CALLON PETROLEUM CO
Form 10-Q
November 05, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM
10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For The Quarterly Period Ended September 30, 2015

OR

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from ____________ to ____________

Commission File Number 001-14039

Callon Petroleum Company

(Exact Name of Registrant as Specified in Its Charter)

Delaware	64-0844345
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification No.)
200 North Canal Street	
Natchez, Mississippi	
(Address of Principal Executive Offices)	39120 (Zip Code)

601-442-1601

(Registrant's Telephone Number, Including Area Code)

Not Applicable

(Former Name, Former Address and Former Fiscal Year, If Changed Since Last Report)

Indicate by check mark whether 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

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	(Do not check if smaller reporting company)	Smaller reporting company

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

The Registrant had 66,287,148 shares of common stock outstanding as of October 30, 2015.

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DEFINITIONS

All defined terms under Rule 4-10(a) of Regulation S-X shall have their prescribed meanings when used in this report. As used in this document:

- ARO: asset retirement obligation.
- Bbl or Bbls: barrel or barrels of oil or natural gas liquids.
- BOE: barrel of oil equivalent, determined by using the ratio of one Bbl of oil or NGLs to six Mcf of gas. The ratio of one barrel of oil or NGL to six Mcf of natural gas is commonly used in the industry and represents the approximate energy equivalence of oil or NGLs to natural gas, and does not represent the economic equivalency of oil and NGLs to natural gas. The sales price of a barrel of oil or NGLs is considerably higher than the sales price of six Mcf of natural gas.
- BBtu: billion Btu.
- BOE/d: BOE per day.
- Btu: a British thermal unit, which is a measure of the amount of energy required to raise the temperature of one pound of water one degree Fahrenheit.
- LIBOR: London Interbank Offered Rate.
- LOE: lease operating expense.
- MBbls: thousand barrels of oil.
- MBOE: thousand BOE.
- Mcf: thousand cubic feet of natural gas.
- MMBtu: million Btu.
- MMcf: million cubic feet of natural gas.
- NGL or NGLs: natural gas liquids, such as ethane, propane, butanes and natural gasoline that are extracted from natural gas production streams.
- NYMEX: New York Mercantile Exchange.
- Oil: includes crude oil and condensate.
- SEC: United States Securities and Exchange Commission.
- GAAP: Generally Accepted Accounting Principles in the United States.

With respect to information relating to our working interest in wells or acreage, “net” oil and gas wells or acreage is determined by multiplying gross wells or acreage by our working interest therein. Unless otherwise specified, all references to wells and acres are gross.

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Part I. Financial Information

Item I. Financial Statements

Callon Petroleum Company

Consolidated Balance Sheets

(in thousands, except par and per share values and share data)

	September 30, 2015 Unaudited
ASSETS	
Current assets:	
Cash and cash equivalents	$ 1,922
Accounts receivable	39,385
Fair value of derivatives	16,763
Other current assets	1,410
Total current assets	59,480
Oil and natural gas properties, full cost accounting method:	
Evaluated properties	2,251,993
Less accumulated depreciation, depletion and amortization	(1,618,027)
Net oil and natural gas properties	633,966
Unevaluated properties	141,581
Total oil and natural gas properties	775,547
Other property and equipment, net	7,905
Restricted investments	3,305
Deferred tax asset	—
Deferred financing costs	15,858
Fair value of derivatives	2,203
Other assets, net	426
Total assets	$ 864,724
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current liabilities:	

Accounts payable and acfuture cash flows of the entity are expected to change significantly as a result of the exchange. SFAS No. 153 is effective for nonmonetary asset exchanges occurring in periods beginning after June 15, 2005. Earlier application is permitted for nonmonetary asset exchanges occurring in periods beginning after December 16, 2004. Management does not expect adoption of SFAS No. 153 to have a material impact, if any, on our financial position or results of operations. In December 2004, the FASB issued SFAS No. 123(R), "Share-Based Payment". SFAS 123(R) amends SFAS No. 123, "Accounting for Stock-Based Compensation", and APB Opinion No. 25, "Accounting for Stock Issued to Employees". SFAS No.123(R) requires that the cost of share-based payment transactions (including those with employees and non-employees) be recognized in the financial statements. SFAS No. 123(R) applies to all share-based payment transactions in which an entity acquires goods or services by issuing (or offering to issue) its shares, share options, or other equity instruments (except for those held by an ESOP) or by incurring liabilities (1) in amounts based (even in part) on the price of our shares or other equity instruments, or (2) that require (or may require) settlement by the issuance of a company's shares or other equity instruments. This statement is effective (1) for public companies qualifying as SEC small business issuers, as of the first interim period or fiscal year beginning after December 15, 2005, or (2) for all other public companies, as of the first interim period or fiscal year beginning after June 15, 2005, or (3) for all nonpublic entities, as of the first fiscal year beginning after December 15, 2005. Management is currently assessing the impact of this statement on its financial position and results of operations. RISK FACTORS THAT MAY AFFECT FUTURE RESULTS This Form 10-K contains forward looking statements concerning our existing and future products, markets, expenses, revenues, liquidity, performance and cash needs as well as our plans and strategies. These forward-looking statements involve risks and uncertainties and are based on current management's expectations and we are not obligated to update this information. Many factors could cause actual results and events to differ significantly from the results anticipated by us and described in these forward looking statements including, but not limited to, the following risk factors. Net Operating Losses. We have experienced recurring losses from operations and had an accumulated deficit of $100,459,000 at December 31, 2004. There is no assurance, however, that any net operating losses will be available to us in the future as an offset against future profits for income tax purposes. Continued Losses. For the year ended December 31, 2004, 2003 and 2002, we had net losses of $3,382,000, $3,186,000 and $3,598,000, respectively, on sales of $2,554,000, $4,310,000, and $4,455,000, respectively. Our independent auditors' opinion on our audited financial statements includes a going concern qualification. Our independent auditors have included an explanatory paragraph in their audit report issued in connection with our financial statements which states that our recurring operating losses raise substantial doubt about our ability to continue as a going concern. Our financial statements do not include any adjustments to the amounts and classification of assets and liabilities that may be necessary should we be unable to continue as a going concern. Our ability to continue as a going concern is dependent upon our ability to generate profitable operations in the future and/or to obtain the necessary financing to meet our obligations and repay our liabilities arising from normal business operations when they come due. The outcome of these matters cannot be predicated with any certainty at this time. The Company's ability to continue as a going concern is dependent on its success at obtaining additional capital sufficient to meet its obligations on a timely basis, and to ultimately attain profitability. Management is actively engaged in seeking to raise capital through product licensing, co-promotional arrangements, or public or private equity financing. The Company believes it has demonstrated the ability to raise the necessary funds for the Company's growth and development activities. However, there is no assurance that the Company will raise capital sufficient to enable the Company to continue its operations through the end of the fiscal year. In the event the Company is unable to successfully obtain additional capital, it is unlikely that the Company will have sufficient cash flows and liquidity to finance its business operations as currently contemplated. Accordingly, in the event additional capital is not obtained, the Company will likely further downsize the organization, defer marketing programs, reduce general and administrative expenses and delay or reduce the scope of research and development projects until it is able to obtain sufficient financing to do so. Nature of Industry. The mobile and stationary power markets, including electric vehicle and hybrid electric vehicles, continue to be subject to rapid technological change. Most of the major domestic and foreign automobile manufacturers: (1) have already produced electric and hybrid vehicles, and/or (2) have developed improved electric storage, propulsion and control systems, and/or (3) are now entering or have entered into production, while continuing to improve technology or incorporate newer technology. Various companies are also developing improved electric storage, propulsion and control systems. In addition, the stationary power market is still in its infancy. A number of established energy companies are developing new technologies. Cost-effective methods to reduce price per kilowatt have yet to be established and the stationary power market is not yet viable. 25 Our current products are designed for use with, and are dependent upon, existing technology. As technologies change, and subject to our limited available resources, we plan to upgrade or adapt our products in order to continue to provide products with the latest technology. We cannot assure you, however, that we will be able to avoid technological obsolescence, that the market for our products will not ultimately be dominated by technologies other than ours, or that we will be able to adapt to changes in or create "leading-edge" technology. In addition, further proprietary technological development by others could prohibit us from using our own technology. Our industry is affected by political and legislative changes. In recent years there has been significant public pressure to enact legislation in the United States and abroad to reduce or eliminate automobile pollution. Although states such as California have enacted such legislation, we cannot assure you that there will not be further legislation enacted changing current requirements or that current legislation or state mandates will not be repealed or amended, or that a different form of zero emission or low emission vehicle will not be invented, developed and produced, and achieve greater market acceptance than electric or hybrid electric vehicles. Extensions, modifications or reductions of current federal and state legislation, mandates and potential tax incentives could also adversely affect our business prospects if implemented. Changed legislative climate. Because vehicles powered by internal combustion engines cause pollution, there has been significant public pressure in Europe and Asia, and enacted or pending legislation in the United States at the federal level and in certain states, to promote or mandate the use of vehicles with no tailpipe emissions ("zero emission vehicles") or reduced tailpipe emissions ("low emission vehicles"). Legislation requiring or promoting zero or low emission vehicles is necessary to create a significant market for electric vehicles. The California Air Resources Board (CARB) is continuing to modify its regulations regarding its mandatory limits for zero emission and low emission vehicles. Furthermore, several car manufacturers have challenged these mandates in court and have obtained injunctions to delay these mandates. There are substantial risks involved in the development of unproven products. In order to remain competitive, we must adapt existing products as well as develop new products and technologies. In fiscal years 2004, 2003 and 2002, we spent collectively in excess of $2,850,000 on research and development of new products and technology. Despite our best efforts a new product or technology may prove to be unworkable, not cost effective, or otherwise unmarketable. We can give you no assurance that any new product or technology we may develop will be successful or that an adequate market for such product or technology will ever develop. 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, are larger, more established companies that have substantially greater financial, personnel, and other resources than we do. These companies may be actively engaged in the research and development of power management and conversion systems. 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. We believe that developing and maintaining a competitive advantage will require continued investment in product development, manufacturing capability and sales and marketing. We cannot assure you however that we will have sufficient resources to make the necessary investments to do so. In addition, current and potential competitors may establish collaborative relationships among themselves or with third parties, including third parties with whom we have relationships. Accordingly, new competitors or alliances may emerge and rapidly acquire significant market share. Future equity financings may dilute your holdings in our company. We need to obtain additional funding through public or private equity or debt financing, collaborative agreements or from other sources. If we raise additional funds by issuing equity securities, current shareholders may experience significant dilution of their holdings. We may be unable to obtain adequate financing on acceptable terms, if at all. If we are unable to obtain adequate funds, we may be required to reduce significantly our spending and delay, scale back or eliminate research, development or marketing programs, or cease operations altogether. Potential intellectual property, shareholder or other litigation could adversely impact our business. Because of the nature of our business, we may face litigation relating to intellectual property matters, labor matters, product liability or shareholder disputes. Any litigation could be costly, divert management attention or result in increased costs of doing business. Although we intend to vigorously defend any future lawsuits, we cannot assure you that we would ultimately prevail in these efforts. An adverse judgment could negatively impact the price of our common stock and our ability to obtain future financing on favorable terms or at all. 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. Accidents involving our products could lead to personal injury or physical damage. 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. This could result in a decline in demand for our products, which would materially adversely affect our financial condition and results of operations. 26 We are highly subject to general economic conditions. The financial success of our company is sensitive to adverse changes in general economic conditions, such as inflation, unemployment, and consumer demand for our products. These changes could cause the cost of supplies, labor, and other expenses to rise faster than we can raise prices. Such changing conditions also could significantly reduce demand in the marketplace for our products. We have no control over any of these changes. We are an early growth stage company. Although our Company was originally founded in 1976, many aspects of our business are still in the early growth stage development, and our proposed operations are subject to all of the risks inherent in a start-up or growing business enterprise, including the likelihood of continued operating losses. Enova is relatively new in focusing its efforts on electric systems, hybrid systems and fuel cell management systems. The likelihood of our success must be considered in light of the problems, expenses, difficulties, complications, and delays frequently encountered in connection with the growth of an existing business, the development of new products and channels of distribution, and current and future development in several key technical fields, as well as the competitive and regulatory environment in which we operate. We operate in a highly regulated business environment and changes in regulation could impose costs on us or make our products less economical. Our products are subject to federal, state, local and foreign laws and regulations, governing, among other things, emissions as well as laws relating to occupational health and safety. Regulatory agencies may impose special requirements for implementation and operation of our products or may significantly impact or even eliminate some of our target markets. We may incur material costs or liabilities in complying with government regulations. In addition, potentially significant expenditures could be required in order to comply with evolving environmental and health and safety laws, regulations and requirements that may be adopted or imposed in the future. We are highly dependent on a few key personnel and will need to retain and attract such personnel in a labor competitive market. Our success is largely dependent on the performance of our key management and technical personnel, including Edwin Riddell, our Chief Executive Officer, Larry Lombard, our Chief Financial Officer, Edward Moore, our Chief Operating Officer and Don Kang, our Vice President of Engineering, the loss of one or more of whom could adversely affect our business. Additionally, in order to successfully implement our anticipated growth, we will be dependent on our ability to hire additional qualified personnel. There can be no assurance that we will be able to retain or hire other 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 continued ability to attract, retain, and motivate additional highly skilled personnel in an increasingly competitive market. 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 7A. Quantitative and Qualitative Disclosures about Market Risk None. Item 8. Financial Statements and Supplementary Data The response to this Item is submitted as a separate section of this Form 10-K. See Item 15. Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure. None. Item 9A. Controls and Procedures We conducted an evaluation of the effectiveness of the design and operation of our "disclosure controls and procedures" (Disclosure Controls) as of the end of the period covered by this Annual Report. The controls evaluation was done under the supervision and with the participation of management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO). Attached as exhibits to this Annual Report are certifications of the CEO and the CFO, which are required in accord with Rule 13a-15(e) of the Exchange Act. This Controls and Procedures section includes the information concerning the controls evaluation referred to in the certifications and it should be read in conjunction with the certifications for a more complete understanding of the topics presented. 27 Definition of Disclosure Controls Disclosure Controls are controls and procedures designed to reasonably assure that information required to be disclosed in our reports filed under the Exchange Act, such as this Annual Report, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure Controls are also designed to reasonably assure that such information is accumulated and communicated to our management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure. Our Disclosure Controls include components of our internal control over financial reporting, which consists of control processes designed to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements in accordance with US generally accepted accounting principles. To the extent that components of our internal control over financial reporting are included within our Disclosure Controls, they are included in the scope of our periodic controls evaluation. Limitations on the Effectiveness of Controls Our management, including the CEO and CFO, does not expect that our Disclosure Controls or our internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. Scope of the Controls Evaluation The evaluation of our Disclosure Controls included a review of the controls' objectives and design, our implementation of the controls and the effect of the controls on the information generated for use in this Annual Report. In the course of the controls evaluation, we sought to identify data errors, controls problems or acts of fraud and confirm that appropriate corrective action, including process improvements, were being undertaken. This type of evaluation is performed on a quarterly basis so that the conclusions of management, including the CEO and CFO, concerning controls effectiveness can be reported in our Quarterly Reports on Form 10-Q and in our Annual Report on Form 10-K. Many of the components of our Disclosure Controls are also evaluated on an ongoing basis by personnel in our Finance organization, as well as our independent auditors who evaluate them in connection with determining their auditing procedures related to their report on our annual financial statements and not to provide assurance on our controls. The overall goals of these various evaluation activities are to monitor our Disclosure Controls, and to modify them as necessary. Among other matters, we also considered whether our evaluation identified any "significant deficiencies" or "material weaknesses" in our internal control over financial reporting, and whether the Company had identified any acts of fraud involving personnel with a significant role in our internal control over financial reporting. This information was important both for the controls evaluation generally, and because item 5 in the certifications of the CEO and CFO require that the CEO and CFO disclose that information to our Board's Audit Committee and to our independent auditors. In the professional auditing literature, "significant deficiencies" are referred to as "reportable conditions," which are deficiencies in the design or operation of controls that could adversely affect our ability to record, process, summarize and report financial data in the financial statements. Auditing literature defines "material weakness" as a particularly serious reportable condition where the internal control does not reduce to a relatively low level the risk that misstatements caused by error or fraud may occur in amounts that would be material in relation to the financial statements and the risk that such misstatements would not be detected within a timely period by employees in the normal course of performing their assigned functions. Conclusions Based upon the controls evaluation, our CEO and CFO have concluded that, subject to the limitations noted above, as of the end of the period covered by this Annual Report, our Disclosure Controls were effective to provide reasonable assurance that material information relating to the Company is made known to management, including the CEO and CFO. 28 PART III Item 10. Directors and Executive Officers of the Registrant Our directors and executive officers hold office until the first meeting of the Board of Directors following the annual meeting of stockholders and until their successors are duly chosen and qualified, or until they resign or are removed from office in accordance with our By-laws. The following table sets forth certain information with respect to the current Directors and executive officers of Enova: Name Age Position ---- --- -------- Anthony N. Rawlinson 49 Chairman of the Board Edwin O. Riddell 62 Chief Executive Officer, President and Director Carl D. Perry 72 Vice chairman Bjorn Ahlstrom (1) 70 Director Dr. Malcolm Currie (1) 77 Director John J. Micek, III (2) (3) 52 Director Donald H. Dreyer (2) 67 Director John Wallace 56 Director Larry B. Lombard 44 Chief Financial Officer Edward M. Moore 43 Chief Operating Officer (1) Member of the Compensation Committee. (2) Member of the Audit Committee. Anthony Rawlinson, Chairman of the Board. Mr. Rawlinson was appointed Chairman of the Board in July 1999. He is Managing Director of The Global Value Investment Portfolio Management Pte. Ltd., a Singapore-based international fund management company managing discretionary equity portfolios for institutions, pension funds and clients globally from 1996 to the present. Mr. Rawlinson is also a director of Calvalley Petroleum. a Canadian listed public company with Yemen oil interests and chairman of Cardsoft Inc., a privately-held company which supplies software for a secure Java environment that meets financial standards. Edwin O. Riddell, President, CEO and Director. Mr. Riddell was appointed President and Chief Executive Officer on August 20, 2004. Mr. Riddell has been a Director of the Company since 1995. Since 1999, Mr. Riddell has been President of CR Transportation Services, a consultant to the electric 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, Engineering, working on electric public transportation systems. From 1979 to 1985, he was Vice President, General Manager and COO of Lift-U, Inc., the leading manufacturer of handicapped wheelchair lifts for the transit industry. Mr. Riddell has also worked with Ford, Chrysler, and General Motors in the area of auto design, and has worked as a member of senior management for a number of public transit vehicle manufacturers. Mr. Riddell has been a member of the American Public Transportation Association's (APTA) Member Board of Governors for over 15 years, and has served on APTA's Board of Directors. Mr. Riddell was also Managing Partner of the U.S. Advanced Battery Consortium. Carl D. Perry, Director, Vice Chairman of the Board. Mr. Perry served as Chief Executive Officer, President and a Director of the Company until August 2004 when he stepped down from his positions to accept the position of vice chairman of the Board. Mr. Perry served as a Director and as an Executive Vice President of the Company from 1993 until 1997. In 1997, Mr. Perry was elected as Chairman of the Board and Chief Executive Officer of the Company, and was elected President in June 1999. In July 1999, Mr. Perry resigned his position as Chairman of the Board to allow Mr. Anthony Rawlinson to become Chairman. Bjorn Ahlstrom, Director. Mr. Ahlstrom was elected to the Board of Directors in June 2004. Mr. Ahlstrom currently is a consultant in the heavy-duty vehicle industry. Mr. Ahlstrom retired as Chairman of Volvo Group North America, Inc. on April 1, 2004. Prior to that, Mr. Ahlstrom was President and Chief Executive Officer of Volvo North America Corporation from 1971 until 1994. During this term, Volvo North America Corporation owned and operated Volvo's businesses in the United States and Canada. Under Mr. Ahlstrom's leadership, 29 VNAC grew from a $50 million car importer in the early 1970s to a $6 billion company with manufacturing and marketing operations for cars, trucks, marine engines, and financial services. In 1981, Mr. Ahlstrom received the Royal Order of the North Star from King Carl XVI Gustaf of Sweden. The United States Government awarded him the Medal of Peace and Commerce in 1983. He received the Ellis Island Medal of Honor in 1990. Mr. Ahlstrom has been awarded honorary Doctor of Law degree from St John's University, NY, and Ramapo College of New Jersey. Malcolm R. Currie, Ph.D, Director. Dr. Currie was re-elected to the Board of Directors in 1999. Dr. Currie had served as a Director of the Company from 1995 through 1997. From 1986 until 1992, Dr. Currie served as Chairman and Chief Executive Officer of Hughes Aircraft Co., and from 1985 until 1988, he was the Chief Executive Officer of Delco Electronics. His career in electronics and management has included research with many patents and papers in microwave and millimeter wave electronics, laser, space systems, and related fields. He has led major programs in radar, commercial satellites, communication systems, and defense electronics. He served as Undersecretary of Defense for Research and Engineering, the Defense Science Board, and currently serves on the Boards of Directors of LSI Logic, Inamed Corp., Innovative Micro Technology, Regal One, and Currie Technologies. He is past president of the American Institute of Aeronautics and Astronautics, and is a Member of the Board of Trustees of the University of Southern California. John R. Wallace, Director. Mr.

Wallace was elected as a Director of the Company in 2002. Mr. Wallace retired from the Ford Motor Company in 2002. From 2002 to the present, he has been working independently as a consultant in the alternative energy sector Prior to his retirement, he was executive director of TH!NK Group. He has been active in Ford Motor Company's alternative fuel vehicle programs since 1990, serving first as: Director, Technology Development Programs; then as Director, Electric Vehicle Programs; Director, Alternative Fuel Vehicles and finally Director, Environmental Vehicles. He is past Chairman of the Board of Directors of TH!NK Nordic; he is past chairman of the United States Advanced Battery Consortium; Co-Chairman of the Electric Vehicle Association of the Americas, and past Chairman of the California Fuel Cell Partnership. He served as Director of Ford's Electronic Systems Research Laboratory, Research Staff, from 1988 through 1990. Prior to joining Ford Research Staff, he was president of Ford Microelectronics, Inc., in Colorado Springs. His other experience includes work as program manager with Intel Corporation. He also served as Director, Western Development Center, for Perkin-Elmer Corporation and as President of Precision Microdesign, Inc. Donald H. Dreyer, Director. Mr. Dreyer was elected a Director of the Company in January 1997. Mr. Dreyer is President and CEO of Dreyer & Company, Inc., a consultancy in credit, accounts receivable and insolvency services, which he founded in 1990. Mr. Dreyer has served as Chairman of the Board of Credit Managers Association of California during the 1994 to 1995 term and remains a current member. Mr. Dreyer is also a member of the American Bankruptcy Institute and the National Advisory Committee of Dun & Bradstreet, Inc. John J. Micek III, Director. Mr. Micek was elected a Director of the Company in April 1999. Mr. Micek has been Managing Director of Silicon Prairie Partners, LP from August 1998 to the present. From June 1997 to August 1998, Mr. Micek was COO of Pelion Systems, Inc. Mr. Micek served as our Vice President, General Counsel and Secretary from March 1994 to March 1997. He also is a practicing attorney specializing in corporate finance and business development in Palo Alto, CA. He is a Board Member of Universal Warranty and also sits on the boards of UTEK Corp., Pelion Systems, Inc., Universal Assurors Agency, Inc., and Armanino Foods. Larry B. Lombard, Chief Financial Officer. Mr. Lombard was appointed Chief Financial Officer in November 2004. He was appointed was appointed Chief Financial Officer in November 2004. He has served as Director of Finance and Administration at Enova Systems, Inc. since 1998. Mr. Lombard has over twenty years experience in management and finance for a wide range of companies including software development, insurance, petroleum and banking. He received his BA in Business Economics, University of California at Los Angeles and his MBA in Global Management from the University of Phoenix. Edward M. Moore, Chief Operating Officer. Mr. Moore was appointed Chief Operating Officer in March 2004. He has served as Vice President, Marketing and Sales at Enova Systems, Inc. since 2000. Mr. Moore was vice president, sales for E-Bus from 1999 to 2000. Mr. Moore has experience in creating and implementing strategic marketing plans for both domestic and international markets. He has an extensive background in the alternative fuels and drive system industry, having worked with GM Hughes, AeroEnvironment and E-Bus in both the technology and marketing fields. He received his BS, Occupational Education from Southern Illinois University and his MBA from the University of Phoenix. Audit Committee We have a standing Audit Committee established in accordance with section 3(a)(58)(A) of the Securities Exchange Act of 1934, as amended, which is composed of Donald H. Dreyer and John J. Micek, III. The Audit Committee has adopted an Audit Committee Charter, which is on file at our corporate headquarters in Torrance California. 30 Audit Committee Financial Expert As required by the Sarbanes-Oxley Act of 2002, our Board of Directors has determined that one member of our Audit Committee, John J. Micek III, is qualified to be an "audit committee financial expert" within the meaning of SEC regulations. The Board reached its conclusion as to the qualifications of Mr. Micek based on his education and experience in analyzing financial statements of a variety of companies. Relationships Among Directors or Executive Officers There are no family relationships among any of the Directors or executive officers of Enova. Section 16(a) Beneficial Ownership Reporting Compliance Section 16(a) of the Securities Exchange Act requires our Directors, executive officers and persons who own more than 10% of our Common Stock (collectively, "Reporting Persons") to file reports of ownership and changes in ownership of our Common Stock to the Securities and Exchange Commission ("SEC"). Copies of these reports are also required to be delivered to Enova. We believe, based solely on our review of the copies of such reports received or written representations from certain Reporting Persons, that each of Messrs. Rawlinson, Riddell, Currie, Micek, Wallace and Dreyer, each of whom is a Director of Enova, failed to file on a timely basis one Form 4, each of which Form 4 reported one transaction, namely the issuance of shares of Common Stock in partial payment of directors' fees for August 2004. Code of Ethics Enova has adopted a code of ethics that applies to its principal executive officer, principal financial officer, principal accounting officer or controller and all persons performing similar functions, if any. We will provide to any person without charge, upon request, a copy of such code of ethics. Requests should be made in writing to: Enova Systems, Inc. Larry Lombard, Chief Financial Officer 19850 S. Magellan Drive Torrance, CA 90502 31 Item 11. Executive Compensation Summary Compensation Table The following table sets forth all compensation earned by our Chief Executive Officer and each of the other most highly compensated executive officers of Enova whose annual salary and bonus exceeded $100,000 for the years ended December 31, 2004, 2003 and 2002 (collectively, the "Named Executive Officers"). Mr. Carl D. Perry was the sole executive officer of Enova whose salary currently exceeded $100,000 prior to December 31, 2003. Name and Principal Position -------------------------- SUMMARY COMPENSATION TABLE ANNUAL COMPENSATION -- Year Salary Bonus ---- ------ ----- Edwin O. Riddell (1) 2004 $114,000 -- Chief Executive Officer and President 2003 -- -- 2002 -- -- Larry B. Lombard (2) 2004 $127,000 -- Chief Financial Officer 2003 -- -- 2002 -- -- Edward M. Moore (3) 2004 $147,000 $30,000 (earned in 2003) Chief Operating Officer 2003 -- -- 2002 -- -- Carl D. Perry (4) 2004 $195,000 -- Former Chief Executive Officer and 2003 $140,000 -- President 2002 $150,000 $30,000 (earned in 2000) (1) Mr. Riddell was elected Chief Executive Officer and president in August 2004. Mr. Riddell commenced employment as a full-time employee in January 2005 at a salary of $208,000 per year. For the period from August 2004 to December 2004, Mr. Riddell was compensated for services on a contractual basis at the rate of $4,000 per week totaling $99,000 in cash during 2004 and $15,000 in director's fees for his service as a director prior to becoming an officer of the company. (2) Mr. Lombard was elected Chief Financial Officer in November 2004. He was elected Acting Chief Financial Officer in March 2004. Mr. Lombard's annual salary is $145,000 per year. Prior to 2004, Mr. Lombard was not an officer of the Company. (3) Mr. Moore was elected Chief Operating Officer in March 2004. Mr. Moore's annual salary is $150,000 per year. Prior to 2004, Mr. Moore was not an officer of the Company. (4) Mr. Perry was elected Chief Executive Officer and president in November 1997 and resigned those positions in August 2004. Mr. Perry's current salary was $120,000 per year which terminated per agreement at December 31, 2004. Upon termination, Mr. Perry is entitled to approximately $75,000 in deferred salary, bonus and vacation pay which will be paid in 2005. Mr. Perry served as Acting Chief Financial Officer during the periods reflected in the above chart through March 6, 2004. 32 Option/SAR Grants The following grants of stock options or stock appreciation rights ("SARs") were made during 2004 to the Named Executive Officers. Option Grants During Fiscal 2004 Number of Securities Percentage of Total Potential Realizable Value of Underlying Options Granted to Exercise Assumed Annual Rates of Stock Price Name of Individual Options Employee in Price Expiration Appreciation for the Option and Position Granted Fiscal 2004 Per Share Date Term (1) ------------ ------- ---------- --------- ---- ----------------------------------- 5% 10% -- --- Larry B. Lombard, Chief Financial Officer 1,000,000 50.0% $0.115 1-25-06 $ 5,750 $ 11,500 Edward M. Moore, Chief Operating Officer 1,000,000 50.0% $0.115 1-25-06 $ 5,750 $ 11,500 (1) Calculated on the basis of $0.115 representing the average of the high bid and low ask prices of the Common Stock on December 31, 2004 Option Exercises and Option Values The following table sets forth information concerning option exercises during 2004, and the aggregate value of unexercised options as of December 31, 2004, held by each of the Named Executive Officers: Aggregated Option/SAR Exercises in 2004 and Option Values at December 31, 2004 Number of Securities Aggregate Underlying Unexercised Value of Unexercised Option Options at In-the-Money Options at Exercises in 2004 December 31, 2004 (#) December 31, 2004 ($) (1) -------------------------- ------------------------ ------------------------- Shares Acquired on Value Name Exercise (#) Realized ($) Exercisable Unexercisable Exercisable Unexercisable ---- ------------ ------------ ----------- ------------ ---------- ------------ Edwin O. Riddell -- -- -- -- --(1) N/A Larry B. Lombard -- -- 2,000,000 -- --(1) N/A Edward M. Moore 1,133,234 $110,800 2,000,000 -- --(1) N/A (1) Calculated on the basis of $0.00 representing the average of the high bid and low ask prices of the Common Stock on December 31, 2004 of $0.115 per share, minus the exercise price. Compensation of Directors During 2004, we issued, or accrued for issuance, an aggregate of 701,255 shares of common stock to the non-executive board members in accordance with the September 1999 Board of Directors compensation package for outside directors, as amended to date. For each meeting attended in person, each outside director is entitled to receive $2,000 in cash and $4,000 of stock valued on the date of the meeting at the average of the closing ask and bid prices; for each telephonic Board meeting, each outside director is entitled to receive $500 in cash and $500 of stock valued on the date of the meeting at the average of the closing ask and bid prices; and for each meeting of a Board committee attended in person, a committee member is entitled to receive $1,000 in cash and $1,000 of stock valued on the date of the meeting at the average of the closing ask and bid prices. All Directors are also reimbursed for out-of-pocket expenses incurred in connection with attending Board and committee meetings. We relied on Rule 506 of Regulation D and Section 4(2) of the Securities Act of 1933, as amended, for the exemption from registration of the sale of such shares. As of December 31, 2004, an aggregate of 3,539,784 shares had been issued, or accrued for issuance, under the above compensation plan for Directors. 33 Edwin O. Riddell The Company entered into a consulting agreement with Edwin Riddell, doing business as CR Transportation Services, wherein the Company compensates CR Transportation at the rate of $4,000 per week plus reasonable expenses for consulting services rendered. Upon Mr. Riddell becoming an employee of Enova in January 2005, this agreement was terminated. Mr. Riddell is not compensated per this agreement when acting in the capacity of a director of the Company. During 2004, the Company paid Mr. Riddell $99,000 in cash for consulting services and expenses and $15,000 for directors fees (which latter amount includes the cash paid and the value of the stock issued to him pursuant to the outside directors' compensation package described above). Donald Dreyer The Company utilizes the consulting service of Donald Dreyer wherein the Company compensates Mr. Dreyer at the rate of $150 per hour plus reasonable expenses for consulting services rendered. Mr. Dreyer is not compensated when acting in the capacity of a director of the Company other than the fees noted above. During 2004, the Company paid Mr. Dreyer $2,000 in cash for consulting services and expenses and $29,000 for directors fees (which latter amount includes the cash paid and the value of the stock issued to him pursuant to the outside directors' compensation package described above). Compensation Committee Interlocks and Insider Participation The Compensation Committee held two meetings in the year ended December 31, 2004. The Compensation Committee currently consists of Mr. Bjorn Ahlstrom and Dr. Malcolm Currie, neither of who have been officers of the Company. Prior to August 2004, Mr. Edwin Riddell was a member of the Compensation Committee. Mr. .Riddell resigned from the committee upon his appointment as Chief Executive Officer. The Compensation Committee's functions are to establish and apply our compensation policies with respect to our Executive Officers, and to administer our stock option plans. REMAINDER OF PAGE INTENTIONALLY LEFT BLANK 34 Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters The following table sets forth certain information known to the Company with respect to beneficial ownership of our Common Stock as of March 30, 2005, by (i) each shareholder known to the Company to own beneficially more than 5% of our Common Stock; (ii) each of our Directors; (iii) the Named Executive Officer; and (iv) all Executive Officers and Directors as a group. Except as indicated in the footnotes to this table and subject to applicable community property laws, the persons named in the table, based on information provided by such persons, have sole voting and investment power with respect to all shares of Common Stock shown as beneficially owned by them. Shares Percentage of Shares Voting Name Beneficially Owned (1) Beneficially Owned (2) Percentage (3) ---- --------------------- --------------------- ------------- Jagen, Pty., Ltd. 145,000,000 33.53% 34.41% 9 Oxford Street, South Ybarra 3141 Melbourne, Victoria Australia Hyundai Heavy Industries, Co. 34,412,238 7.96% 8.17% 1 Cheona-Dong, Dong-Ku Ulsan, Korea Citibank N.A 29,405,754 6.80% 6.98% 111 Wall Street, 8th Floor New York, NY 10043 Anthony N. Rawlinson 25,545,001 5.91% 6.06% c/o Enova Systems, Inc. 19850 South Magellan Drive Torrance, CA 90502 Edwin O. Riddell 1,712,119(4) * * c/o Enova Systems, Inc. 19850 South Magellan Drive Torrance, CA 90502 Carl D. Perry 10,045,045 2.32% 2.38% John J. Micek III 1,644,267(5) * * Bjorn Ahlstrom 114,242 * * Dr. Malcolm Currie 679,369 * * Donald H. Dreyer 620,287 * * John R. Wallace 200,433 * * Delphi Delco Electronics 1,278,720(6) * * Jean Schulz 1,329,111(7) * * Larry B. Lombard 2,800,000(8) * * Edward M. Moore 2,030,000(9) * * All directors and executive officers 45,390,763(10) 10.50% 9.70% as a group (10 persons) * Indicates less than 1% (1) Number of Common Stock shares includes Series A Preferred Stock, Series B Preferred Stock and Common Stock shares issuable pursuant to stock options, warrants and other securities convertible into Common Stock beneficially held by the person or class in question which may be exercised or converted within 60 days after March 30, 2005. 35 (2) The percentages are based on the number of shares of Common Stock, Series A Preferred Stock and Series B Preferred Stock owned by the shareholder divided by the sum of: (i) the total Common Stock outstanding, (ii) the Series A Preferred Stock owned by such shareholder; (iii) the Series B Preferred Stock owned by such shareholder; and (iv) Common Stock issuable pursuant to warrants, options and other convertible securities exercisable or convertible by such shareholder within sixty (60) days after March 30, 2005. (3) The percentages are based on the number of shares of Common Stock, Series A Preferred Stock and/or Series B Preferred Stock owned by the shareholder divided by the sum of: (i) the total Common Stock outstanding, (ii) the total Series A Preferred Stock outstanding and (iii) the total Series B Preferred Stock outstanding. This percentage calculation has been included to show more accurately the actual voting power of each of the shareholders, since the calculation takes into account the fact that the outstanding Series A Preferred Stock and Series B Preferred Stock are entitled to vote together with the Common Stock as a single class on certain matters to be voted upon by the shareholders. (4) Includes 1,000,000 shares of Common Stock issuable pursuant to stock options exercisable at a price of $.115. (5) Includes 1,000,000 shares of Common Stock issued to Silicon Prairie Partners, LP, a limited partnership in which John J. Micek III is the general partner. (6) The number of shares shown represents the ownership of 639,360 shares of Series B Preferred Stock, each of which is convertible into two shares of Common Stock. These 639,360 shares represent more than 5% of the outstanding shares of Series B Preferred Stock. (7) The number of shares shown represents the ownership of 1,329,111 shares of Series A Preferred Stock, each of which is convertible into one share of Common Stock. These 1,329,111 shares represent more than 5% of the outstanding shares of Series A Preferred Stock. (8) Includes 2,000,000 shares of Common Stock issuable pursuant to stock options exercisable at a price from $.115 to $.16. (9) Includes 2,000,000 shares of Common Stock issuable pursuant to stock options exercisable at prices from $.0115 to $.20. (10) Includes 5,000,000 shares of Common Stock issuable pursuant to stock options exercisable at prices from $.115 to $.20 per share and 1,000,000 shares of Common Stock issued to Silicon Prairie Partners, LP, a limited partnership in which John J. Micek III is the general partner. Equity Compensation Plan Information The following table provides information regarding our equity compensation plans as of December 31, 2004: Equity Compensation Plan Information Number of securities remaining available for future issuance under Number of securities to Weighted-average equity compensation be issued upon exercise exercise price of plans (excluding of outstanding options, outstanding options, securities reflected warrants and rights warrants and rights in column (a)) Plan category (a) (b) (c) ------------ --- --- --- Equity compensation plans approved by security holders 9,984,167 $0.14 41,844,000 Equity compensation plans not approved by security holders -- -- -- Total 9,984,167 $0.14 41,844,000 Our board of directors adopted the 1996 Employee and Consultant Stock Option Plan in October 1996 which was subsequently approved by our shareholders in May 1997. A total of 15,000,000 shares were reserved for issuance under the 1996 Plan. Options granted under the 1996 Plan may be either incentive stock 36 options, as defined in Section 422 of the Internal Revenue Code of 1986, or nonstatutory stock options. The 1996 Plan provides that options may be granted to employees (including officers and directors who are also employees), directors and consultants. Incentive stock options may only be granted to employees. In 1999, our board of directors and shareholders approved an amendment to the 1996 Plan to increase the number of shares of common stock reserved for issuance thereunder by 30,000,000 shares and in 2004, our board of directors and shareholders approved an amendment to the 1996 Plan to increase the number of shares of common stock reserved for issuance thereunder by 20,000,000 shares, bringing the total number of shares issuable under the 1996 Plan to 65,000,000. The share increases to the 1996 Plan assured that a sufficient reserve of common stock are available to provide us with the continuing opportunity to utilize equity incentives to attract and retain the services of employees essential to our long-term growth and financial success. A copy of the actual 1996 Plan document was previously filed with the Securities and Exchange Commission. Options granted under the amended 1996 Plan will vest over such periods as may be determined by the board of directors and will generally have an exercise price equal to the closing price for our stock on the NASDAQ OTC Bulletin Board on the last trading day immediately prior to the date of grant. As of December 31, 2004, the Company had reserved 41,844,000 common shares for issuance under the 1996 Plan, as amended. Options to purchase 2,000,000 shares of Enova common stock were granted to employees in 2004. Item 13. Certain Relationships and Related Transactions The following are certain transactions entered into between Enova and its officers, directors and principal shareholders and their affiliates since January 1, 2004. During 2004, Hyundai Heavy Industries, Co. (HHI) purchased 11,335,315 shares increasing their ownership in Enova Systems, Inc. to 7.96%. Additionally, during 2004, we purchased from HHI approximately $246,000 in components, materials and services for manufacture of our drive systems and power management systems. These purchases were made on terms and conditions equal to or better than our standard commercial terms with other vendors. At the year ended December 31, 2004, our outstanding payables balance due HHI was approximately $2,000. The Company entered into a consulting agreement with Edwin Riddell, doing business as CR Transportation Services, wherein the Company compensates CR Transportation at the rate of $4,000 per week plus reasonable expenses for consulting services rendered. Upon Mr. Riddell becoming an employee of Enova in January 2005, this agreement was terminated. Mr. Riddell is not compensated per this agreement when acting in the capacity of a director of the Company. During 2004, the Company paid Mr. Riddell $99,000 in cash for consulting services and expenses and $15,000 for directors fees (which latter amount includes the cash paid and the value of the stock issued to him pursuant to the outside directors' compensation package described above). Pursuant to a written agreement approved by the Board of Directors and its Audit Committee, a finder's fee of $92,500 was accrued to be paid, through the issuance of restricted shares of common stock in Enova, totaling 608,553 shares at a price of $0.15 per share, in conjunction with a private placement funding in the first quarter of 2004 to The Global Value Investment Portfolio Management Pte Ltd, a Singapore Company which is substantially owned by two affiliated parties: Anthony Rawlinson, Chairman of the Board of our Company and Borl partnership, owned by Boris Liberman Family Trusts, which is also affiliated with Jagen Pty Ltd., a large affiliate shareholder in Enova. Said shares were subsequently issued in the first quarter of 2005. Item 14. Principal Accountant Fees and Services Singer Lewak Greenbaum & Goldstein LLP were engaged on November 21, 2003 to audit our financial statements for the fiscal year ended December 31, 2004 and 2003. Moss Adams, LLP served as our auditors prior to November 21, 2003 and audited our financial statements for the fiscal year ended December 31, 2002. Audit Fees ---------- The aggregate fees billed during the last two fiscal years for professional services rendered by Singer Lewak Greenbaum & Goldstein LLP for the audit of Enova's financial statements for the fiscal year ended December 31, 2004 and for its review of financial statements included in Enova's Form 10-Q-s during the last two fiscal years and other services that are normally provided by an accountant in connection with statutory and regulatory filings or engagements during such fiscal years were $73,970 for fiscal 2004 and $7,500 for fiscal 2003. The aggregate fees billed during the last two fiscal years for professional services rendered by Moss Adams, LLP for its review of financial statements included in Enova's Form 10-Q-s and other services that are normally provided by an accountant in connection with statutory and regulatory filings or engagements during such fiscal years were $31,050 for fiscal 2003 and $87,210 for fiscal 2002. 37 Audit-Related Fees ------------------ Singer Lewak Greenbaum & Goldstein LLP did not perform for Enova any assurance and related services that were reasonably related to the performance of the audit of our financial statements for the fiscal year ended December 31, 2004. Moss Adams, did not perform for Enova any assurance and related services that were reasonably related to the performance of the audit of our financial statements for the fiscal year ended December 31, 2004. Tax Fees -------- Singer Lewak Greenbaum & Goldstein LLP did not perform for Enova any tax compliance, tax advice and tax planning services in fiscal 2003 or fiscal 2004. Moss Adams, LLP did not perform for Enova any tax compliance, tax advice and tax planning services in fiscal 2003. All Other Fees -------------- Neither Singer Lewak Greenbaum & Goldstein LLP nor Moss Adams, LLP performed any other services for fees other than audit fees in fiscal 2004 or 2003. PART IV Item 15. Exhibits and Financial Statement Schedules (a)1. Financial Statements The financial statements filed as a part of this report are identified in the Index to Financial Statements on page F-1. (a)2. Financial Statement Schedule No financial statement schedules are filed as a part of this report. (a)3. Exhibits See Item 15 (c) for Index of Exhibits. (b) Reports on Form 8-K On February 2, 2005, Registrant filed a Form 8-K, with date of earliest event reported of September 20, 2004, reporting under items 1 and 3. (c) Exhibits Exhibit Number Description -------------- ----------- 3.1 Amended and Restated Articles of Incorporation of the Registrant (filed as Exhibit 3.1 to the Registrant's Annual Report on Form 10K for the year ended December 31, 2000 filed on March 30, 2001 and incorporated herein by reference). 3.2 Bylaws of Registrant (filed as Exhibit 3.12 to the Registration

Statement on Form 10 filed on November 29, 1994, and incorporated herein by reference). 4.1 Cashless Exercise Warrants dated October 25, 1996 issued to Fontal International, Ltd. (filed as Exhibit 4.1 to the Registrant's Annual Report on Form 10-K for the year ended July 31, 1996, as filed on November 12, 1996, and incorporated herein by reference). 10.1 Form of Stock Option Agreement under 1993 Employee and Consultant Stock Plan (filed as Exhibit 10.15 to the Registration Statement on Form 10 filed on November 29, 1994, and incorporated herein by reference). 10.2 Form of Solar Electric Engineering, Inc. 1993 Employee and Consultant Stock Plan (filed as Exhibit 10.16 to the Registration Statement on Form 10 filed on November 29, 1994, and incorporated herein by reference). 38 10.3 Form of Confidential Private Placement Memorandum and Debt Restructuring Disclosure Statement of U.S. Electricar, Inc., dated January 2, 1996, delivered by Enova to certain of its unsecured trade creditors, including exhibits (filed as Exhibit 10.91 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended January 31, 1996, as filed on March 18, 1996, and incorporated herein by reference). 10.4 Form of Stock Purchase, Note and Debt Exchange Agreement dated January 2, 1996 between Enova and certain unsecured trade creditors (filed as Exhibit 10.92 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended January 31, 1996, as filed on March 18, 1996, and incorporated herein by reference). 10.5 Form of Indemnification Agreement (filed as Exhibit 10.63 to the Registration Statement on Form 10 filed on November 29, 1994, and incorporated herein by reference). 10.6 Form of Security Agreement made as of May 31, 1995, between Enova and Credit Managers Association of California, Trustee (filed as Exhibit 10.85 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended April 30, 1996, as filed on June 14, 1996, and incorporated herein by reference). 10.7 Amended 1996 Employee and Consultant Stock Option Plan (filed as Exhibit 10.7 to the Registrant's Annual Report on Form 10-K for fiscal year ended July 31, 1999, as filed on October 29, 1999, and incorporated herein by reference). 10.8 Stock Purchase Agreement and Technology License Agreement dated February 27, 1997, by and between Enova and Hyundai Motor Company and Hyundai Electronics Industries Co., Ltd. (filed as Exhibit 10.98 to the Registrant's Quarterly Report on Form 10-Q for fiscal quarter ended January 31, 1997, as filed on March 14, 1997, and incorporated herein by reference). 10.9 Letter of Intent between Registrant and a domestic supplier, dated December 9, 1999, to design, develop and manufacture low voltage electric drive system components (filed as Exhibit 10.16 to the Registrant's Annual Report on Form 10-K for fiscal year ended December 31, 2000 and incorporated herein by reference). 10.10 Put/Call Option to sell Itochu shares between Registrant and Carl D. Perry dated September 1, 1999 (filed as Exhibit 10.16 to the Registrant's Annual Report on Form 10-K for fiscal year ended December 31, 2000 and incorporated herein by reference). 10.11 Agreement (redacted) between the Registrant and a customer dated June 14, 2001, to develop and produce power management systems. (filed as Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q for Six Months ended June 30, 2001 and incorporated herein by reference). 10.12 Agreement (redacted) between the Registrant and Eco Power Technology, dated June 12, 2001, to produce and sell power drive systems (filed as Exhibit 10.19 to Amendment No. 6 to the Registrant's Registration Statement on Form S-1, No. 333-85308, and incorporated herein by reference). 10.13 Agreement (redacted) between the Registrant and Tomoe Electro-Mechanical Engineering and Manufacturing, Inc., dated November 19, 2001, to produce and sell power drive systems (filed as Exhibit 10.20 to Amendment No. 6 to the Registrants Registration Statement on Form S-1, No. 333-85308, and incorporated herein by reference). 10.14 Agreement (redacted) between the Registrant and Moriah Corporation, dated January 22, 2002, to produce and sell power drive systems (filed as Exhibit 10.21 to Amendment No. 6 to the Registrant's Registration Statement on Form S-1, No. 333-85308, and incorporated herein by reference). 10.15 Form of Stock Purchase Agreement dated June 7, 2002 between Registrant and each of the selling shareholders listed in a Prospectus dated July 26, 2002 (filed as Exhibit 10.22 to Amendment No. 1 to the Registrant's Registration Statement on Form S-1, No. 333-96829, and incorporated herein by reference). 10.16 Form of Registration Rights Agreement dated June 7, 2002 between Registrant and each of the selling shareholders listed in a Prospectus dated July 26, 2002 (filed as Exhibit 10.23 to Amendment No. 1 to the Registrant's Registration Statement on Form S-1, No. 333-96829, and incorporated herein by reference). 10.17 Joint Venture Agreement (redacted**) to form advanced research and development corporation, dated as of March 18, 2003, by and between the Registrant and Hyundai Heavy Industries Co. Ltd. (filed as Exhibit 10.24 to the Registrant's Quarterly Report on Form 10-Q for Three Months ended March 31, 2003 and incorporated herein by reference). 39 10.18 Securities

Purchase Agreement dated as of March 18, 2003, by and between the Registrant and Hyundai Heavy Industries Co. Ltd. (filed as Exhibit 10.25 to the Registrant's Quarterly Report on Form 10-Q for Three Months ended March 31, 2003 and incorporated herein by reference). 10.19 Form of Stock Purchase Agreement dated March 30, 2004 between Registrant and various investors. (filed as Exhibit 10.19 to the Registrant's Quarterly Report on Form 10-Q for Three Months ended March 31, 2004 and incorporated herein by reference). 10.20 Form of Registration Rights Agreement dated March 30, 2004 between Registrant and various investors. (filed as Exhibit 10.20 to the Registrant's Quarterly Report on Form 10-Q for Three Months ended March 31, 2004 and incorporated herein by reference). 10.21 Form of Finder's Fee agreement dated April 1, 2004 between Registrant and The Global Value Investment Portfolio Management Pte Ltd as disclosed in our Form 10-Q for the quarter ended March 31, 2004. (filed as Exhibit 10.21 to the Registrant's Quarterly Report on Form 10-Q for Six Months ended June 30, 2004 and incorporated herein by reference). 23.1* Consent of Singer Lewak Greenbaum & Goldstein LLP, Independent Registered Public Accounting Firm 23.2* Consent of Moss Adams, LLP, Independent Registered Public Accounting Firm 24* Power of Attorney (included on signature page) 31.1* Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act Of 2002 31.2* Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 32* Certification Pursuant to 18 U.S.C. Section 1350 ---------------------- * Filed herewith. 40 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/ Larry B. Lombard -------------------------------- Larry B. Lombard, Chief Financial Officer Dated: March 31, 2005 POWER OF ATTORNEY KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Larry B. Lombard, 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/ Larry B. Lombard Chief Financial Officer ------------------------------------ (Principal Financial Officer) March 31, 2005 Larry B. Lombard /s/ Edwin O. Riddell Chief Executive Officer March 31, 2005 ------------------------------------ and Director Edwin O. Riddell (Principal Executive Officer) /s/ Anthony N. Rawlinson Chairman March 31, 2005 ------------------------------------ Anthony N. Rawlinson /s/ Carl D. Perry Vice Chairman March 31, 2005 ------------------------------------ Carl D. Perry /s/ Malcolm Currie Director March 31, 2005 ------------------------------------ Malcolm Currie /s/ Bjorn Ahlstrom Director March 31, 2005 ------------------------------------ Bjorn Ahlstrom /s/ John J. Micek, III Director March 31, 2005 ------------------------------------ John J. Micek, III /s/ Donald H. Dreyer Director March 31, 2005 ------------------------------------ Donald H. Dreyer /s/ John R. Wallace Director March 31, 2005 ------------------------------------ John R. Wallace 41 ENOVA SYSTEMS, INC. FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2004, 2003, AND 2002 ENOVA SYSTEMS, INC. CONTENTS December 31, 2004 REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM Board of Directors and Stockholders Enova Systems, Inc. Torrance, California We have audited the balance sheets of Enova Systems, Inc. as of December 31, 2004 and

2003, and the related statements of operations, stockholders' equity/(deficit), and cash flows for each of the two years in the period ended December 31, 2004. These financial statements are the responsibility of the Company's management. 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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 provided 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, 2004 and 2003, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2004, 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 a going concern. As discussed in Note 2 to the financial statements, the Company has suffered recurring losses from operations and negative cash flows from operations. These factors, among others, raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. SINGER LEWAK GREENBAUM & GOLDSTEIN LLP Los Angeles, California March 10, 2005 1 REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM To the Stockholders and Board of Directors Enova Systems, Inc. We have audited the statements of operations, stockholders' equity, and cash flows of Enova Systems, Inc., for the year ended December 31, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audit provides a reasonable basis for our opinion. In our opinion, the financial statements referred to above present fairly, in all material respects, the results of Enova Systems, Inc.'s, operations and cash flows for the year ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America. /s/ MOSS ADAMS LLP Santa Rosa, California February 24, 2003 2 ENOVA SYSTEMS, INC. BALANCE SHEETS December 31, -- ASSETS 2004 2003 ---------- ---------- Current assets Cash and cash equivalents $1,575,000 $ 530,000 Accounts receivable 522,000 803,000 Inventories and supplies 1,036,000 1,606,000 Note receivable - related party -- 8,000 Prepaid expenses and other current assets 304,000 78,000 ---------- ---------- Total Current Assets 3,437,000 3,025,000 Property and equipment, net 387,000 481,000 Equity method investment 1,768,000 960,000 Other assets 296,000 404,000 ---------- ---------- Total assets $5,888,000 $4,870,000 ========== ========== The accompanying notes are an integral part of these financial statements. 3 ENOVA SYSTEMS, INC. BALANCE SHEETS December 31, -- LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT) 2004 2003 ---------- ---------- Current liabilities Accounts payable $ 66,000 $ 768,000 Deferred revenues 392,000 -- Line of credit 229,000 120,000 Accrued payroll and related expense 194,000 120,000 Other accrued expenses 13,000 98,000 Current portion of notes payable 166,000 131,000 Current portion of capital lease obligations 6,000 23,000 ---------- ---------- Total current liabilities 1,066,000 1,260,000 Accrued interest payable 1,378,000 1,122,000 Capital lease obligations, net of current portion -- 5,000 Notes payable, net of current portion 3,341,000 3,347,000 ---------- ---------- Total liabilities $5,785,000 $5,734,000 ---------- ---------- Commitments and contingencies The accompanying notes are an integral part of these financial statements. 4 ENOVA SYSTEMS, INC. BALANCE SHEETS December 31, -- LIABILITIES AND STOCKHOLDERS'

EQUITY (DEFICIT) (continued) 2004 2003 ------------- ------------- Stockholders' equity (deficit) Series A convertible preferred stock - no par value 30,000,000 shares authorized 2,748,000 and 2,820,000 shares issued and outstanding Liquidating preference at $0.60 per share, aggregating $1,648,507 and $1,692,000 $ 1,774,000 $ 1,837,000 Series B convertible preferred stock - no par value 5,000,000 shares authorized 1,217,000 and 1,217,000 shares issued and outstanding Liquidating preference at $2 per share aggregating $2,434,000 2,434,000 2,434,000 Common Stock, no par value 500,000,000 shares authorized 415,265,000 and 378,341,000 shares issued and outstanding 90,465,000 86,054,000 Common stock subscribed 165,000 60,000 Stock notes receivable (1,176,000) (1,203,000) Additional paid-in capital 6,900,000 7,031,000 Accumulated deficit (100,459,000) (97,077,000) ------------- ------------- Total stockholders' equity (deficit) 103,000 (864,000) ------------- ------------- Total liabilities and stockholders' equity (deficit) $ 5,888,000 $ 4,870,000 ============= ============= The accompanying notes are an integral part of these financial statements. 5 ENOVA SYSTEMS, INC. STATEMENTS OF OPERATIONS For the Years Ended December 31, --- 2004 2003 2002 ------------- ------------- ------------- Net revenues Research and development contracts $ 1,070,000 $ 1,889,000 $ 1,843,000 Production 1,484,000 2,421,000 2,612,000 ------------- ------------- ------------- Total net revenues 2,554,000 4,310,000 4,455,000 ------------- ------------- ------------- Cost of revenues Research and development contracts 499,000 1,326,000 1,288,000 Production 1,627,000 1,978,000 2,496,000 Writedown Ford Think program inventory 113,000 -- -- ------------- ------------- ------------- Total cost of revenues 2,239,000 3,304,000 3,784,000 ------------- ------------- ------------- Gross profit 315,000 1,006,000 671,000 ------------- ------------- ------------- Other costs and expenses Research & development 925,000 799,000 1,152,000 Selling, general & administrative 2,325,000 2,919,000 2,837,000 Interest and financing fees, net 255,000 234,000 199,000 Equity in losses of equity method investee 192,000 40,000 -- Asset impairment -- 200,000 -- Legal settlements -- -- 81,000 ------------- ------------- ------------- Total other costs and expenses 3,697,000 4,192,000 4,269,000 ------------- ------------- ------------- Net loss $ (3,382,000) $ (3,186,000) $ (3,598,000) ============= ============= ============= Basic loss and diluted loss per share $ (0.01) $ (0.01) $ (0.01) ============= ============= ============= Weighted-average number of shares outstanding 397,435,175 334,839,700 326,390,422 ============= ============= ============= The accompanying notes are an integral part of these financial statements. 6 ENOVA SYSTEMS, INC. STATEMENTS OF STOCKHOLDERS' EQUITY For the Years Ended December 31, --- Convertible Preferred Stock --- Series A Series B Common Stock ---------------------------- ---------------------------- ---------------------------- Shares Amount Shares Amount Shares Amount ------------ ------------- ------------ ------------- ----------- ------------- Balance, December 31, 2000 2,844,000 $ 1,867,000 1,217,000 $ 2,434,000 244,249,000 $ 75,680,000 Issuance of common stock for Exercise of warrants 50,000,000 3,000,000 Exercise of options 1,805,000 181,000 Services 448,000 98,000 Legal settlement 6,000,000 900,000 Warrants issued for value participation agreement Net loss -- -- -- ------------ ------------- ------------ ------------- ----------- ------------- Balance, December 31, 2001 2,844,000 1,867,000 1,217,000 2,434,000 302,502,000 79,859,000 Conversion of Series A preferred stock (20,000) (25,000) 20,000 25,000 Issuance of common stock for Cash, net of offering costs of $206,000 41,100,000 3,904,000 Exercise of options 30,000 3,000 Services 1,242,000 190,000 Legal settlement 300,000 45,000 Stock notes receivable Net loss ------------ ------------- ------------ ------------- ----------- ------------- Common Stock Subscribed Stock Additional ---------------------------- Notes Paid-In Accumulated Shares Amount Receivable Capital Deficit Total ------------ ------------- ------------- ------------- ------------- ------------- Balance, December 31, 2000 45,000 $ 13,000 $ (1,149,000) $ 6,372,000 $ (86,865,000) $ (1,648,000) Issuance of common stock for Exercise of warrants 3,000,000 Exercise of options (59,000) 122,000 Services 955,000 147,000 245,000 Legal settlement 900,000 Warrants issued for value participation agreement 577,000 577,000 Net loss -- (3,428,000) (3,428,000) ------------ ------------- ------------- ------------- ------------- ------------- Balance, December 31, 2001 1,000,000 160,000 (1,208,000) 6,949,000 (90,293,000) (232,000) Conversion of Series A preferred stock -- Issuance of common stock for Cash, net of offering costs of $206,000 1,000,000 100,000 4,004,000 Exercise of options 3,000 Services (628,000) (130,000) 60,000 Legal settlement 45,000 Stock notes receivable 5,000 5,000 Net loss (3,598,000) (3,598,000) ------------ ------------- ------------- ------------- ------------- ------------- 7 ENOVA SYSTEMS, INC. STATEMENTS OF STOCKHOLDERS' EQUITY For the Years Ended December 31, --- Convertible Preferred Stock --- Series A Series B Common Stock ----------------------------- ---------------------------- ---------------------------- Shares Amount Shares Amount Shares Amount ------------ ------------- ------------ ------------- ----------- ------------- Balance, December 31, 2002 2,824,000 $ 1,842,000 1,217,000 $ 2,434,000 345,194,000 $ 84,026,000 Conversion of Series A preferred stock (4,000) (5,000) 4,000 5,000 Issuance of common stock for Cash 23,077,000 1,500,000 Issuance of subscribed common stock 1,000,000 100,000 Exercise of options 8,694,000 389,000 Stock option Services 372,000 34,000 Net loss ------------ ------------- ------------ ------------- ----------- ------------- Balance, December 31, 2003 2,820,000 $ 1,837,000 1,217,000 $ 2,434,000 378,341,000 $ 86,054,000 Conversion of Series A preferred stock (73,000) (63,000) 73,000 63,000 Issuance of common stock for Cash 27,585,000 3,450,000 Issuance of subscribed common stock 367,000 60,000 Exercise of options 8,464,000 783,000 Stock option conversions 321,000 39,000 Services 114,000 16,000 Net loss ------------ ------------- ------------ ------------- ----------- ------------- Balance, December 31, 2004 2,747,000 $ 1,774,000 1,217,000 $ 2,434,000 415,265,000 $ 90,465,000 ============ ============= ============ ============= =========== ============= Common Stock Subscribed Stock Additional ---------------------------- Notes Paid-In Accumulated Shares Amount Receivable Capital Deficit Total ------------ ------------- ------------- ------------- ------------- ------------- Balance, December 31, 2002 1,372,000 $ 130,000 $ (1,203,000) $ 6,949,000 $ (93,891,000) $ 287,000 Conversion of Series A preferred stock -- Issuance of common stock for Cash 1,500,000 Issuance of subscribed common stock (1,000,000) (100,000) -- Exercise of options 389,000 Stock option 82,000 82,000 Services 754,000 30,000 64,000 Net loss (3,186,000) (3,186,000) ------------ ------------- ------------- ------------- ------------- ------------- Balance, December 31, 2003 1,126,000 $ 60,000 $ (1,203,000) $ 7,031,000 $ (97,077,000) $ (864,000) Conversion of Series A preferred stock -- Issuance of common stock for Cash 27,000 3,477,000 Issuance of subscribed common stock (1,126,000) (60,000) -- Exercise of options 783,000 Stock option conversions (39,000) -- Services 1,196,000 165,000 (92,000) 89,000 Net loss (3,382,000) (3,382,000) ------------ ------------- ------------- ------------- ------------- ------------- Balance, December 31, 2004 1,196,000 $ 165,000 $ (1,176,000) $ 6,900,000 $(100,459,000) $ 103,000 ============ ============= ============= ============= ============= ============= 8 ENOVA SYSTEMS, INC. STATEMENTS OF CASH FLOWS For the Years Ended December 31, --- 2004 2003 2002 ----------- ----------- ----------- Cash flows from operating activities Net loss $(3,382,000) $(3,186,000) $(3,598,000) Adjustments to reconcile net loss to net cash used by operating activities Depreciation and amortization 377,000 351,000 134,000 Provision for asset impairment -- 200,000 -- Equity in losses 192,000 40,000 -- Issuance of common stock for services 89,000 34,000 60,000 Issuance of common stock for legal settlement -- -- 45,000 (Increase) decrease in Accounts receivable 281,000 457,000 (19,000) Inventory and supplies 570,000 48,000 (727,000) Note receivable - related party 8,000 24,000 25,000 Prepaid expenses and other current assets (226,000) 29,000 (20,000) Other assets -- (14,000) 76,000 Increase (decrease) in Accounts payable (702,000) (424,000) 1,025,000 Accrued expenses (11,000) (112,000) 87,000 Deferred revenues 392,000 -- -- Accrued interest payable 256,000 234,000 212,000 ----------- ----------- ----------- Net cash used by operating activities (2,156,000) (2,319,000) (2,700,000) ----------- ----------- ----------- Cash flows from investing activities Purchases of property and equipment $ (175,000) $ (113,000) $ (613,000) ----------- ----------- ----------- Net cash used in investing activities (175,000) (113,000) (613,000) ----------- ----------- ----------- Cash flows from financing activities Net increase from line of credit $ 109,000 $ 106,000 $ 14,000 Payment on notes payable and capital lease obligations (33,000) (1,000) (24,000) Proceeds from notes payable 40,000 -- -- Proceeds from sales of common stock 2,450,000 600,000 4,210,000 Offering costs -- -- (206,000) Proceeds from exercise of stock options 783,000 389,000 3,000 Payments on stock notes receivable 27,000 -- 5,000 ----------- ----------- ----------- Net cash provided by financing activities 3,376,000 1,094,000 4,002,000 ----------- ----------- ----------- Net increase (decrease) in cash and 1,045,000 (1,338,000)

689,000 cash equivalents Cash and cash equivalents, beginning of year 530,000 1,868,000 1,179,000 ----------- ----------- ----------- Cash and cash equivalents, end of year $ 1,575,000 $ 530,000 $ 1,868,000 =========== =========== =========== 9 ENOVA SYSTEMS, INC. STATEMENTS OF CASH FLOWS For the Years Ended December 31, --- 2004 2003 2002 ----------- ----------- ----------- Supplemental disclosure of cash flow information Interest paid $ 10,000 $ 9,000 $ 8,000 =========== =========== =========== Income taxes paid $ -- $ -- $ -- =========== =========== =========== Supplemental schedule of non- cash investing and financing activities Equipment acquired under capital lease agreements $ -- $ -- $ 52,000 =========== =========== =========== Conversion of preferred stock to common stock $ 63,000 $ (5,000) $ 25,000 =========== =========== =========== Acquired investment under common stock purchase $ 1,000,000 $ 1,000,000 $ -- =========== =========== =========== Offering costs on common stock purchases $ 92,500 $ -- $ -- =========== =========== =========== Common stock issued for purchase of options $ 39,000 $ -- $ -- =========== =========== =========== The accompanying notes are an integral part of these financial statements. 10 ENOVA SYSTEMS, INC. NOTES TO FINANCIAL STATEMENTS December 31, 2004 --- NOTE 1 - ORGANIZATION AND LINE OF BUSINESS General ------- Enova Systems, Inc. (the "Company") is a California corporation that develops drive trains and related components for electric, hybrid electric, and fuel cell systems for mobile and stationary 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 develops and sells components in the United States and Asia, and sells components in Europe. Liquidity --------- At December 31, 2004, the Company had a net working capital of approximately $2,365,000 as compared to $1,765,000 at December 31, 2003, representing an increase of $600,000. This increase is due primarily to capital raised during the year offset by losses from operations. Operating and investing activities used approximately $2,157,000 and $175,000, respectively, while financing activities provided $3,377,000. During the year ended December 31, 2004, the Company increased its headcount minimally to control expenses and still maintain its competitive edge in power management systems. The Company's business plan for 2005 provides for raising additional capital in order to continue with the Company's operations until it becomes profitable. The Company will also continue to search for areas in which to further reduce expenses and increase sales. Stock Purchase Agreement ------------------------ The Company has entered into a joint venture agreement (the Agreement) with Hyundai Heavy Industries of Korea ("HHI") to create a joint venture corporation, Hyundai-Enova Innovative Technology Center (the "ITC") to be domiciled in Torrance, California. In conjunction with this Agreement, HHI and the Company entered into a stock purchase agreement in which HHI agreed to make a $3 million investment in the Company through the purchase of shares of the Company's authorized and unissued common stock pursuant to Regulation D of the Securities Act of 1933. This investment was made in two installments of $1.5 million each. The first installment was made in June 2003 upon incorporation of the ITC and in consideration for the issuance to HHI by the Company of 23,076,923 shares of common stock at $0.065 per share. The second installment was made in September 2004 in consideration for the issuance to HHI by the Company of 11,335,315 shares of common stock at $0.1323 per share. The Company invested $1 million of each installment into the ITC in consideration for the issuance to the Company of a 40% equity interest in the ITC (the balance of the installments, in the amount of $500,000 each, is to be retained by Enova). HHI acquired a 60% equity interest in ITC by investing $3 million in the ITC in two installments of $1.5 million each, to be made concurrently with the two installment payments to be paid by HHI for the Company's common stock. HHI and the Company have invested an aggregate of $5 million in the ITC. 11 ENOVA SYSTEMS, INC. NOTES TO FINANCIAL STATEMENTS December 31, 2004 --- NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES Management's Plans Related to Liquidity and Capital Needs --- The Company has incurred significant losses from operations. During the year ended December 31, 2004, the Company incurred a net loss of $3,382,000, and it had negative cash flows from operations of $2,156,000. At December 31, 2004 the Company had an accumulated deficit of $100,460,000. Such losses have resulted principally from research and development costs, sales and marketing costs and general and administrative costs associated with the development of the Company's technologies and products and expanding its level of operations. The Company is subject to all of the many risks inherent in growing a new enterprise, and the development and commercialization of new products, including changing technologies, competition from companies offering the same or similar products, managing growth and lack of financial resources. As with any growing enterprise, there can be no assurance that the Company will achieve or sustain profitability or positive cash flow from operations. The accompanying financial statements have been prepared on a going concern basis which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. Over the next few years the Company expects to incur losses from operations as it continues to develop future products and market its current products. The Company will need to raise additional capital through debt or equity financings or collaborative arrangements with industry partners to continue its business operations. The Company's ability to continue as a going concern is dependent on its success at obtaining additional capital sufficient to meet its obligations on a timely basis, and to ultimately attain profitability. Management is actively engaged in seeking to raise capital through product licensing, co-promotional arrangements, or public or private equity financing. The Company believes it has demonstrated the ability to raise the necessary funds for the Company's growth and development activities. However, there is no assurance that the Company will raise capital sufficient to enable the Company to continue its operations through the end of the fiscal year. In the event the Company is unable to successfully obtain additional capital, it is unlikely that the Company will have sufficient cash flows and liquidity to finance its business operations as currently contemplated. Accordingly, in the event additional capital is not obtained, the Company will likely further downsize the organization, defer marketing programs, reduce general and administrative expenses and delay or reduce the scope of research and development projects until it is able to obtain sufficient financing to do so. These factors could significantly limit the Company's ability to continue as a going concern. The balance sheets do not include any adjustments relating to recoverability and classification of recorded asset amounts or the amounts of classification of liabilities that might be necessary should the Company be unable to continue in existence. 12 ENOVA SYSTEMS, INC. NOTES TO FINANCIAL STATEMENTS December 31, 2004 -- NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued) Contract Services Revenue and Cost Recognition --- 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 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. Comprehensive Income ------------------- The Company utilizes Statement of Financial Accounting Standards ("SFAS") No. 130, "Reporting Comprehensive Income." This statement establishes standards for reporting comprehensive income and its components in a financial statement. Comprehensive income as defined includes all changes in equity (net assets) during a period from non-owner sources. Examples of items to be included in comprehensive income, which are excluded from net income, include foreign currency translation adjustments, minimum pension liability adjustments, and unrealized gains and losses on available-for-sale securities. Comprehensive income is not presented in the Company's financial statements since the Company did not have any changes in equity from non-owner sources. Cash and Cash

Equivalents ------------------------ Highly liquid investments with an original maturity of three months or less are considered cash equivalents. 13 ENOVA SYSTEMS, INC. NOTES TO FINANCIAL STATEMENTS December 31, 2004 --- NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued) Accounts Receivable ------------------- Receivables are reported at net realizable value and are considered past due when payments have not been received for 90 days. In general, receivables are charged off as uncollectible upon exhausting all avenues of collection. Receivables older than 90 days totaled $165,000 (without reserve) and $678,000 (of which $595,000 had been reserved for) at December 31, 2004 and 2003, respectively. The Company believes the $165,000 will be collected in its entirety in 2005 pending resolution of various customer requests. Allowance for Doubtful Accounts ------------------------------- The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. A considerable amount of judgment is required in assessing the ultimate realization of accounts receivable including the current credit-worthiness of each customer. 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. As of December 31, 2004, the Company did not maintain any allowances for doubtful accounts as all prior uncollectible balances have been charged to bad debt expense. Inventories and Supplies ----------------------- 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, and is stated at the lower of cost (first-in, first-out) or market. During 2004, the Company charged off $107,000 of inventory related to a prior project with Ford Th!nk program which was terminated in 2003. Additionally, the Company charged-off approximately $167,000 for obsolete or slow-moving inventory for a total of $274,000 during the year ended December 31, 2004. Property and Equipment --------------------- Property and equipment are stated at cost and depreciated using the straight-line method over the estimated useful lives of the related assets, which range from three to seven years. Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate the sum of expected cash flows from use of the asset is less than its carrying value. 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. Equity Method Investment ----------------------- Investment in joint venture (see Note 1) is accounted for by the equity method. 14 ENOVA SYSTEMS, INC. NOTES TO FINANCIAL STATEMENTS December 31, 2004 --- NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued) Fair Value of Financial Instruments ---------------------------------- The carrying amount of financial instruments, including cash and cash equivalents, accounts receivable, accounts payable and accrued expenses, approximate fair value due to the short maturity of these instruments. The carrying value of all other financial instruments is representative of their fair values. The Company's short and long term debt may be substantially less than the carrying value since there is no readily ascertainable market for the debt given the financial position of the Company. Stock-Based Compensation ----------------------- SFAS No. 123, "Accounting for Stock-Based Compensation," establishes and encourages the use of the fair value based method of accounting for stock-based compensation arrangements under which compensation cost is determined using the fair value of stock-based compensation determined as of the date of grant and is recognized over the periods in which the related services are rendered. The statement also permits companies to elect to continue using the current implicit value accounting method specified in Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," to account for stock-based compensation. Summary of Statement SFAS No. 148 "Accounting for Stock-Based Compensation--Transition and Disclosure" amends SFAS No. 123 to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of Statement 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company has elected to use the intrinsic value based method and has disclosed the pro forma effect of using the fair value based method to account for its stock-based compensation. The Company has adopted only the disclosure provisions of SFAS No. 123. It applies APB Opinion No. 25 and related interpretations in accounting for its plans and does not recognize compensation expense for its stock-based compensation plans other than for restricted stock and options issued to outside third parties. For purposes of adjusted pro forma disclosures, the estimated fair value of the options is amortized to expense over the vesting period. 15 ENOVA SYSTEMS, INC. NOTES TO FINANCIAL STATEMENTS December 31, 2004 --- NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued) Stock-Based Compensation (continued) ---------------------------------- If the Company had elected to recognize compensation expense based upon the fair value at the grant date for awards under this plan consistent with the methodology prescribed by SFAS No. 123, the Company's net loss and loss per share would be reduced to the pro forma amounts indicated below for the years ended December 31, 2004, 2003, and 2002: 2004 2003 2002 ----------- ----------- ----------- Loss applicable to common stockholders $(3,382,000) $(3,186,000) $(3,598,000) Stock-based employee compensation expense determined under fair value presentation for all options (76,000) (315,000) (197,000) Pro forma net loss $(3,458,000) $(3,501,000) $(3,795,000) Basic and diluted loss per common share As reported $ (0.01) $ (0.01) $ (0.01) Pro forma $ (0.01) $ (0.01) $ (0.01) For purposes of computing the pro forma disclosures required by SFAS No. 123, the fair value of each option granted to employees and directors is estimated using the Black-Scholes option-pricing model with the following weighted-average assumptions for the years ended December 31, 2004, 2003, and 2002: dividend yields of 0%, 0%, and 0%, respectively; expected volatility of 73%, 88%, and 83%, respectively; risk-free interest rates of 4%, 4%, and 4%, respectively; and expected lives of one, three, and five years, respectively. The weighted-average fair value of options granted during the year ended December 31, 2004 for which the exercise price equals the market price on the grant date was $0, and the weighted-average exercise price was $0.115. The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which do not have vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options. Advertising Expense ------------------ The Company expenses all advertising costs, including direct response advertising, as they are incurred. Advertising expense for the years ended December 31, 2004, 2003, and 2002 was $12,000, $21,000, and $20,000, respectively. 16 ENOVA SYSTEMS, INC. NOTES TO FINANCIAL STATEMENTS December 31, 2004 --- NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued) Research and Development ----------------------- Costs of researching and developing new technology or significantly altering existing technology is expensed as incurred. Income Taxes ------------ The Company utilizes SFAS No. 109, "Accounting for Income Taxes," which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred income taxes are recognized for the tax consequences in future years of differences between the tax bases of assets and liabilities and their financial reporting amounts at each year-end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized. Loss Per Share ------------- The Company utilizes SFAS No. 128, "Earnings 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. Estimates --------- The preparation of financial statements 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. Concentrations 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. At times, such cash and cash equivalents may be in excess of the Federal Deposit Insurance Corporation insurance limit of $100,000. 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. 17 ENOVA SYSTEMS, INC. NOTES TO FINANCIAL STATEMENTS December 31, 2004 -- NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued) Major Customers --------------- During the year ended December 31, 2004, the Company conducted business with five customers whose sales comprised 16%, 13%, 10%, 9% and 8% of total revenues. As of December 31, 2004, these customers accounted for 0%, 9%, 33%, 0% and 13%, respectively, of total accounts receivable. In addition, one of the Company's stockholders accounted for 10%, 1%, and 16% of total revenues during the years ended December 31, 2004, 2003, and 2002, respectively. This stockholder holds less than 5% of the total issued and outstanding common stock. Demand deposits are placed with known, creditable financial institutions. Recently Issued Pronouncements ----------------------------- In November 2004, the FASB issued SFAS No. 151,"Inventory Costs". SFAS No. 151 amends the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage) under the guidance in ARB No. 43, Chapter 4, "Inventory Pricing". Paragraph 5 of ARB No. 43, Chapter 4, previously stated that ". . . under some circumstances, items such as idle facility expense, excessive spoilage, double freight, and rehandling costs may be so abnormal as to require treatment as current period charges. . . ." This statement requires that those items be recognized as current-period charges regardless of whether they meet the criterion of "so abnormal." In addition, this statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. This statement is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. Management does not expect adoption of SFAS No. 151 to have a material impact, if any, on the Company's financial position or results of operations. In December 2004, the FASB issued SFAS No. 152, "Accounting for Real Estate Time-Sharing Transactions". The FASB issued this statement as a result of the guidance provided in AICPA Statement of Position (SOP) 04-2, "Accounting for Real Estate Time-Sharing Transactions". SOP 04-2 applies to all real estate time-sharing transactions. Among other items, the SOP provides guidance on the recording of credit losses and the treatment of selling costs, but does not change the revenue recognition guidance in SFAS No. 66, "Accounting for Sales of Real Estate", for real estate time-sharing transactions. SFAS No. 152 amends Statement No. 66 to reference the guidance provided in SOP 04-2. SFAS No. 152 also amends SFAS No. 67, "Accounting for Costs and Initial Rental Operations of Real Estate Projects", to state that SOP 04-2 provides the relevant guidance on accounting for incidental operations and costs related to the sale of real estate time-sharing transactions. SFAS No. 152 is effective for years beginning after June 15, 2005, with restatements of previously issued financial statements prohibited. Management does not expect adoption of SFAS No. 152 to have a material impact, if any, on the Company's financial position or results of operations. 18 ENOVA SYSTEMS, INC. NOTES TO FINANCIAL STATEMENTS December 31, 2004 -- NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued) Recently Issued Pronouncements (continued) --- In December 2004, the FASB issued SFAS No. 153, "Exchanges of Nonmonetary Assets," an amendment to Opinion No. 29, "Accounting for Nonmonetary Transactions". SFAS No. 153 eliminates certain differences in the guidance in Opinion No. 29 as compared to the guidance contained in standards issued by the International Accounting Standards Board. The amendment to Opinion No. 29 eliminates the fair value exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. Such an exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS No. 153 is effective for nonmonetary asset exchanges occurring in periods beginning after June 15, 2005. Earlier application is permitted for nonmonetary asset exchanges occurring in periods beginning after December 16, 2004. Management does not expect adoption of SFAS No. 153 to have a material impact, if any, on the Company's financial position or results of operations. In December 2004, the FASB issued SFAS No. 123(R), "Share-Based Payment". SFAS 123(R) amends SFAS No. 123, "Accounting for Stock-Based Compensation", and APB Opinion No. 25, "Accounting for Stock Issued to Employees". SFAS No.123(R) requires that the cost of share-based payment transactions (including those with employees and non-employees) be recognized in the financial statements. SFAS No. 123(R) applies to all share-based payment transactions in which an entity acquires goods or services by issuing (or offering to issue) its shares, share options, or other equity instruments (except for those held by an ESOP) or by incurring liabilities (1) in amounts based (even in part) on the price of the company's shares or other equity instruments, or (2) that require (or may require) settlement by the issuance of a company's shares or other equity instruments. This statement is effective (1) for public companies qualifying as SEC small business issuers, as of the first interim period or fiscal year beginning after December 15, 2005, or (2) for all other public companies, as of the first interim period or fiscal year beginning after June 15, 2005, or (3) for all nonpublic entities, as of the first fiscal year beginning after December 15, 2005. Management is currently assessing the impact of this statement on its financial position and results of operations. Fourth Quarter Adjustments ------------------------- During the fourth quarter of fiscal 2004, the Company: o wrote-down inventory by a net of $275,000 for obsolete and slow-moving inventory. The Company charged off approximately $113,000 of this reduction for inventory relating to raw materials for the Ballard/Ford Th!nk city program which was terminated in 2003. This was inventory specific to that program which the Company believed may be useable in other components, or would be purchased by third parties, but was not due to the Company's increased focus on the heavy-duty hybrid markets. The Company also charged off an additional $162,000 in obsolete or slow moving inventory during 2004. This resulted in an increase of cost of sales by $275,000 for the year. 19 ENOVA SYSTEMS, INC. NOTES TO FINANCIAL STATEMENTS December 31, 2004 -- NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued) Fourth Quarter Adjustments (continued) ------------------------------------- o allocated certain expenses to cost of sales, which had been charged to general and administrative expense, based on the Company's improved method of apportioning such costs. This resulted in an increase in cost of sales of approximately $147,000 in the fourth quarter, a portion of which may have been attributable to prior quarters in 2004 but none that the Company believes would have a material impact on the presentation of those quarters. The above two adjustments (i) increased cost of sales by $422,000 in the fourth quarter, (ii) reduced gross profit by $422,000, (iii) increased loss from operations by $275,000 and (iv) reduced net loss by $275,000. NOTE 3 - PROPERTY AND EQUIPMENT Property and equipment at December 31, 2004 and 2003 consisted of the following: 2004 2003 ---------- ---------- Computers $ 229,000 $ 213,000 Machinery and equipment 709,000 715,000 Furniture and office equipment 192,000 192,000 Demonstration vehicles and buses 461,000 297,000 Equipment under capital lease obligations 94,000 94,000 Leasehold improvements 68,000 68,000 ---------- ---------- 1,754,000 1,579,000 Less accumulated depreciation and amortization 1,367,000 1,098,000 ---------- ---------- Total $ 387,000 $ 481,000 ========== ========== Depreciation and amortization expense was $377,000, $351,000, and $134,000 for the years ended December 31, 2004, 2003, and 2002, respectively. 20 ENOVA SYSTEMS, INC. NOTES TO FINANCIAL STATEMENTS December 31, 2004 -- NOTE 4 - EQUITY METHOD INVESTMENT During the year ended December 31, 2004, the Company invested $1,000,000 of the proceeds received from sale of common stock to HHI into a joint venture formed with HHI in 2003 (see Note 1). The Company's share of income and losses is 40% as stated in the agreement. During the year ended December 31, 2004, the Company recorded $192,000 as its proportionate share of losses in the joint venture. The following is the condensed financial position and results of operations of ITC, as of and for the year ended December 31, 2004: Financial position Current assets $ 4,406,000 Property and equipment, net 15,000 Liabilities (3,000) ---------------- Equity $ 4,418,000 ================ Operations Net revenues $ - Expenses (481,000) ---------------- Net loss $ (481,000) ================ Companies proportionate share of net loss $ (192,000) =============== NOTE 5 - OTHER ASSETS During the year ended December 31, 2002, the

Company incurred legal costs of $78,000 associated with two patents. These patents have been capitalized and are being amortized over their estimated useful lives. In June 2001, a strategic relationship with Ford Motor Company was entered into to develop and manufacture a high power, high voltage conversion module for Ford's fuel cell vehicle. Warrants were issued to Ford Motor Company in exchange for Ford's commitment to enter into a five-year agreement. The issuance of the warrants was recorded as a non-current asset (Value Participation Agreement) at its fair market value of $577,000, which was determined using the Black-Scholes option pricing model, and is being amortized on a straight-line basis over the life of the contract. 2004 2003 -------- -------- Patents $ 92,000 $ 92,000 Valuation Participation Agreement 577,000 577,000 -------- -------- 669,000 669,000 Less accumulated amortization 373,000 265,000 -------- -------- Total $296,000 $404,000 ======== ======== 21 ENOVA SYSTEMS, INC. NOTES TO FINANCIAL STATEMENTS December 31, 2004 --- NOTE 6 - LINE OF CREDIT The Company has available $250,000 revolving line of credit from a bank with interest payable monthly at 3.25%. The line of credit is secured by $250,000 Certificate of Deposit and its maturity has been extended until April 2005. NOTE 7- DEFERRED REVENUES - Tomoe LTA Long-Term Contract The Company has entered into a development and production contract with Tomoe Electro-Mechanical Engineering and Manufacturing, Inc. for eight battery-electric locomotives for the Singapore Land Transport Authority for service vehicles for the Singapore Mass Rapid Transit Circle Line system for maintenance, repair, shunting and recovery of passenger trains. The contract commenced in August 2004 and completion of the contract will take approximately 15-18 months and is valued at approximately $3,100,000. The Company is recording revenues for this long-term, fixed price contract on the basis of the percentage-of-completion method. The contract contains several deliverables over its life and therefore the Company will divide these deliverables into separate units of accounting based on relative fair values. Revenue recognition criteria will be assessed separately for each separate unit of accounting. As of December 31, 2004, the Company recorded revenues of $68,000 related to the development portion of this contract. 22 ENOVA SYSTEMS, INC. NOTES TO FINANCIAL STATEMENTS December 31, 2004 --- NOTE 8- NOTES PAYABLE Notes payable at December 31, consisted of the following: 2004 2003 --------------- ---------------- Secured note payable to Credit Managers Association of California, bearing interest at 6% per annum during 2003 and at prime plus 3% per annum in 2004 and through maturity. Principal and unpaid interest due in April 2016. A sinking fund escrow is required to be funded with 10% of future equity financing, as defined in the agreement. $ 3,332,000 $ 3,332,000 Unsecured note payable, bearing interest at 10% per annum. This note payable is in default. 120,000 120,000 Secured note payable to a Coca Cola Enterprises in the original amount of $40,000, bearing interest at 5% per annum. Principal and unpaid interest due in July 2005. 40,000 - Secured note payable to a financial institution in the original amount of $33,000, bearing interest at 8% per annum, payable in 36 equal monthly installments. 15,000 26,000 --------------- ---------------- 3,507,000 3,478,000 Less current portion 166,000 131,000 --------------- ---------------- Long-term portion $ 3,341,000 $ 3,347,000 =============== ================ Future minimum principal payments of notes payable at December 31, 2004 consisted of the following: Year Ending December 31, 2005 $ 166,000 2006 9,000 2007 - 2008 - 2009 - Thereafter 3,332,000 ---------- Total $3,507,000 ========== 23 ENOVA SYSTEMS, INC. NOTES TO FINANCIAL STATEMENTS December 31, 2004 --- NOTE 9- COMMITMENTS AND CONTINGENCIES Leases ------ The Company leases its facilities under an operating lease agreement, which requires monthly payments of $13,250 and expires in February 2008. At March 2005, the monthly payments will increase to $13,700 per the terms of the lease agreement. In addition, the Company rents manufacturing and office equipment under various capital lease agreements. Future minimum lease payments under these non-cancelable operating and capital lease obligations at December 31, 2004 were as follows: Year Ending Operating Capital December 31, Leases Leases ------------ --------- -------- 2005 $ 164,000 $ 6,000 2006 155,000 -- 2007 166,000 -- 2008 28,000 -- --------- -------- $ 513,000 6,000 ========= Less amount representing interest -- -------- Less current portion 6,000 -------- Long-term portion $ -- ======== Rent expense was $140,000, $150,000, and $206,000 for the years ended December 31, 2004, 2003, and 2002, respectively. NOTE 10 - STOCKHOLDERS' EQUITY Common Stock ------------ During the year ended

December 31, 2004, the Company issued 27,585,000 shares of common stock for cash totaling $3,450,000. In addition, the Company issued 481,000 shares of common stock to directors as compensation totaling $47,000. Common Stock Subscribed ---------------------- At December 31, 2004, the Company was committed to issue 1,196,000 shares of common stock totaling $165,000 as compensation and as finder's fees to its directors. In the prior year, the Company incorrectly reported the number of subscribed common stock. The actual shares subscribed as of December 31, 2003 totaling 367,000 shares differed from the previously reported number of shares by 760,000 shares, totaling $29,000. The effect of this error was not material to the reported results. This difference has been corrected in the current year's financial statements. 24 ENOVA SYSTEMS, INC. NOTES TO FINANCIAL STATEMENTS December 31, 2004 -- Series A Preferred Stock ----------------------- Series A preferred stock is currently unregistered and convertible into common stock on a one-to-one basis 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 have the same voting rights as common stockholders. The stock has 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 have been declared on the Series A preferred stock. Substantially all of the stock notes receivable stem from a Board of Directors plan for the sale of shares of Series A preferred stock in 1993 to certain officers and directors (Participants). In general, the Participants could purchase the preferred stock for a combination of cash, promissory notes payable to the Company, and conversion of debt and deferred compensation due to the Participants. All shares issued under this plan were pledged to the Company as security for the notes. The notes provided for interest at 8% per annum payable annually, with the full principal amount and any unpaid interest due on January 31, 1997. The notes remain outstanding. The likelihood of collecting the interest on these notes is remote; therefore, accrued interest has not been recorded since the fiscal year ended July 31, 1997. Series B Preferred Stock ----------------------- Series B preferred stock is currently unregistered and each share is convertible into shares of common stock on a two-for-one basis 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. 25 ENOVA SYSTEMS, INC. NOTES TO FINANCIAL STATEMENTS December 31, 2004 -- NOTE 10 - STOCKHOLDERS' EQUITY (Continued) Stock Options and Warrants ------------------------- During the year ended December 31, 2004, the Company issued 8,464,000 shares of common stock from the exercise of options by certain employees in exchange for cash totaling $783,000. During 2004, the stockholders of the Company approved an increase of 20,000,000 shares for the 1996 Stock Option Plan for incentive and non-statutory stock options during the period of the Plan, which expires in 2006. The Plan now reserves 65,000,000 shares under the plan. Options under the 1996 Plan expire over a period not to exceed ten years. The following summarizes common stock option activity: 1996 Plan 1993 Plan Other --------------------------- --------------------------- --------------------------- Weighted- Weighted- Weighted- Average Average Average Exercise Exercise Exercise Shares Price Shares Price Shares Price ---------- -------- ---------- -------- ---------- -------- Outstanding, December 31, 2001 20,866,000 $ 0.10 9,654,000 $ 0.52 1,495,000 $ 1.70 Granted 900,000 $ 0.10 -- $ -- -- $ -- Exercised -- $ -- (35,000) $ 0.10 -- $ -- Forfeited (439,000) $ 0.10 (2,565,000) $ 0.52 -- $ -- ---------- ---------- ---------- Outstanding, December 31, 2002 21,327,000 $ 0.11 7,054,000 $ 0.52 1,495,000 $ 1.70 Granted 9,998,000 $ 0.05 -- $ -- -- $ -- Exercised

(8,638,000) $ 0.05 -- $ -- -- $ -- Forfeited (1,556,000) $ 0.11 (7,054,000) $ 0.52 (1,495,000) $ 1.70 ---------- ---------- ---------- Outstanding, December 31, 2003 21,131,000 $ 0.12 -- $ -- -- $ -- Granted 2,000,000 $ 0.12 -- $ -- -- $ -- Exercised (10,981,000) $ 0.10 -- $ -- -- $ -- Forfeited (4,795,000) $ 0.12 -- $ -- -- $ -- ---------- ---------- ---------- Outstanding , December 31, 2004 7,355,000 $ 0.12 -- $ -- -- $ -- ========== ========== ========== Exercisable, December 31, 2004 6,418,000 $ 0.12 -- $ -- -- $ -- ========== ========== ========== The weighted-average remaining contractual life of the options outstanding at December 31, 2004 was 1.2 years. The exercise prices of the options outstanding at December 31, 2004 ranged from $0.11 to $0.30. Options exercisable were 6,418,000, 20,898,000, 28,304,228 at December 31, 2004, 2003 and 2002. 26 ENOVA SYSTEMS, INC. NOTES TO FINANCIAL STATEMENTS December 31, 2004 --- NOTE 10 - STOCKHOLDERS' EQUITY (Continued) Stock Options and Warrants (Continued) ------------------------- The agreement with Ford Motor Company (see Note 5) included issuing warrants to Ford to purchase 4.6% of the fully diluted common stock of the Company over a 66 month period. The number of shares to be acquired will be adjusted from time to time for increases in the Company's fully diluted common stock. The vesting of these warrants is dependent upon Ford meeting specific purchase requirements. The fair value of warrants granted were estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions: dividend yield of 0%, expected volatility of 102%, risk-free interest rate of 4.76% and an expected life of the warrants of 66 months. Warrants issued and vested under this agreement totaled 2,500,000 at an exercise price of $0.29 per share during the year ended December 31, 2001. No warrants were vested under this program during 2004 and 2003. As of June 30, 2004, Ford is no longer eligible for further vesting of its warrants per the terms of the Value Participation Agreement. NOTE 11 - INCOME TAXES Significant components of the Company's deferred tax assets and liabilities for federal and state income taxes as of December 31, 2004 and 2003 consisted of the following: 2004 2003 ----------- ----------- Deferred tax assets Federal tax loss carry-forward $31,542,000 $31,286,000 State tax loss carry-forward 893,000 712,000 Basis difference 1,610,000 1,610,000 Other, net 555,000 555,000 ----------- ----------- 36,027,000 34,163,000 Less valuation allowance 36,027,000 34,163,000 ----------- ----------- Net deferred tax assets $ -- $ -- =========== =========== As of December 31, 2004, the Company had net operating loss carry forwards for federal and state income tax purposes of approximately $95,571,000 and $9,393,000, respectively. The net operating loss carry forwards began expiring in 2003. NOTE 12 - RELATED PARTY TRANSACTIONS During 2004, the Company purchased approximately $246,000 in components, materials and services from HHI. The outstanding balance owed to HHI at December 31, 2004 was approximately $2,000. 27 ENOVA SYSTEMS, INC. NOTES TO FINANCIAL STATEMENTS December 31, 2004 --- NOTE 12 - RELATED PARTY TRANSACTIONS (continued) During 2004, the Company paid a total of $101,000 to two of its directors in consulting fees. During 2004, pursuant to a written agreement approved by the Board of Directors and its Audit Committee, a finder's fee of $92,500 was accrued to be paid, through the issuance of restricted shares of common stock in Enova, totaling 608,553 shares at a price of $0.15 per share, in conjunction with a private placement funding in the first quarter of 2004 to The Global Value Investment Portfolio Management Pte Ltd, a Singapore Company which is substantially owned by two affiliated parties: Anthony Rawlinson, Chairman of the Board of our Company and Borl partnership, owned by Boris Liberman Family Trusts, which is also affiliated with Jagen Pty Ltd., a large affiliate shareholder in Enova. Said shares were subsequently issued in the first quarter of 2005. NOTE 13 - 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, 2004, 2003, and 2002 the Company did not make any contributions to the plan. NOTE 14 - 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: 2004 2003 2002 ---------- ---------- ---------- United States $1,465,000 $2,672,000 $2,478,000 Italy 32,000 213,000 1,040,000 Korea 258,000 297,000 726,000 Japan 1760,000 146,000 87,000 China 256,000 738,000 -- Malaysia -- 184,000 65,000 Ireland 166,000 -- 59,000 Canada -- 738,000 -- England 203,000 60,000 -- ---------- ---------- ---------- Total $2,554,000 $4,310,000

$4,455,000 ========== ========== ========== 28 SUPPLEMENTAL INFORMATION 29 REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM Board of Directors and Stockholders Enova Systems, Inc. Torrance, California Our audits were conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States) and were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental schedule II is presented for purposes of complying with the Securities and Exchange Commission's rules and is not a part of the basic financial statements. This schedule has been subjected to the auditing procedures applied in our audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole. SINGER LEWAK GREENBAUM & GOLDSTEIN LLP Los Angeles, California March 10, 2005 30 ENOVA SYSTEMS, INC. VALUATION AND QUALIFYING ACCOUNTS - SCHEDULE II -- Balance, Additions Deductions Balance, Beginning Charged to from End of Year Operations Reserve of Year -------- --------- -------- -------- Allowance for doubtful accounts December 31, 2004 $595,000 $ -- $595,000 $ -- ======== ========= ======== ======== December 31, 2003 $ -- $ 595,000 $ -- $595,000 ======== ========= ======== ======== December 31, 2002 $ -- $ -- $ -- $ -- ======== ========= ======== ======== Reserve for obsolete inventories December 31, 2004 $ 80,000 $ -- $ -- $ 80,000 ======== ========= ======== ======== December 31, 2003 $ 80,000 $ -- $ -- $ 80,000 ======== ========= ======== ======== December 31, 2002 $ 80,000 $ -- $ -- $ 80,000 ======== ========= ======== ======== The accompanying notes are an integral part of these financial statements. 31