controls Company, L.L.C. in the amount of $2,014,169 regarding claims for two counts. In 2008, Arens Controls Company, L.L.C. (“Arens”) filed claims against Enova with the United States District Court Northern District of Illinois. A Partial Settlement Agreement, as amended on January 14, 2011, resolved certain claims made by Arens. However, the claims were preserved under two remaining counts concerning i) anticipatory breach of contract by Enova for certain purchase orders that resulted in lost profit to Arens and ii) reimbursement for engineering and capital equipment costs incurred by Arens exclusively for the fulfillment of certain purchase orders received from Enova.

On September 24, 2013, Enova and Arens entered into a Settlement Agreement and Mutual Release (the "Settlement Agreement") to resolve the remaining issues between them. Under the terms of the Settlement Agreement, Enova filed on September 27, 2013 a motion to dismiss the pending appeal with prejudice and Arens agreed that, for a period of 120 calendar days from the date of the Settlement Agreement, Arens would not take any action to enforce the Judgment. Thereafter, Arens is entitled, without further notice, to enforce the Judgment against Enova or otherwise exercise all available procedures and remedies for collection of the full amount of the Judgment and Enova has agreed not to contest the validity of the Judgment. However, if Enova had paid to Arens $300,000 at any time during the 120 day period, then within 3 business days after Arens received confirmation of such payment, Arens agreed to file a satisfaction of judgment stating that the Judgment has been satisfied and completely release and forever discharge Enova from any and all claims for damages whatsoever that occurred prior to the date of the Settlement Agreement. In exchange for Arens's release, Enova agreed to completely release and forever discharge Arens from any and all claims for damages whatsoever that occurred prior to the date of the Settlement Agreement. The Company was not able to comply with the due date for such payment by January 22, 2014. Therefore, the judgment against the Company can be enforced without further notice.

Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures which are designed to provide reasonable assurance that information required to be disclosed in the Company’s periodic Securities and Exchange Commission (“SEC”) reports is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to its principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Table of Contents

As required by SEC Rule 13a-15(b) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) as of September 30, 2013. Based on that evaluation, our management, including the Chief Executive Officer and Chief Financial Officer, concluded that as of September 30, 2013, our disclosure controls and procedures were not effective to ensure the information required to be disclosed by an issuer in the reports it files or submits under the Securities Exchange Act of 1934, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms relating to us, and was accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

As required by Rule 13a-15(b) under the Securities and Exchange Act of 1934, as amended, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures for the period covered by this report. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer has concluded that the Company's internal control over disclosure controls and procedures was not effective as of September 30, 2013.

Changes in Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rule 13a-15(f) and 15d-15(f) promulgated under the Exchange Act. We maintain internal control over financial reporting designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

In June 2012, all but two of the Company's employees resigned, and such staff reduction resulted in our inability to complete documentation of proper accounting procedures and management review. Not all fully implemented fundamental elements of an effective control were present as of September 30, 2013, including formalized monitoring procedures. Based on this evaluation, management has concluded that the aforementioned factors constituted a material weakness in the Company's internal control over financial reporting as of September 30, 2013.

Table of Contents

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

As reported in our Form 10-K for the fiscal year 2012, six of the eight counts in the litigation between Enova and Arens Controls Company, L.L.C. were settled. The two counts that were not settled remained outstanding. The two remaining counts concerned i) anticipatory breach of contract by Enova for certain purchase orders that resulted in lost profit to Arens and ii) reimbursement for engineering and capital equipment costs incurred by Arens exclusively for the fulfillment of certain purchase orders received from Enova.

On December 12, 2012, a judgment was entered under the two remaining counts by the United States District Court Northern District of Illinois in favor of Arens Controls Company, L.L.C. in the amount of $2,014,169. The Company filed an appeal of the judgment in the 7th Circuit Court of Appeals on January 15, 2013. The Company believes the court committed errors leading to the verdict and judgment. However, there can be no assurance that the appeal will be successful, a negotiated settlement can be attained, or that Arens will enforce its claim in the state of California and thereby cause the Company to go into bankruptcy.

On September 24, 2013, and in order to avoid the risks and costs associated with the pending appeal, Enova and Arens entered into a Settlement Agreement and Mutual Release (the "Settlement Agreement") to resolve the remaining issues between them. Under the terms of the Settlement Agreement, Enova was required to file, and filed on September 27, 2013, a motion to dismiss the pending appeal with prejudice. Arens agreed that, for a period of 120 calendar days from the date of the Settlement Agreement, Arens shall not take any action to enforce the Judgment. Thereafter, Arens will be entitled, without further notice, to enforce the Judgment against Enova or otherwise exercise all available procedures and remedies for collection of the full amount of the Judgment; and Enova agrees that it will not contest the validity of the Judgment. However, notwithstanding the foregoing, if Enova pays Arens $300,000 at any time during such 120 day period, then within 3 business days after Arens receives confirmation of such payment, Arens will file a satisfaction of judgment stating that the Judgment has been satisfied. Upon receipt of such $300,000 payment, Arens will completely release and forever discharge Enova from any and all claims for damages whatsoever that occurred prior to the date of the Settlement Agreement. In exchange for Arens's release, Enova will completely release and forever discharge Arens from any and all claims for damages whatsoever that occurred prior to the date of the Settlement Agreement.

On September 24, 2013, Enova and Arens entered into a Settlement Agreement and Mutual Release (the "Settlement Agreement") to resolve the remaining issues between them. Under the terms of the Settlement Agreement, Enova filed on September 27, 2013 a motion to dismiss the pending appeal with prejudice and Arens agreed that, for a period of 120 calendar days from the date of the Settlement Agreement, Arens would not take any action to enforce the Judgment. Thereafter, Arens is entitled, without further notice, to enforce the Judgment against Enova or otherwise exercise all available procedures and remedies for collection of the full amount of the Judgment and Enova has agreed not to contest the validity of the Judgment. However, if Enova had paid to Arens $300,000 at any time during the 120 day period, then within 3 business days after Arens received confirmation of such payment, Arens agreed to file a satisfaction of judgment stating that the Judgment has been satisfied and completely release and forever discharge Enova from any and all claims for damages whatsoever that occurred prior to the date of the Settlement Agreement. In exchange for Arens's release, Enova agreed to completely release and forever discharge Arens from any and all claims for damages whatsoever that occurred prior to the date of the Settlement Agreement. The Company was not able to comply with the due date for such payment by January 22, 2014. Therefore, the judgment against the Company can be enforced without further notice

From time to time, we are subject to legal proceedings arising out of the conduct of our business, including matters relating to commercial transactions. We recognize a liability for any contingency that is probable of occurrence and reasonably estimable. We continually assess the likelihood of adverse outcomes in these matters, as well as potential ranges of probable losses (taking into consideration any insurance recoveries), based on a careful analysis of each matter with the assistance of outside legal counsel and, if applicable, other experts.

Given the uncertainty inherent in litigation, we do not believe it is possible to develop estimates of the range of reasonably possible loss for these matters. Considering our past experience, we do not expect the outcome of these matters, either individually or in the aggregate, to have a material adverse effect on our consolidated financial position. Because most contingencies are resolved over long periods of time, potential liabilities are subject to change due to new developments, changes in settlement strategy or the impact of evidentiary requirements, which could cause us to pay damage awards or settlements (or become subject to equitable remedies) that could have a material adverse effect on our results of operations or operating cash flows in the periods recognized or paid.

Table of Contents

ITEM 1A. Risk Factors

Our Annual Report on Form 10-K for the fiscal year ended December 31, 2012 lists risk factors for the Company. There have been no material changes from the risk factors as previously disclosed in such Annual Report on Form 10-K.

ITEM 2. Unregistered Sales of Equity and Use of Proceeds

None.

ITEM 3. Defaults upon Senior Securities

None.

ITEM 4. Mine Safety Disclosures

Not applicable.

ITEM 5. Other Information

None.

ITEM 6. Exhibits

a) Exhibits

31.1	Certification of the Chief Executive Officer and Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act Of 2002.*
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*
101. XML	XBRL Instance Document**
101.XSD	XBRL Taxonomy Extension Schema Document**
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document**
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document**
101.LAB	XBRL Taxonomy Extension Label Linkbase Document**
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document**

* Filed herewith

** In accordance with Regulation S-T, the XBRL-related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall be deemed to be “furnished” and not “filed.”

Table of Contents

SIGNATURE

Pursuant to the requirements 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.

Date: May 2, 2014

ENOVA SYSTEMS, INC. (Registrant)

By; /s/ John Micek
John Micek, Chief Executive Officer and Chief Financial Officer