ENOVA SYSTEMS INC
Form 10-Q
August 14, 2003

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

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended June 30 ,2003

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. 0-25184

ENOVA SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

CALIFORNIA	95-3056150
(State or other jurisdiction of incorporation or organization)	(IRS employer identification number)

19850 South Magellan Drive Torrance, CA 90502

(Address of Principal Executive Offices and Zip Code)
Registrant's telephone number, including area code (310) 527-2800

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 is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes [ ] No [X]

As of August 13, 2003, there were 345,398,000 shares of Common Stock, no par value, 2,820,000 shares of Series A Preferred Stock, no par value, and 1,217,000 shares of Series B Preferred Stock, no par value, outstanding.

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PART 1. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
ENOVA SYSTEMS, INC.
BALANCE SHEETS
(In thousands, except for share and per share data)

	Jun --- (U
ASSETS	
CURRENT ASSETS:	
Cash	
Accounts receivable, net of allowance of $358,000 and $0 respectively	
Inventory	

Stockholder receivable	
Prepaids and other current assets	
Total Current Assets	
PROPERTY, PLANT AND EQUIPMENT - NET	
OTHER ASSETS	
TOTAL ASSETS	
LIABILITIES AND SHAREHOLDERS' (DEFICIT)	
CURRENT LIABILITES:	
Accounts payable	
Line of credit	
Accrued payroll and related expense	
Other accrued expenses	
Bonds and notes payable	
Total Current Liabilities	
ACCRUED INTEREST PAYABLE	
CAPITAL LEASE OBLIGATIONS	
LONG TERM DEBT	
TOTAL LIABILITIES	
SHAREHOLDERS' (DEFICIT):	
Series A convertible preferred stock - No par value; 30,000,000 shares authorized; 2,820,000 and 2,824,000 shares issued and outstanding at 6/30/03 and 12/31/02 liquidating preference at $0.60 per share aggregating $1,692,000 and $1,695,000	
Series B convertible preferred stock - No par value; 5,000,000 shares authorized; 1,217,000 shares issued and outstanding at 6/30/03 and 12/31/02 liquidating preference at $2.00 per share aggregating $2,434,000	
Common Stock - No par value; 500,000,000 shares authorized; 345,398,000 and 345,194,000 shares issued and outstanding at 6/30/03 and 12/31/02	
Common stock subscribed	
Stock notes receivable	
Additional paid-in capital	
Accumulated deficit	
Total Shareholders' equity (deficit)	
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)	

Note: The balance sheet at December 31, 2002 has been derived from the audited financial statements at that date. See notes to financial statements.

ENOVA SYSTEMS, INC.
INCOME and EXPENSE STATEMENTS
(Unaudited)

(In thousands, except for share and per share data)

	Three Months Ended June 30		
	2003	2002	
NET REVENUES			
Research and development contracts	$ 405	$ 978	$
Production	$ 950	$ 496	$
	$ 1,355	$ 1,474	$
COST OF REVENUES			
Research and development contracts	200	782	
Production	1,002	378	
	1,202	1,160	
GROSS MARGIN	153	314	
OTHER COSTS AND EXPENSES:			
Research & development	114	181	
Engineering	225	0	
Selling, general & administrative	966	573	
Interest and financing fees	54	55	
Other (income)/expense	0	45	
Interest income	(2)	(4)	
Total other costs and expenses	1,356	850	
NET LOSS	$ (1,203)	$ (536)	$
NET LOSS PER COMMON SHARE:	$ (0.01)	$ (0.01)	$
WEIGHTED AVERAGE SHARES OUTSTANDING	345,594,000	345,627,095	34

ENOVA SYSTEMS, INC.
STATEMENTS OF CASH FLOWS
(UNAUDITED)
(In thousands)

	Six Months Ended June 30,	
	2003	2002
OPERATIONS		
Net loss	$(1,946)	$(1,241)
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation and Amortization	168	123
Stock/Options issued for Services	16	(246)
Change in operating assets and liabilities:		
Accounts Receivable	263	(166)
Inventory	338	(425)
Stockholder receivable	0	(8)
Prepaids and other assets	(39)	(1)
Accounts payable and accrued expenses	421	669
Net cash used by operating activities	(779)	(1,295)
INVESTING:		
Purchases of property, plant and equipment, net of disposals	(74)	(230)
Net cash used by investing activities	(74)	(230)
FINANCING:		
Borrowing (Repayments) on leases	(16)	40
Proceeds from issuance of common stock	0	4,210
Net cash provided by financing activities	(16)	4,250
NET INCREASE (DECREASE) IN CASH AND EQUIVALENTS	(869)	2,725
CASH AND EQUIVALENTS:		
Beginning of period	1,868	1,179
End of period	$ 999	$ 3,904

ENOVA SYSTEMS, INC.
STATEMENTS OF CASH FLOWS (Continued)
SUPPLEMENTAL CASH FLOW INFORMATION
(UNAUDITED)
(In thousands)

	Six Months Ended June 30

	2003	2002
Cash paid for interest	$ --	$ --
NONCASH INVESTING AND FINANCING ACTIVITIES:		
Issuance of common stock for services	$ 12	$ 12
Conversion of Series A preferred stock to common stock	$ 5	$ --

ENOVA SYSTEMS, INC.

NOTES TO FINANCIAL STATEMENTS
(Unaudited)
For the Six Months Ended June 30, 2003 and 2002

NOTE 1 - Basis of Presentation

The accompanying unaudited financial statements have been prepared from the records of our company without audit and have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not contain all the information and notes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the financial position at June 30, 2003 and the interim results of operations and cash flows for the three and six months ended June 30, 2003 have been included. The balance sheet at December 31, 2002, presented herein, has been prepared from the audited financial statements of our company for the year then ended.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions affecting the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities. The December 31, 2002 and June 30, 2003 inventories are reported at market value. Inventories have been valued on the basis that they would be used, converted and sold in the normal course of business. Certain accrued expenses are based upon an analysis of future costs expected to be incurred in meeting contracted obligations. The amounts estimated for the above, in addition to other estimates not specifically addressed, could differ from actual results; and the difference could have a significant impact on the financial statements.

Accounting policies followed by us are described in Note 1 to the audited financial statements for the fiscal year ended December 31, 2002. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted for purposes of the interim financial statements. The financial statements should be read in conjunction with the audited financial statements, including the notes thereto, for the year ended December 31, 2002, which are included in our Form 10-K Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 as filed with the Securities and Exchange Commission.

Loss per common share is computed using the weighted average number of common shares outstanding. Since a loss from operations exists, diluted earnings per

share number is not presented because the inclusion of common stock equivalents, consisting of Series A and B preferred stock, unexercised stock options and warrants, would be anti-dilutive.

The results of operations for the three and six months ended June 30, 2003 presented herein are not necessarily indicative of the results to be expected for the full year.

NOTE 2 - Notes Payable, Long-Term Debt and Other Financing

Notes payable and long-term debt is comprised of the following (in thousands):

	June 30, 2003 (unaudited)	December 31, 2002
Secured subordinated promissory note - CMAC as exclusive agent for Non-Qualified Creditors; interest at 3% through 2001, 6% in 2002 and 2003, and then at prime plus 3% thereafter through the date of maturity; interest payments are made upon payment of principal, with principal and interest due no later than April 2016; with an interest in a sinking fund escrow with a zero balance as of December 31, 2002 and June 30, 2003. The sinking fund escrow requires the Company to fund the account with 10% of future equity financing, including convertible debt converted to equity, based upon approval of the new investors per the terms of the note.	3,332	3,332
Other	120	120
	3,452	3,452
Less current maturities	120	120
Total	$3,332	$3,332

Note 3 - Stock-based compensation

On June 30, 2003, the Company issued 10,518,212 options from our Employee Stock Option Plan to purchase Enova Systems common stock at an exercise price of $0.051 per share to a number of employees in lieu of cash compensation for a three month period. This plan was approved by the Board of Directors prior to implementation. Under the plan, these employees receive stock options, determined based on the discounted difference of the option exercise price of their monthly salary reduction, which will vest over the three-month period and be exercisable for a period of three years from the grant date. The exercise price represents a 15% discount to the market price of $0.06 as of the date of the grant. As such, a charge against compensation expense totaling $94,664 for the effects of this discount will be booked over the three months commencing June 30, 2003.

Additionally, the Company accounts for stock-based employee compensation arrangements in accordance with the provisions of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB No. 25) and complies with the disclosure provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS No. 123). Under APB No. 25, compensation expense is the excess, if any, of the fair value of the Company's stock at a measurement date over the amount that must be paid to acquire the stock.

As of January 1, 2003 the Company adopted the disclosure requirements of SFAS 148, Accounting for Stock Based Compensation, which amends accounting principals Board ("APB") No. 28 by adding to the list of disclosures to be made for interim periods.

SFAS No. 123 requires a fair value method to be used when determining compensation expense for stock options and similar equity instruments. SFAS No. 123 permits a company to continue to use APB No. 25 to account for stock-based compensation to employees, but pro forma disclosures of net income and earnings per share must be made as if SFAS No. 123 had been adopted in its entirety. For purposes of pro forma disclosures, the estimated fair value of the options is amortized over the options' vesting period. Stock options issued to non-employees are valued under the provisions of SFAS No. 123. Had compensation cost for the Company's options been determined based on the methodology prescribed under SFAS No. 123, the Company's net income and income per share would have been as follows:

	Three Months Ended June 30, 2003	Three Months Ended June 30, 2002	Six Months Ended June 30, 2003	M E Ju
Net loss for the quarter	$(1,257)	$ (536)	$ (2,000)	$(1
Compensation expense, net of tax effect	$ (61)	$ (49)	$ (79)	$
Proforma net loss	$(1,318)	$ (585)	$ (2,079)	$(1
Proforma loss per common share	$ (0.01)	$(0.01)	$ (0.01)	$ (

The fair value of each option is estimated on date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	Three Months Ended June 30, 2003	Six Months Ended June 30, 2003
Dividends	0%	0%
Expected volatility	88%	88%
Risk-free interest rate	4.0%	4.0%
Expected life	3 years	3 years

Note 4- Ballard Power Systems

Our development and production program with Ballard Power Systems for low voltage 30kW electric drive system components for use in Ford's Global Th!nk City was terminated by Ford and Th!nk Nordic in early 2003, as previously reported. Under the terms of the contract, Ballard is liable for all costs incurred by Enova which are normally associated with the production including inventory and other development or production costs. In the second quarter of 2003, we invoiced Ballard for approximately $922,000 for work-in-process inventory and other additional material, tooling and engineering costs for the initial production of the drive system component. Of this amount, Ballard remitted $580,400 during the second quarter. We anticipate receiving the remaining balance during the third quarter, however, there are no assurances that these remaining balances will be collected in full or part.

Note 5 - Advanced Vehicle Systems

In April 2003, one of our customers, Advanced Vehicle Systems, Inc., filed for bankruptcy protection under Chapter 11 of the U.S. Bankruptcy Code. At the time of filing, AVS had an outstanding account balance with Enova of approximately $595,000 of which approximately $564,000 is for components delivered during the first quarter of 2003. During the second quarter, Enova was informed by AVS that various vehicle manufacturing contracts which were anticipated to be completed were terminated by AVS customers. Enova was therefore unable to obtain critical vendor status for these contracts. Enova's Audit Committee chairman has been appointed chairman of the creditor's committee formed by the Bankruptcy Court. Enova believes it will recover a portion of the funds now owed by AVS; however there are no assurances that we may recover any or all of these amounts owed. As of June 30, 2003, we have reserved an additional $305,000 against these balances owed as an allowance for uncollectible receivables bringing the total reserved to date to $357,000. There are no assurances that we will not be required to take additional reserves for uncollectible receivables in subsequent quarters as we learn more during the bankruptcy proceedings.

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

OVERVIEW

The following information should be read in conjunction with the consolidated interim financial statements and the notes thereto in Part I, Item I of this Quarterly Report and with Management's Discussion and Analysis of Financial Condition and Results of Operations contained in the Company's Annual report on Form 10-K for the year ended December 31, 2002. The matters addressed in this Management's Discussion and Analysis of Financial Condition and Results of Operations, with the exception of the historical information presented contains certain forward-looking statements involving risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including the risks discussed in this Item 2 and specifically discussed in this report under the heading "Certain Factors That May Affect Future Results" following this Management's Discussion and Analysis section, and elsewhere in this report.

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. Actual results could differ significantly from those estimates under different assumptions and conditions. The Company believes that the following discussion addresses the

Company's most critical accounting policies, which are those that are most important to the portrayal of the Company's financial condition and results. The Company constantly re-evaluates these significant factors and makes adjustments where facts and circumstances dictate. Historically, actual results have not significantly deviated from those determined using the necessary estimates inherent in the preparation of financial statements. Estimates and assumptions include, but are not limited to, customer receivables, inventories, equity investments, fixed asset lives, contingencies and litigation. The Company has also chosen certain accounting policies when options were available, including:

- The first-in, first-out (FIFO) method to value our inventories;
- The intrinsic value method, or APB Opinion No. 25, to account for our stock options;
- Review of customers' receivable to determine the need for an allowance for credit losses

based on estimates of customers' ability to pay. If the financial condition of our customers were to deteriorate, additional allowances may be required.

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 consolidated financial statements.

GENERAL

Enova Systems, Inc., a California Corporation ("Enova" or the "Company"), was incorporated on July 30, 1976. The Company's fiscal year ends December 31. All year references refer to fiscal years.

Enova believes it is a leader in the development and production of commercial digital power management systems. Power management systems control and monitor electric power in an automotive or commercial application such as an automobile or a stand-alone power generator. Drive systems are comprised of an electric motor, an electronics control unit and a gear unit which power an electric vehicle. Hybrid systems, which are similar to pure electric drive systems, contain an internal combustion engine in addition to the electric motor, eliminating external recharging of the battery system. A 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. Stationary power systems utilize similar components to those which are in a mobile drive system in addition to other elements. These stationary systems are effective as power-assist or back-up systems, alternative power, for residential, commercial and industrial applications.

Enova develops and produces advanced software, firmware and hardware for applications in these alternative power markets. Our focus is digital power conversion, power management, and system integration, for two broad market applications - vehicle power generation and stationary power generation.

Specifically, we develop; design and produce drive systems and related components for electric, hybrid-electric, fuel cell and microturbine-powered vehicles. We also develop, design and produce power management and power conversion components for stationary distributed power generation systems. These

stationary applications can employ fuel cells, microturbines, or advanced batteries for power storage and generation. Additionally, we perform research and development to augment and support others' and our own related product development efforts.

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.

During the quarter ended June 30, 2003, we continued to develop and produce electric and hybrid electric drive systems and components for Ford Motor Company (Ford), the City of Honolulu and several domestic and international vehicle and bus manufacturers in Italy, the United Kingdom, Malaysia and Japan. Our various electric and hybrid-electric drive systems, power management and power conversion systems are being used in applications including Class 8 trucks, monorail systems, transit buses and industrial vehicles. Enova has furthered its development and production of systems for both mobile and stationary fuel cell powered systems with major companies such as Ford, ChevronTexaco and UTC Fuel Cells, a division of United Technologies. We also are continuing on our current research

and development programs with ChevronTexaco, the U.S. Air Force and the U.S. Department of Transportation (DOT) as well as developing new programs with Hyundai Heavy Industries (HHI), the U.S. government and other private sector companies.

Heavy-Duty Drive Systems - Buses and Truck for Urban operators

Heavy-duty drive system sales continue to be a primary strategy of Enova's. Our PantherTM 120kW and PantherTM 240kW drive systems are developed completely in-house and are in production and operating in global markets. Sales of our PantherTM 120kW drive systems continue to provide revenues for our company. Hyundai Heavy Industries has been selected as our outsource manufacturer for the Panther 120kW controller, as well as the manufacturer of the motor and controller for our Panther 240kW drive systems. This is a specific strategy of Enova's to minimize capital outlays and maximize efficiencies by utilizing proven manufacturing partners.

Eco Power Technology of Italy purchased an additional 5 Panther 120kW electric and hybrid electric drive systems in the second quarter of 2003. Eco Power is one of the largest integrators of medium size transit buses for the European shuttle bus market, with key customers in Turin and Genoa, Italy. There are currently approximately 30 vehicles in operation in Italy using Panther power. For the quarter ended June 30, 2003, we billed approximately $138,000 for these systems.

Tomoe Electro-Mechanical Engineering and Manufacturing, Inc. of Japan continue to procure our 120kW and 90kW drive systems for integration into their industrial vehicle platforms. Enova's systems are currently in Tomoe's passenger tram as well as other transportation systems. We anticipate additional orders for these systems in 2003, however at this time; there are no assurances that such additional orders will be forthcoming.

Wrights Environment, a division of Wrights Bus, one of the largest low-floor bus

manufacturers in the United Kingdom, has integrated into two of its buses our hybrid electric PantherTM 120kW drive system, which utilizes a 30kW Capstone microturbine as its power source. These buses are currently in field service and are performing to specifications. Although we anticipate additional orders for both electric and hybrid-electric 120kW drive systems during 2003, at this time there are no assurances that such additional orders will be forthcoming.

In the high performance heavy-duty drive system area, Enova's proprietary 240kW drive system has been successfully integrated into several heavy-duty applications including several 38 foot transit buses and a Class 8 urban delivery truck. This 240kW drive system is capable of providing 3,000 ft-lbs of torque at the drive shaft. Additionally, Enova has modified the Panther 90kW to be used in an 180kW, dual wheel motor configuration, expanding its potential market penetration with bus and delivery vehicle manufacturers.

Additionally, we are in discussions with other bus manufacturers, industrial, commercial and military vehicle manufacturers regarding the purchase of our heavy-duty, high performance, 240kW drive systems in 2003. There are no assurances, however that these discussions will result in any sales of the Panther 240kW or 120kW drive systems.

Light-Duty Drive Systems - Automobiles and Delivery vehicles

Our 90kW controller, motor and gear unit is utilized in light duty vehicles such as midsize automobiles and delivery vehicles. As part of our corporate strategy to outsource manufacturing, Enova selected Hyundai Heavy Industries to produce the Enova developed Panther 90kW drive system.

The City of Honolulu Hawaii has contracted with Enova to upgrade several S-10 trucks in its electric vehicle fleet. During the second quarter, we commenced the upgrade of 3 trucks to our Panther 90kW drive system. Two additional vehicles will begin to be upgraded in the 3rd quarter of 2003. This program is expected to generate approximately $100,000 for Enova and will be completed by late 2003.

We continue to cross-sell our systems to new and current customers in the light and medium duty vehicle markets both domestically and globally.

Ford Motor Company - Fuel Cell Technology

The High Voltage Energy Converter (HVEC) development program with Ford Motor Company for their fuel cell vehicle continues to advance on schedule. This converter is a key component in Ford's Focus Fuel Cell Vehicle. It converts high voltage power from the fuel cell into a lower voltage for use by the drive system and electronic accessories. The system is completing advanced testing in its final prototype phase prior to production. We anticipate receiving an order for limited production in late 2003; however, we can give no assurance at this time that such sales will occur. For the quarter ended June 30, 2003, we billed approximately $63,000 for this Ford program.

Ballard Power Systems

Our development and production program with Ballard Power Systems for low voltage 30kW electric drive system components for use in Ford's Global Th!nk City was terminated by Ford and Th!nk Nordic in early 2003, as previously reported. In the second quarter of 2003, we invoiced Ballard for approximately $922,000 for materials purchased for the initial production of the drive system component and other additional material, tooling and engineering costs. Of this

amount, Ballard remitted $580,400 during the second quarter. We anticipate receiving the remaining balance during the third quarter, however, there are no assurances that these remaining balances will be collected in full or part.

Research and Development Programs

We are aggressively pursuing several government and commercially sponsored development programs for both ground and marine heavy-duty drive system applications.

Our program with the U.S. Air Force and the State of Hawaii to integrate a Panther 120kW hybrid drive system into a second 30-foot bus for the Hickman Air Force base has been amended to develop this propulsion system as a fuel cell hybrid. The program is scheduled to be completed in the fourth quarter of 2003. Anticipated revenues from this program are approximately $600,000.

The all-electric Hyundai Santa Fe SUV demonstration project has been extended for another two years for three of the vehicles. Fast-charging capabilities and performance will be the primary focus of this continued evaluation.

Several other programs are in discussion in conjunction with the U.S. Navy, U.S. Air Force, and several other government agencies and private corporations. We anticipate finalizing the terms of these contracts in the third quarter of 2003 however there can be no assurances at this time that such contracts will be realized.

We intend to establish new development programs with the Hawaii High Technology Development Corporation in mobile and marine applications as well as other state and federal government agencies as funding becomes available.

Stationary Power Applications

Enova continues to attract new partners and customers from both fuel cell manufacturers and petroleum companies. It is our belief that utilizing our power management systems for stationary applications for fuel cells will open new markets for our Company. There are no assurances, however, that we will successfully develop such applications or that any such applications will find acceptance in the marketplace.

We are currently designing a process controller for ChevronTexaco Technology Ventures (CTTV) for their fuel reformer for a stationary fuel cell application. The first prototype of the controller board for this system is in test and evaluation and we are now progressing to the second phase of the program. For the three months ended June 30, 2003, Enova has billed ChevronTexaco $152,900.

Our Fuel Cell Care (FCU) units are being delivered to UTC Fuel Cells, a division of United Technologies Corp., for use in their stationary fuel cell systems. In the second quarter of 2003, UTC Fuel Cell ordered 6 additional fuel cell care units. Sales to UTC for the three months ended June 30, 2003 totaled $17,000.

We believe the stationary power market will play a key role in our future. We continue to pursue alliances with leading manufacturers in this area. There are, however, no assurances that this market will develop as anticipated or that such alliances will occur.

LIQUIDITY AND CAPITAL RESOURCES

We have experienced cash flow shortages due to operating losses primarily

attributable to research, development, marketing and other costs associated with our strategic plan as an international manufacturer and supplier of electric propulsion and power management systems and components. Cash flows from operations have not been sufficient to meet our obligations. Therefore, 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. We anticipate that we may require additional outside financing within the next six months to meet research, development and general operations expenditures through 2003.

In the second quarter of 2003, management determined that it was necessary to re-assess current resource allocations and overhead costs. Due to the loss of Advanced Vehicle Systems (AVS) - please refer to Part II, Item 1, Legal Proceedings - and an overall slowdown in heavy-duty drive system purchases, management analyzed current processes and budgets for potential targets for cost reduction. Management therefore implemented several cost reduction programs including personnel reductions, work-week modifications and other cost reduction endeavors to achieve these goals. Personnel levels have been reduced to 32 employees currently from 45 at December 31, 2002. As another element of this workforce reorganization, full-time salaried employees had their compensation packages modified wherein they would receive a portion of their salaries over a three-month period as stock options in lieu of cash compensation. As a result of these changes, we have reduced monthly cash outlays by approximately $150,000 without impact to our current operations.

During the six months ended June 30, 2003, we spent $779,000 in cash on operating activities to fund our net loss of $1,946,000 resulting from factors explained in the following section of this discussion and analysis. Accounts receivable decreased by $263,000 from December 31, 2002 balances due to the write-down of AVS receivables (refer to Part II, Item 1 below) and payments from other customers against outstanding balances. Inventory decreased by $338,000 from December 31, 2002 to June 30, 2003 primarily due to charges against cost of sales for those inventories related to the terminated Ballard program which were billed to them.

Current liabilities increased by a net of $420,000 from December 31, 2002 to June 30, 2003 as a result of additional power management and conversion component inventory purchases and payables due Hyundai Autonet in connection with the termination of the Ballard program which represented approximately $280,000 of this increase.

Capital lease obligations decreased by $16,000 during the six months ended June 30, 2003 from December 31, 2002, also due to scheduled payments of these liabilities.

Interest accruing on notes payable increased by $109,000 for the six months ended June 30, 2003 from December 31, 2002 per the terms of our notes payable.

The operations of the Company during the second quarter of fiscal 2003 were financed primarily by the funds received on engineering contracts and sales of drive system components as well as cash reserves provided by equity financings. It is management's intention to continue to support current operations through sales of products and engineering contracts, as well as to seek additional financing through private placements and other means to increase inventory reserves and to continue internal research and development.

The future unavailability or inadequacy of financing to meet future needs could

force the Company to delay, modify, suspend or cease some or all aspects of its planned operations this year.

RESULTS OF OPERATIONS

Net revenues for the three months ending June 30, 2003 were $1,355,000 as compared to $1,474,000 for the corresponding period in 2002. Net production sales for the quarter ended June 30, 2003 increased by $454,000 or 91% compared to the same period in 2002. The increase in production revenues is attributable primarily due to the sales of work-in-process inventory, equipment and other costs in connection with Ballard Power Systems termination of the LVDS30 program. Net research and development sales are a result of additional engineering services for the ChevronTexaco fuel reformer process controller and development work on the Ford HVEC program. R&D revenues decreased to $405,000 from $978,000 for the quarter ended June 30, 2003 or 59% as a result of a shift to more production programs.

Cost of sales for the three months ended June 30, 2003 increased to $1,202,000 compared to cost of sales of $1,160,000 for the same three-month period in 2002 representing a gross margin on revenues of approximately 14% in the second quarter of 2003. The reduction in gross margins in the second quarter was caused by the revenues generated from Ballard being primarily contractually mandated costs on work-in-process, raw materials and equipment which did not contain margins per the terms of the termination agreement.

Internal research, development and engineering expenses increased in the three months ended June 30, 2003 to $339,000 as compared with $181,000 in the same period in 2002. As noted in the first quarter of 2003, Enova continues to allocate increased engineering resources to the development of its diesel generation motor, upgraded proprietary control software, enhanced DC-DC converters and advanced digital inverters and other power management firmware.

Selling, general and administrative expenses increased $393,000 to $966,000 for the three months ended June 30, 2003 from the previous year's comparable period. The majority of this increase was due to i) the additional allowance of $305,000 for uncollectible receivables from AVS (reference Part II, Item 1 below) and ii) additional costs associated with the workforce and compensation reductions

as noted elsewhere in this Form 10-Q. Without these non-recurring charges, general and administrative expenses for the current quarter would have been comparable to those of the same quarter in 2002.

Interest and financing fees remained the consistent at approximately $55,000 for the second quarter of 2003 and 2002.

We incurred a loss from continuing operations of $1,203,000 in the second quarter of 2003 compared to a loss of $536,000 in the second quarter of 2002. As noted above, this increase was primarily due to non-recurring costs in connection with the AVS receivables and the workforce restructuring. We will continue to review all costs and develop methods in our efforts to produce our systems more efficiently by utilizing contract manufacturers where applicable.

CERTAIN FACTORS THAT MAY AFFECT FUTURE RESULTS

This Form 10-Q contains forward-looking statements concerning our existing and future products, markets, expenses, revenues, liquidity, performance and cash needs as well as our plans and strategies. Forward-looking statements may be identified by the use of terminology such as "may," "anticipate," "estimate,"

"plans," "expects," "believes," "will," "potential" and by other comparable terminology or the negative of any of the foregoing. These forward-looking statements involve risks and uncertainties and are based on current management's expectations and we are not obligated to update this information. Many factors could cause actual results and events to differ significantly from the results anticipated by us and described in these forward looking statements including, but not limited to, the following risk factors.

Net Operating Losses. We experienced recurring losses from operations and had an accumulated deficit of $95,837,000 at June 30, 2003. There is no assurance, however, that any net operating losses will be available to us in the future as an offset against future profits for income tax purposes.

Continued Losses. For the six months ended June 30, 2003 and 2002, we had losses from continuing operations of $1,946,000 and $1,241,000 respectively on sales of $2,694,000 and $2,415,000, respectively.

Nature of Industry. The mobile and stationary power markets, including electric vehicle and hybrid electric vehicles, continue to be subject to rapid technological change. Most of the major domestic and foreign automobile manufacturers: (1) have already produced electric and hybrid vehicles, and/or (2) have developed improved electric storage, propulsion and control systems, and/or (3) are now entering or have entered into production, while continuing to improve technology or incorporate newer technology. Various companies are also developing improved electric storage, propulsion and control systems. In addition, the stationary power market is still in its infancy. A number of established energy companies are developing new technologies. Cost-effective methods to reduce price per kilowatt have yet to be established and the stationary power market is not yet viable.

Our current products are designed for use with, and are dependent upon, existing technology. As technologies change, and subject to our limited available resources, we plan to upgrade or adapt our products in order to continue to provide products with the latest technology. We cannot assure you, however, that we will be able to avoid technological obsolescence, that the market for our products will not ultimately be dominated by technologies other than ours, or that we will be able to adapt to changes in or create "leading-edge" technology. In addition, further proprietary technological development by others could prohibit us from using our own technology.

Changed Legislative Climate. Our industry is affected by political and legislative changes. In recent years there has been significant public pressure to enact legislation in the United States and abroad to reduce or eliminate automobile pollution. Although states such as California have enacted such legislation, we cannot assure you that there will not be further legislation enacted changing current requirements or that current legislation or state mandates will not be repealed or amended, or that a different form of zero emission or low emission vehicle will not be invented, developed and produced, and achieve greater market acceptance than electric or hybrid electric vehicles. Extensions, modifications or reductions of current federal and state legislation, mandates and potential tax incentives could also adversely affect our business prospects if implemented.

Because vehicles powered by internal combustion engines cause pollution, there has been significant public pressure in Europe and Asia, and enacted or pending legislation in the United States at the federal level and in certain states, to promote or mandate the use of vehicles with no tailpipe emissions ("zero emission vehicles") or reduced tailpipe emissions ("low emission vehicles").

Legislation requiring or promoting zero or low emission vehicles is necessary to create a significant market for electric vehicles. The California Air Resources Board (CARB) is continuing to modify its regulations regarding its mandatory limits for zero emission and low emission vehicles. Furthermore, several car manufacturers have challenged these mandates in court and have obtained injunctions to delay these mandates.

Our products are subject to federal, state, local and foreign laws and regulations, governing, among other things, emissions as well as laws relating to occupational health and safety. Regulatory agencies may impose special requirements for implementation and operation of our products or may significantly impact or even eliminate some of our target markets. We may incur material costs or liabilities in complying with government regulations. In addition, potentially significant expenditures could be required in order to comply with evolving environmental and health and safety laws, regulations and requirements that may be adopted or imposed in the future.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

None.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures.

In accordance with Rule 13a-15(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), an evaluation was carried out by the Company's President, Chief Executive Officer and acting Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-14(c) and 15d-14(c) under the Exchange Act) as of the end of the quarter ended June 30, 2003. Based upon that evaluation of these disclosure controls and procedures, the President, Chief Executive Officer and acting Chief Financial Officer concluded that the disclosure controls and procedures were effective as of the end of the quarter ended June 30, 2003 to ensure that material information relating to the Company was made known to him particularly during the period in which this quarterly report on Form 10-Q was being prepared.

Changes in internal controls over financial reporting.

There was not any change in the Company's internal control over financial reporting that occurred during the quarter ended June 30, 2003 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We may from time to time become a party to various legal proceedings arising in the ordinary course of business.

In April 2003, one of our customers, Advanced Vehicle Systems, Inc., filed for bankruptcy protection under Chapter 11 of the U.S. Bankruptcy Code. At the time of filing, AVS had an outstanding account balance with Enova of approximately $595,000 of which approximately $564,000 is for components delivered during the first quarter of 2003. During the second quarter, Enova was informed by AVS that various vehicle manufacturing contracts which were anticipated to be completed

were terminated by AVS customers. Enova was therefore unable to obtain critical vendor status for these contracts. Enova's Audit Committee chairman has been appointed chairman of the creditor's committee formed by the Bankruptcy Court. Enova believes it will recover a portion of the funds now owed by AVS; however there are no assurances that we may recover any or all of these amounts owed. As of June 30, 2003, we have reserved an additional $305,000 against these balances owed as an allowance for uncollectible receivables bringing the total reserved to date to $357,000. There are no assurances that we will not be required to take additional reserves for uncollectible receivables in subsequent quarters as we learn more during the bankruptcy proceedings.

Item 2. Changes in Securities and Use of Proceeds

As discussed in Note 3 to the financial statements and in the Liquidity and Capital Resources section, we issued stock options to several employees in connection with a workforce reorganization plan during the second quarter of 2003. The proceeds from the exercise of these options will be used for general operations.

Item 3. Defaults Upon Senior Securities:

None.

Item 4. Submission of Matters to a Vote of Securities Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits and Reports on Form 8-K:

(a) Exhibits:

99.1* Certification of the Chief Executive Officer / Acting Chief Financial Officer, dated August 14, 2003 (This certification required as Exhibit 31 under Item 601(a) of Regulation S-K is filed as Exhibit 99.1 pursuant to SEC interim filing guidance.)

99.2* Written Statement of the Chief Executive Officer / Acting Chief Financial Officer, dated August 14, 2003 (This certification required as Exhibit 32 under Item 601(a) of Regulation S-K is furnished in accordance with Item 601(b)(32)(iii) of Regulation S-K as Exhibit 99.3 pursuant to SEC interim filing guidance.)

* - attached herewith

(b) Reports on Form 8-K

The Company filed a report on Form 8-K under Items 7 and 9 dated May 28, 2003, reporting the announcement of the Company's earnings for the first quarter of 2003.

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: August 14, 2003

ENOVA SYSTEMS, INC.
(Registrant)

/s/ Carl D. Perry

By: Carl D. Perry, President, Chief Executive Officer and Acting Chief Financial Officer