ENOVA SYSTEMS INC
Form 10-Q
May 17, 2010

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ending March 31, 2010

or

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

For the transition period from __________ to __________

Commission file no. 1-33001
ENOVA SYSTEMS, INC.
(Exact name of registrant as specified in its charter)

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

1560 West 190th Street, Torrance, California 90501
(Address of principal executive offices, including zip code)
(310) 527-2800
(Registrant s telephone number, including area code)

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

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

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 o	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company þ

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

As of April 30, 2010, there were 31,404,336 shares of common stock outstanding.

ENOVA SYSTEMS, INC.
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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ENOVA SYSTEMS, INC.
BALANCE SHEETS

	March 31, 2010 (unaudited)	December 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	$ 11,889,000	$ 13,078,000
Short term investments	200,000	200,000
Accounts receivable, net of allowance for doubtful accounts of $31,000 as of March 31, 2010 and December 31, 2009	952,000	1,442,000
Inventories and supplies, net	5,507,000	5,605,000
Prepaid expenses and other current assets	453,000	263,000
Total current assets	19,001,000	20,588,000
Property and equipment, net	1,283,000	1,363,000
Intangible assets, net	59,000	60,000
Total assets	$ 20,343,000	$ 22,011,000
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 383,000	$ 415,000
Deferred revenues	210,000	357,000
Accrued payroll and related expenses	469,000	277,000
Other accrued liabilities	1,143,000	1,287,000
Current portion of notes payable	66,000	68,000
Total current liabilities	2,271,000	2,404,000
Accrued interest payable	1,094,000	1,074,000
Notes payable, net of current portion	1,281,000	1,286,000
Total liabilities	4,646,000	4,764,000
Stockholders equity:		
Series A convertible preferred stock no par value, 30,000,000 shares authorized; 2,652,000 shares issued and outstanding; liquidating preference at $0.60 per share as of March 31, 2010 and December 31, 2009	530,000	530,000
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 March 31, 2010 and December 31, 2009	1,094,000	1,094,000
Common Stock no par value, 750,000,000 shares authorized; 31,404,000 shares issued and outstanding as of March 31, 2010 and December 31, 2009	144,018,000	143,995,000
Additional paid-in capital	8,482,000	8,336,000
Accumulated deficit	(138,427,000)	(136,708,000)

Total stockholders equity		15,697,000		17,247,000
Total liabilities and stockholders equity	$	20,343,000	$	22,011,000

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

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ENOVA SYSTEMS, INC.
STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
Revenues	$ 929,000	$ 688,000
Cost of revenues	846,000	579,000
Gross income	83,000	109,000
Operating expenses		
Research and development	322,000	254,000
Selling, general & administrative	1,477,000	1,495,000
Total operating expenses	1,799,000	1,749,000
Operating loss	(1,716,000)	(1,640,000)
Other income and (expense)		
Interest and other income (expense), net	(3,000)	(6,000)
Equity in losses of non-consolidated joint venture, net		(10,000)
Total other income (expense), net	(3,000)	(16,000)
Net loss	$ (1,719,000)	$ (1,656,000)
Basic and diluted loss per share	$ (0.05)	$ (0.08)
Weighted average number of common shares outstanding	31,404,000	20,845,000

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

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

	For the Three Months Ended March 31,	
	2010	**2009**
Cash flows from operating activities:		
Net loss	$ (1,719,000)	$ (1,656,000)
Adjustments to reconcile net loss to net cash used in operating activities:		
Inventory reserve	9,000	61,000
Depreciation and amortization	138,000	158,000
Loss on asset disposal		2,000
Equity in losses of non-consolidated joint venture		10,000
Issuance of common stock for director services		45,000
Issuance of common stock for employee services	23,000	100,000
Stock option expense	146,000	104,000
(Increase) decrease in:		
Accounts receivable	490,000	89,000
Inventory and supplies	89,000	238,000
Prepaid expenses and other current assets	(190,000)	42,000
Increase (decrease) in:		
Accounts payable	(32,000)	(30,000)
Deferred revenues	(147,000)	51,000
Accrued payroll and related expenses	192,000	(22,000)
Other accrued liabilities	(144,000)	(425,000)
Accrued interest payable	20,000	21,000
Net cash used in operating activities	(1,125,000)	(1,212,000)
Cash flows from investing activities:		
Purchases of property and equipment	(57,000)	(6,000)
Net cash used in investing activities	(57,000)	(6,000)
Cash flows from financing activities:		
Payments on notes payable	(7,000)	(16,000)
Net cash used in financing activities	(7,000)	(16,000)
Net decrease in cash and cash equivalents	(1,189,000)	(1,234,000)
Cash and cash equivalents, beginning of period	13,078,000	5,324,000
Cash and cash equivalents, end of period	$ 11,889,000	$ 4,090,000
Supplemental disclosure of cash flow information:		
Interest paid	$ 2,000	$ 1,000
Assets acquired through financing arrangements	$	$ 38,000

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

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ENOVA SYSTEMS, INC.
NOTES TO FINANCIAL STATEMENTS
(Unaudited)
Three months ended March 31, 2010 and 2009

1. Description of the Company and its Business

Enova Systems, Inc. (Enova or the Company) changed its name in July 2000. The Company was previously known as U.S. Electricar, Inc., a California corporation, which was incorporated on July 30, 1976. The Company is a globally recognized leader as a supplier of efficient, environmentally-friendly digital power components and systems products, in conjunction with associated engineering services. The Company s core competencies are focused on the commercialization of power management and conversion systems for mobile and stationary applications.

2. Summary of Significant Accounting Policies

Basis of Presentation Interim Financial Statements

The financial information as of and for the three months ended March 31, 2010 and 2009 is unaudited but includes all adjustments (consisting only of normal recurring adjustments) that the Company considers necessary for a fair statement of its financial position at such dates and the operating results and cash flows for those periods. The year-end balance sheet data was derived from audited financial statements, and certain information and note disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to SEC rules or regulations; however, the Company believes the disclosures made are adequate to make the information presented not misleading.

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

The results of operations for the interim periods presented are not necessarily indicative of the results of operations to be expected for the fiscal year. These interim financial statements should be read in conjunction with the audited financial statements for the year ended December 31, 2009, which are included in the Company s Annual Report on Form 10-K for the year then ended.

Fair Value of Financial Instruments

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

Revenue Recognition

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

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

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

The Fee for the Arrangement is Fixed or Determinable Prior to recognizing revenue, a customer s fee is either fixed or determinable under the terms of the written contract. Fees for professional consulting services, engineering services and

equipment sales are fixed under the terms of the written contract. The customer s fee is negotiated at the outset of the arrangement and is not subject to refund or adjustment during the initial term of the arrangement.

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.

FASB ASC 605-25 addresses the accounting for arrangements that may involve the delivery or performance of multiple products, services and/or rights to use assets. Specifically, FAS ASC 605-25 requires the recognition of revenue from milestone payments over the remaining minimum period of performance obligations. As required, the Company applies the principles of FAS ASC 605-25 to multiple element agreements.

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 received are classified as current assets. Amounts billed to clients in excess of revenues recognized to date are classified as current liabilities on contracts.

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

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

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

Inventory

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

Inventory reserve

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

Allowance for doubtful accounts

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

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 one year from the date of delivery, 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 twelve month period. The warranty liability is evaluated on an ongoing basis for adequacy and may be adjusted as additional information regarding expected warranty costs become known.

Stock Based Compensation

The accounting principles require measurement of compensation cost for stock-based awards classified as equity at their fair value on the date of grant and the recognition of compensation expense over the service period for awards expected to vest. Such grants are recognized as expense over the service period, net of estimated forfeitures.

See Note 11 S*tock Options* for further information on stock-based compensation expense.

3. Inventory

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

	March 31, 2010	December 31, 2009
Raw Materials	$ 6,160,000	$ 6,341,000
Work In Progress	240,000	132,000
Finished Goods	95,000	111,000
Reserve for Obsolescence	(988,000)	(979,000)
Total	$ 5,507,000	$ 5,605,000

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4. Property and Equipment

Property and equipment consisted of the following at:

	March 31, 2010	December 31, 2009
Computers and software	$ 556,000	$ 556,000
Machinery and equipment	847,000	795,000
Furniture and office equipment	98,000	98,000
Demonstration vehicles and buses	507,000	507,000
Leasehold improvements	1,348,000	1,348,000
Construction in process	13,000	8,000
	3,369,000	3,312,000
Less accumulated depreciation and amortization	(2,086,000)	(1,949,000)
Total	$ 1,283,000	$ 1,363,000

Depreciation and amortization expense was $137,000 and $157,000 for the three months ended March 31, 2010 and 2009, respectively, and within those total expenses, the amortization of leasehold improvements was $67,000 for the three months ended March 31, 2010 and 2009.

5. Other Accrued Liabilities

Other accrued liabilities consisted of the following at:

	March 31, 2010	December 31, 2009
Accrued Inventory Received	$ 319,000	$ 334,000
Accrued Professional Services	332,000	395,000
Accrued Warranty	492,000	558,000
Total	$ 1,143,000	$ 1,287,000

Accrued warranty consisted of the following activities during the quarters ended March 31:

	2010	2009
Balance at beginning of quarter	$ 558,000	$ 545,000
Accruals for warranties issued during the period	38,000	42,000
Warranty claims	(104,000)	(49,000)
Balance at end of quarter	$ 492,000	$ 538,000

6. Intangible Assets

Intangible assets consist of legal fees directly associated with patent licensing. The Company has been granted three patents. These patents have been capitalized and are being amortized on a straight-line basis over a period of 20 years.

Intangible assets consisted of the following at:

	March 31,	December 31,

	2010	2009
Patents	$ $93,000	$ 93,000
Less accumulated amortization	(34,000)	(33,000)
Total	$ $59,000	$ 60,000

Amortization expense charged to operations was $1,000 for the three months ended March 31, 2010 and 2009.

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

Notes payable consisted of the following at:

	March 31, 2009	December 31, 2009
Secured note payable to Credit Managers Association of California, bearing interest at prime plus 3% (6.25% as of March 31, 2010), 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 financial institution in the original amount of $23,000, bearing interest at 11.70%, payable in 36 equal monthly installments of principal and interest through October 1, 2010	6,000	8,000
Secured note payable to 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 $39,000, bearing interest at 4.99% per annum, payable in 48 equal monthly installments of principal and interest through September 1, 2011	16,000	18,000
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	30,000	32,000
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	17,000	18,000
	1,347,000	1,354,000
Less current portion	(66,000)	(68,000)
Long-term portion	$ 1,281,000	$ 1,286,000

As of March 31, 2010 and December 31, 2009, the balance of long term interest payable with respect to the Credit Managers Association of California note amounted to $1,073,000 and $1,054,000, respectively. Interest expense on notes payable amounted to approximately $22,000 and $24,000 during the quarters ended March 31, 2010 and 2009, respectively.

8. Revolving Credit Agreement

The Company entered into a secured revolving credit facility with a financial institution (the Credit Agreement) for $200,000, which is secured by a $200,000 certificate of deposit. The facility expires on June 30, 2010. 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 (Landlord), with respect to the lease of the Company s corporate headquarters at 1560 West 190th Street, Torrance, California.

9. Stockholders Equity

During the quarters ended March 31, 2010 and 2009, the Company issued shares of common stock valued at $0 and $45,000, respectively, to directors as compensation based upon the trading value of the common stock on the date of issuance. During the quarters ended March 31, 2010 and 2009, the Company issued shares of common stock valued at $23,000 and $100,000, respectively, to employees as compensation based upon the trading value of the common stock on the date of issuance.

10. Subsequent Events

The Company has evaluated subsequent events through the filing date of this Form 10-Q and has determined that there were no subsequent events to recognize or disclose in these financial statements.

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11. Stock Options

Stock Option Program Description

As of March 31, 2010, 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, executives and directors 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 2006 Plan has a total of 3,000,000 shares reserved for issuance, of which 1,680,000 shares were available for grant as of March 31, 2010. All stock options have terms of between five and ten years and generally vest and become fully exercisable from one to three years from the date of grant. As of March 31, 2010, the Company had 1,371,000 options outstanding which were comprised of issuances under the 1996 Plan and the 2006 Plan of 74,000 and 1,297,000, respectively.

Share-based compensation expense related to stock options reduced the Company s results of operations as follows:

	For the three months ended	
	March 31, 2010	March 31, 2009
Income from continuing operations before income taxes	$146,000	$104,000
Income from continuing operations after income taxes	$146,000	$104,000
Cash flows from operations	$146,000	$104,000
Cash flows from financing activities	$	$

As of March 31, 2010, the total compensation cost related to non-vested awards not yet recognized is $766,000. The weighted average period over which the future compensation cost is expected to be recognized is 19 months. The aggregate intrinsic value represents the total pretax intrinsic value, which is the difference between the Company s closing stock price on the last trading day of the first quarter of fiscal 2010 of $1.57 and the exercise price times the number of shares that would have been received by the option holders if they had exercised their options on March 31, 2010. This amount will change based on the fair market value of the Company s stock.

The following table summarizes information about stock options outstanding and exercisable at March 31, 2010:

	Number of Share Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term in Years	Aggregate Intrinsic Value
Outstanding at December 31, 2009	1,410,000	$ 2.10	7.65	
Granted		$		
Exercised		$		
Forfeited or Cancelled	(39,000)	$ 3.42		
Outstanding at March 31, 2010	1,371,000	$ 2.06	7.52	$ 565,000
Exercisable at March 31, 2010	620,000	$ 2.94	6.87	$ 166,000

The weighted-average remaining contractual life of the options outstanding at March 31, 2010 was 7.52 years. The exercise prices of the options outstanding at March 31, 2010 ranged from $0.21 to $4.35. Options exercisable were

620,000 and 531,000 at March 31, 2010 and December 31, 2009, respectively. The weighted average grant-date fair value of options granted during the three months ended March 31, 2010 and 2009 was $0 and $0.19, respectively. The Company s policy is to issue shares from its authorized shares upon the exercise of stock options.

There were no new options granted during the three months ended March 31, 2010. The fair values of all stock options granted during the three months ended March 31, 2009 were estimated on the date of grant using the Black-Scholes option-pricing model with the following range of assumptions:

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	For the three months ended March 31,	
	2010	**2009**
Expected life (in years)		3
Average risk-free interest rate		2%
Expected volatility		194%
Expected dividend yield		0%
Forfeiture rate		3%

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

12. Concentrations

The Company s trade receivables are concentrated with few customers. The Company performs credit evaluations on their customers financial condition. Concentrations of credit risk, with respect to accounts receivable, exist to the extent of amounts presented in the financial statements. Three customers represented 55%, 22% and 11%, respectively, of total gross accounts receivable at March 31, 2010, and two customers represented 77% and 11%, respectively, of total gross accounts receivable at December 31, 2009.

The Company s revenues are concentrated with few customers. For the three months ended March 31, 2010, two customers represented 69% and 12% of gross revenues. For the three months ended March 31, 2009, three customers represented 37%, 25%, and 21% of gross revenues.

13. Recent Accounting Pronouncements

In April 2010, the FASB amended ASC 718 Compensation Stock Compensation, effective for reporting periods beginning on or after December 15, 2010, to provide guidance on the effect of denominating the exercise price of share-based payment awards denominated in the currency of a market in which a substantial portion of the entity s equity securities trades that differs from the functional currency of the employer entity or payroll currency of the employee. The amendments affect entities that have previously considered such awards as liabilities because of their foreign currency exercise price. The updated guidance amends ASC 718 to clarify that such awards should not be considered to contain a condition that is not a market, performance, or service condition, and therefore should not be classified as a liability if the award otherwise qualifies as equity. The Company does not expect the adoption of this guidance to have a material impact on our financial statements.

In February 2010, the FASB issued ASU 2010-09, *Amendments to Certain Recognition and Disclosure Requirement*. The standard amends ASC Topic 855 to address certain implementation issues related to an entities requirement to perform and disclose subsequent-event procedures. The standard requires SEC filers to evaluate subsequent events through the date the financial statements are issued and exempts SEC filers from disclosing the date through which subsequent events have been evaluated. The Company evaluates subsequent events through the date and time of the filing of the applicable periodic report with the SEC. The Company evaluated subsequent events through the date of issuance of its Quarterly Report on Form 10-Q. The Company is not aware of any subsequent events which would require recognition or disclosure in the financial statements.

In January 2010, the FASB issued ASU 2010-06, *Improving Disclosures about Fair Value Measurements*. The standard amends ASC Topic 820, *Fair Value Measurements and Disclosures* to require additional disclosures related to transfers between levels in the hierarchy of fair value measurement. The Company adopted this standard on January 1, 2010. The standard does not change how fair values are measured; accordingly, the standard will not have an impact on the Company s financial statements. At March 31, 2010, the Company did not transfer any assets or liabilities that are measured at fair value on a recurring basis between Levels 1 and 2, and did not have any transfers into and out of Level 3.

In October 2009, the FASB issued ASU No. 2009-13, *Revenue Recognition* (ASC Topic 605) *Multiple-Deliverable Revenue Arrangements*, *a consensus of the FASB Emerging Issues Task Force.* This guidance modifies the fair value requirements of ASC subtopic 605-25 *Revenue Recognition-Multiple Element Arrangements* by allowing the use of the best estimate of selling price for determining the selling price of a deliverable. A vendor is now required to use its best estimate of the selling price when vendor specific objective evidence or third-party evidence of the selling price cannot be determined. In addition, the residual method of allocating arrangement consideration is no longer permitted. This guidance is effective for the Company in 2011. The Company does not expect the adoption of ASU No. 2009-13 to have a significant impact on its financial statements.

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

This Quarterly Report on Form 10-Q contains statements indicating expectations about future performance and other forward-looking statements that involve risks and uncertainties. We usually use words such as may, will, should, expect, plan, anticipate, believe, estimate, predict, future, intend, potential, or continue or the neg or similar expressions to identify forward-looking statements. These statements appear throughout this Quarterly Report on Form 10-Q and are statements regarding our current intent, belief or expectation, primarily with respect to our operations and related industry developments. Examples of these statements include, but are not limited to, statements regarding the following: our future operating expenses, our future losses, our future expenditures for research and development and the sufficiency of our cash resources. You should not place undue reliance on these forward-looking statements, which apply only as of the date of this Quarterly Report on Form 10-Q. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including the risks faced by us and described in our Annual Report on Form 10-K for the year ended December 31, 2009.

The following discussion and analysis should be read in conjunction with the unaudited interim financial statements and notes thereto included in Part I, Item 1 of this Quarterly Report on Form 10-Q and with the financial statements and notes thereto and Management s Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended December 31, 2009.

Overview

Enova believes it is a leader in the development and production of proprietary, commercial digital power management systems for transportation vehicles and stationary power generation systems. Power management systems control and monitor electric power in an automotive or commercial application such as an automobile or a stand-alone power generator. Electric drive systems are comprised of an electric motor, an electronics control unit, a gear unit and batteries which power an electric vehicle. Hybrid systems, which are similar to pure electric drive systems, contain an internal combustion engine in addition to the electric motor, eliminating external recharging of the battery system. Our hybrid systems can alternatively utilize a hydrogen fuel cell as a power source to recharge the battery system. Stationary power systems utilize similar components to those which are in a mobile drive system in addition to other elements.

A fundamental element of Enova s strategy is to develop and produce advanced proprietary software, firmware and hardware for applications in these alternative power markets. Our focus is digital power conversion, power management, and system integration, focusing chiefly on vehicle power generation.

Specifically, we develop, design and produce drive systems and related components for electric, hybrid-electric and fuel cell vehicles. We also develop, design and produce power management and power conversion components for stationary distributed power generation systems. Additionally, we perform research and development (R&D) to augment and support others and our own related product development efforts.

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

Enova s primary market focus centers on both electric series and parallel hybrid medium and heavy-duty drive systems for multiple vehicle and marine applications. A series hybrid system is one where only the electric motor connects to the drive shaft; a parallel hybrid system is one where both the internal combustion engine and the electric motor are connected to the drive shaft. We believe series-hybrid and parallel hybrid medium and heavy-duty drive system sales offer Enova the greatest return on investment in both the short and long term. 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. By aligning ourselves with key customers 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 or expense. As we

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penetrate more market areas, we are continually refining both our market strategy and our product line to maintain our leading edge in power management and conversion systems for mobile applications.

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

Recent Developments

In February 2010, Enova was awarded an exclusive supplier contract with the U.S. General Services Administration (GSA), which provides vehicles for government agencies and armed forces. Under that contract, Enova will supply our Ze all-electric walk-in step vans to the GSA under the Cargo Vans category. We received our first order from a military installation in April and have planned a series of demonstrations with government officials in the second quarter of 2010. The order reflects increased awareness by federal agencies of the Department of Energy s (DOE) Federal Management Program recent publication titled Guidance for Federal Agencies on Executive Order 13514 Section 12 Federal Fleet Management , under which federal agencies are required to reduce their petroleum consumption by 2% annually for a total 30% reduction by 2020. The Ze van can completely displace the petroleum use of its gasoline or diesel counterpart. Enova has partnered with Freightliner Custom Chassis Corporation (Freightliner), a subsidiary of Daimler Trucks North America LLC, to integrate and deploy the Ze technology with their MT-45 walk-in van chassis.

Also in February 2010, Enova lauded Smith Electric Vehicles (Smith) recent GSA announcement of the Smith Newton product offering in the Medium and Heavy Duty Vans category with a gross vehicle weight rating (GVWR) of 25,500 lbs. The Smith Newton is an exclusive, all-electric medium and heavy duty truck offering on the GSA product menu. This was augmented by Navistar s continued leadership in the American school bus market with its exclusive GSA contract to supply hybrid school buses.

In March 2010, Smith Electric Vehicles was selected to receive an additional $22 million in grant funding from the Department of Energy (DOE), bringing the total DOE grant funding available to Smith to $32 million toward the production of all electric, zero emissions commercial trucks. Smith Electric has selected Enova as the exclusive drive system supplier for its flagship Newton route delivery vehicles, which incorporates Enova s 120kW drive system controller. The DOE grant will be used to help offset Smith s future vehicle development cost and to incentivize its customers to participate in a commercial electric vehicle demonstration program. Enova received an order from Smith for delivery in the second quarter of 2010 and continues to be a close strategic partner in the implementation of Smith s North American initiatives.

In April 2010, Enova expanded its all electric Zero Emissions (Ze) drive system offerings to include a Ford F-150 utility truck and Chevrolet Express cargo van. The Ford F-150 is the highest sales volume pick-up truck in the United States and has been integrated with a 90kW all-electric Ze drive system. The Chevy Express cargo van is one of the top selling domestic fleet vans in its vehicle classification and has been integrated with a 120kW all-electric Ze drive system. The all-electric Ford F150 will undergo a series of 3rd party testing at a nationally recognized clean vehicle testing center starting in June. Testing will include a range of dynamometer and on-road testing programs.

The California Air Resources Board (CARB) recently started its $20 million Hybrid Voucher Incentive Program (HVIP) to stimulate the purchase of hybrid trucks and buses. The HVIP is designed to offset about half of the incremental additional cost of eligible hybrid medium- and heavy-duty vehicles using a simplified purchase voucher. This amount was deemed critical by fleets and manufacturers to assist the early market. The HVIP is also designed to assist fleets and dealers by reducing this cost right at the time of purchase, and has been designed to simplify implementation. Currently, Navistar s Hybrid School Buses with Enova s Charge Depleting systems are eligible for rebates of between $20,000 and $30,000 depending on the weight class.

CARB also started The Clean Vehicle Rebate Project (CVRP) which is administered statewide by the California Center for Sustainable Energy (CCSE). A total of $4.1 million was appropriated from the CARB s Air Quality Improvement Program for the CVRP in order to promote the production and use of zero-emission vehicles, including electric, plug-in hybrid electric, and fuel cell vehicles. The Smith Newton, which is powered by Enova s Ze all-electric drive system, is eligible for a $20,000 rebate.

During the first quarter of 2010, we also continued to produce electric and hybrid electric drive systems and components for other customers, including First Auto Works (FAW) in China, United Kingdom bus manufacturers including Tanfield Engineering Systems and Wright Bus, and Navistar and HCATT in North America.

Enova has incurred significant operating losses in the past. As of March 31, 2010, we had an accumulated deficit of approximately $138.4 million. We expect to incur additional operating losses until we achieve a level of product sales sufficient to cover our operating and other expenses. However, the Company believes that its business outlook will improve, especially in light of government policies being implemented in the United States, China and the United Kingdom regarding the curbing of green house gas emissions in the future as well as intentions to provide government incentives that may induce consumption of our products and services.

We continue to receive greater recognition from both governmental and private industry with regards to both commercial and military application of our hybrid drive systems and fuel cell power management technologies. Although we believe that current negotiations with above named parties may result in additional production contracts during 2010 and beyond, there are no assurances that such additional agreements will be realized.

Critical Accounting Policies

In the ordinary course of business, the Company has made a number of estimates and assumptions relating to the reporting of results of operations and financial condition in the preparation of its financial statements in conformity with accounting principles generally accepted in the United States of America. The Company constantly re-evaluates these significant factors and makes adjustments where facts and circumstances dictate. Estimates and assumptions include, but are not limited to, customer receivables, inventories, equity investments, fixed asset lives, contingencies and litigation. There have been no material changes in estimates or assumptions compared to our most recent Annual Report for the fiscal year ended December 31, 2009.

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

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

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

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

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

Stock-based Compensation The Company calculates stock-based compensation expense in accordance with FASB ASC 718, Share-Based Payment (FASB ASC 718). This pronouncement requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors, including employee stock options to be based on estimated fair values.

Revenue recognition The Company is required to make judgments based on historical experience and future expectations, as to the reliability of shipments made to its customers. These judgments are required to assess the propriety of the recognition of revenue based on ASC 605 and related guidance. The Company makes these assessments based on the following factors: i) customer-specific information, ii) return policies, and iii) historical experience for issues not yet identified.

The Company manufactures proprietary products and other products based on design specifications provided by its customers. Revenue from sales of products are generally recognized at the time title to the goods and the benefits and risks of ownership

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passes to the customer which is typically when products are shipped based on the terms of the customer purchase agreement. Revenue relating to long-term fixed price contracts is recognized using the percentage of completion method. Under the percentage of completion method, contract revenues and related costs are recognized based on the percentage that costs incurred to date bear to total estimated costs. Changes in job performance, estimated profitability and final contract settlements may result in revisions to cost and revenue, and are recognized in the period in which the revisions are determined. Contract costs include all direct materials, subcontract and labor costs and other indirect costs. General and administrative costs are charged to expense as incurred. At the time a loss on a contract becomes known, the entire amount of the estimated loss is accrued. The aggregate of costs incurred and estimated earnings recognized on uncompleted contracts in excess of related billings is shown as a current asset, and billings on uncompleted contracts in excess of costs incurred and estimated earnings is shown as a current liability.

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

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

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RESULTS OF OPERATIONS
Three Months Ended March 31, 2010 compared to Three Months Ended March 31, 2009
First Quarter of Fiscal 2010 vs. First Quarter of Fiscal 2009

	Three Months Ended March 31,			As a % of Revenues March 31,	
	2010	**2009**	**% Change**	**2010**	**2009**
Revenues	$ 929,000	$ 688,000	35%	100%	100%
Cost of revenues	846,000	579,000	46%	91%	84%
Gross profit (loss)	83,000	109,000	-24%	9%	16%
Operating expenses					
Research and development	322,000	254,000	27%	35%	37%
Selling, general & administrative	1,477,000	1,495,000	-1%	159%	217%
Total operating expenses	1,799,000	1,749,000	3%	194%	254%
Operating loss	(1,716,000)	(1,640,000)	-5%	-185%	-238%
Other income and (expense)					
Interest and other income (expense)	(3,000)	(6,000)	50%	0%	-1%
Equity in losses of non-consolidated joint venture		(10,000)	100%	0%	-1%
Total other income (expense)	(3,000)	(16,000)	81%	0%	-2%
Net loss	$ (1,719,000)	$ (1,656,000)	-4%	-185%	-241%

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

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

Revenue. Net revenues increased by $241,000 or 35% for the three months ended March 31, 2010 to $929,000 as compared to $688,000 for the corresponding period in 2009. Revenues in the current quarter were derived mainly from fulfillment of our initial major order from Smith Electric Vehicles, the North American subsidiary of Tanfield Group Plc, as well as Freightliner (FCCC) and the Hawaii Center for Advanced Transportation Technologies (HCATT). The increase in revenue for the three months ended March 31, 2010 compared to 2009 was mainly due to the delivery of twenty electric drive systems to Smith Electric Vehicles and the completion of initial deliveries to FCCC. Although we have seen indications for future production growth, there can be no assurance there will be continuing demand for our products and services.

Cost of Revenues. Cost of revenues consists of component and material costs, direct labor costs, integration costs and overhead related to manufacturing our products as well as inventory valuation reserve amounts. The cost of revenues for the three months ended March 31, 2010 increased by 46% to $846,000 from $579,000 for the corresponding period in 2009, primarily due to the increase in revenue and an increase in inventory charges recorded in the first quarter of 2010.

Gross Margin. Gross margin declined for the three months ended March 31, 2010 to $83,000 (9% of revenue) from $109,000 (16% of revenue) for the same period in 2009. The change in gross margin is primarily attributable to the recognition of revenue on certain higher profit development contracts in the first quarter of 2009 and our recording an increased inventory charge in 2010. We continue to focus on key customer production contracts, maturity of our supply chain, and efficiencies gained through focus on our manufacturing and inventory processes that have resulted in tighter controls over production costs. As we make deliveries on higher volume production contracts in the second quarter of 2010, we expect to achieve continued benefit from these initiatives, although we may continue to experience variability in our gross margin.

Research and Development (R&D). Internal research, development and engineering expenses increased $68,000 or 27% in the three months ended March 31, 2010 to $322,000 from $254,000 for the same period in 2009. R&D costs were higher as we devoted increased engineering personnel resources to the development of our next generation motor control unit and charger, testing of new battery technologies, as well as engine off capability for our post transmission parallel hybrid drive system. We also continued to allocate necessary resources to the development and testing of upgraded proprietary control software, enhanced DC-DC converters and digital inverters as well as other power management firmware.

Selling, General, and Administrative Expenses (S, G & A). Selling, general and administrative expenses decreased $18,000 or 1% for the three months ended March 31, 2010 to $1,477,000 from $1,495,000 for the same period in 2009. S, G & A is comprised of activities in the executive, finance, marketing, field service and quality departments, and non-cash charges for depreciation and options expense. The Company implemented a series of cost savings measures in response to the severe sales environment through the first quarter of 2009 and has selectively increased expenditures in support of key strategic marketing and customer service initiatives in 2010.

Interest and Other Income (Expense). Interest and Other Income (Expense) increased by $3,000 to a net expense of $3,000 for the three months ended March 31, 2010 from a net expense of $6,000 for the same period in 2009. Interest income increased as a result of the Company having a larger average investable cash balance after our equity raise in December 2009.

Equity in Losses of Non-consolidated Joint Venture. A loss of $10,000 was recorded in the three months ended March 31, 2009, reflecting the pro-rata share of losses attributable to our forty percent investment interest in the Hyundai-Enova Innovative Technology Center (ITC). The joint venture partners, Hyundai Heavy Industries, Enova and ITC, mutually agreed to the dissolution of ITC, which was completed on April 6, 2009.

Net Loss. Net loss increased by $63,000 or 4% for the three months ended March 31, 2010 to $1,719,000 from $1,656,000 for the same period in 2009. The increase in the net loss was mainly due to increased R&D costs incurred in the first quarter of 2010.

Comparability of Quarterly Results. Our quarterly results have fluctuated in the past and we believe they will continue to do so in the future. Certain factors that could affect our quarterly operating results are described in Part I, Item 1A-Risk Factors contained in our Form 10K for 2009. Due to these and other factors, we believe that quarter-to-quarter comparisons of our results of operations are not meaningful indicators of future performance.

LIQUIDITY AND CAPITAL RESOURCES

We have experienced cash flow shortages due to operating losses primarily attributable to research and development, marketing and other general and administrative costs associated with our strategic plan as an international developer and supplier of electric drive and power management systems and components. Cash flows from operations have not been sufficient to meet our obligations. Therefore, we have had to raise funds through several financing transactions. The extent of our capital needs will phase out once we reach a breakeven volume in sales or develop and/or acquire the capability to manufacture and sell our products profitably. Our operations during the three months ended March 31, 2010 were financed by product sales as well as from working capital reserves.

The Company has a secured revolving credit facility with a financial institution (the Credit Agreement) for $200,000 which expires on June 30, 2010. The Credit Agreement is secured by a $200,000 certificate of deposit (CD). The interest rate is the certificate of deposit rate plus 1.25% with interest payable monthly and the principal due at maturity. As of March 31, 2010, the renewed Credit Agreement was fully drawn as the financial institution has issued a $200,000 irrevocable letter of credit in favor of Sunshine Distribution LP (Landlord), with respect to the lease of the Company s new corporate headquarters at 1560 West 190th Street, Torrance, California. We anticipate that the credit facility will be renewed with similar terms as the existing facility.

Net cash used in operating activities was $1,125,000 for the three months ended March 31, 2010 compared to $1,212,000 for the three months ended March 31, 2009. Cash used in operations for the first three months of 2010 decreased compared to 2009 due to lower personnel, operations and administrative expenditures, our continued utilization of inventory on-hand for current year sales and collections of customer receivables from the second half of 2009. Non-cash items include expense for stock-based compensation, depreciation and amortization, and issuance of common stock for employee services. Stock compensation to our directors was changed effective in 2010 from the issuance of common stock to stock option grants. This resulted in an increase in stock options expense of $42,000 to $146,000 in the first three months of 2010 compared to the first three months of 2009 and a decrease in the issuance of common stock for director services from $45,000 to $0. We continued to conserve cash resources by maintaining our reduced employee headcount and restrictions on administration and operating expenditures. As of March 31, 2010, the Company had $11,889,000 of cash and cash equivalents.

Net cash used in investing activities for capital expenditures was $57,000 for the first three months of 2010 compared to net cash used of $6,000 for capital expenditures in the first three months of 2009.

Net cash used in financing activities totaled $7,000 for the first three months of 2010, compared to net cash used in financing activities of $16,000 for the first three months of 2009.

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As of March 31, 2010, net accounts receivable was $952,000, a 34% decrease from the balance at December 31, 2009 of $1,442,000. The decrease in the receivable balance was due to collections on orders for FAW and HCATT shipped during the second half of 2009.

Inventory decreased by $98,000 when comparing the balances at March 31, 2010 and December 31, 2009, which represents a 2% decrease in the inventory balance between the two dates. The decrease resulted from net inventory activity including receipts totaling approximately $473,000 and normal consumption of approximately $571,000 due to sales and research activities during the first three months of 2010.

Prepaid expenses and other current assets increased by a net $190,000, or 72%, to $453,000 at March 31, 2010 from the December 31, 2009 balance of $263,000. A deposit of $179,000 was made on a purchase order to Hyundai Heavy Industries for electric motors to be delivered in the second quarter of 2010.

Property and equipment decreased by $80,000, net of depreciation, at March 31, 2010, when compared to the December 31, 2009 balance of $1,363,000. In the first three months of 2010, the Company recognized depreciation expense of $137,000 and recorded additions to fixed assets totaling $57,000.

Accounts payable decreased in the first three months of 2010 by $32,000 to $383,000 from $415,000 at December 31, 2009.

Deferred revenues were $210,000 at March 31, 2010 compared to a $357,000 balance at December 31, 2009. This balance is expected to be realized into revenue in the second quarter of 2010 and is associated with prepayment on purchase orders from several different customers.

Accrued payroll and related expenses increased by $192,000, or 69%, to $469,000 at March 31, 2010 compared to a balance of $277,000 at December 31, 2009. The change is primarily due to the accrual of a management estimate of 2010 employee incentive bonuses on a prorated monthly basis, which was not done in 2009.

Other accrued liabilities decreased by $144,000, or 11%, to $1,143,000 at March 31, 2010 from the balance of $1,287,000 at December 31, 2009, primarily due to payments for accrued professional services as well as a net decrease in the accrued warranty balance as costs for warranty repairs were greater than warranty accruals for sales during the quarter.

Accrued interest payable was $1,094,000 at March 31, 2010, an increase of 2% from the balance of $1,074,000 at December 31, 2009. The increase is due to interest related to our debt instruments, primarily the secured note payable in the amount of $1,238,000 to the Credit Managers Association of California.

Our ongoing operations and anticipated growth will require us to make necessary investments in human and production resources, regulatory compliance, as well as sales and marketing efforts. We anticipate that our current cash balance and projected cash inflow as mentioned in the Recent Development section above regarding our capital raise will be adequate to meet our working capital and capital expenditure needs for at least the next 12 months. If we require additional capital resources to grow our Company, we may seek to sell more equity securities. The sale of equity securities could result in dilution to our stockholders. 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, we may be compelled to delay or curtail our plans to develop our business, which could have a material adverse effect on our operations, market position and competitiveness.

Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

None.

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ITEM 4T. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

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

As required by Rule 13a-15(b) under the Securities and Exchange Act of 1934, as amended, the Company carried out an evaluation, under the supervision and with the participation of the Company s management, including the Company s Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company s disclosure controls and procedures for the period covered by this report. Based on that evaluation, the Company s Chief Executive Officer and Chief Financial Officer have concluded that the Company s internal control over disclosure controls and procedures was effective as of March 31, 2010.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended March 31, 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

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

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

ITEM 1A. Risk Factors

There have been no other material changes from the risk factors as previously disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2009.

ITEM 2. Unregistered Sales of Equity and Use of Proceeds

None.

ITEM 3. Defaults upon Senior Securities

None.

ITEM 4. Removed and Reserved

ITEM 5. Other Information

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None.

ITEM 6. Exhibits

a) Exhibits

31.1 Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act Of 2002.*

31.2 Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*

32.1 Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*

* - Filed herewith

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SIGNATURE

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

Date: May 17, 2010

ENOVA SYSTEMS, INC. (Registrant)

/s/ Jarett Fenton

By: Jarett Fenton, Chief Financial Officer

EXHIBIT INDEX

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