

ENOVA SYSTEMS INC  
Form 10-K  
May 02, 2014

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

Form 10-K

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

For the fiscal year ended December 31, 2013

Or

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

For the transition period from to \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-33001

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

California  
(State or Other Jurisdiction of  
Incorporation or Organization)

95-3056150  
(I.R.S. Employer  
Identification Number)

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

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

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

| Title of Each Class        | Name of Each Exchange on Which Registered |
|----------------------------|---|
| Common Stock, no par value | None.                                     |

Securities registered pursuant to Section 12(g) of the Act:  
None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act: Yes  No

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. 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 Act.) Yes [ ] No [X]

As of June 30, 2013, the approximate aggregate market value of common stock held by non-affiliates of the Registrant was \$350,000 (based upon the closing price for shares of the Registrant's common stock as reported by the OTCQB). As of March 31, 2014, there were 64,520,195 shares of common stock, no par value, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None.

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ENOVA SYSTEMS, INC.  
2013 FORM 10-K ANNUAL REPORT

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PART I

ITEM 1. BUSINESS

General

In July 2000, we changed our name to Enova Systems, Inc. (“Enova” or “the Company”). Our company, previously known as U.S. Electricar, Inc., a California corporation, was incorporated on July 30, 1976.

THE FOLLOWING BUSINESS DISCUSSION SET FORTH BELOW AND ELSEWHERE IN THIS 10-K IS QUALIFIED IN ITS ENTIRETY BY THE FOLLOWING: ENOVA REMAINS INSOLVENT AND OWES IN EXCESS OF \$4.6 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 JANUARY 22, 2014. THEREFORE, THE JUDGMENT AGAINST THE COMPANY CAN BE ENFORCED WITHOUT FURTHER NOTICE.

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 has been 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](http://www.enovasystems.com), contains up-to-date information on our company, our products 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.

Due to the reduction in our operations in June 2012, our ability to produce electric and hybrid electric drive systems and components was severely restricted.. In 2013, we had limited sales for systems and components to First Auto Works of China (“FAW”) and Smith Electric Vehicles (“Smith”) as well as other domestic and international vehicle and bus manufacturers. Our various electric and hybrid-electric drive systems, power management and power conversion systems are being used in applications including several light, medium and heavy duty trucks, train locomotives, transit buses and industrial vehicles.

For the year ended December 31, 2013, the following customers each accounted for more than ten percent (10%) of our total revenues:

| Customer                           | Percent |
|------------------------------------|---------|
| First Auto Works Group Corporation | 76%     |
| Smith Electric Vehicles, N.A.      | 19%     |

Please refer to the Management’s Discussion and Analysis of Financial Condition and Results of Operations in Item 7 below and our financial statements in Item 8 below for further analysis of our results.

#### Climate Change Initiatives and Environmental Legislation

Because vehicles powered by internal combustion engines cause pollution (greenhouse gasses), there has been significant public pressure in throughout the world to reduce these emissions. Thus, the US (federal and state levels) and countries in Europe and Asia have enacted legislation to promote the use of zero or low emission vehicles. We believe legislation requiring or promoting zero or low emission vehicles is necessary to create a significant market for both hybrid electric (“HEV”) and electric vehicles (“EV”).

As our products reduce emissions and dependence on foreign energy, they 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.

#### Strategic Alliances, Partnering and Technology Developments

Our strategy has been to adapt ourselves to the ever-changing environment of alternative fuel markets for mobile applications. Originally focusing on pure electric drive systems, we have the potential to be positioned as a global supplier of drive systems for electric, hybrid and fuel cell applications.

We continue to seek and establish alliances with major players in the automotive and fuel cell fields. We believe the medium and heavy-duty hybrid market’s best chances of significant growth lie in identifying and pooling the largest possible numbers of early adopters in high-volume applications. We seek to utilize our competitive advantages, including customer alliances, to gain greater market share. By aligning ourselves with key customers in our target market(s), we believe that the alliance will result in the latest technology being implemented and customer



requirements being met, with a minimal level of additional time or expense.

- 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. The Enova drive system is integrated and branded under the name of Jiefang CA6120URH hybrid. The Jiefang 40 ft. long hybrid city bus can carry up to 103 passengers and travel at a speeds of over 50 miles per hour. With the Enova hybrid system components, the Jiefang bus meets Euro III emission standards, consumes only 7.84 miles per gallon and achieves a reduction of 20 percent in harmful emissions.

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- Smith Electric Vehicles N.A. Inc. (“Smith”) – Enova continues to supply Smith with electric drive system components. Smith has deployed several hundred vehicles utilizing Enova's electric drive system. Smith develops, produces and sells zero-emission commercial electric vehicles that are designed to be an alternative to traditional diesel trucks, providing higher efficiency and lower total cost of ownership. Smith has manufacturing facilities in Kansas City, Missouri, and outside of Newcastle, UK. Smith's vehicle designs leverage more than 80 years of market knowledge from selling and servicing electric vehicles in the United Kingdom. Smith produces the Newton and the Edison.

Through the first half of 2012, we continued development of our next generation Omni-series 200kVA-capable power inverter for hybrid-electric and all-electric vehicles power management and drive system component. The inverter has undergone a series of rigorous tests, based on specifications from FCCC, Navistar, Ford and Enova's own internal requirements. We are also progressed in the design of a next generation on-board 10kW charger, which is designed to be compatible with a wide range of vehicle drive systems and motors, and can be configured for HEV, PHEV and EV applications. Our various electric and hybrid-electric drive systems, power management and power conversion systems continue to be used in applications including Class 3-6 trucks, transit buses and heavy industrial vehicles.

Research and development programs included our advanced power management systems for fuel cells and upgrades and improvements to our current power conversion and management components. Provided we can obtain additional resources, we intend to continue to research and develop new technologies and products, both internally and in conjunction with alliance partners and other manufacturers.

#### Electric and Hybrid-Electric Drive Products

Enova's hybrid and electric drive systems provide all the functionality one would find under the hood of an internal combustion engine powered vehicle. The hybrid and electric power system consists of an enhanced electric motor and the electronic controls that regulate the flow of electricity to and from the batteries at various voltages and power to propel the vehicle. In addition to the motor and controller, the system includes a gear reduction/differential unit which ensures the desired propulsion and performance. The system is designed to be installed as a “drop in,” fully integrated turnkey fashion, or on a modular, “as-needed” basis. Regardless of power source (battery, fuel cell, diesel generator or turbine) the hybrid and electric power system is designed to meet the customer's drive cycle requirements. Enova's all electric drive systems use largely the same designs as the hybrid systems, except that there is no internal combustion engine in the vehicle.

Hybrid vehicles are those that utilize an electric motor and batteries in conjunction with an internal combustion engine (“ICE”), whether piston or turbine. With a hybrid system, a small piston or turbine engine — fueled by gasoline or diesel, CNG, methane, etc., in a tank — supplements the electric motor and battery. These systems are self-charging, in that the operating ICE recharges the battery.

There are two types of hybrid systems: series and parallel. In a series hybrid system, only the electric motor connects to the drive shaft and in a parallel hybrid system, both the internal combustion engine and the electric motor connect to the drive shaft. In a series hybrid system, the ICE turns the generator, which charges the battery, which — through a control unit — powers the electric motor that turns the wheels. In a parallel hybrid system, both the electric motor and the ICE can operate simultaneously to drive the wheels (see diagrams below). In both hybrid systems and in pure electric systems, regenerative braking occurs which assists in the charging of the batteries.

The parallel hybrid system is ideally suited for conditions where most of the driving is done at constant speed cruising, with a smaller amount of the driving involving random acceleration, such as “uphill” or with “stop and go” conditions. For acceleration, the controller causes the electric motor to assist the ICE, both running simultaneously.

When speed is steady or the ground is flat, only the ICE runs. Additionally, when the batteries are low, the controller causes the ICE and motor to charge the batteries. As a result, the series hybrid system is best suited for starts and stops, and is ideal for applications such as urban transit buses and urban garbage trucks. The design of the series hybrid system is based on a driving cycle with a high percentage of random acceleration conditions.

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## Manufacturing Strategy

We have developed a multi-tiered manufacturing strategy that allows us to meet the market's demand for high quality production goods while optimizing cost of goods sold across the spectrum of low to high volumes. At the core of this strategy is a strong reliance on pre-selected highly qualified outside manufacturing houses that specialize in various aspects of the manufacturing process. This outsourcing strategy helps Enova control product costs while also minimizing fixed costs within the organization.

## Competitive Conditions

The competition to develop and market electric, hybrid and fuel cell powered vehicles continued to accelerate during the last year and we expect this trend to continue as governments in our target markets adopt initiatives to reduce greenhouse gas emissions. In the event governments in our target markets completely rescinded their support for the reduction of greenhouse gas emissions and sustainability initiatives, our business model would be adversely and significantly affected. Moreover, although competition within the mobile hybrid sector is still somewhat fragmented, there are indications of some consolidation at this time. The competition consists of development stage companies as well as major U.S. and international companies. The larger companies tend to focus on single solutions and maintain the capital and wherewithal to aggressively market such. The smaller competitors offer a more diversified product line, but do not have the market presence to generate significant penetration at this juncture.

Our research and experience has indicated that our target market segments certainly focus on price, but would buy based on reliability, performance and quality support when presented the life-cycle business model for EV-HEV technologies for their application. Our future prospects are highly dependent upon the successful development and introduction of new products that are responsive to market needs and can be manufactured and sold at a profit. There can be no assurance that we will be able to successfully develop or market any such products.

The development of hybrid-electric and alternative fuel vehicles, such as compressed natural gas, fuel cells and hybrid cars poses a competitive threat to our markets for low emission vehicles or LEVs but not in markets where government mandates call for zero emission vehicles or ZEVs. Enova is involved in the development of hybrid vehicles and fuel cell systems in order to meet future government requirements and applications.

Various providers of electric vehicles have proposed products or offer products for sale in this emerging market. These products encompass a wide variety of technologies aimed at both consumer and commercial markets. As the industry matures, key technologies and capabilities are expected to play critical competitive roles. Our goal is to position ourselves as a long term competitor in this industry by focusing on all-electric, hybrid and fuel cell powered drive systems and related sub systems, component integration, technology application and strategic alliances.

We believe the hybrid and electric vehicle market is poised for growth over the medium and long term and that Enova's products are positioned to capitalize on demands being placed on the market by offering solutions. Enova believes that our competitive advantages include:

- Providing a full product line of power management and power conversion, and supporting system integration
- Providing products that allow the hardware to be software programmable and configurable
- Offering a product line designed for the most advanced new fuel systems: electric, hybrid, fuel cell and solar power applications
- Providing fully integrated, "drop-in" energy management and conversion system in "one box"

- Offering systems with reduced footprint and weight, high functionality and low cost — characteristics essential for all market applications
- Meeting changing and sophisticated requirements of emerging alternative power markets and applications.
- Positioning ourselves as a strategic ally with our global customer base, manufacturers and our R&D partners.

By building a business based on long-standing relationships with clients such as Freightliner Custom Chassis Corporation, Smith Electric Vehicles, First Auto Works and Optare, we believe we are building defenses against competition by securing customers with global reach and OEM status. Teaming with recognized global manufacturers allows Enova to avoid devoting resources to manufacturing infrastructure and allows us access to production capacity at relatively low costs.

#### Research and Development

Enova's strategy has been one of continual enhancement of its current product line and development of more efficient and reliable products for alternative energy sectors. Subject to available resources, management believes R&D must be continued in order to remain competitive, minimize production costs and meet customer specifications. We seek to provide internal funding where technology development is critical to our future.

For the years ended December 31, 2013, and 2012, we spent \$0 and \$805,000, respectively, on internal research and development activities. In June 2012, our engineering staff was eliminated 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.

#### Intellectual Property

Enova relies on unpatented trade secrets and know-how and proprietary technological innovation and expertise which are protected in part by confidentiality and invention assignment agreements with its employees, advisors and consultants and non-disclosure agreements with certain of its suppliers and distributors. If these agreements are breached, Enova may not have adequate remedies for any breach and Enova's unpatented proprietary intellectual property may otherwise become known or independently discovered by competitors.

Enova will evaluate technology protection on its Omni Drive System that may be pursued. The Omni system contains many areas where Enova will have unique advantages in comparison to existing technologies and the company intends to fully protect these areas. This process involves complex legal and factual questions, and the breadth of claims allowed is uncertain. Accordingly, there can be no assurance that patent applications filed by us will result in patents being issued. Moreover, there can be no assurance that third parties will not assert claims against us with respect to existing and future products. Although we intend to vigorously protect our rights, there can be no assurance that these measures will be successful. In the event of litigation to determine the validity of any third party claims, such litigation could result in significant expense to Enova.

#### Employees

As of December 31, 2013, we had a total of 1 full-time and 1 part-time employee. We also employ one individual as a part-time independent contractor engaged on a monthly basis.

#### Available and Additional Information

Included in Item 8 of this 10K are audited financial statements which include revenues, a measure of profit or loss and total assets.

We file electronically with the SEC our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934. We make available free of charge on or through our website copies of these reports as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. The SEC maintains an

internet site that contains reports, proxy and information statements and other information regarding our filings at [www.sec.gov](http://www.sec.gov). You may also read and copy any of our materials filed with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. Information regarding the operation of the Public Reference Room can be obtained by calling the SEC at 1-800-SEC-0330. Our website address is [www.enovsystems.com](http://www.enovsystems.com). Information found on, or that can be accessed through, our website is not incorporated by reference into this annual report.

## ITEM 1A. RISK FACTORS

The statements in this Section describe the major risks to our business and should be considered carefully. In addition, these statements constitute our cautionary statements under the Private Securities Litigation Reform Act of 1995 and apply to all sections of this Form 10-K.

This annual report on Form 10-K, including the documents that we incorporate by reference, 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,” “future,” “intend,” “potential,” or “continue” or the negative of these terms or similar expressions to identify forward-looking statements. These statements appear throughout the Form 10-K 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 expansion plans, 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 annual report. 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 this “Risk Factors” section and elsewhere in this annual report.

We cannot guarantee that any forward-looking statement will be realized, although we believe we have been prudent in our plans and assumptions. Achievement of future results is subject to risks, uncertainties and potentially inaccurate assumptions. Should known or unknown risks or uncertainties materialize, or should underlying assumptions prove inaccurate, actual results could differ materially from past results and those anticipated, estimated or projected. You should bear this in mind as you consider forward-looking statements.

We undertake no obligation to publicly update forward-looking statements, whether as a result of new information, future events or otherwise. You are advised, however, to consult any further disclosures we make on related subjects in our 10-Q and 8-K reports to the SEC. Also note that we provide the following cautionary discussion of risks, uncertainties and possibly inaccurate assumptions relevant to our businesses. These are factors that, individually or in the aggregate, we think could cause our actual results to differ materially from expected and historical results. We note these factors for investors as permitted by the Private Securities Litigation Reform Act of 1995. You should understand that it is not possible to predict or identify all such factors. Consequently, you should not consider the following to be a complete discussion of all potential risks or uncertainties.

We may be forced into bankruptcy if we cannot reach a settlement with our two major creditors

Enova owes in excess of \$4.6 million in aggregate to its two principal creditors, Arens Controls Company, L.L.C. (“Arens”) and the Credit Managers Association. 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 \$2,014,169, the Company does not currently believe it has any alternative other than to cease operations.

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.

Raising additional funds by issuing securities, engaging in debt financings or through licensing arrangements may cause substantial dilution to existing stockholders, restrict our operations or require us to relinquish proprietary rights.

To the extent that we raise additional capital by issuing equity securities as we did in 2011, April 2012, May 2012 and February 2014, our existing stockholders' ownership may be substantially diluted. Any debt financing we enter into may involve covenants that restrict our operations or our ability to enter into other funding arrangements. These restrictive covenants may include limitations on additional borrowing and specific restrictions on the use of our assets, as well as prohibitions on our ability to create liens, pay dividends, redeem our stock or make investments. In addition, if we raise additional funds through licensing arrangements, it may be necessary to relinquish potentially valuable rights to our potential products or proprietary technologies, or grant licenses on terms that are not favorable to us.

Our history of operating losses and our expectation of continuing losses may hurt our ability to reach profitability or continue operations.

We have experienced significant operating losses since our inception. Our net loss was \$2,904,000 for the year ended December 31, 2013 and our accumulated deficit was \$162,251,000 as of December 31, 2013. It is likely that we will continue to incur substantial net operating losses for the foreseeable future, which may adversely affect our ability to continue operations. To achieve profitable operations, we must successfully develop and market our products at higher margins. We may not be able to generate sufficient product revenue to become profitable. Even if we do achieve profitability, we may not be able to sustain or increase our profitability on a quarterly or yearly basis.

We are dependent on access to capital markets in order to fund continued operations of the Company.

We do not currently have adequate internal liquidity to fund the Company's operations on an ongoing basis. We will need to continue to look for partnering opportunities and other external sources of liquidity, including the public and private financial markets and strategic partners. We may not be able to obtain financing arrangements in amounts or on terms acceptable to us in the future. In the event we are unable to obtain additional financing when needed, and without substantial reductions in development programs and strategic initiatives, we do not expect that our cash and cash equivalents and short-term investments will be sufficient to fund our operating and capital needs for the twelve months following December 31, 2013.

Because we depend upon sales to a limited number of customers, our revenues will be reduced if we lose a major customer

Our revenue is dependent on significant orders from a limited number of customers. In the fiscal year ended December 31, 2013, our two largest customers comprised 95% of revenues. We believe that revenues from major customers will continue to represent a significant portion of our revenues. This customer concentration increases the risk of quarterly fluctuations in our revenues and operating results. The loss or reduction of business from one or a combination of our significant customers could adversely affect our revenues, financial condition and results of operations. Moreover, our success will depend in part upon our ability to obtain orders from new customers, as well as the financial condition and success of our customers and general economic conditions.

Our future growth depends on consumers' willingness to accept hybrid and electric vehicles

Our growth is highly dependent upon the acceptance by consumers of, and we are subject to an elevated risk of any reduced demand for, alternative fuel vehicles in general and electric vehicles in particular. If the market for electric vehicles does not develop as we expect or develops more slowly than we expect, our business, prospects, financial condition and operating results will be materially and adversely affected. The market for alternative fuel vehicles is relatively new, rapidly evolving, characterized by rapidly evolving and changing technologies, price competition,

additional competitors and changing consumer demands or behaviors. Factors that may influence the acceptance of alternative fuel vehicles include:

- perceptions about alternative fuel vehicles safety (in particular with respect to lithium-ion battery packs), design, performance and cost, especially if adverse events or accidents occur that are linked to the quality or safety of alternative fuel vehicles;
- volatility in the cost of oil and gasoline;

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- consumer's perceptions of the dependency of the United States on oil from unstable or hostile countries;
- improvements in fuel of the internal combustion engine;
- the environmental consciousness of consumers;
- government regulation
- Macroeconomics

We extend credit to our customers, which exposes us to credit risk

Most of our outstanding accounts receivable are from a limited number of large customers. At December 31, 2013, the two highest outstanding accounts receivable balances totaled approximately \$420,000 which represents 100% of our gross accounts receivable. If we fail to monitor and manage effectively the resulting credit risk and a material portion of our accounts receivable is not paid in a timely manner or becomes uncollectible, our business would be significantly harmed, and we could incur a significant loss associated with any outstanding accounts receivable.

Our business is affected by current economic and financial market conditions in the markets we serve

Current global economic and financial markets conditions, including severe disruptions in the credit markets and the significant and potentially prolonged global economic recession, may materially and adversely affect our results of operations and financial condition. We are particularly impacted by any global automotive slowdown and its effects on OEM inventory levels, production schedules, support for our products and decreased ability to accurately forecast future product demand.

The nature of our industry is dependent on technological advancement and is highly competitive

The mobile power market, including electric vehicle and hybrid electric vehicles, continue to be subject to rapid technological changes. Most of the major domestic and foreign automobile manufacturers: (1) have already produced electric and hybrid vehicles, (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.

Our industry is affected by political and legislative changes

In recent years there has been significant legislation enacted in the United States and abroad to reduce or eliminate automobile pollution, promote or mandate the use of vehicles with no tailpipe emissions ("zero emission vehicles") or reduced tailpipe emissions ("low emission vehicles"). 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.

We may be unable to effectively compete with other companies who have significantly greater resources than we have

Many of our competitors, in the automotive, electronic, and other industries, have substantially greater financial, personnel, and other resources than we do. Because of their greater resources, some of our competitors may be able to adapt more quickly to new or emerging technologies and changes in customer requirements, or to devote greater

resources to the promotion and sales of their products than we can.

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We may be exposed to product liability or tort claims if our products fail, which could adversely impact our results of operations

A malfunction or the inadequate design of our products could result in product liability or other tort claims. Any liability for damages resulting from malfunctions could be substantial and could materially adversely affect our business and results of operations. In addition, a well-publicized actual or perceived problem could adversely affect the market's perception of our products.

We are highly dependent on a few key personnel and will need to retain and attract such personnel in a labor competitive market

Our ability to continue in business is dependent on the performance of key management and technical personnel, the loss of whom could severely affect our business. Additionally, in order to successfully implement any future growth, we will be dependent on our ability to generate resources necessary to hire qualified personnel. There can be no assurance that we will be able to retain or hire necessary personnel. We do not maintain key man life insurance on any of our key personnel. We believe that our future success will depend in part upon our ability to attract, retain, and motivate highly skilled personnel in an increasingly competitive market.

We are highly dependent on a few vendors for key system components made to our engineering specifications and disruption of vendor supply could adversely impact our results of operations.

Our product specifications often involve upfront investment in tooling and machinery, which result in our commitment to a limited number of high quality vendors that can meet our manufacturing standards. Any disruption to our supply of key components from the suppliers would have an adverse impact on our business and results of operations.

There are minimal barriers to entry in our market

We presently license or own only certain proprietary technology, and therefore have created little or no barrier to entry for competitors other than the time and significant expense required to assemble and develop similar production and design capabilities.

Our competitors may enter into exclusive arrangements with our current or potential suppliers, thereby giving them a competitive edge which we may not be able to overcome, and which may exclude us from similar relationships.

#### ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

#### ITEM 2. PROPERTIES

Our corporate offices are located at a manufacturing and warehouse facility at 2945 Columbia Street, Torrance, California which we are sub-leasing on a month-to-month basis. We believe our facilities are adequate for our current needs. The lease on our former corporate offices ended on January 31, 2013.

#### ITEM 3. LEGAL PROCEEDINGS

Given the nature of our business, we are subject from time to time to lawsuits, investigations and disputes (some of which involve substantial amounts claimed) arising out of the conduct of our business, including matters relating to

commercial transactions. Other than the Arens matter outlined below, we are not aware of any other pending legal matters. 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.

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.

The Company reported in a 8-K filed January 20, 2011 that we entered into a Partial Settlement Agreement, as amended on January 14, 2011, with Arens Controls Company, L.L.C. ("Arens") to resolve certain claims made by Arens in connection with its action captioned Arens Controls Company, L.L.C. v. Enova Systems, Inc., filed in 2008 with the Northern District of Illinois of the U.S. District Court (the "Legal Action"). In the Legal Action, Arens asserted eight counts against Enova, including certain claims regarding inventory asserted by Arens to be valued at \$1,671,000 (the "Inventory Claim"), a claim for payment under certain invoices, and claims for certain other monetary obligations of Enova to Arens.

Under the terms of the Settlement Agreement, we paid \$327,000 directly to Arens and Arens dismissed with prejudice all but two of the counts under the Legal Action. Additionally, under the Settlement Agreement (as amended), on January 14, 2011, we acquired the inventory that was the subject of the Inventory Claim (the "Inventory") for payment of \$1,498,000, net of an agreed upon reduction of \$173,000 for the acquisition price of such Inventory. In return, Arens was deemed to have released us from any further liability on the Inventory Claim. However, per the terms of the Settlement Agreement (as amended), Arens preserved its claims under two of the counts in the Legal Action.

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, 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.

#### ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.



## PART II

## ITEM MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER

## 5. MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Shares of our common stock now trade on the OTCQB Exchange under the trading symbols of "ENVA" and on the London Stock Exchange AIM Market under the symbol "ENVS.L" or "ENV.L". Our common stock was listed on the NYSE MKT LLC up until we were delisted effective October 31, 2012. The following table sets forth the high and low sales closing prices of our Common Stock as reflected on the NYSE MKT LLC and OTCBB.

|                | Common Stock |           |
|----------------|--------------|-----------|
|                | High Price   | Low Price |
| Calendar 2013  |              |           |
| Fourth Quarter | \$ 0.01      | \$ 0.01   |
| Third Quarter  | \$ 0.02      | \$ 0.01   |
| Second Quarter | \$ 0.02      | \$ 0.01   |
| First Quarter  | \$ 0.09      | \$ 0.01   |
| Calendar 2012  |              |           |
| Fourth Quarter | \$ 0.12      | \$ 0.01   |
| Third Quarter  | \$ 0.14      | \$ 0.04   |
| Second Quarter | \$ 0.38      | \$ 0.03   |
| First Quarter  | \$ 0.55      | \$ 0.17   |

As of March 31, 2014, there were approximately 1,000 holders of record of our Common Stock. As of March 31, 2014, approximately 100 shareholders held our common stock to be issued and approximately 32 shareholders held our Series B Preferred Stock. The number of holders of record excludes beneficial holders whose shares are held in the name of nominees or trustees.

## Dividend Policy

To date, we have neither declared nor paid any cash dividends on shares of our Common Stock or Series B Preferred Stock. We presently intend to retain all future earnings for our business and do not anticipate paying cash dividends on our Common Stock or Series B Preferred Stock in the foreseeable future. We are required to pay dividends on our Series B Preferred Stock before dividends may be paid on any shares of Common Stock. At December 31, 2013, Enova had an accumulated deficit of approximately \$162,251,000 and, until this deficit is eliminated, will be prohibited from paying dividends on any class of stock except out of retained earnings, unless it meets certain asset and other tests under Section 500 et. seq. of the California Corporations Code.

## ITEM SELECTED FINANCIAL DATA

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The following selected financial data tables set forth selected financial data for the years ended December 31, 2013, 2012 and 2011. The statement of operations data and balance sheet data for and as of the years ended December 31, 2013, 2012, and 2011 are derived from the audited financial statements of Enova. The following selected financial data should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and the Financial Statements, including the notes thereto, appearing elsewhere in this Form 10-K.

|  | For and as of the Years Ended         |            |            |
|--|---------------------------------------|------------|------------|
|  | December 31,                          |            |            |
|  | 2013                                  | 2012       | 2011       |
|  | (In thousands, except per share data) |            |            |
| <b>Statement of Operations Data</b>                  |                                       |            |            |
| Net revenues   | \$ 426                                | \$ 1,103   | \$ 6,622   |
| Cost of revenues                                     | 2,078                                 | 2,407      | 6,364      |
| Gross profit (loss)                                  | (1,652)                               | (1,304)    | 258        |
| <b>Operating expenses</b>                            |                                       |            |            |
| Research and development                             | -                                     | 805        | 2,039      |
| Selling, general and administrative                  | 1,081                                 | 3,915      | 5,075      |
| Total operating expenses                             | 1,081                                 | 4,720      | 7,114      |
| <b>Other income and (expense)</b>                    |                                       |            |            |
| Loss on litigation                                   | -                                     | (2,014)    | (41)       |
| Interest and other income (expense), net             | (171)                                 | (197)      | (87)       |
| Total other income and (expense)                     | (171)                                 | (2,211)    | (128)      |
| Net loss   | \$ (2,904)                            | \$ (8,235) | \$ (6,984) |
| <b>Per common share:</b>                             |                                       |            |            |
| Basic and diluted loss per share                     | \$ (0.07)                             | \$ (0.19)  | \$ (0.22)  |
| Weighted average number of common shares outstanding | 44,520                                | 43,952     | 31,537     |
| <b>Balance Sheet Data</b>                            |                                       |            |            |
| Total assets   | \$ 550                                | \$ 3,055   | \$ 9,340   |
| Long-term debt                                       | \$ 1,238                              | \$ 1,262   | \$ 1,286   |
| Shareholders’ equity (deficit)                       | \$ (5,522)                            | \$ (2,634) | \$ 5,298   |

## ITEM MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read this Management’s Discussion and Analysis of Financial Condition and Results of Operations in conjunction with our 2013 Financial Statements and accompanying Notes. The matters addressed in this Management’s Discussion and Analysis of Financial Condition and Results of Operations may contain certain forward-looking statements involving risks and uncertainties.

## Overview

Enova Systems has been a leading innovator of proprietary hybrid and electric drive systems propelling the alternative energy industry. Our core competencies are focused on the development and commercialization of power management and conversion systems for mobile applications. Enova applies unique ‘enabling technologies’ in the areas of alternative energy propulsion systems for medium and heavy-duty vehicles as well as power conditioning and management systems for distributed generation systems.

Enova's product focus has been on digital power management and power conversion systems. Its software and hardware manage and control the power that drives a vehicle, converting the power into the appropriate forms required by the vehicle or device and manage the flow of this energy to optimize efficiency and provide protection for both the system and its users. Our products and systems are the enabling technologies for power systems.

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The latest state-of-the-art technologies in hybrid and electric vehicles and fuel cell systems all require some type of power management and conversion mechanism. Enova Systems supplies these essential components. Enova drive systems are ‘fuel-neutral,’ meaning that they have the ability to utilize any type of fuel, including diesel, liquid natural gas or bio-diesel fuels. Enova has performed significant research and development to augment and support others’ and our internal product development efforts.

Our products are “production-engineered.” This means they are designed so they can be commercially produced (i.e., all formats and files are designed with manufacturability in mind, from the start). For the automotive market, Enova designs its products to ISO 9001 manufacturing and quality standards. We believe Enova’s redundancy of systems and rigorous quality standards result in high performance and reduced risk. For every component and piece of hardware, there are detailed performance specifications. Each piece is tested and evaluated against these specifications, which enhances and confirms the value of the systems to OEM customers.

The Company acknowledges the principal barrier to commercialization of our drive systems is cost. The cost of engineering proprietary software and hardware for our drive systems is high because economies of production in specialized hybrid drive system component parts, batteries, and vehicle integration have not been achieved. Therefore, the cost of our products and engineering services are currently higher than our gasoline and diesel competitor counterparts. We also believe maturation into commercialization of our drive systems will result in decreases to our long run average costs of materials and services as volume increases over time.

#### Critical Accounting Policies

The preparation of financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to product returns, bad debts, inventories, intangible assets, income taxes, stock-based compensation, warranty obligations, contingencies, and litigation. We base our estimates on historical experience and on various other assumptions believed to be reasonable under the circumstances, including current and anticipated worldwide economic conditions, both in general and specifically in relation to the hybrid and electric vehicle markets, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Our significant accounting policies are described in Note 2 to the financial statements included in Item 8 of this Form 10-K. We believe the following critical accounting policies necessitated that significant judgments and estimates be used in the preparation of its financial statements. We have reviewed these policies with our Audit Committee.

**Revenue Recognition** — We generally recognizes 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.

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.

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 billed are classified as current assets under contract work-in-progress. 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.

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**Warranty** — 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.

**Allowance for doubtful accounts** — The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable; however, changes in circumstances relating to accounts receivable may result in a requirement for additional allowances in the future. Past due balances over 90 days and other higher risk amounts are reviewed individually for collectibility. If the financial condition of the Company's customers were to deteriorate resulting in an impairment of their ability to make payment, additional allowances may be required. In addition, the Company maintains a general reserve for all invoices by applying a percentage based on the age category. Account balances are charged against the allowance after all collection efforts have been exhausted and the potential for recovery is considered remote.

**Inventory** — Inventories include material, labor, and manufacturing overhead are priced at the lower of cost or market utilizing the 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 (i.e., cycle counts). 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.

**Property and Equipment** — Property and equipment are stated at cost and depreciated over the estimated useful lives of the related assets, which range from three to seven years using the straight-line method for financial statement purposes. The Company uses other depreciation methods (generally, accelerated depreciation methods) for tax purposes where appropriate. Amortization of leasehold improvements is computed using the straight-line method over the shorter of the remaining lease term or the estimated useful lives of the improvements.

Repairs and maintenance are expensed as incurred. Expenditures that increase the value or productive capacity of assets are capitalized. When property and equipment are retired, sold, or otherwise disposed of, the asset's cost and related accumulated depreciation are removed from the accounts and any gain or loss is included in operations.

**Impairment of Long-Lived Assets** — The Company reviews the carrying value of property and equipment for impairment whenever events and circumstances indicate that the carrying value of an asset may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. In cases where undiscounted expected future cash flows are less than the carrying value, an impairment loss is recognized equal to an amount by which the carrying value exceeds the fair value of assets. The factors considered by management in performing this assessment include current operating results, trends, and prospects, as well as the effects of obsolescence, demand, competition, and other economic factors. Long-lived assets that management commits to sell or abandon are reported at the lower of carrying amount or fair value less cost to sell.

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.

The Company's determination of estimated fair value of share-based awards utilizes the Black-Scholes option-pricing model. The Black-Scholes model is affected by the Company's stock price as well as assumptions regarding certain highly complex and subjective variables. These variables include, but are not limited to; the Company's expected stock price volatility over the term of the awards as well as actual and projected employee stock option exercise behaviors.

**Deferred Income Taxes** — We evaluate the need for a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. We have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for a valuation allowance. We determined that we may not be able to realize all or part of its net deferred tax asset in the future, thus a full valuation allowance was recorded against our deferred tax assets.

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.

**Research and Development** — Research, development, and engineering costs are expensed in the period incurred. Costs of significantly altering existing technology are expensed as incurred.

#### 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.

#### Results of Operations

##### Years Ended December 31, 2013 and 2012

**Net Revenues.** Net revenues were \$426,000 for the year ended December 31, 2013, representing a decrease of \$677,000 or 61% from net revenues of \$1,103,000 during the same period in 2012. Revenues in the current year were negatively affected by uncertainty over the Company's ability to continue operations after our restructuring in June 2012, which reduced our capacity to pursue new business. The decrease in revenue for the twelve months ended December 31, 2013 compared to the same period in 2012 was mainly due to a decrease in deliveries to our core customer base in the United States. Revenues in 2013 were mainly attributable to shipments to First Auto Works in China and Smith Electric Vehicles, N.A.. We will have fluctuations in revenue from quarter to quarter and there can be no assurance there will be continuing demand for our products and services.

**Cost of Revenues.** Cost of revenues were \$2,078,000 for the year ended December 31, 2013, compared to \$2,407,000 for the year ended December 31, 2012, representing a decrease of \$329,000, or 14%. Cost of revenues decreased in 2013 compared to the same period in the prior year primarily due to the decrease in revenue. We recorded a charge of approximately \$1,660,000 and \$1,436,000 during 2013 and 2012, respectively, increasing our inventory obsolescence reserve after management updated its estimate of the realizable value of inventory. Cost of revenues consists of component and material costs, direct labor costs, integration costs and overhead related to manufacturing our products as well as warranty accruals and inventory valuation reserve amounts. Product development costs incurred in the performance of engineering development contracts for the U.S. Government and private companies are charged to cost of sales.

**Gross Margin.** The gross margin for the year ended December 31, 2013 was negative 387.8% compared to a negative 118.2% in the prior year. The decrease in gross margin is primarily attributable to lower production volumes and charges to increase the inventory reserve in 2013 associated with certain obsolete parts.

**Research and Development Expenses.** Research and development expenses consist primarily of personnel, facilities, equipment and supplies for our research and development activities. Non-funded development costs are reported as research and development expense. Research and development expenses during the year ended December 31, 2013 were \$0 compared to \$805,000 for the same period in 2012, a decrease of \$805,000 or 100%. We reduced engineering



staff 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 from the beginning of the second half of 2012.

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**Selling, General and Administrative Expenses.** Selling, general and administrative expenses consist primarily of sales and marketing costs, including consulting fees and expenses for travel, promotional activities and personnel and related costs for the quality and field service functions and general corporate functions, including finance, strategic and business development, human resources, IT, accounting reserves and legal costs. Selling, general and administrative expenses decreased by \$2,834,000, or 72%, during the year ended December 31, 2013 to \$1,081,000 from \$3,915,000 in the prior year, which decrease is attributable the Company's implementation of reduced operational capacity, the termination of employment with the Company by approximately 90% of the Company's workforce and other cost savings measures. We continually monitor S, G & A in light of our business outlook and are taking proactive steps to control these costs.

**Loss on Litigation.** For the year ended December 31, 2012, loss on litigation was \$2,014,000 due to our recording a charge for a judgment entered in the litigation with Arens Controls, as detailed in Item 3 – Legal Proceedings of this Form 10-K.

**Interest and Other Income (Expense).** For the year ended December 31, 2013, interest and other expense was \$171,000, an increase of \$26,000 or 13%, from an expense of \$197,000 in 2012. The primary reason for the increase is due to reduced impairment charges on the write-down of fixed assets.

#### 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 year ended December 31, 2013 were financed by product sales working capital reserves and an equity offering in May 2012 that resulted in net proceeds of \$132,000. As of December 31, 2013, the Company had \$1,000 of cash and cash equivalents.

On June 30, 2010, the Company entered into a secured 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 \$74,000 for the year ended December 31, 2013, an increase of \$3,314,000 compared to \$3,388,000 for the year ended December 31, 2012. Operating cash used increased in 2013 compared to the prior year primarily due to decreases in our operating expenses that resulted from the reduction of our operational capacity from June 2012 and the use of our existing cash resources to fund our current operations. Non-cash items include expense for stock-based compensation, depreciation and amortization, inventory reserve and other losses. These non-cash items decreased by \$2,524,000 for the year ended December 31, 2013 as compared to the same period in the prior year primarily due to the accrual of the Arens litigation judgment in December 2012 and a decrease in depreciation due to the end of the lease for our former headquarters, which lease expired in January 2013. The decrease in net loss was primarily due the decrease in our operating expenses of \$3,639,000 as compared to 2012 and a decrease in other net expenses of \$2,040,000. As of December 31, 2013, the Company had \$1,000 of cash and cash

equivalents compared to \$57,000 as of December 31, 2012.

Net cash from investing activities was \$29,000 for the year ended December 31, 2013, compared to net cash \$237,000 for the year ended December 31, 2012. In 2013 and 2012, proceeds from the sale of fixed assets were \$29,000 and \$53,000, respectively. In 2012, a certificate of deposit investment of \$200,000 was redeemed in order to fund drawdowns from an irrevocable letter of credit by Sunshine Distribution L.P. to pay rent on our corporate headquarters during the fourth quarter of 2012, and investing expenditures of \$16,000 for capital expenditures were expended mainly for the acquisition and integration of test vehicles and for test equipment utilized in R&D and production.

Net cash used in financing activities totaled \$11,000 for the year ended December 31, 2013, a decrease of \$123,000 compared to net cash provided by financing activities of \$112,000 for the year ended December 31, 2012. Financing activities in 2013 and 2012 for payments on vehicle notes were \$11,000 and \$20,000, respectively. In 2012, we received proceeds of \$132,000 from the issuance of Common Stock during second quarter of 2012 from the Lincoln Park facility, as explained in Note 11 – Stockholders' Equity to the financial statements included in this Form 10-K.

Net accounts receivable decreased by \$208,000, or 100%, to \$0 as of December 31, 2013 from \$208,000 as of December 31, 2012. The decrease in the receivable balance was primarily due to an increase in the Reserve for Doubtful Accounts. As of December 31, 2013 and December 31, 2012, the Company maintained a reserve for doubtful accounts receivable of \$404,000 and \$313,000, respectively, primarily related to financial instability at a major customer and concern over the Company's capacity to collect on overdue receivables.

Inventory decreased by \$1,776,000, or 81%, from \$2,203,000 as of December 31, 2012 to \$427,000 as of December 31, 2013. The decrease resulted from net inventory activity including receipts totaling \$305,000, consumption of \$421,000 and an inventory reserve charge of \$1,660,000.

Prepaid expenses and other current assets decreased by \$200,000, or 83%, to \$42,000 at December 31, 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.

Long term accounts receivable decreased by \$38,000, or 100%, to \$0 at December 31, 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 and an increase in the reserve for doubtful accounts. 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 full amount of the long-term receivable.

Property and equipment, net of depreciation, decreased by \$227,000, or 74%, to \$80,000 at December 31, 2013 compared to a balance of \$307,000 at December 31, 2012. The decrease is primarily due to depreciation expense of \$130,000 and a loss on disposed and impaired assets of \$34,000.

Accounts payable increased by \$84,000, or 15%, to \$642,000 at December 31, 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 \$36,000, or 100%, to \$36,000 at December 31, 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 December 31, 2013 compared to a balance of \$118,000 at December 31, 2012. The Company received prepayments on purchase orders from certain customers. 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 \$96,000, or 98%, to \$194,000 at December 31, 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 December 31, 2013 compared to the balance at December 31, 2012. As disclosed in Item 3. Legal Proceedings of Part I of this Form 10-K, 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.

Other accrued liabilities increased by \$39,000, or 15%, to \$294,000 at December 31, 2013 compared to a balance of \$255,000 at December 31, 2012. The increase was primarily due to an increase in accruals for professional fees and a reserve for costs associated with the return of repossessed vehicles.

Accrued interest increased by \$83,000, or 6%, to \$1,401,000 at December 31, 2013 from \$1,318,000 at December 31, 2012. The majority of the increase is associated with the interest accrued on the \$1.2 million note due the Credit Managers Association of California.

#### Going concern

To date, the Company has incurred recurring net losses and negative cash flows from operations. At December 31, 2013, the Company had an accumulated deficit of approximately \$162.3 million, working capital of approximately negative \$3.0 million and shareholders' equity deficit of approximately \$5.5 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 shareholders.

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. 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 caused the Company to delay all of its product development activities. Failure to obtain adequate financing also may 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 December 31, 2013, the Company had approximately \$1,000 in cash and cash equivalents and we do not anticipate that our existing cash and anticipated receivables collections will be sufficient to meet projected operating requirements through the end of 2014 to continue operations and market trading.

We have also accessed the capital markets to obtain limited operating funds. In April 2012, we entered into two Purchase Agreements (the facility) with Lincoln Park Capital Fund to issue up to \$10,000,000 in shares of our common stock and received proceeds of \$132,000, net of financing costs of \$152,000, from the initial purchase of shares of Common Stock from Lincoln Park in the second quarter. 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 MKT LLC on October 31, 2012, the Company can no longer raise funds from the facility. In February 2014, the Company entered into Subscription Agreements with various offshore investors to sell approximately 19,999,998 common shares of newly issued shares at a price of 0.0075 pence (approximately US\$0.01 per share) to certain eligible offshore investors on the Alternative Investment Market of the London Stock Exchange (the "AIM Exchange") for GBP 150,000 (approximately US\$248,000) in gross proceeds by a private subscription. The net proceeds from the offering were approximately US\$223,000.

#### 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.

The Company filed a notice of appeal in January 11, 2013. The Company believes the court committed errors leading to the verdict and judgment, and the Company is evaluating its options on appeal. However, there can be no assurance that the appeal will be successful or a negotiated settlement can be attained or that Arens will assert its claim in the state of California, and thereby cause the Company to go into bankruptcy.

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

Other than contractual obligations incurred in the normal course of business, we do not have any off-balance sheet financing arrangements or liabilities.

#### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.



ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

ENOVA SYSTEMS, INC.  
CONTENTS

December 31, 2013 and 2012

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders  
of Enova Systems, Inc.:

We have audited the accompanying balance sheets of Enova Systems, Inc. (the "Company") as of December 31, 2013 and 2012, and the related statements of operations, stockholders' equity (deficit), and cash flows for of the years then ended. The Company's management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Enova Systems, Inc. as of December 31, 2013 and 2012, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as going concern. As discussed in Note 1 to the financial statements, the Company's significant recurring losses and lack of working capital raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are disclosed are described in Note 1. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ PMB Helin Donovan, LLP  
PMB Helin Donovan, LLP  
Austin, Texas  
May 2, 2014

## ENOVA SYSTEMS, INC.

## BALANCE SHEETS

|  | December 31,  |               |
|--|---------------|---------------|
|  | 2013          | 2012          |
| <b>ASSETS</b>  |               |               |
| Current assets:  |               |               |
| Cash and cash equivalents  | \$ 1,000      | \$ 57,000     |
| Accounts receivable, net   | -             | 208,000       |
| Inventories and supplies, net  | 427,000       | 2,203,000     |
| Prepaid expenses and other current assets  | 42,000        | 242,000       |
| Total current assets   | 470,000       | 2,710,000     |
| Long term accounts receivable  | -             | 38,000        |
| Property and equipment, net  | 80,000        | 307,000       |
| Total assets   | \$ 550,000    | \$ 3,055,000  |
| <b>LIABILITIES AND STOCKHOLDERS' DEFICIT</b>   |               |               |
| Current liabilities:   |               |               |
| Accounts payable   | \$ 642,000    | \$ 558,000    |
| Loans from employees   | 36,000        | -             |
| Deferred revenues  | 213,000       | 118,000       |
| Accrued payroll and related expenses   | 194,000       | 98,000        |
| Accrued loss for litigation settlement   | 2,014,000     | 2,014,000     |
| Other accrued liabilities  | 294,000       | 255,000       |
| Current portion of notes payable   | 40,000        | 66,000        |
| Total current liabilities  | 3,433,000     | 3,109,000     |
| Accrued interest payable   | 1,401,000     | 1,318,000     |
| Notes payable, net of current portion  | 1,238,000     | 1,262,000     |
| Total liabilities  | 6,072,000     | 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 December 31, 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 December 31, 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 December 31, 2013 and December 31, 2012   | 145,512,000   | 145,512,000   |
| Additional paid-in capital   | 9,595,000     | 9,579,000     |
| Accumulated deficit  | (162,251,000) | (159,347,000) |
| Total stockholders' deficit  | (5,522,000)   | (2,634,000)   |
| Total liabilities and stockholders' deficit  | \$ 550,000    | \$ 3,055,000  |

The accompanying notes are an integral part of these financial statements.



## ENOVA SYSTEMS, INC.

## STATEMENTS OF OPERATIONS

|  | For the Years Ended<br>December 31, |                |
|--|-------------------------------------|----------------|
|  | 2013                                | 2012           |
| Revenues   | \$ 426,000                          | \$ 1,103,000   |
| Cost of revenues                                     | 2,078,000                           | 2,407,000      |
| Gross loss   | (1,652,000)                         | (1,304,000)    |
| Operating expenses                                   |                                     |                |
| Research and development                             | -                                   | 805,000        |
| Selling, general & administrative                    | 1,081,000                           | 3,915,000      |
| Total operating expenses                             | 1,081,000                           | 4,720,000      |
| Operating loss                                       | (2,733,000)                         | (6,024,000)    |
| Other income and (expense), net                      |                                     |                |
| Loss on litigation                                   | -                                   | (2,014,000)    |
| Interest and other income (expense)                  | (171,000)                           | (197,000)      |
| Total other income and (expense), net                | (171,000)                           | (2,211,000)    |
| Net loss   | \$ (2,904,000)                      | \$ (8,235,000) |
| Basic and diluted loss per share                     | \$ (0.07)                           | \$ (0.19)      |
| Weighted average number of common shares outstanding | 44,520,000                          | 43,952,000     |

The accompanying notes are an integral part of these financial statements.

## ENOVA SYSTEMS, INC.

## STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)

| Convertible Preferred Stock<br>Series A          |            | Series B |              | Common Stock to<br>be Issued |            | Common Stock |                | Additional         | Accumulated      |
|--|------------|----------|--------------|------------------------------|------------|--------------|----------------|--------------------|------------------|
| Shares   | Amount     | Shares   | Amount       | Shares                       | Amount     | Shares       | Amount         | Paid-in<br>Capital | Deficit          |
| Balance,<br>December<br>31,<br>2011              |            |          |              |                              |            |              |                |                    |                  |
| 2,642,000  | \$ 528,000 | 546,000  | \$ 1,094,000 |                              |            | 42,765,000   | \$ 145,380,000 | \$ 9,408,000       | \$ (151,112,000) |
| Issuance<br>of<br>common<br>stock<br>for<br>cash |            |          |              |                              |            |              |                |                    |                  |
|  |            |          |              |                              |            | 1,755,000    | 132,000        |                    |                  |
| Stock<br>option<br>expense                       |            |          |              |                              |            |              |                |                    |                  |
| (2,642,000)                                      | (528,000)  |          |              |                              |            |              |                | 171,000            |                  |
| Conversion<br>to<br>common<br>stock              |            |          |              |                              |            |              |                |                    |                  |
| Common<br>stock<br>to<br>be<br>issued            |            |          |              |                              |            |              |                |                    |                  |
|  |            |          |              | 59,000                       | 528,000    |              |                |                    |                  |
| Net<br>loss                                      |            |          |              |                              |            |              |                |                    |                  |
|  |            |          |              |                              |            |              |                |                    | (8,235,000)      |
| Balance,<br>December<br>31,<br>2012              |            |          |              |                              |            |              |                |                    |                  |
| -  | \$ -       | 546,000  | \$ 1,094,000 | 59,000                       | 528,000    | 44,520,000   | \$ 145,512,000 | \$ 9,579,000       | \$ (159,347,000) |
| Stock<br>option<br>expense                       |            |          |              |                              |            |              |                |                    |                  |
|  |            |          |              |                              |            |              |                | 16,000             |                  |
| Net<br>loss                                      |            |          |              |                              |            |              |                |                    |                  |
|  |            |          |              |                              |            |              |                |                    | (2,904,000)      |
| Balance,<br>December<br>31,<br>2013              |            |          |              |                              |            |              |                |                    |                  |
| -  | \$ -       | 546,000  | \$ 1,094,000 | 59,000                       | \$ 528,000 | 44,520,000   | \$ 145,512,000 | \$ 9,595,000       | \$ (162,251,000) |

The accompanying notes are an integral part of these financial statements.

## ENOVA SYSTEMS, INC.

## STATEMENTS OF CASH FLOWS

|   | For the Years Ended<br>December 31 |                |
|---|------------------------------------|----------------|
|   | 2013                               | 2012           |
| Cash flows from operating activities:                                       |                                    |                |
| Net loss  | \$ (2,904,000)                     | \$ (8,235,000) |
| Adjustments to reconcile net loss to net cash used in operating activities: |                                    |                |
| Bad debt expense  | 108,000                            | 296,000        |
| Inventory reserve expense   | 1,660,000                          | 1,436,000      |
| Depreciation and amortization   | 130,000                            | 466,000        |
| Loss on disposal of property and equipment                                  | 29,000                             | 28,000         |
| Loss on asset impairment  | 34,000                             | 90,000         |
| Loss on litigation  | -                                  | 2,014,000      |
| Stock option expense  | 16,000                             | 171,000        |
| (Increase) decrease in operating assets:                                    |                                    |                |
| Accounts receivable   | 118,000                            | 255,000        |
| Inventory and supplies  | 116,000                            | 397,000        |
| Prepaid expenses and other current assets                                   | 166,000                            | -              |
| Long term accounts receivable   | 20,000                             | 41,000         |
| Increase (decrease) in operating liabilities:                               |                                    |                |
| Accounts payable  | 84,000                             | 204,000        |
| Loans from employees  | 36,000                             | -              |
| Deferred revenues   | 95,000                             | (202,000)      |
| Accrued payroll and related expense   | 96,000                             | (168,000)      |
| Other accrued liabilities   | 39,000                             | (262,000)      |
| Accrued interest payable  | 83,000                             | 81,000         |
| Net cash used in operating activities                                       | (74,000)                           | (3,388,000)    |
| Cash flows from investing activities:                                       |                                    |                |
| Sale of certificate of deposit, restricted                                  | -                                  | 200,000        |
| Proceeds from the sale of fixed assets                                      | 29,000                             | 53,000         |
| Purchases of property and equipment   | -                                  | (16,000)       |
| Net cash provided by investing activities                                   | 29,000                             | 237,000        |
| Cash flows from financing activities:                                       |                                    |                |
| Payment on notes payable  | (11,000)                           | (20,000)       |
| Net proceeds from the issuance of common stock                              | -                                  | 132,000        |
| Net cash provided by (used in) financing activities                         | (11,000 )                          | 112,000        |
| Net decrease in cash and cash equivalents                                   | (56,000)                           | (3,039,000)    |
| Cash and cash equivalents, beginning of period                              | 57,000                             | 3,096,000      |
| Cash and cash equivalents, end of period                                    | \$ 1,000                           | \$ 57,000      |
| Supplemental disclosure of cash flow information:                           |                                    |                |
| Interest paid   | \$ 1,000                           | \$ 5,000       |
| Non-cash investing and financing activities                                 |                                    |                |
| Assets repossessed and notes payable relieved                               | \$ 39,000                          | \$ -           |



The accompanying notes are an integral part of these financial statements.

ENOVA SYSTEMS, INC.

NOTES TO FINANCIAL STATEMENTS

1. Description of Business

General

Enova Systems, Inc., (the "Company" or "Enova"), is a California corporation that develops, designs and produces drive systems and related components for electric, hybrid electric, and fuel cell systems for mobile applications. The Company retains development and manufacturing rights to many of the technologies created, whether such research and development is internally or externally funded. The Company sells drive systems and related components in the United States, Asia and Europe.

Liquidity

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. The Company has sustained recurring losses and negative cash flows from operations. Management believes that the Company's losses in recent years have primarily resulted from a combination of insufficient product and service revenue to support the Company's skilled and diverse technical staff believed to be necessary to support exploitation of the Company's technologies. Historically, the Company's growth and working capital needs have been funded through a combination of private and public equity offerings, and debt financing. During 2013, the Company's working capital needs have been funded primarily through a combination of product sales, asset sales and existing cash reserves. As of December 31, 2013, the Company had approximately \$1,000 of cash and cash equivalents. At December 31, 2013, the Company had net working capital of negative \$2,963,000 compared to negative \$399,000 at December 31, 2012, representing a decrease of approximately \$2,564,000.

Management manages costs in line with estimated total revenue. However, there can be no assurance that anticipated revenue will be realized or that the Company will successfully implement its plans. Management implemented measures to conserve cash, including the reduction of over 80% of employee headcount in the second quarter of 2012, and stringent controls over inventory purchases and administrative expenses. The Company will continue to conserve available cash by closely scrutinizing expenditures during 2014. The Company will need to raise additional capital to accomplish continue in business over the next year. The Company can make no assurance with respect to either the availability or terms of such financing and capital when it may be required.

Going Concern

The Company has experienced and continues to experience operating losses and negative cash flows from operations, as well as an ongoing requirement for substantial additional capital investment. At December 31, 2013, the Company had an accumulated deficit of approximately \$162.3 million, working capital of approximately negative \$2,963,000 and shareholders' equity deficit of approximately \$5.5 million. Over the past years, the Company has been funded through a combination of debt financing and private equity offerings. As of December 31, 2013, the Company had approximately \$1,000 in cash and cash equivalents.

The Company will need to raise additional capital to pursue recovery of its business over the long term and is currently pursuing a variety of funding options. There can be no assurance as to the availability or terms upon which such financing and capital might be available. If the Company is not successful in its efforts to raise additional funds, the Company may be required to cease its business operations.

In February 2014, the Company entered into Subscription Agreements with various offshore investors to sell approximately 19,999,998 common shares of newly issued shares at a price of 0.0075 pence (approximately US\$0.01 per share) to certain eligible offshore investors on the Alternative Investment Market of the London Stock Exchange (the "AIM Exchange") for GBP 150,000 (approximately US\$248,000) in gross proceeds by a private subscription. The net proceeds from the offering were approximately US\$223,000. The Company continues to pursue other options to raise additional capital fund continuing operations; however, there can be no assurance that we can successfully raise additional funds through the capital markets.

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The accompanying financial statements do not include any adjustments relating to the recoverability of assets and classification of liabilities that might be necessary should the Company be unable to continue as a going concern.

#### 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 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.

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, 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.

## 2. Summary of Significant Accounting Policies

### Basis of Presentation

These financial statements have been prepared in accordance with accounting principles generally accepted in the United States.

### Reclassifications

Certain amounts in the prior year have been reclassified to conform to the current year presentation. This change in classification does not affect previously reported cash flows from operating or financing activities in the Company's previously reported Statements of Cash Flows, or the Company's previously reported Statements of Operations for any period.

### 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 exists;
- Delivery has occurred or services have been rendered;
- The fee for the arrangement is fixed or determinable; and
- Collectibility is reasonably assured.

**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. Receipt of a customer purchase order is the primary method of determining that persuasive evidence of an arrangement exists.

**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 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.

**Collectibility is Reasonably Assured** — The Company determines that collectibility is reasonably assured prior to recognizing revenue. Collectibility 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 collectibility 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 collectibility 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.

Since some customer orders contain multiple items such as equipment and services which are delivered at varying times, the Company determines whether the delivered items can be considered separate units of accounting. Delivered items are considered separate units of accounting if delivered items have value to the customer on a standalone basis, there is objective and reliable evidence of the fair value of undelivered items, and if delivery of undelivered items is probable and substantially in the Company's control. The recognition of revenue from milestone payments is over the remaining minimum period of performance obligation. As required, the Company evaluates its sales contract to ascertain whether multiple element agreements are present.

The Company 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. 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 billed are classified as current assets under contract work-in-progress. Amounts billed to clients in excess of revenues recognized to date are classified as current liabilities under advance billings 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.

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. The Company has entered into several production and development contracts with customers. The Company has evaluated these contracts, ascertained the specific revenue generating activities of each contract, and established 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.

### 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.

### Shipping and Handling Costs

The Company includes shipping and handling costs associated with inbound and outbound freight in costs of goods sold.

### Cash and Cash Equivalents

Short-term, highly liquid investments with an original maturity of three months or less are considered cash equivalents. Certificates of deposits that have a penalty for early withdrawal are excluded from cash and cash equivalents.

### Accounts Receivable and Allowance for Doubtful Accounts

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable; however, changes in circumstances relating to accounts receivable may result in a requirement for additional allowances in the future. Past due balances over 90 days and other higher risk amounts are reviewed individually for collectability. If the financial condition of the Company's customers were to deteriorate resulting in an impairment of their ability to make payment, additional allowances may be required. In addition, the Company maintains a general reserve for all invoices by applying a percentage based on the age category. Account balances are charged against the allowance after all collection efforts have been exhausted and the potential for recovery is considered remote. As of December 31, 2013 and 2012, the Company maintained a reserve of \$404,000 and \$313,000 for doubtful accounts receivable. There was bad debt expense recorded of \$108,000 in 2013 and \$296,000 in 2012, respectively.

### Inventory

Inventories and supplies are comprised of materials used in the design and development of electric, hybrid electric, and fuel cell drive systems, and other power and ongoing management and control components for production and ongoing development contracts, finished goods and work-in-progress, and is stated at the lower of cost or market utilizing the first-in, first-out (FIFO) cost flow assumption. The Company maintains a perpetual inventory system and continuously records the quantity on-hand and standard cost for each product, including purchased components, subassemblies and finished goods. The Company maintains 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



The Company maintains 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.

## Property and Equipment

Property and equipment are stated at cost and depreciated over the estimated useful lives of the related assets, which range from three to seven years using the straight-line method for financial statement purposes. The Company uses other depreciation methods (generally, accelerated depreciation methods) for tax purposes where appropriate. Amortization of leasehold improvements is computed using the straight-line method over the shorter of the remaining lease term or the estimated useful lives of the improvements.

Repairs and maintenance are expensed as incurred. Expenditures that increase the value or productive capacity of assets are capitalized. When property and equipment are retired, sold, or otherwise disposed of, the asset's cost and related accumulated depreciation are removed from the accounts and any gain or loss is included in operations.

## Impairment of Long-Lived Assets

The Company reviews the carrying value of property and equipment for impairment whenever events and circumstances indicate that the carrying value of an asset may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. In cases where undiscounted expected future cash flows are less than the carrying value, an impairment loss is recognized equal to an amount by which the carrying value exceeds the fair value of assets. The factors considered by management in performing this assessment include current operating results, trends, and prospects, as well as the effects of obsolescence, demand, competition, and other economic factors. Long-lived assets that management commits to sell or abandon are reported at the lower of carrying amount or fair value less cost to sell.

## Fair Value of Financial Instruments

The carrying amount of financial instruments, including cash and cash equivalents, certificates of deposit, accounts receivable, accounts payable and other accrued liabilities, approximate fair value due to the short maturity of these instruments. The recorded values of notes payable and long-term debt approximate their fair values, as interest approximates market rates.

The Company defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. At December 31, 2013 and 2012, the Company had no financial assets or liabilities periodically re-measured at fair value.

## 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.

The Company's determination of estimated fair value of share-based awards utilizes the Black-Scholes option-pricing model. The Black-Scholes model is affected by the Company's stock price as well as assumptions regarding certain highly complex and subjective variables. These variables include, but are not limited to the Company's expected stock price volatility over the term of the awards as well as actual and projected employee stock options exercise behaviors.

The cash flows from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options are to be classified as financing cash flows. Due to the Company's loss position, there were no such tax benefits for the years ended December 31, 2013 and 2012.

The Company determines the fair value of the restricted stock awards utilizing the quoted market prices of the Company's shares on the date they were granted.

#### Research and Development

Research development, and engineering costs are expensed in the period incurred. Costs of significantly altering existing technology are expensed as incurred.

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## Income Taxes

The Company accounts for income taxes under an asset and liability approach. This process involves calculating the temporary and permanent differences between the carrying amounts of the assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The temporary differences can result in deferred tax assets and liabilities, which would be recorded on the Company's balance sheets. The Company must assess the likelihood that its deferred tax assets will be recovered from future taxable income and, to the extent the Company believes that recovery is not likely, the Company must establish a valuation allowance. Changes in the Company's valuation allowance in a period are recorded through the income tax provision on the statements of operations.

Uncertainty in income taxes are recognized in the Company's financial statements based on the recognition threshold and measurement attributes for financial statement disclosure of tax positions taken or expected to be taken on a tax return. The impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is more-likely-than-not to be sustained upon audit by the relevant taxing authority. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained. During 2013 and 2012, the Company did not recognize any liability for unrecognized income tax benefits.

## Loss Per Share

Basic loss per share is computed by dividing loss available to common stockholders by the weighted-average number of common shares outstanding. Diluted loss per share is computed similar to basic loss per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential common shares had been issued and if the additional common shares were dilutive. Common equivalent shares are excluded from the computation if their effect is anti-dilutive. The Company's common share equivalents consist of stock options, warrants and preferred stock.

The potential shares, which are excluded from the determination of basic and diluted net loss per share as their effect is anti-dilutive, are as follows:

|                                      | Fiscal Years Ended<br>December 31, |            |
|--------------------------------------|------------------------------------|------------|
|                                      | 2013                               | 2012       |
| Options to purchase common stock     | 5,210,000                          | 810,000    |
| Warrants to purchase common stock    | 11,250,000                         | 11,250,000 |
| Common shares to be issued           | 59,000                             | 59,000     |
| Series B preferred shares conversion | 24,000                             | 24,000     |
| Potential equivalent shares excluded | 16,543,000                         | 12,143,000 |

## Commitments and Contingencies

Certain conditions may exist as of the date the financial statements are issued, which may result in a loss to the Company but which will only be resolved when one or more future events occur or fail to occur. The Company's management and its legal counsel assess such contingent liabilities, and such assessment inherently involves an exercise of judgment. In assessing loss contingencies related to legal proceedings that are pending against the Company or unasserted claims that may result in such proceedings, the Company's legal counsel evaluates the perceived merits of any legal proceedings or unasserted claims as well as the perceived merits of the amount of relief sought or expected to be sought therein. If the assessment of a contingency indicates that it is probable that a material loss has been incurred and the amount of the liability can be estimated, then the estimated liability would be accrued in the Company's financial statements. If the assessment indicates that a potentially material loss contingency is not

probable, but is reasonably possible, or is probable but cannot be estimated, then the nature of the contingent liability, together with an estimate of the range of possible loss if determinable and material, would be disclosed.

Loss contingencies considered remote are generally not disclosed unless they involve guarantees, in which case the nature of the guarantee would be disclosed.

#### Estimates

The preparation of financial statements in accordance 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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

### Concentration of Credit Risk

Financial instruments which potentially subject the Company to concentrations of credit risk consist of cash and cash equivalents and accounts receivable. The Company places its cash and cash equivalents with high credit, quality financial institutions. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk on cash and cash equivalents. With respect to accounts receivable, the Company routinely assesses the financial strength of its customers and, as a consequence, believes that the receivable credit risk exposure is limited.

### 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

Inventories, consisting of materials, labor, and manufacturing overhead, are stated at the lower of cost (first-in, first-out) or market and consist of the following at December 31:

|                          | 2013         | 2012         |
|--------------------------|--------------|--------------|
| Raw materials            | \$ 3,098,000 | \$ 3,988,000 |
| Work-in-process          | 222,000      | 2,000        |
| Finished goods           | 449,000      | 587,000      |
| Reserve for obsolescence | (3,342,000)  | (2,374,000)  |
|                          | \$ 427,000   | \$ 2,203,000 |

Inventory reserve charged to operations amounted to \$1,660,000 and \$1,436,000 during 2013 and 2012, respectively. Inventory valuation adjustments and other inventory write-offs in 2013 and 2012 amounted to \$692,000 and \$245,000, respectively.

### 4. Property and Equipment

Property and equipment consisted of the following at December 31:

|  | 2013      | 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               | 127,000   | 675,000     |
| Leasehold improvements                         | -         | 1,327,000   |
|  | 523,000   | 3,204,000   |
| Less accumulated depreciation and amortization | (443,000) | (2,897,000) |
| Total  | \$ 80,000 | \$ 307,000  |

Depreciation and amortization expense was \$130,000 and \$466,000 for the years ended December 31, 2013 and 2012, respectively, which included amortization expense of leasehold improvements of \$23,000 and \$262,000 for the years ended December 31, 2013 and 2012, respectively.



Fixed assets totaling \$405,000 and \$482,000 were retired or disposed of in the years ended December 31, 2013 and 2012, respectively. For the year ended December 31, 2013, fixed assets with an original book value of \$272,000 were exchanged in settlement of vendor payables, two vehicles were sold and four vehicles were repossessed. For the year ended December 31, 2013, the Company recorded proceeds from the sale of fixed assets of \$29,000 and a loss on the disposal of fixed assets of \$29,000. 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. For the year ended December 31, 2012, the Company recorded an impairment loss of \$90,000 and loss on the disposal of fixed assets of \$28,000.

## 5. Litigation judgment

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.

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.

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.

There can be no assurance that 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.

## 6. Other Accrued Liabilities

Other accrued liabilities consisted of the following at December 31:

|                               | 2013      | 2012      |
|-------------------------------|-----------|-----------|
| Accrued inventory received    | \$ 10,000 | \$ 14,000 |
| Accrued professional services | 161,000   | 45,000    |
| Accrued warranty              | 74,000    | 117,000   |



|       |            |            |
|-------|------------|------------|
| Other | 49,000     | 79,000     |
| Total | \$ 294,000 | \$ 255,000 |

Accrued warranty consisted of the following activities for the years ended December 31:

|  | 2013       | 2012       |
|--|------------|------------|
| Balance at beginning of year                     | \$ 117,000 | \$ 227,000 |
| Accruals for warranties issued during the period | 96,000     | 141,000    |
| Warranty claims                                  | (139,000)  | (251,000)  |
| Balance at end of year                           | \$ 74,000  | \$ 117,000 |

## 7. Notes Payable

Notes payable at December 31, consisted of the following:

|   | 2013         | 2012         |
|---|--------------|--------------|
| Secured note payable to Credit Managers Association of California, bearing interest at prime plus 3% (6.25% as of December 31, 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   | —            | 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  | —            | 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   | —            | 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       |
|   | 1,278,000    | 1,328,000    |
| Less current portion of notes payable   | (40,000)     | (66,000)     |
| Notes payable, net of current portion   | \$ 1,238,000 | \$ 1,262,000 |

As of December 31, 2013 and 2012, the balance of long term interest payable amounted to \$1,401,000 and \$1,318,000, respectively, of which the Credit Managers Association of California note amounted to \$1,365,000 and \$1,286,000, respectively. Interest expense on notes payable amounted to approximately \$85,000 and \$88,000 during the years ended December 31, 2013 and 2012, 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, which is included in accounts payable at December 31, 2013. In the fourth quarter of 2013, three vehicles that secured notes due on February 19, 2014, August 25, 2014 and April 9, 2015 were repossessed by the secured lenders. The Company has accrued approximately \$18,000 for final settlements for the three vehicles, which is included in other accrued liabilities at December 31, 2013.

Future minimum principal payments of notes payable at December 31, 2013 consisted of the following:

| Year Ending December 31 | Principal Amounts |
|-------------------------|-------------------|
| 2014                    | \$ 40,000         |
| 2015                    | —                 |
| 2016                    | 1,238,000         |
| Thereafter              | —                 |
| Total                   | \$ 1,278,000      |

#### 8. Revolving Credit Agreement

On June 30, 2010, the Company entered into a secured revolving credit facility with a financial institution for \$200,000 which was secured by a \$200,000 certificate of deposit. The facility is for a period of 3 years and 6 months from July 1, 2010 to December 31, 2013. 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 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.

#### 9. Deferred Revenues

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

#### 10. Commitments and Contingencies

##### Leases

In October 2007, the Company entered into a lease agreement with Sunshine Distribution LP ("Landlord"), with respect to the lease of an approximately 43,000 square foot facility located at 1560 West 190th Street, Torrance, California (the "Lease"). The lease term commenced on November 1, 2007, and expired January 31, 2013. Our corporate offices are currently located at a manufacturing and warehouse facility at 2945 Columbia Street, Torrance, California which we are sub-leasing on a month-to-month basis.

The total base monthly rent at our former headquarters was approximately \$39,000. Under the Lease, Enova paid the Landlord certain commercially reasonable and customary common area maintenance costs of approximately \$5,000 per month, increasing ratably as these costs are increased to the Landlord. The Lease was secured by an irrevocable standby letter of credit in the amount of \$200,000 and naming the Landlord as the beneficiary. Rent expense was approximately \$111,000 and \$537,000 for the years ended December 31, 2013, and 2012, respectively.

#### 11. Stockholders' Equity

##### Common Stock

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 additional shares of the Company's common stock, subject to certain limitations. We issued a total of 1,754,974 shares of common stock in the second quarter of 2012, of which 1,450,000 shares were issued for cash proceeds of \$132,000, net of financing costs of \$152,000, as consideration for its commitment to purchase common stock under the \$3,400,000 Purchase Agreement and commissions on each drawdown, the Company issued to Lincoln Park a total of 304,974 shares of common stock. The purchase agreement stipulates that our shares be listed on a national exchange in order to access the facility. As the company's shares were delisted from the NYSE MKT LLC on October 31, 2012, the Company is no longer able to sell shares to Lincoln Park under the facility.

On February 23, 2014, Enova Systems, Inc, entered into Subscription Agreements with various offshore investors to sell approximately GBP 150,000 (approximately US\$248,000) 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\$0.01 per 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.

During the twelve months ended December 31, 2013 and 2012, the Company did not issue any shares of common stock to directors or employees as compensation.

#### Series A Preferred Stock

Series A preferred stock was convertible into 1/45 of a share of common stock at the election of the holder or automatically upon the occurrence of certain events including: sale of stock in an underwritten public offering; registration of the underlying conversion stock; or the merger, consolidation, or sale of more than 50% of the Company. Holders of Series A preferred stock had the same voting rights as common stockholders. The stock had a liquidation preference of \$0.60 per share plus any accrued and unpaid dividends in the event of voluntary or involuntary liquidation of the Company. Dividends are non-cumulative and payable at the annual rate of \$0.036 per share if, when, and as declared by, the Board of Directors. No dividends were declared on the Series A preferred stock.

On October 26, 2012, the Company registered 58,714 shares of common stock through a Form S-3 Registration Statement, which became effective on November 21, 2012. Therefore, all 2,642,159 outstanding shares of Series A Preferred Stock were automatically converted into 58,714 of common stock as of the effectiveness of the registration statement. The Company has not issued the common shares as of December 31, 2013.

#### Series B Preferred Stock

Series B preferred stock is currently unregistered. Each share is convertible into 2/45 of a share of common stock at the election of the holder or automatically upon the occurrence of certain events including: sale of stock in an underwritten public offering, if the offering results in net proceeds of \$10,000,000, and the per share price of common stock is at least \$2.00; and the merger, consolidation, or sale of common stock or sale of substantially all of the Company's assets in which gross proceeds received are at least \$10,000,000. The Series B preferred stock has certain liquidation and dividend rights prior and in preference to the rights of the common stock and Series A preferred stock. The stock has a liquidation preference of \$2.00 per share together with an amount equal to, generally, \$0.14 per share compounded annually at 7% per year from the filing date, less any dividends paid. Dividends on the Series B preferred stock are non-cumulative and payable at the annual rate of \$0.14 per share if, when, and as declared by, the Board of Directors. No dividends have been declared on the Series B preferred stock.

## 12. Stock Options

### Stock Option Program Description

For the year ended December 31, 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, Inc. approved amendments to the Company's 2006 Equity Compensation Plan to (a) increase the number of shares authorized for issuance thereunder 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. The 2006 Plan has a total of 4,400,000 and 270,000 shares that were granted in 2013 and 2012, respectively.

Stock-based compensation expense related to stock options was \$16,000 and \$171,000 for the years ended December 31, 2013 and 2012, respectively. As of December 31, 2013, the total compensation cost related to non-vested awards not yet recognized is \$42,000. The remaining period over which the future compensation cost is expected to be recognized is 26 months.

Stock-based compensation expense recognized in the Statement of Operations for the years ended December 31, 2013 and 2012 has been based on awards ultimately expected to vest. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. If the actual number of forfeitures differs from that estimated by management, additional adjustments to compensation expense may be required in future periods.

The following is a summary of changes to outstanding stock options during the fiscal year ended December 31, 2013 and 2012:

|                                  | Number of<br>Share<br>Options | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Life | Aggregate<br>Intrinsic<br>Value (1) |
|----------------------------------|-------------------------------|--|---|-------------------------------------|
| Outstanding at December 31, 2011 | 2,529,000                     | \$ 1.07                                  | 6.09  | \$ —                                |
| Granted                          | 270,000                       | \$ 0.08                                  | 3.96  | \$ —                                |
| Exercised                        | —                             | \$ —                                     | —   | \$ —                                |
| Forfeited or Cancelled           | (1,989,000)                   | \$ 1.11                                  | —   | \$ —                                |
| Outstanding at December 31, 2012 | 810,000                       | \$ 0.64                                  | 4.06  | \$ —                                |
| Granted                          | 4,400,000                     | \$ 0.02                                  | 2.66  | \$ —                                |
| Exercised                        | —                             | \$ —                                     | —   | \$ —                                |
| Forfeited or Cancelled           | —                             | \$ —                                     | —   | \$ —                                |
| Outstanding at December 31, 2013 | 5,210,000                     | \$ 0.12                                  | 2.72  | \$ —                                |
| Exercisable at December 31, 2013 | 675,000                       | \$ 0.75                                  | 3.26  | \$ —                                |
| Vested and expected to vest(2)   | 5,210,000                     | \$ 0.12                                  | 2.72  | \$ —                                |

(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.

During 2013 and 2012, the Company granted 4,400,000 and 270,000 options for fair value of \$39,500 and \$13,500, respectively. During 2013 and 2012, zero and 1,989,000 options were forfeited.

At December 31, 2013, there were 3,790,000 shares available for grant under the 2006 plan. The exercise prices of the options outstanding at December 31, 2013 ranged from \$0.02 to \$4.35. The weighted-average grant date fair value of the options granted during the years ended December 31, 2013 and 2012 was \$0.01 and \$0.05, respectively.



Unvested share activity for the year ended December 31, 2013 is summarized below:

|                                       | Unvested<br>Number of<br>Options | Weighted-Average<br>Grant Date Fair<br>Value |
|---------------------------------------|----------------------------------|--|
| Unvested balance at December 31, 2012 | 236,000                          | \$ 0.04                                      |
| Granted                               | 4,400,000                        | \$ 0.02                                      |
| Vested                                | (101,000)                        | \$ 0.11                                      |
| Forfeited                             | —                                | \$ —   |
| Unvested balance at December 31, 2013 | 4,535,000                        | \$ 0.02                                      |

The Company settles employee stock option exercises with newly issued common shares. The table below presents information related to stock option activity for the fiscal years ended December 31, 2013 and 2012:

|   | Years Ended<br>December 31, |      |
|---|-----------------------------|------|
|   | 2013                        | 2012 |
| Total intrinsic value of stock options exercised            | \$ —                        | \$ — |
| Cash received from stock option exercises                   | \$ —                        | \$ — |
| Gross income tax benefit from the exercise of stock options | \$ —                        | \$ — |

#### Valuation and Expense Information

The fair value of stock-based awards to officers and employees is calculated using the Black-Scholes option pricing model. The Black-Scholes model requires subjective assumptions, including future stock price volatility and expected time to exercise, which greatly affect the calculated values. The expected term of options granted is calculated by using the SAB 107 “simplified method” of estimating the expected term which is derived by taking the average of the time to vesting and the full term of the option. The risk-free rate selected to value any particular grant is based on the bond equivalent yields that corresponds to the pricing term of the grant effective as of the date of the grant. The expected volatility is based on the historical volatility of the Company’s stock price. These factors could change in the future, affecting the determination of stock-based compensation expense in future periods.

The fair values of all stock options granted during the fiscal years ended December 31, 2013 and 2012 were estimated on the date of grant using the following range of assumptions:

|                                 | Years Ended December 31, |             |
|---------------------------------|--------------------------|-------------|
|                                 | 2013                     | 2012        |
| Expected life (in years)        | 1.5                      | 1.5- 6.5    |
| Average risk-free interest rate | 1.66%                    | 1.66%       |
| Expected volatility             | 118%                     | 108% - 136% |
| 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, if applicable, 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.



## 13. 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 during the fiscal year ended December 31, 2013 and 2012:

|                                  | Number of<br>Share<br>Options | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Life |
|----------------------------------|-------------------------------|--|---|
| Outstanding at December 31, 2011 | 11,250,000                    | \$ 0.22                                  | 5.00  |
| Granted                          | —                             | \$ —                                     | —   |
| Exercised                        | —                             | \$ —                                     | —   |
| Forfeited or Cancelled           | —                             | \$ —                                     | —   |
| Outstanding at December 31, 2012 | 11,250,000                    | \$ 0.22                                  | 4.00  |
| Granted                          | —                             | \$ —                                     | —   |
| Exercised                        | —                             | \$ —                                     | —   |
| Forfeited or Cancelled           | —                             | \$ —                                     | —   |
| Outstanding at December 31, 2013 | 11,250,000                    | \$ 0.22                                  | 3.00  |
| Exercisable at December 31, 2013 | 11,250,000                    | \$ 0.22                                  | 3.00  |

## 14. Income Taxes

Significant components of the Company’s deferred tax assets and liabilities for federal and state income taxes as of December 31, consisted of the following:

|                                   | 2013          | 2012          |
|-----------------------------------|---------------|---------------|
| Deferred tax assets               |               |               |
| Net operating loss carry-forwards | \$ 27,516,000 | \$ 27,079,000 |
| Stock based compensation          | 852,000       | 845,000       |
| Other, net                        | 36,000        | (406,000)     |
|                                   | 28,404,000    | 27,518,000    |
| Less valuation allowance          | (28,404,000)  | (27,518,000)  |
| Net deferred tax assets           | \$ —          | \$ —          |

The Tax Reform Act of 1986 limits the use of net operating loss carryforwards in certain situations where changed occur in the stock ownership of a company. In the event the Company has had a change in ownership, utilization of the carryforwards could be restricted.

Deferred taxes arise from temporary differences in the recognition of certain expenses for tax and financial reporting purposes. The deferred tax assets have been offset by a valuation allowance since management does not believe the recoverability of these in future years is more likely than not to occur. The valuation allowance increased by \$887,000 in 2013 compared to a increase of \$1,788,000 in 2012. As of December 31, 2013, the Company had net operating loss carry forwards for federal and state income tax purposes of approximately \$67,817,000 and \$50,428,000, respectively. These operating loss carry forwards will expire in 2014 through 2033.

The provision for income taxes differs from the amount computed by applying the U.S. federal statutory tax rate (34% in 2013 and 2012) to income taxes as follows:

|   | December 31,<br>2013 | December 31,<br>2012 |
|---|----------------------|----------------------|
| Tax benefit computed at 34%             | \$ (987,000)         | \$ (2,800,000)       |
| Change in valuation allowance           | 887,000              | 1,788,000            |
| State tax (net of Federal benefit)      | (169,000)            | (480,000)            |
| Change in carryovers and tax attributes | 269,000              | 1,492,000            |
| Net tax benefit                         | \$ —                 | \$ —                 |

The Company files federal income tax returns in the U.S. and in various state jurisdictions. The Company has not been audited by the Internal Revenue Service or any state for income taxes. The Company reviews its recognition threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. The Company reviews all material tax positions for all years open to statute to determine whether it is more likely than not that the positions taken would be sustained based on the technical merits of those positions. The Company did not recognize any adjustments for uncertain tax positions as of and during the years ended December 31, 2013 and 2012.

#### 15. Employee Benefit Plan

The Company has a 401(k) profit sharing plan covering substantially all employees. Eligible employees may elect to contribute a percentage of their annual compensation, as defined, to the plan. The Company may also elect to make discretionary contributions. For the years ended December 31, 2013 and 2012, the Company did not make any contributions to the plan. The Company closed the 401(k) plan in 2013.

#### 16. Geographic Area Data

The Company operates as a single reportable segment and attributes revenues to countries based upon the location of the entity originating the sale. Revenues by geographic area are as follows:

|                | 2013       | 2012         |
|----------------|------------|--------------|
| United States  | \$ 87,000  | \$ 142,000   |
| China          | 324,000    | 716,000      |
| United Kingdom | 8,000      | 243,000      |
| Korea          | 7,000      | —            |
| Japan          | —          | 2,000        |
| Total          | \$ 426,000 | \$ 1,103,000 |

#### 17. Concentration

During the years ended December 31, 2013 and 2012, the Company's sales were concentrated with a few large customers. During the year ended December 31, 2013, sales to two customers comprised 76% and 19% of total revenues and two customers accounted for 62% and 38% of gross accounts receivable, respectively. During the year ended December 31, 2012, sales to two customers comprised 63% and 20% of total revenues and two customers accounted for 61% and 39% of gross accounts receivable, respectively. The Company performs ongoing credit evaluations of certain customers' financial condition and generally requires no collateral from its customers. The Company's inventory purchases are concentrated with certain key vendors that produce components according to our

engineering specifications. During the year ended December 31, 2013, 47% of purchases were concentrated with one vendor and during the year ended December 31, 2012, 39% of purchases were concentrated with one vendor.

## 18. 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\$0.01 per 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 GBP50,000 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.

## 19. Related Party Transactions

As of December 31, 2013, Mr. Micek, who serves as Chief Executive Officer, and another employee, have loaned the Company a total of \$36,000 in support of continued operations. In addition, in an 8-K filed on March 6, 2014, Mr. Micek orally agreed to loan the Company the amount of \$50,000, with repayment due on demand. As of April 23, 2014, Mr. Micek has advanced \$43,000 to the Company.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES

None.

ITEM CONTROLS AND PROCEDURES

9A.

Evaluation of Disclosure Controls and Procedures

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 December 31, 2013. Based on that evaluation, our management, including the Chief Executive Officer and Chief Financial Officer, concluded that as of December 31, 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.

Management’s Report on 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) 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.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of management, including the Company’s Chief Executive Officer and Chief Financial Officer, the Company conducted an evaluation of the effectiveness of its internal control over financial reporting based on the framework in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. This evaluation included an assessment of the design of the Company’s internal control over financial reporting and testing of the operational effectiveness of its internal control over financial reporting.

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 December 31, 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 December 31, 2013.



This annual report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting. We were not required to have, nor have we engaged our independent registered public accounting firm, to perform an audit of internal control over financial reporting pursuant to the rules of the Securities and Exchange Commission that permits us to provide only management's report in this annual report.

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## Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting during the quarter ended December 31, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## ITEM 9B. OTHER INFORMATION

None.

## ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The following table sets forth certain information with respect to the current Directors and executive officers of Enova Systems Inc.:

| Name                         | Age | Position  |
|------------------------------|-----|---|
| Christopher Thunen (2)       | 36  | Director  |
| John Micek                   | 60  | Chief Executive Officer, Chief Financial Officer, Treasurer, Secretary and Director |
| Edwin O. Riddell(1)(3)(4)(6) | 71  | Director  |
| James Burness(2)(4)(5)       | 65  | Director  |

|     |  |
|-----|--|
| (1) | Audit Committee Chairman                     |
| (2) | Audit Committee Member                       |
| (3) | Compensation Committee Chairman              |
| (4) | Compensation Committee Member                |
| (5) | Nominating and Governance Committee Member   |
| (6) | Nominating and Governance Committee Chairman |

John J. Micek. Mr. Micek was re-appointed to Enova's Board of Directors in 2007, was appointed as Chief Financial Officer, Treasurer and Secretary of the Company effective January 1, 2011 and, on June 27, 2012, was appointed to serve, in addition to the foregoing, as President and Chief Executive Officer of the Company. He previously served on the Board between April 1999 and July 2005. From 2000 to 2010, Mr. Micek was Managing Director of Silicon Prairie Partners, LP, a Palo Alto, California based family-owned venture fund. Since April 2010, Mr. Micek has been Managing Partner of Verdant Ventures, a merchant bank dedicated to sourcing and funding University and corporate lab spinouts in areas including cleantech and pharma. He also is admitted to practice law in California and his prior practice focused on financial services. Currently, Mr. Micek actively serves on the Board of Directors of Armanino Foods of Distinction, Innovaro Corporation and JAL/Universal Assurors. Additionally, he currently is an adjunct faculty professor in Corporate Governance and Ethics at the graduate school of Economics at the University of San Francisco. Mr. Micek was on the Board of Directors of Universal Warranty Corporation, a wholly owned subsidiary of GMACI, from 2000-2003.

Mr. Micek's finance and business background, longstanding relationship with our Company, and his performance as a board member of our Company led the Board of Directors to conclude that he should be nominated to serve another term as a director.

Edwin O. Riddell. Mr. Riddell has served on the Board of Directors since 1995. He also served as our President and Chief Executive Officer from August 20, 2004 until his retirement effective August 28, 2007. Between 1999 and 2004, Mr. Riddell was President of CR Transportation Services, a consultant to the electric and hybrid vehicle

industry. From 1992 to 1999, Mr. Riddell was Product Line Manager of the Transportation Business Unit at the Electric Power Research Institute, and from 1985 until 1992, he served with the Transportation Group, Inc. as Vice President of Engineering, working on electrically driven public transportation systems. From 1979 to 1985, Mr. Riddell was Vice President, General Manager and COO of Lift-U, Inc., a manufacturer of handicapped wheelchair lifts for the transit industry. He has also worked with Ford, Chrysler, and General Motors in the area of auto design, and as a member of senior management for a number of public transit vehicle manufacturers. Mr. Riddell served as a member of the American Public Transportation Association's (APTA) Member Board of Governors for over 15 years, and served on APTA's Board of Directors. Mr. Riddell was also Managing Partner of the U.S. Advanced Battery Consortium. He also serves on the Electric Drive Association Board of Directors.

Mr. Riddell's prior service as chief executive officer of our Company, historical perspective on our Company's business, relationships and strategy; and his performance as a board member of our Company led the Board of Directors to conclude that he should be nominated to serve another term as a director.

Christopher Thunen. Mr. Thunen was appointed to the Board of Directors in 2012. Mr. Thunen currently works in the capital markets advisory group at Scarsdale Equities, LLC, where he is responsible for coordinating banking activities for the group's clients. From 2011 to 2012, Mr. Thunen was a Vice President in the Capital Markets Advisory Group at Merriman Capital, Inc., where he was also responsible for coordinating client banking activities. Mr. Thunen holds a J.D. from Harvard Law School, an M.A. from Yale University, and a B.A. from Amherst College. He is admitted to the State Bars of California and Connecticut and holds FINRA Series 7, 63, 86, and 87 securities licenses.

Mr. Thunen's capital markets and corporate finance experience led the Board of Directors to conclude that he should be nominated to serve a full term as a director.

James A. Burness. Mr. Burness was appointed to the Board of Directors in 2013. Mr. Burness is currently a general partner of Burness Dwight Partners and Innovation Ventures, a life science advisory firm where he is responsible for advising companies on finance strategies and strategic direction since 1998. Prior to that, Mr. Burness served from 1994 to 1998 as Senior VP and Head of the Life Science IR practice for Russell Welsh responsible for financing strategies and interactions with Wall St. and the financial /scientific media for life science and biotech companies. From 1980 to 1987, Mr. Burness worked as an Executive Assistant in the Office of the Chairman of the New York Stock Exchange where he was responsible for day to day operations of the Exchange, interactions with Committees and Board, the SEC and Congress, and began his career in 1974 as a senior official at the US Securities and Exchange Commission (SEC), Division of Corporate Finance responsible for S-1 registration statements, proxy contests and annual reports.

Mr. Burness's experience in advising start-ups firms and prior work with the SEC and the NYSE led the Board of Directors to conclude that he should be nominated to serve a full term as a director.

There is no family relationship between any director, nominee, or executive officer of Enova Systems.

#### Board of Directors and its Committee

**Audit Committee.** The Board of Directors has established an Audit Committee in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934, as amended. The current members of this committee are Messrs. Riddell (Chair), Burness and Thunen. The Board has determined that the members of the Audit Committee are "independent" under the rules of the SEC and that, although Enova is no longer subject to the independence requirements of the NYSE MKT LLC, such members would be considered "independent" under the NYSE MKT LLC rules. In addition to being independent, Mr. Burness has been determined by the Board to be an "audit committee financial expert" as defined by the SEC. Mr. Burness' designation by the Board as an "audit committee financial expert" is not intended to be a representation that he is an expert for any purpose as a result of such designation, nor is it intended to impose on him any duties, obligations or liability that are greater than the duties, obligations or liability imposed on him as a member of the Audit Committee and the Board in the absence of such designation.

**Compensation Committee.** The Board of Directors has established a Compensation Committee. The current members of this committee are Messrs. Riddell (Chair) and Burness. Although the Company is no longer listed on the NYSE MKT LLC, the Board has determined that Messrs. Riddell and Burness would be considered "independent" members of the Compensation Committee under the rules of the NYSE MKT LLC.

Nominating and Governance Committee. The Board of Directors has established a Nominating and Governance Committee. The current member of this committee is Messr. Riddell. There have been no material changes during the last fiscal year to the procedures by which security holders may recommend nominees to Enova's board of directors.

## Code of Ethics

Enova Systems has adopted a “Code of Ethics For Officers, Directors, and Employees” consistent with SEC’s rules requiring a Code of Ethics. It applies to our Board of Directors, Chief Executive Officer, Chief Financial Officer and principal accounting officer, and employees. A copy of the Code of Ethics for Officers, Directors, and Employees may be obtained free of charge by writing to Enova Systems, Inc., 2945 Columbia Street, Torrance, California 90503, Attention: Chief Financial Officer or by accessing the “Investor Relations” section of our website (www.enovsystems.com). To the extent required by the rules of the SEC, we will post on our website any amendments and waivers relating to our code of ethics.

## Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934 requires our officers and directors and beneficial owners of greater than 10% owners of our common stock to file reports of ownership and changes in ownership with the SEC and provide copies to us. Based solely on a review of Section 16 reports and written representations from officers and directors, we believe that during the fiscal year ended December 31, 2013, our officers, directors, and greater than 10% owners timely filed all reports they were required to file under Section 16(a), except as follows: Anthony Low-Beer failed to file on a timely basis a Form 4 in connection with sale of all of his group’s shares of our outstanding Common Stock.

## ITEM 11. EXECUTIVE COMPENSATION

The table below summarizes the total compensation for the fiscal years ended December 31, 2013 and 2012 paid to or earned by the only executive officer of the Company during the fiscal year ended December 31, 2013.

## SUMMARY COMPENSATION TABLE

| Name and Principal Position                                       | Fiscal Year | Salary (\$)(A) | Bonus (\$)(B) | Options Awards (\$)(C) | Non-Equity Incentive Plan Compensation (\$) | All other Compensation (\$)(D) | Total (\$) |
|---|-------------|----------------|---------------|------------------------|---|--------------------------------|------------|
| John Micek<br>Chief Executive Officer and Chief Financial Officer | 2013        | \$ 150,069     | \$ —          | \$ 39,547              | \$ —  | \$ 12,844                      | \$ 202,460 |
|   | 2012        | \$ 159,769     | \$ 59,996     | \$ —                   | \$ —  | \$ 11,192                      | \$ 230,957 |

- (A) Due to the financial condition of the Company, Mr. Micek's salary in the amount of \$92,205 was deferred as of December 31, 2013.
- (B) For the 2012 year, Mr. Micek earned bonus compensation based on the Board of Directors meeting on July 27, 2012 which established certain cash incentive bonus awards, the payment of which is dependent upon the settlement of certain account receivables and account payables. Under these guidelines, an incentive bonus of \$59,996 was accrued in 2012.
- (C) The valuation of option awards issued to employees are calculated in accordance with SEC rules as the grant date fair value in accordance with FASB ASC 718 consistent with the assumptions set forth in Note 12 to the financial statements in this Annual Report on Form 10-K.
- (D) For Mr. Micek, the amount shown attributable to 2013 includes (i) \$12,844 in medical insurance premiums paid. In 2012, the amount shown attributable for Mr. Micek includes (i) \$173 value of life insurance premiums paid; (ii) \$5,019 in medical insurance premiums paid; and (iii) \$6,000 in office rent.

Employment Arrangements

As previously disclosed in a Form 8-K filed on July 3, 2012, for the 2012 year, the Board established certain incentive bonus awards for Mr. Micek, the payment of which were dependent upon the settlement of certain account receivables and account payables.

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## Equity Awards

The following table presents information regarding outstanding equity awards held by the executive officer named in the Summary Compensation Table at December 31, 2013.

## Outstanding Equity Awards at Fiscal Year-End December 31, 2013

| Name       | Number of Securities Underlying Unexercised Options (#) Exercisable | Option Awards   |                       |                        |
|------------|---|---|-----------------------|------------------------|
|            |   | Number of Securities Underlying Unexercised Options (#) Unexercisable | Option Exercise Price | Option Expiration Date |
| John Micek | 4,400,000(A)  | 4,400,000   | \$ 0.02               | 8/27/2016              |
|            | 250,000(B)  | —   | \$ 0.19               | 12/18/2014             |
|            | 14,583(C)   | —   | \$ 0.86               | 5/12/2021              |
|            | 34,500(D)   | —   | \$ 1.17               | 12/8/2019              |

- (A) The options were granted on August 27, 2013. The vesting of the option was made conditional upon the Board approving, and Enova entering into definitive agreements covering and thereafter consummating, (x) a sale of all or substantially all of Enova's assets or (y) the acquisition of Enova by another entity by means of a merger, share exchange, tender offer or other similar transaction or (z) the acquisition by Enova of another entity by means of a merger, share exchange, tender offer or other similar transaction.
- (B) The options were granted on December 19, 2011 and vested in January 2012 based on the attainment of the vesting requirement that the Company's common stock had a Volume Weighted Average Price for a ten day trading period equal to or greater than twice the exercise price of the options based on the average of the closing bid and asked prices of the Company's common stock on the NYSE MKT LLC.
- (C) The options were granted on May 13, 2011 and vest over three years on a quarterly basis on the last day of each calendar quarter provided the option holder is then an officer of Enova as of such date. The first 1/12 or 8.33% of the shares under each option vested on June 30, 2011. In the event there is a change of control of Enova, the options will become fully vested.
- (D) The options were granted on December 8, 2009 and vested over one year on a quarterly basis on the last day of each calendar quarter provided the option holder is then an officer of Enova as of such date.

## Current Equity Incentive Plans

We presently have only one active stock-based compensation plan. The 2006 Equity Compensation Plan authorizes the Compensation Committee to grant stock options and other stock awards to employees and consultants, including executives and directors, and such grants are currently approved by the whole board of directors. The determination of whether option grants are appropriate each year is based upon individual measures established for each individual within the subjective determination of the board of directors. Options are not necessarily granted to each executive during each year. Options granted to executive officers generally vest in conjunction with the attainment of the performance goals of the Company. In 2013, Mr. Micek was granted stock options from the plan covering an aggregate of 4,400,000 shares of our common stock.

## Director Compensation



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The table below summarizes the total compensation we paid to our Directors (other than Mr. Micek) for the fiscal year ended December 31, 2013:

| Non-Executive<br>Director Name | Fees<br>Earned or<br>Paid in<br>Cash<br>(\$) | Option<br>Awards<br>(\$) | Total<br>(\$) |
|--------------------------------|--|--------------------------|---------------|
| Christopher Thunen             | \$ —   | —\$                      | —             |
| Edwin Riddell                  | \$ —   | —\$                      | —             |
| James Burness                  | \$ —   | —\$                      | —             |

In addition, as part of our cost saving measures, the members of the Board on the audit committee agreed to terminate cash compensation for service on that committee effective July 1, 2012.

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. The Company's determination of estimated fair value of share-based awards utilizes the Black-Scholes option-pricing model.

#### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The table below sets forth information as to (a) any person, including their address, known to us to own beneficially more than 5% of our voting securities, (b) equity securities beneficially owned by each of our named executive officers and directors; and (c) equity securities beneficially owned by the current executive officers and directors as a group. Beneficial ownership is determined in accordance with the SEC's Regulation 13D-G. Accordingly, the information below reflects stock options, warrants, and other securities beneficially held by the specified person that may be exercised or converted into common stock within 60 days of March 1, 2014. Except as indicated in the footnotes to this table and subject to applicable community property laws, the persons named in the table to our knowledge have sole voting and investment power with respect to all shares of securities shown as beneficially owned by them. The information in this table is as of March 1, 2014 based upon an aggregate of 44,603,185 voting shares from (i) 44,520,197 shares of common stock outstanding, (ii) 58,714 shares of common stock to be issued and (iii) potential conversion of Series B Preferred Stock into 24,274 shares of common stock.

| Owner   | Number of Shares of Common Stock | Percent of Common Stock | Percent of Common Stock, Series B Preferred Stock, Common Stock to be Issued and Voting Together |
|---|----------------------------------|-------------------------|--|
| Jagen, Pty., Ltd.(1)<br>9 Oxford Street, South Ybarra 3141 Melbourne,<br>Victoria Australia   | 3,222,222                        | 7.2%                    | 7.2%   |
| Shell Asset Management BV(2)<br>Sir Winston Churchillaan 366H, 2285 SJ Rijswijk ZH,<br>The Netherlands<br>527 Madison Avenue, Suite 2600, New York, NY<br>10022 | 6,054,960                        | 13.6%                   | 13.5%  |
| John J. Micek(3)  | 4,884,908                        | 11.0%                   | 11.0%  |
| Edwin O. Riddell(4)   | 178,667                          | 0.4%                    | 0.4%   |
| All Executive Officers and Directors as a group (5)   | 5,063,575                        | 11.4%                   | 11.4%  |

(1) Jagen Pty. Ltd. (Jagen) shares beneficial ownership with Jagen's controlling shareholder, the B. Liberman Family Trust and its trustee, Jagen Nominees, Pty. Ltd. Boris and Helen Liberman possess ultimate voting and discretionary authority over the shares.

(2) Based on a Form 3 filed December 15, 2009. Shell Asset Management Company BV manages assets of The Shell Group and its subsidiaries and affiliates, including certain pension plans organized for the benefit of employees of The Shell Group. As such, The Shell Group and such subsidiaries and affiliates, including such pension plans, have the right to the receipt of dividends from, and the proceeds from the sale of, the shares of common stock.

- (3) Includes 307,417 shares of common stock underlying stock options that are exercisable within 60 days.
- (4) Includes 99,000 shares of common stock underlying stock options that are exercisable within 60 days.
- (5) Includes 406,417 shares of common stock underlying stock options that are exercisable within 60 days.

## Equity Compensation Plan Information

For the fiscal year ended December 31, 2013, we had two equity compensation plans: the 1996 Option Plan and the 2006 Equity Compensation Plan. Each plan was adopted with the approval of our shareholders. The 1996 Stock Option Plan has expired for purposes of issuing new grants. The 1996 Stock Option Plan, however, will continue to govern awards previously granted under that plan. The 2006 plan, adopted at our annual meeting in November 2006 and amended in August 2013, has a total of 9,000,000 shares reserved for issuance. The following table provides information regarding our equity compensation plans as of December 31, 2013:

| Plan Category  | Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights<br>(a) | Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights<br>(b) | Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))<br>(c) |
|--|--|--|--|
| Equity compensation plans approved by security holders     | 5,210,000  | \$ 0.12  | 3,790,000(A)   |
| Equity compensation plans not approved by security holders | —  | —  | —  |
| <b>Total</b>   | <b>5,210,000</b>   | <b>\$ 0.12</b>   | <b>3,790,000</b>   |

(A) While the 2006 Plan was approved by the shareholders, an August 2013 amendment to the 2006 Plan, increasing the number of shares available thereunder from 3,000,000 to 9,000,000 has not been presented to shareholders for their consideration, nor does the Company intend to present such amendment to the shareholders for approval.

#### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Currently the Company does not have written policies and procedures for the review, approval or ratification of related person transactions. However, given the Company's small size, senior management and the audit committee or the board of directors is able to review all transactions consistent with applicable securities rules governing Company transactions and proposed transactions exceeding \$120,000 in which a related person has a direct or indirect material interest. Currently the Board of Directors reviews related person transactions and has approval authority with respect to whether a related person transaction is within the Company's best interest.

Mr. Micek, who serves as Chief Executive Officer, Chief Financial Officer and Director, has loaned the Company a total of \$62,965 as of April 15, 2014 in support of its continued operations. In addition, in an 8-K filed on March 6, 2014, Mr. Micek orally agreed to loan the Company the amount of \$50,000, with repayment due on demand.

Each of Messrs. Burness, Riddell and Thunen, who represent more than 50% of our directors, would be considered “independent” within the meaning of the NYSE Amex rules as applicable to smaller reporting companies, although Enova is no longer subject to the independence requirements of the NYSE MKT LLC. As for disclosure regarding independence requirements for board committees, see item 10 of this Form 10-K.

ITEM PRINCIPAL ACCOUNTANT FEES AND SERVICES

14.

PMB Helin Donovan LLP served as our registered independent auditor for the most recently completed fiscal year, and has served in that role since its appointment by the Audit Committee on January 31, 2007.

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## Pre-Approval of Audit and Permissible Non-Audit Services

The Audit Committee pre-approves all audit and permissible non-audit services provided by the independent auditors. These services may include audit services, audit-related services, tax services and other services. The independent auditors and management are required to periodically report to the Audit Committee regarding the extent of services provided by the independent auditors in accordance with this pre-approval, and the fees for the services performed to date. The Audit Committee may also pre-approve particular services on a case-by-case basis.

## Audit Fees

The following table sets forth the aggregate fees billed or to be billed by our principal accountant for the following services for the years ended December 31, 2013 and 2012:

|                    | 2013      | 2012      |
|--------------------|-----------|-----------|
| Audit Fees         | \$ 44,000 | \$ 54,000 |
| Audit-Related Fees | \$ —      | —         |
| Tax Fees           | \$ 550    | \$ 14,500 |
| All Other Fees     | \$ —      | \$ 15,000 |
| Total              | \$ 44,550 | \$ 83,500 |

The tax fees above were pre-approved by our Audit Committee as appropriate, which concluded that the provision of such services by PMB Helin Donovan was compatible with the maintenance of that firm's independence in the conduct of its auditing functions. Other fees were attributable to due diligence work performed in connection to capital markets activities of the Company.

## PART IV

## ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

## (a) 1. Financial Statements

The financial statements filed as a part of this report are included in Item 8 of this report.

## (a) 2. Financial Statement Schedule

No financial statement schedules are filed as a part of this report.

## (a) 3. Exhibits

| Exhibit # | Description   |
|-----------|---|
| 3.1       | Our Amended and Restated Articles of Incorporation (incorporated by reference to Exhibit 3.1 of our Annual Report on Form 10-K for the fiscal year ending December 31, 2006, as filed on April 2, 2007)   |
| 3.2       | Our Amended and Restated bylaws (incorporated by reference to Exhibit 3.2 of our Quarterly Report on Form 10-Q for the period ended September 30, 2009, as filed on November 12, 2009)  |
| 10.1      | Form of Indemnification Agreement (incorporated by reference to Exhibit 10.26 of our Quarterly Report on Form 10-Q for the period ended June 30, 2005, as filed on August 15, 2005)   |
| 10.2      | Form of Security Agreement entered into May 31, 1995 between us and Credit Managers Association of California, Trustee (incorporated by reference to Exhibit 10.65 of our Quarterly Report on Form 10-Q for the period ended April 30, 1996, as filed on June 14, 1996)                     |
| 10.3      | Commercial Promissory Note dated October 10, 2007 between us and Union Bank of California (incorporated by reference to Exhibit 10.3 of our Annual Report Form 10-K for the period ended December 31 2007, as filed on March 26, 2008)  |
| 10.4      | Placing Agreement in connection with an application to join AIM dated July 19, 2005 between us and Investec Bank (UK) Limited (incorporated by reference to Exhibit 10.28 of our amended Quarterly Report on Form 10-Q for the period ended September 30, 2005, as filed November 21, 2005) |
| 10.5      | Placing Agreement dated July 25, 2007 between us and Investec Bank (UK) Limited (incorporated by reference to Exhibit 10 of our Current Report on Form 8-K as amended filed August 7, 2007)   |
| 10.6      | Facility Lease Agreement entered into October 17, 2007 between us and Sunshine Distribution L.P., (incorporated by reference to Exhibit 10.1 of our Current Report on Form 8-K filed October 23, 2007)  |
| 10.7      | Retirement Agreement and Limited Release entered into July 12, 2007 between us and Edwin Riddell, formerly our Chief Executive Officer and President (incorporated by reference to Exhibit 10 of our Current Report on Form 8-K as amended filed July 16, 2007)+                            |
| 10.8      | Employment Agreement entered into February 11, 2008 between us and Michael Staran, our President and Chief Executive Officer (incorporated by reference to Exhibit 10.1 of our Current Report on Form 8-K filed February 15, 2008)+   |
| 10.9      | Placing Agreement entered into March 26, 2008 (incorporated by reference to Exhibit 10 of our Current Report on Form 8-K/A filed April 4, 2008)   |
| 10.10     | Securities Purchase Agreement entered into April 23, 2008 (incorporated by reference to Exhibit 10.1 of our Current Report on Form 8-K filed April 24, 2008)  |
| 10.11     | Registration Rights Agreement entered into April 23, 2008 (incorporated by reference to Exhibit 10.2 of our Current Report on Form 8-K filed April 24, 2008)  |
| 10.12     | Securities Purchase Agreement entered into October 29, 2009 (incorporated by reference to Exhibit 99.1 of our Current Report on Form 8-K filed October 30, 2009)  |

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|         |   |
|---------|---|
| 10.13   | Placing Agreement entered into October 29, 2009 (incorporated by reference to Exhibit 99.3 of our Current Report on Form 8-K filed October 30, 2009)  |
| 10.14   | Registration Rights Agreement entered into December 15, 2009 (incorporated by reference to Exhibit 99.1 of our Current Report on Form 8-K filed December 15, 2009)  |
| 10.15   | Amendment to Employment Agreement between us and Michael Staran entered into on February 17, 2009 (incorporated by reference to Item 5.02 of our Current Report on Form 8-K filed February 23, 2009)+                   |
| 10.16   | Severance Agreement between us and John Mullins effective as of August 31, 2009 (incorporated by reference on our annual report on Form 10-K for the year ended December 31, 2010 filed on March 30, 2011)+             |
| 10.17   | Agreement relating to the appointment of a Nominated Adviser and Broker dated June 20, 2011 between us and Daniel Stewart (UK) Plc (incorporated by reference to Exhibit 10.23 of on Form 10-K filed on March 29, 2012. |
| 10.18   | Warrant and Common Stock Purchase Agreement dated December 15, 2011 (incorporated by reference to Exhibit 99.1 of our Current Report on Form 8-K filed December 19, 2011).  |
| 10.19   | Form of Warrant (incorporated by reference to Exhibit 99.2 of our Current Report on Form 8-K filed December 19, 2011)   |
| 10.20   | Form of Registration Rights Agreement dated December 2011 (incorporated by reference to Exhibit 99.3 of our Current Report on Form 8-K filed December 19, 2011)   |
| 10.21   | Purchase Agreement dated April 23, 2012 (incorporated by reference to Exhibit 10.1 of our Current Report on Form 8-K filed April 25, 2012).   |
| 10.22   | Purchase Agreement dated April 24, 2012 (incorporated by reference to Exhibit 10.2 of our Current Report on Form 8-K filed April 25, 2012).   |
| 10.23   | Registration Rights Agreement dated April 23, 2012 (incorporated by reference to Exhibit 10.3 of our Current Report on Form 8-K filed April 25, 2012).  |
| 10.24   | Amendment of the 2006 Equity Compensation Plan*   |
| 31.1    | Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002*   |
| 32      | Certification Pursuant to 18 U.S.C. Section 1350*   |
| 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 Annual Report on Form 10-K shall be deemed to be “furnished” and not “filed”.

+ Management contract or compensatory plan or arrangement.

# Portions of the exhibit have been omitted pursuant to a request for confidential treatment submitted to the Securities and Exchange Commission.



SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

ENOVA SYSTEMS, INC.

By: /s/ John Micek  
John Micek  
Chief Executive Officer & Chief  
Financial Officer

Dated: May 2, 2014

## POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints John Micek, with full power to act alone, his true and lawful attorney-in-fact and agent, with full power of substitution for him and in his name, place and stead, in any and all capacities, to sign any and all amendments to the annual report on Form 10-K, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney-in-fact full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorney-in-fact and agent may lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, each of the undersigned has executed this Power of Attorney as of the date indicated. Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the registrant and in the capacities and on the date indicated.

| Signature                                    | Title  | Date           |
|--|--|----------------|
| /s/ John Micek<br>John Micek                 | Chief Executive Officer,<br>Chief Financial Officer, and Director<br>(Principal Executive Officer and Principal<br>Accounting Officer) | May 2,<br>2014 |
| /s/ Edwin Riddell<br>Edwin Riddell           | Director, Chairman of the Board  | May 2,<br>2014 |
| /s/ James Burness<br>James Burness           | Director   | May 2,<br>2014 |
| /s/ Christopher Thunen<br>Christopher Thunen | Director   | May 2,<br>2014 |