Santander Consumer USA Holdings Inc.
Form 10-Q
October 29, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
ý Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2015
¨ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
Commission File Number: 001-36270
SANTANDER CONSUMER USA HOLDINGS INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	32-0414408
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
1601 Elm Street, Suite 800, Dallas, Texas	75201
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (214) 634-1110
Not Applicable
(Former name, former address, and formal fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý 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 ST (Section 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 ý 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 ý	Accelerated filer ¨
Non-accelerated filer ¨	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 ý
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at October 23, 2015
Common Stock ($0.01 par value)	357,902,036 shares

INDEX

Cautionary Note Regarding Forward-Looking Information		3
PART I: FINANCIAL INFORMATION		6
Item 1.	Unaudited Condensed Consolidated Financial Statements	6
	Unaudited Condensed Consolidated Balance Sheets	6
	Unaudited Condensed Consolidated Statements of Income and Comprehensive Income	7
	Unaudited Condensed Consolidated Statements of Equity	8
	Unaudited Condensed Consolidated Statements of Cash Flows	9
	Note 1. Description of Business, Basis of Presentation, and Significant Accounting Policies and Practices	10
	Note 2. Finance Receivables	12
	Note 3. Leases	14
	Note 4. Credit Loss Allowance and Credit Quality	15
	Note 5. Debt	21
	Note 6. Variable Interest Entities	24
	Note 7. Derivative Financial Instruments	26
	Note 8. Other Assets	29
	Note 9. Income Taxes	30
	Note 10. Commitments and Contingencies	30
	Note 11. Related-Party Transactions	32
	Note 12. Computation of Basic and Diluted Earnings per Common Share	37
	Note 13. Fair Value of Financial Instruments	37
	Note 14. Employee Benefit Plans	40
	Note 15. Shareholders' Equity	42
	Note 16. Subsequent Events	43
Item 2.	Management’s Discussion and Analysis of Financial Condition and Results of Operations	44
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	73
Item 4.	Controls and Procedures	73
PART II: OTHER INFORMATION		74
Item 1.	Legal Proceedings	74
Item 1A.	Risk Factors	74
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	74
Item 3.	Defaults upon Senior Securities	74
Item 4.	Mine Safety Disclosures	74
Item 5.	Other Information	74
Item 6.	Exhibits	76
SIGNATURES		77
EXHIBITS		

Unless otherwise specified or the context otherwise requires, the use herein of the terms " we," "our," "us," "SC," and the "Company" refer to Santander Consumer USA Holdings Inc. and its consolidated subsidiaries.

Cautionary Note Regarding Forward-Looking Information

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Any statements about our expectations, beliefs, plans, predictions, forecasts, objectives, assumptions, or future events or performance are not historical facts and may be forward-looking. These statements are often, but not always, made through the use of words or phrases such as "anticipates," "believes," "can," "could," "may," "predicts," "potential," "should," "will," "estimate," "plans," "projects," "continuing," "ongoing," "expects," " similar words or phrases. Although we believe that the expectations reflected in these forward-looking statements are reasonable, these statements are not guarantees of future performance and involve risks and uncertainties which are subject to change based on various important factors, some of which are beyond our control. For more information regarding these risks and uncertainties as well as certain additional risks that we face, refer to the Risk Factors detailed in Item 1A of Part I of our Annual Report on Form 10-K for the year ended December 31, 2014, as well as factors more fully described in Part I, Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this report, including the exhibits hereto, and subsequent reports and registration statements filed from time to time with the SEC. Among the factors that could cause our financial performance to differ materially from that suggested by the forward-looking statements are:

- we operate in a highly regulated industry and continually changing federal, state, and local laws and regulations could materially adversely affect our business;
- adverse economic conditions in the United States and worldwide may negatively impact our results;
- our business could suffer if our access to funding is reduced;
- we face significant risks implementing our growth strategy, some of which are outside our control;
- we may incur unexpected costs and delays in connection with exiting our personal lending business;
- our agreement with Chrysler may not result in currently anticipated levels of growth and is subject to certain performance conditions that could result in termination of the agreement;
- our business could suffer if we are unsuccessful in developing and maintaining relationships with automobile dealerships;
- our financial condition, liquidity, and results of operations depend on the credit performance of our loans;
- loss of our key management or other personnel, or an inability to attract such management and personnel, could negatively impact our business;
- we are subject to certain bank regulations, including oversight by the OCC, the CFPB, the European Central Bank, and the Federal Reserve, which oversight and regulation may limit certain of our activities, including the timing and amount of dividends and other limitations on our business; and
- future changes in our relationship with Santander could adversely affect our operations.

If one or more of the factors affecting our forward-looking information and statements proves incorrect, its actual results, performance or achievements could differ materially from those expressed in, or implied by, forward-looking information and statements. Therefore, we caution not to place undue reliance on any forward-looking information or statements. The effect of these factors is difficult to predict. Factors other than these also could adversely affect our results, and the reader should not consider these factors to be a complete set of all potential risks or uncertainties. New factors emerge from time to time, and management cannot assess the impact of any such factor on our business or the extent to which any factor, or combination of factors, may cause results to differ materially from those contained in any forward-looking statement. Any forward-looking statements only speak as of the date of this document, and we undertake no obligation to update any forward-looking information or statements, whether written or oral, to reflect any change, except as required by law. All forward-looking statements attributable to us are expressly qualified by these cautionary statements.

Glossary

The following is a list of abbreviations, acronyms, and commonly used terms used in this Quarterly Report on Form 10-Q.

ABS	Asset-backed securities
Advance Rate	The maximum percentage of unpaid principal balance that a lender is willing to lend.
ALG	Automotive Lease Guide
APR	Annual Percentage Rate

ASU	Accounting Standards Update
Bluestem	Bluestem Brands, Inc., an online retailer for whose customers SC provides financing
Board	SC's Board of Directors
Capmark	Capmark Financial Group Inc., an investment company
CBP	Citizens Bank of Pennsylvania
CCAR	Comprehensive Capital Analysis and Review
CCART	Chrysler Capital Auto Receivables Trust, a securitization platform
Centerbridge	Centerbridge Partners, L.P., a private equity firm
CEO	Chief Executive Officer
CFPB	Consumer Financial Protection Bureau
CFO	Chief Financial Officer
Chrysler	Fiat Chrysler Automobiles US LLC
Chrysler Agreement	Ten-year private-label financing agreement with Chrysler
Clean-up Call	The early redemption of a debt instrument by the issuer, generally when the underlying portfolio has amortized to 10% of its original balance
Credit Enhancement	A method such as overcollateralization, insurance, or a third-party guarantee, whereby a borrower reduces default risk
Dealer Loan	A floorplan line of credit, real estate loan, working capital loan, or other credit extended to an automobile dealer
Dodd-Frank Act	Comprehensive financial regulatory reform legislation enacted by the U.S. Congress on July 21, 2010
DOJ	U.S. Department of Justice
DRIVE	Drive Auto Receivables Trust, a securitization platform
ECOA	Equal Credit Opportunity Act
ERM	Enterprise Risk Management
Employment Agreement	The amended and restated employment agreement, executed as of December 31, 2011, by and among SC, Banco Santander, S.A. and Thomas G. Dundon
Exchange Act	Securities Exchange Act of 1934, as amended
FASB	Financial Accounting Standards Board
FICO®	A common credit score created by Fair Isaac Corporation that is used on the credit reports that lenders use to assess an applicant's credit risk. FICO® is computed using mathematical models that take into account five factors: payment history, current level of indebtedness, types of credit used, length of credit history, and new credit
FIRREA	Financial Institutions Reform, Recovery and Enforcement Act of 1989
Floorplan Line of Credit	A revolving line of credit that finances inventory until sold
FRB	Federal Reserve Bank of Boston
FTC	Federal Trade Commission
IPO	SC's Initial Public Offering
ISDA	International Swaps and Derivative Association
LFS	Loss Forecasting Score
MEP	SC's 2011 Management Equity Plan
MSA	Master Service Agreement
Nonaccretable Difference	The difference between the undiscounted contractual cash flows and the undiscounted expected cash flows of a portfolio acquired with deteriorated credit quality
NPWMD	Non-Proliferation of Weapons of Mass Destruction
OCC	Office of the Comptroller of the Currency
Overcollateralization	A credit enhancement method whereby more collateral is posted than is required to obtain financing

OEM	Original equipment manufacturer
Private-label	Financing branded in the name of the product manufacturer rather than in the name of the finance provider

RC	Risk Committee of the Board
Remarketing	The controlled disposal of leased vehicles that have been reached the end of their lease term or of financed vehicles obtained through repossession
Residual Value	The future value of a leased asset at the end of its lease term
RSU	Restricted stock unit
Santander	Banco Santander, S.A.
SBNA	Santander Bank, N.A., a wholly-owned subsidiary of SHUSA. Formerly Sovereign Bank, N.A.
SC	Santander Consumer USA Holdings Inc., a Delaware corporation, and its consolidated subsidiaries
SCRA	Servicemembers Civil Relief Act
SDART	Santander Drive Auto Receivables Trust, a securitization platform
SEC	U.S. Securities and Exchange Commission
Separation Agreement	The Separation Agreement dated July 2, 2015 entered into by Thomas G. Dundon with SC, DDFS LLC, SHUSA, Santander Consumer USA Inc. (the wholly owned subsidiary of SC) and Banco Santander, S.A.
SHUSA	Santander Holdings USA, Inc., a wholly-owned subsidiary of Santander and the majority owner of SC
SUBI	Special unit of beneficial interest (in a titling trust used to finance leases)
Subvention	Reimbursement of the finance provider by a manufacturer for the difference between a market loan or lease rate and the below-market rate given to a customer
TDR	Troubled Debt Restructuring
Trusts	Special purpose financing trusts utilized in SC’s financing transactions
Turn-down	A program where by a lender has the opportunity to review a credit application for approval only after the primary lender or lenders have declined the application
U.S. GAAP	U.S. Generally Accepted Accounting Principles
VIE	Variable Interest Entity
Warehouse Facility	A revolving line of credit generally used to fund finance receivable originations

PART I: FINANCIAL INFORMATION
Item 1. Condensed Consolidated Financial Statements
SANTANDER CONSUMER USA HOLDINGS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited) (Dollars in thousands, except per share amounts)

	September 30, 2015	December 31, 2014
Assets		
Cash and cash equivalents	$104,552	$33,157
Finance receivables held for sale, net	2,709,944	46,585
Finance receivables held for investment, net	23,464,030	23,915,551
Restricted cash - $37,917 and $44,805 held for affiliates, respectively	2,217,879	1,920,857
Accrued interest receivable	394,692	364,676
Leased vehicles, net	6,078,865	4,862,783
Furniture and equipment, net of accumulated depreciation of $56,219 and $45,768, respectively	50,642	41,218
Federal, state and other income taxes receivable	256,956	502,035
Related party taxes receivable	—	459
Deferred tax asset	14,488	21,244
Goodwill	74,056	74,056
Intangible assets, net of amortization of $26,857 and $21,990, respectively	53,710	53,682
Due from affiliates	63,924	102,457
Other assets	507,490	403,416
Total assets	$35,991,228	$32,342,176
Liabilities and Equity		
Liabilities:		
Notes payable — credit facilities	$6,654,184	$6,402,327
Notes payable — secured structured financings	20,027,111	17,718,974
Notes payable — related party	3,525,000	3,690,000
Accrued interest payable	19,855	17,432
Accounts payable and accrued expenses	378,552	315,130
Federal, state and other income taxes payable	417	319
Deferred tax liabilities, net	698,509	492,303
Related party taxes payable	396	—
Due to affiliates	148,250	48,688
Other liabilities	178,113	98,654
Total liabilities	31,630,387	28,783,827
Commitments and contingencies (Notes 5 and 10)		
Equity:		
Common stock, $0.01 par value — 1,100,000,000 shares authorized;		
357,954,177 and 349,029,766 shares issued and 357,902,036 and 348,977,625 shares outstanding, respectively	3,579	3,490
Additional paid-in capital	1,592,100	1,560,519
Accumulated other comprehensive income (loss), net	(24,239)	3,553
Retained earnings	2,789,401	1,990,787
Total stockholders’ equity	4,360,841	3,558,349
Total liabilities and equity	$35,991,228	$32,342,176

See notes to unaudited condensed consolidated financial statements.

SANTANDER CONSUMER USA HOLDINGS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(Unaudited) (Dollars in thousands, except per share amounts)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2015	2014	2015	2014
Interest on finance receivables and loans	$1,334,655	$1,177,828	$3,885,902	$3,481,605
Leased vehicle income	389,537	263,148	1,077,620	629,209
Other finance and interest income	9,334	2,512	23,413	3,636
Total finance and other interest income	1,733,526	1,443,488	4,986,935	4,114,450
Interest expense — Including $49,795, $30,877, $136,261, and $101,956 to affiliates, respectively	171,420	129,135	470,898	381,895
Leased vehicle expense	296,352	200,397	850,534	499,601
Net finance and other interest income	1,265,754	1,113,956	3,665,503	3,232,954
Provision for credit losses	744,140	769,689	2,088,856	2,057,419
Net finance and other interest income after provision for credit losses	521,614	344,267	1,576,647	1,175,535
Profit sharing	11,818	10,556	46,835	66,773
Net finance and other interest income after provision for credit losses and profit sharing	509,796	333,711	1,529,812	1,108,762
Investment gains, net — Including ($5,654), $347, ($5,654) and $5,923 from affiliates, respectively	1,567	38,015	109,481	95,431
Servicing fee income — Including $4,650, $5,453, $13,665, and $17,029 from affiliates, respectively	35,910	20,547	88,756	53,051
Fees, commissions, and other — Including $225, $6,318, $9,106, and $17,390 to affiliates, respectively	93,076	91,399	288,477	275,733
Total other income	130,553	149,961	486,714	424,215
Salary and benefits expense	136,291	88,940	347,804	384,544
Repossession expense	60,770	50,738	175,066	144,817
Other operating costs — Including $2,199, $151, $7,877, and $748 from affiliates, respectively	90,282	62,228	263,280	202,219
Total operating expenses	287,343	201,906	786,150	731,580
Income before income taxes	353,006	281,766	1,230,376	801,397
Income tax expense	129,106	90,397	431,762	282,081
Net income	$223,900	$191,369	$798,614	$519,316
Net income	$223,900	$191,369	$798,614	$519,316
Other comprehensive income (loss):				
Change in unrealized gains (losses) on cash flow hedges, net of tax of $11,066, $5,044, $16,626, and $4,324	(18,513)	8,685	(27,792)	7,409
Comprehensive income	$205,387	$200,054	$770,822	$526,725
Net income per common share (basic)	$0.63	$0.55	$2.26	$1.49
Net income per common share (diluted)	$0.62	$0.54	$2.23	$1.46
Dividends declared per common share	$—	$—	$—	$0.15
Weighted average common shares (basic)	357,846,564	348,955,505	354,150,973	348,630,740
Weighted average common shares (diluted)	362,221,918	355,921,570	357,837,426	355,809,576

See notes to unaudited condensed consolidated financial statements.

SANTANDER CONSUMER USA HOLDINGS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF EQUITY
(Unaudited) (In thousands)

	Common Stock		Additional Paid-In	Accumulated Other Comprehensive	Retained	Total Stockholders'
	Shares	Amount	Capital	Income (Loss)	Earnings	Equity
Balance — January 1, 2014	346,760	$3,468	$1,409,463	$ (2,853)	$1,276,754	$2,686,832
Stock issued in connection with employee incentive compensation plans	2,221	22	18,674	—	—	18,696
Stock-based compensation expense	—	—	123,276	—	—	123,276
Net income	—	—	—	—	519,316	519,316
Other comprehensive income, net of taxes	—	—	—	7,409	—	7,409
Dividends declared per common share of $0.15	—	—	—	—	(52,316)	(52,316)
Balance — September 30, 2014	348,981	$3,490	$1,551,413	$ 4,556	$1,743,754	$3,303,213
Balance — January 1, 2015	348,978	$3,490	$1,560,519	$ 3,553	$1,990,787	$3,558,349
Stock issued in connection with employee incentive compensation plans	8,924	89	114,589	—	—	114,678
Stock-based compensation expense	—	—	20,928	—	—	20,928
Stock-based compensation reclassified to liabilities (Note 14)	—	—	(102,799)	—	—	(102,799)
Tax sharing with affiliate	—	—	(1,137)	—	—	(1,137)
Net income	—	—	—	—	798,614	798,614
Other comprehensive loss, net of taxes	—	—	—	(27,792)	—	(27,792)
Balance — September 30, 2015	357,902	$3,579	$1,592,100	$ (24,239)	$2,789,401	$4,360,841

See notes to unaudited condensed consolidated financial statements.

SANTANDER CONSUMER USA HOLDINGS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited) (Dollars in thousands)

	For the Nine Months Ended September 30,	
	2015	2014
Cash flows from operating activities:		
Net income	$798,614	$519,316
Adjustments to reconcile net income to net cash provided by operating activities		
Derivative mark to market	(678)	(15,868)
Provision for credit losses	2,088,856	2,057,419
Depreciation and amortization	936,259	561,432
Accretion of discount, net of amortization of capitalized origination costs	(752,394)	(636,604)
Originations and purchases of receivables held for sale	(3,810,662)	(3,248,055)
Proceeds from sales of and collections on receivables held for sale	3,019,253	3,264,855
Investment gains, net	(109,481)	(95,431)
Stock-based compensation	20,928	123,276
Deferred tax expense	209,884	49,358
Changes in assets and liabilities:		
Accrued interest receivable	(59,538)	(83,597)
Accounts receivable	(8,832)	(10,328)
Federal income tax and other taxes	264,595	336,778
Other assets	(14,278)	(52,134)
Accrued interest payable	1,515	3,403
Other liabilities	128,461	47,660
Due to/from affiliates	10,506	(46,516)
Net cash provided by operating activities	2,723,008	2,774,964
Cash flows from investing activities:		
Originations of and disbursements on finance receivables held for investment	(13,695,695)	(12,504,602)
Collections on finance receivables held for investment	7,764,374	7,042,299
Proceeds from sale of loans held for investment	1,950,276	2,392,773
Leased vehicles purchased	(4,138,748)	(3,706,763)
Manufacturer incentives received	799,252	744,089
Proceeds from sale of leased vehicles	1,717,234	412,167
Change in revolving personal loans	(197,448)	(177,478)
Purchases of furniture and equipment	(15,584)	(13,862)
Sales of furniture and equipment	310	662
Change in restricted cash	(467,165)	(425,821)
Other investing activities	(9,434)	(4,526)
Net cash used in investing activities	(6,292,628)	(6,241,062)
Cash flows from financing activities:		
Proceeds from notes payable related to secured structured financings — net of debt issuance costs	11,816,224	10,310,701
Payments on notes payable related to secured structured financings	(8,343,736)	(7,071,464)
Proceeds from unsecured notes payable	5,745,000	3,348,334
Payments on unsecured notes payable	(5,910,000)	(3,681,399)
Proceeds from notes payable	20,373,451	20,028,887
Payments on notes payable	(20,121,595)	(19,405,515)
Proceeds from stock option exercises, gross	87,714	24,529

Excess tax benefit on stock option exercises	26,390	—
Repurchase of stock - employee tax withholding	(1,263)	(5,999)
Dividends paid	—	(52,316)
Cash collateral received (paid) on derivatives	(31,170)	3,698
Net cash provided by financing activities	3,641,015	3,499,456
Net increase in cash and cash equivalents	71,395	33,358
Cash — Beginning of period	33,157	10,531
Cash — End of period	$104,552	$43,889
Noncash investing and financing transactions:		
Transfer of retail installment contracts to repossessed vehicles	$1,268,249	$1,103,809

See notes to unaudited condensed consolidated financial statements.

SANTANDER CONSUMER USA HOLDINGS INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except per share amounts)
(Unaudited)

1. Description of Business, Basis of Presentation, and Significant Accounting Policies and Practices

Santander Consumer USA Holdings Inc., a Delaware Corporation (together with its subsidiaries, “SC” or “the Company”), is the holding company for Santander Consumer USA Inc., an Illinois corporation, and subsidiaries, a specialized consumer finance company focused on vehicle finance. The Company’s primary business is the indirect origination of retail installment contracts principally through manufacturer-franchised dealers in connection with their sale of new and used vehicles to retail consumers.

In conjunction with the Chrysler Agreement, a ten-year private label financing agreement with Chrysler Group that became effective May 1, 2013, the Company offers a full spectrum of auto financing products and services to Chrysler customers and dealers under the Chrysler Capital brand. These products and services include consumer retail installment contracts and leases, as well as dealer loans for inventory, construction, real estate, working capital and revolving lines of credit.

The Company also originates vehicle loans through a web-based direct lending program, purchases vehicle retail installment contracts from other lenders, and services automobile and recreational and marine vehicle portfolios for other lenders. Additionally, the Company has several relationships through which it provides personal loans, private label credit cards and other consumer finance products.

As of September 30, 2015, the Company was owned approximately 59.0% by SHUSA, a subsidiary of Santander, approximately 31.2% by public shareholders, approximately 9.8% by DDFS LLC, an entity affiliated with Thomas G. Dundon, the Company’s former Chairman and CEO and approximately 0.1% by other holders, primarily members of senior management. Pursuant to a Separation Agreement with Mr. Dundon, SHUSA was deemed to have delivered, as of July 3, 2015, an irrevocable notice to exercise the call option with respect to all the shares of Company common stock owned by DDFS LLC and consummate the transactions contemplated by the call option notice, subject to required bank regulatory approvals and any other approvals required by law being obtained (the "Call Transaction"). Pursuant to the Separation Agreement, because the Call Transaction was not consummated prior to October 15, 2015 (the “Call End Date”), DDFS is free to transfer any or all of its shares of Company common stock, subject to the terms and conditions of the Amended and Restated Loan Agreement, dated as of July 16, 2014, between DDFS and Santander. In the event the Call Transaction were to be completed after the Call End Date, interest would accrue on the price paid per share in the Call Transaction at the overnight LIBOR rate on the third business day preceding the consummation of the Call Transaction plus 100 basis points with respect to any shares of Company common stock ultimately sold in the Call Transaction. (Note 11).

Basis of Presentation

The accompanying condensed consolidated financial statements include the accounts of the Company and its subsidiaries, including certain Trusts, which are considered VIEs. The Company also consolidates other VIEs for which it was deemed to be the primary beneficiary. All intercompany balances and transactions have been eliminated in consolidation.

The accompanying condensed consolidated financial statements as of September 30, 2015 and December 31, 2014, and for the three and nine months ended September 30, 2015 and 2014, have been prepared in accordance with U.S. GAAP for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, these financial statements contain all adjustments, consisting of normal recurring adjustments, necessary to present fairly the financial position, results of operations and cash flows for the periods indicated. Results of operations for the periods presented herein are not necessarily indicative of results of operations for the entire year. These financial statements should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended December 31, 2014, filed on March 2, 2015.

Certain prior year amounts have been reclassified to conform to current year presentation; specifically, retail installment contracts held for investment, personal loans, receivables from dealers, and capital lease receivables, which previously were reported as separate line items in the condensed consolidated balance sheet, now are reported in aggregate in the condensed consolidated balance sheet as finance receivables held for investment, net, with disclosure of the components in Note 2 – Finance Receivables and Note 3 – Leases. Additionally, related-party assets and liabilities, which previously were disclosed separately within certain line items in the condensed consolidated balance sheet, are now reported as separate line items in the condensed consolidated balance sheet. The classification of related-party assets and liabilities reported in the condensed consolidated balance sheets as of September 30, 2015 and December 31, 2014 is as follows:

Related-Party Assets and Liabilities Classification as of	
September 30, 2015	December 31, 2014
Related party taxes receivable	Federal, state and other income taxes receivable
Due from affiliates	Other assets
Notes payable – related party	Notes payable – credit facilities
Related party taxes payable	Federal, state and other income taxes payable
Due to affiliates	Accrued interest payable
	Accounts payable and accrued expenses
	Other liabilities

The reclassifications in the condensed consolidated balance sheets also are reflected in the corresponding categories in the condensed consolidated statements of cash flows.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosures of contingent assets and liabilities as of the date of the financial statements and the amount of revenue and expenses during the reporting periods. Actual results could differ from those estimates and those differences may be material. These estimates include the determination of credit loss allowance, discount accretion, impairment, expected end-of-term lease residual values, values of repossessed assets, and income taxes. These estimates, although based on actual historical trends and modeling, may potentially show significant variances over time.

Business Segment Information

The Company has one reportable segment: Consumer Finance, which includes the Company’s vehicle financial products and services, including retail installment contracts, vehicle leases, and dealer loans, as well as financial products and services related to motorcycles, recreational vehicles, and marine vehicles. It also includes the Company’s personal loan and point-of-sale financing operations.

Recently Adopted Accounting Standards

In June 2014, the FASB issued ASU 2014-11, Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures. The standard requires entities to account for repurchase-to-maturity transactions as secured borrowings, eliminates accounting guidance on linked repurchase financing transactions, and expands disclosure requirements related to certain transfers of financial assets that are accounted for as secured borrowings. This guidance became effective for the Company January 1, 2015 and implementation of this guidance did not have a significant impact on the Company’s financial position, results of operations, or cash flows.

In April 2015, the FASB issued ASU 2015-03, Imputation of Interest. This ASU requires that debt issuance costs, as well as discounts arising from the imputation of interest, be recorded as part of the basis of the related note, rather than as a separate asset or liability. In August 2015, the FASB and SEC further clarified their views on debt costs incurred in connection with a line of credit arrangement with ASU 2015-15. The guidance should be applied retrospectively and will be effective for fiscal years beginning after December 31, 2015. Early adoption is permitted. The Company early adopted ASU 2015-3 in its third quarter ended September 30, 2015. The adoption of this guidance did not have a material impact to the Company’s consolidated financial statements for current or previous interim and annual reporting periods.

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, which provides guidance on a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. The effective date for this ASU, which was deferred by ASU 2015-14 issued in August 2015, is for fiscal years beginning after December 15, 2017, the Company does not expect the adoption to have a material impact to the condensed consolidated financial statements.
In June 2014, the FASB issued ASU 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could be Achieved after the Requisite Service Period. This standard affects entities that issue share-based payments when the terms of an award stipulate that a performance target could be achieved after an employee completes the requisite service period. This guidance is effective for fiscal years beginning after December 15, 2015. The Company is currently evaluating the impact of the adoption on its condensed consolidated financial statements.
In January 2015, the FASB issued ASU 2015-01, Income Statement - Extraordinary and Unusual Items. This standard simplifies income statement classification by removing the concept of extraordinary items from U.S. GAAP, and as a result, items that are both unusual and infrequent no longer will be separately reported net of tax after continuing operations. This guidance is effective for periods beginning after December 15, 2015. The Company does not expect the adoption to have a material impact to the condensed consolidated financial statements.
In February 2015, the FASB issued ASU 2015-02, Consolidation: Amendments to the Consolidation Analysis. This ASU changes the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. This guidance is effective for periods beginning after December 15, 2015. The Company is in the process of evaluating the impacts of the adoption of this ASU.

2. Finance Receivables

Finance receivables held for investment includes individually acquired retail installment contracts and loans, purchased receivables portfolios, capital leases (Note 3) and, prior to September 30, 2015, personal loans. The Company's portfolio of individually acquired retail installment contracts and loans held for investment was comprised of the following at September 30, 2015 and December 31, 2014:

	September 30, 2015		
	Retail Installment Contracts Acquired Individually	Receivables from Dealers Held for Investment	Personal Loans (a)
Unpaid principal balance	$26,718,576	$76,293	$—
Credit loss allowance (Note 4)	(3,159,102)	(926)	—
Discount	(592,625)	—	—
Capitalized origination costs and fees	46,964	—	—
Net carrying balance	$23,013,813	$75,367	$—

(a) As of September 30, 2015 all of the Company's personal loans were classified as held for sale.

	December 31, 2014		
	Retail Installment Contracts Acquired Individually	Receivables from Dealers Held for Investment	Personal Loans
Unpaid principal balance	$24,555,106	$100,164	$2,128,769
Credit loss allowance (Note 4)	(2,726,338)	(674)	(348,660)
Discount	(597,862)	—	(1,356)
Capitalized origination costs and fees	39,680	—	1,024
Net carrying balance	$21,270,586	$99,490	$1,779,777

Purchased receivables portfolios, which were acquired with deteriorated credit quality, were comprised of the following at September 30, 2015 and December 31, 2014:

	September 30, 2015	December 31, 2014
Unpaid principal balance	$412,645	$846,355
Outstanding recorded investment	$452,937	$873,134
Less: Impairment	(177,403)	(189,275)
Outstanding recorded investment, net of impairment	$275,534	$683,859

As of September 30, 2015, the Company determined that it no longer had the intent to hold its personal loans for investment and that classification of all personal loans as held for sale was appropriate as of that date. In connection with the reclassification to held for sale, the Company adjusted the credit loss allowance associated with the personal loan portfolio to reflect the valuation of the portfolio at the lower of cost or market through provision for credit losses, and the adjusted credit loss allowance was released through provision for credit losses. The net impact of the reclassification of the personal loan portfolio to held for sale was a decrease to provision expense of $13,999. Future loan originations and purchases under the Company's personal lending platform will also be classified as held for sale. As of September 30, 2015, personal loans held for sale totaled $1,884,191.

As of September 30, 2015, retail installment contracts held for sale and receivables from dealers held for sale totaled $825,753 and zero, respectively. As of December 31, 2014, retail installment contracts and receivables from dealers held for sale totaled $45,424 and $1,161, respectively. Sales of retail installment contracts for the three and nine months ended September 30, 2015 included principal balance amounts of $3,057,654 and $5,993,407, respectively. Sales of retail installment contracts for the three and nine months ended September 30, 2014 included principal balance amounts of $2,413,251 and $5,483,149, respectively. The Company retains servicing of sold retail installment contracts and was servicing $10,490,844 and $7,372,884 as of September 30, 2015 and December 31, 2014, respectively, of contracts sold to unrelated third parties. Proceeds from sales of charged-off assets for the three and nine months ended September 30, 2015 were $13,730 and $117,693, respectively. Proceeds from sales of charged-off assets for the three and nine months ended September 30, 2014 were $24,987 and $26,674, respectively.

Retail installment contracts are collateralized by vehicle titles, and the Company has the right to repossess the vehicle in the event the consumer defaults on the payment terms of the contract. Most of the Company's retail installment contracts held for investment are pledged against warehouse facilities or securitization bonds (Note 5). Most of the creditors on the Company's retail installment contracts are retail consumers; however, $1,058,560 and $816,100 of the unpaid principal balance represented fleet contracts with commercial borrowers as of September 30, 2015 and December 31, 2014, respectively.

Borrowers on the Company's retail installment contracts held for investment are located in Texas (17%), Florida (13%), California (10%), Georgia (5%) and other states each individually representing less than 5% of the Company's total.

Receivables from dealers held for investment includes a term loan with a third-party vehicle dealer and lender that operates in multiple states. The loan allowed committed borrowings of $50,000 at September 30, 2015 and December 31, 2014, and the unpaid principal balance of the facility was $50,000 at each of those dates. The term loan will mature on December 31, 2018.

The remaining receivables from dealers held for investment are all Chrysler-related. Borrowers on these Chrysler dealer receivables are located in Virginia (40%), California (24%), New York (19%), Mississippi (8%), Missouri (7%) and other states each individually representing less than 5% of the Company's total.

Borrowers on the Company's personal loans are located in California (11%), Texas (8%), New York (8%), Florida (7%), and other states each individually representing less than 5% of the Company's total.

Changes in accretable yield on the Company's purchased receivables portfolios for the periods indicated were as follows:

	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2015	September 30, 2014	September 30, 2015	September 30, 2014
Balance — beginning of period	$238,372	$305,254	$264,416	$403,400
Accretion of accretable yield	(16,509)	(43,231)	(64,383)	(164,651)
Reclassifications from (to) nonaccretable difference	16,838	36,394	38,668	59,668
Balance — end of period	$238,701	$298,417	$238,701	$298,417

During the three and nine months ended September 30, 2015 and 2014, the Company did not acquire any vehicle loan portfolios for which it was probable at acquisition that not all contractually required payments would be collected.

3. Leases

The Company has both operating and capital leases, which are separately accounted for and recorded on the Company's condensed consolidated balance sheets. Operating leases are reported as leased vehicles, net, while capital leases are included in finance receivables held for investment, net.

Operating Leases

Leased vehicles, net, which is comprised of leases originated under the Chrysler Agreement, consisted of the following as of September 30, 2015 and December 31, 2014:

	September 30, 2015	December 31, 2014
Leased vehicles	$8,173,562	$6,309,096
Less: accumulated depreciation	(1,287,960)	(804,629)
Depreciated net capitalized cost	6,885,602	5,504,467
Manufacturer subvention payments	(821,539)	(645,874)
Origination fees and other costs	14,802	4,190
Net book value	$6,078,865	$4,862,783

During the three and nine months ended September 30, 2015, the Company executed bulk sales of Chrysler Capital leases with an aggregate depreciated net capitalized cost of zero and $1,316,958, respectively, and a net book value of zero and $1,155,171, respectively, to a third party. The bulk sales agreements included certain provisions whereby the Company agreed to share in residual losses for lease terminations with losses over a specific percentage threshold (Note 10). The Company retained servicing on the sold leases. Due to the accelerated depreciation permitted for tax purposes, these sales generated large taxable gains that the Company will defer through a qualified like-kind exchange program. In order to qualify for this deferral, the proceeds from the sales (along with the proceeds from recent lease terminations for which the Company also intends to defer the taxable gain) are held in a qualified exchange account, which is classified as restricted cash, until reinvested in new lease originations. Any taxable gains that do not qualify for deferral will be recognized upon expiration of the reinvestment period.

The following summarizes the future minimum rental payments due to the Company as lessor under operating leases as of September 30, 2015:

Remainder of 2015	$282,067
2016	1,014,377
2017	622,376
2018	159,777
2019	830
Thereafter	—
Total	$2,079,427

Capital Leases

Certain leases originated by the Company are accounted for as capital leases, as the contractual residual values are nominal amounts. Capital lease receivables, net consisted of the following as of September 30, 2015 and

December 31, 2014   On December 27, 2016, the Company exchanged 9,735,925 shares or rights to acquire shares of its Common Stock, for 9,736 shares of a newly designated class of Series A Convertible Preferred Stock. See "- Securities Exchange Agreement with Alpha Capital" below. See also Note 3 – Securities Exchange Agreement with Alpha Capital, above.   On January 5, 2017, the Company entered into a definitive securities purchase agreement with an institutional investor (the "Purchaser") for the purchase and sale of an aggregate of 700,000 shares of Common Stock in a registered direct offering for $5.00 per share or gross proceeds of $3,500. The Company paid the placement agent a fee of $210 plus reimbursement of out-of-pocket expenses, as well as other offering-related expenses.

On June 5, 2017, the Company entered into a Securities Purchase Agreement with certain institutional investors (the "Investors") providing for the issuance and sale by the Company to the Investors of an aggregate of 3,750,000 shares of Common Stock, at a purchase price per share of $2.70. The gross proceeds to the Company was $10,125 before deducting placement agent fees and offering expenses of $922.

Employee Stock Option Grant

In September 2014, Microbot Israel's board of directors approved a grant of 403,592 stock options (1,167,693 stock options as retroactively adjusted to reflect the Merger) to its CEO, through MEDX Venture Group LLC. Each option was exercisable into an ordinary share, at an exercise price of $0.80 ($0.28 as retroactively adjusted to reflect the Merger). The stock options were fully vested at the date of grant.

On May 2, 2016, Microbot Israel's board of directors approved a grant of 500,000 stock options (1,447,223 as retroactively adjusted to reflect the Merger) to certain of its employees and directors. Each stock option was exercisable into an ordinary share, NIS 0.001 par value, of Microbot Israel, at an exercise price equal to the ordinary share's par value. The stock options were fully vested at the date of grant. As a result, the Company recognized compensation expenses in the amount of $675 included in general and administrative expenses. As the exercise price of the stock options is nominal, Microbot Israel estimated the fair value of the options as equal to the Company's share price of $1.35 ($0.47 as retroactively adjusted to reflect the Merger) at the date of grant.   A summary of the Company's option activity related to options to employees and directors, and related information is as follows:

MICROBOT MEDICAL INC.

U.S. dollars in thousands

(Except share data and exercise prices)

Notes to the Interim Condensed Consolidated Financial Statements

(Cont'd)

	For the six month period ended June 30, 2017		
	Number of stock options	**Weighted average exercise price**	**Aggregate intrinsic value**
Outstanding at beginning of period	2,614,916	$ 0.13	
Granted	-	-	
Exercised	-	-	
Cancelled	-	-	
Outstanding at end of period	2,614,916	$ 0.13	$3,739,330
Vested and expected-to-vest at end of period	2,614,916	$ 0.13	$3,739,330

	For the twelve months ended December 31, 2016		
	Number of stock options	Weighted average exercise price	**Aggregate intrinsic value**
Outstanding at beginning of period	1,167,693	$ 0.28	
Granted	1,447,223	(*)	
Exercised	-	-	
Cancelled	-	-	
Outstanding at end of period	2,614,916	$ 0.13	$3,739,330
Vested and expected-to-vest at end of period	2,614,916	$ 0.39	$3,739,330

(*) Less than 1

The aggregate intrinsic value in the table above represents the total intrinsic value (the difference between the fair market value of the Common Stock and Microbot Israel's common shares on June 30, 2017 and December 31, 2016 respectively, and the exercise price, multiplied by the number of in-the-money stock options on those dates) that would have been received by the stock option holders had all stock option holders exercised their stock options on those dates.

The stock options outstanding as of June 30, 2017, and December 31, 2016, have been separated into exercise prices, as follows:

Exercise price	Stock options outstanding as of June 30,	Stock options outstanding as of December 31,	Weighted average remaining contractual life – years as of June 30,	Weighted average remaining contractual life – years as of December 31,	Stock options exercisable as of June 30,	Stock options exercisable as of December 31,
$	2017	2016	2017	2016	2017	2016
0.28	1,167,693	1,167,693	7.75	8.0	1,167,693	1,167,693
(*)	1,447,223	1,447,223	9.25	9.5	1,447,223	1,447,223
	2,614,916	2,614,916	7.15	7.4	2,614,916	2,614,916

(*) Less than 1

16

MICROBOT MEDICAL INC.

U.S. dollars in thousands

(Except share data and exercise prices)

Notes to the Interim Condensed Consolidated Financial Statements

(Cont'd)

Compensation expense recorded by the Company in respect of its stock-based employee compensation awards in accordance with ASC 718-10 for the period ended June 30, 2017 and 2016 was $0.

The fair value of the stock options is estimated at the date of grant using Black-Scholes options pricing model with the following weighted-average assumptions:

	Year ended December 31, 2016	
Expected volatility	77.3	%
Risk-free interest	0.6	%
Dividend yield	0	%
Expected life of up to (years)	5.0	

Shares Issued to Service Provider

In connection with the Merger, the Company issued an aggregate of 7,802,639 restricted shares of its Common Stock to certain advisors. The fair value of the award of approximately $10,000 was estimated based on the share price of the Common Stock of $1.28 as of the date of grant. The portion of the expense in excess of the cash and other current assets acquired in the Merger, in the amount of $7,300, was included in general and administrative expenses in the Statements of Comprehensive Loss.

On May 26, 2017, the Company issued an aggregate of 50,000 nonrefundable shares of Common Stock to a consultant as part of investor relations services. The Company recorded expenses of approximately $154 with respect to the issuance of these shares.

Securities Exchange Agreement with Alpha Capital

On December 16, 2016, the Company entered into a Securities Exchange Agreement with Alpha Capital, pursuant to which Alpha Capital exchanged 9,735,925 shares of Common Stock or rights to acquire shares of the Common Stock held by it, for 9,736 shares of a newly designated class of the Series A Convertible Preferred Stock. The Common Stock and Common Stock underlying the rights to acquire Common Stock include all of the shares of Common Stock issued or issuable to Alpha Capital pursuant to the Merger. The 9,735,925 shares of Common Stock and the rights to acquire Common Stock were cancelled and the Company's issued and outstanding shares of Common Stock were reduced to 26,518,315.

On May 9, 2017, the Company entered into a Securities Exchange Agreement with Alpha Capital pursuant to which the Company agreed to issue 3,254 shares of the Series A Convertible Preferred Stock, in exchange for the full satisfaction, termination and cancellation of that outstanding 6% convertible promissory note of the Company in the principal amount of approximately $2,029, issued on November 28, 2016 and held by Alpha Capital. The Series A Convertible Preferred Stock is the same series of securities as the Company's existing Series A Convertible Preferred Stock issued in December 2016.

On May 11, 2017, the holder of the Series A Convertible Preferred Stock delivered to the Company a request to convert 700 shares of the Series A Convertible Preferred Stock for 700,000 shares of Common Stock, pursuant to the terms of conversion of the Series A Convertible Preferred Stock. On May 12, 2017, the Company issued the 700,000 shares of Common Stock.

Between May 18, 2017 and June 30, 2017, the holder of the Series A Convertible Preferred Stock converted an aggregate of 2,554 shares of the Series A Convertible Preferred Stock for an aggregate of 2,554,000 shares of Common Stock.

MICROBOT MEDICAL INC.

U.S. dollars in thousands

(Except share data and exercise prices)

Notes to the Interim Condensed Consolidated Financial Statements

(Cont'd)

Repurchase of Shares

The Company intends to enter into a definitive agreement with up to three Israeli shareholders that were former shareholders of Microbot Medical Ltd., pursuant to which the Company would repurchase, at a discount on the fair value of the share at the date of repurchase, up to $500,000 of Common Stock held by them, in the aggregate, if and to the extent such shareholders are unable to sell enough of their shares to cover certain of their Israeli tax liabilities resulting from the Merger. Such repurchase(s), if any, would occur only after the two year anniversary of the Merger. The transaction is subject to negotiating final terms and entering into definitive agreements with such shareholders.

The Company evaluated whether an embedded derivative that requires bifurcation exists within such shares that may be subject to repurchase. The Company concluded the fair value of such derivative instrument would be nominal and in any case would represent an asset to the Company as (a) the settlement requires acquiring the shares at a discount on the fair market value of the share at the time of re purchase and in no circumstances the acquisition price will be higher than approximately one dollar per share (representing 25% discount on the fair market value of the share at the merger closing date) and (b)it is assumed that the selling shareholders would use such right as last resort as such repurchase at a discount on the fair market value of such shares results in a loss to be incurred by the selling shareholders.

In accordance with ASC 480-10-S99-3A (formerly EITF D-98), the Company classified the maximum amount it may be required to pay in the event the repurchase right is exercised ($500,000) as temporary equity.

NOTE 7 - BASIC AND DILUTED NET LOSS PER SHARE

The basic and diluted net loss per share and weighted average number of shares of Common Stock used in the calculation of basic and diluted net loss per share are as follows:

Six months

	Ended June 30,	
	2017	2016
	Unaudited	Audited
Net loss attributable to shareholders of the company	$3,662	$265
Net loss attributable to shareholders of preferred shares	1,153	175
Net loss used in the calculation of basic net loss per share	$4,815	$440
Net loss per share	$0.13	$0.02
Weighted average number of common shares	28,165,518	13,182,660

As the inclusion of common share equivalents in the calculation would be anti-dilutive for all periods presented, diluted net loss per share is the same as basic net loss per share.

The weighted average number of shares of Common Stock outstanding has been retroactively restated for the equivalent number of shares of Common Stock received by the accounting acquirer as a result of the reverse recapitalization and reverse stock split as if these shares of Common Stock had been outstanding as of the beginning of the earliest period presented.

NOTE 8 - TAXES ON INCOME

The Company is subject to income taxes under the Israeli and U.S. tax laws:

18

MICROBOT MEDICAL INC.

U.S. dollars in thousands

(Except share data and exercise prices)

Notes to the Interim Condensed Consolidated Financial Statements

(Cont'd)

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Corporate Tax Rates

The Company is subject to Israeli corporate tax rate of 25% in the year 2016, 24% in year 2017 and 23% from year 2018.

The Company is subject to a blended U.S. tax rate (Federal as well as state corporate tax) of 35%.

A. As of June 30, 2017, the Company generated net operating losses in Israel of approximately $6,553, which may be carried forward and offset against taxable income in the future for an indefinite period.

As of June 30, 2017, the Company generated net operating losses in the U.S. of approximately $479,277. Net operating losses in the United States are available through 2035. Utilization of U.S. net operating losses may be subject to substantial annual limitation due to the "change in ownership" provisions of the Internal Revenue Code of 1986 and similar state provisions. The annual limitation may result in the expiration of net operating losses before utilization.

B. The Company is in its development stage and has not yet generated revenues, therefore, it is more likely than not that sufficient taxable income will not be available for the tax losses to be utilized in the future. Therefore, a valuation allowance was recorded to reduce the deferred tax assets to its recoverable amounts.

	As of June 30, 2017	**As of December 31, 2016**
Net loss carry-forward	$485,830	$481,015
Total deferred tax assets	485,830	481,015
Valuation allowance	(485,830)	(481,015)
Net deferred tax assets	$-	$-

C. Reconciliation of Income Taxes:

The following is a reconciliation of the taxes on income assuming that all income is taxed at the ordinary statutory corporate tax rate in Israel and the effective income tax rate:

	As of June 30,	
	2017	2016
Net loss as reported in the statements of operations	$4,815	$440
Statutory tax rate	24 %	25 %
Income Tax under statutory tax rate	1,156	110
Change in valuation allowance	(1,156)	(110)
Actual income tax	$-	$-

19

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

Forward Looking Statements

The following discussion should be read in conjunction with our unaudited financial statements and related notes included in Item 1, “Financial Statements,” of this Quarterly Report on Form 10-Q, as well as our Annual Report on Form 10-K for the fiscal year ended December 31, 2016. Certain information contained in this MD&A includes “forward-looking statements.” Statements which are not historical reflect our current expectations and projections about our future results, performance, liquidity, financial condition and results of operations, prospects and opportunities and are based upon information currently available to us and our management and their interpretation of what is believed to be significant factors affecting our existing and proposed business, including many assumptions regarding future events. Actual results, performance, liquidity, financial condition and results of operations, prospects and opportunities could differ materially and perhaps substantially from those expressed in, or implied by, these forward-looking statements as a result of various risks, uncertainties and other factors, including those risks described in detail in the section entitled “Risk Factors” of our Annual Report on Form 10-K for the year ended December 31, 2016.

Forward-looking statements, which involve assumptions and describe our future plans, strategies, and expectations, are generally identifiable by use of the words “may,” “should,” “would,” “will,” “could,” “scheduled,” “expect,” “anticipate,” ‘ “believe,” “intend,” “seek,” or “project” or the negative of these words or other variations on these words or comparable terminology.

In light of these risks and uncertainties, and especially given the nature of our existing and proposed business, there can be no assurance that the forward-looking statements contained in this section and elsewhere in this Quarterly Report on Form 10-Q will in fact occur. Potential investors should not place undue reliance on any forward-looking statements. Except as expressly required by the federal securities laws, there is no undertaking to publicly update or revise any forward-looking statements, whether as a result of new information, future events, changed circumstances or any other reason.

Overview

Microbot is a pre-clinical medical device company specializing in the research, design and development of next generation micro-robotics assisted medical technologies targeting the minimally invasive surgery space. Microbot is primarily focused on leveraging its micro-robotic technologies with the goal of improving surgical outcomes for patients.

Microbot is currently developing its first two product candidates: The Self Cleaning Shunt, or SCS, for the treatment of hydrocephalus and Normal Pressure Hydrocephalus, or NPH; and TipCAT, a self-propelling, semi-disposable endoscope that is being developed initially for use in colonoscopy procedures. Microbot's product candidates are being designed to bring greater functionality to conventional medical devices and to reduce the known risks associated with such devices. Microbot is currently aiming to complete pre-clinical studies required for regulatory submission for both product candidates within the next 24 months.

Microbot has no products approved for commercial sale and has not generated any revenues from product sales since its inception in 2010. From inception to June 30, 2017, Microbot has raised cash proceeds of approximately $18,000,000 to fund operations, primarily from government grants, loans, and private placement offerings of debt and equity securities.

Microbot has never been profitable and has incurred significant operating losses in each year since inception. Net losses for the quarters ended June 30, 2017 and 2016 were approximately $4,815,000 and $440,000, respectively. Substantially all of Microbot's operating losses resulted from expenses incurred in connection with its research and development programs and from general and administrative costs associated with its operations, and finance expense mainly from revaluation of warrants and a convertible note. As of June 30, 2017, Microbot had a net working capital of approximately $12,855,000, consisting primarily of cash and cash equivalents. Microbot expects to continue to incur significant expenses and increasing operating losses for at least the next several years as it continues the clinical development of, and seeks regulatory approval for its product candidates. Accordingly, Microbot will continue to require substantial additional capital to continue its clinical development and potential commercialization activities, however, at this time it believes that its net cash will be sufficient to fund its operations for at least 12 months and fund operations necessary to continue development activities of the SCS and TipCAT. The amount and timing of Microbot's future funding requirements will depend on many factors, including the timing and results of its clinical development efforts.

Estimated completion dates and costs for Microbot's clinical development and research programs can vary significantly for each current and future product candidate and are difficult to predict. As a result, Microbot cannot estimate with any degree of certainty the costs it will incur in connection with development of its product candidates at this point in time. Microbot anticipates it will make determinations as to which programs and product candidates to pursue and how much funding to direct to each program and product candidate on an ongoing basis in response to the scientific success of early research programs, results of ongoing and future clinical trials, its ability to enter into collaborative agreements with respect to programs or potential product candidates, as well as ongoing assessments as to each current or future product candidate's commercial potential.

Financial Operations Overview

Research and Development Expenses

Research and development expenses consist primarily of salaries and related expenses and overhead for Microbot's research, development and engineering personnel, prototype materials and research studies, and obtaining and maintaining Microbot's patent portfolio. Microbot expenses its research and development costs as incurred.

Research and development expenses are charged to the statement of operations as incurred. Grants for funding of approved research and development projects are recognized at the time the Company is entitled to such grants, on the basis of the costs incurred and applied as a deduction from the research and development expenses.

Microbot may pay fees to third-parties for manufacturing and other services that are based on contractual milestones that may result in uneven payment flows. There may be instances in which payments made to vendors will exceed the level of services provided and result in a prepayment of the research and development expense.

General and Administrative Expenses

General and administrative expenses consist primarily of the costs associated with management costs, salaries, professional fees for accounting, auditing, consulting and legal services, and allocated overhead expenses.

Microbot expects that its general and administrative expenses may increase in the future as it expands its operating activities, maintains and expands its patent portfolio and incurs additional costs associated with the merger with StemCells, the cost of being a public company and maintaining compliance with exchange listing and SEC requirements. These additional costs include management costs, legal fees, accounting fees, directors' and officers' liability insurance premiums and expenses associated with investor relations.

Income Taxes

Microbot has incurred net losses and has not recorded any income tax benefits for the losses. It is still in its development stage and has not yet generated revenues, therefore, it is more likely than not that sufficient taxable income will not be available for the tax losses to be utilized in the future.

Critical Accounting Policies and Significant Judgments and Estimates

Microbot's management's discussion and analysis of its financial condition and results of operations are based on its financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles, or GAAP. The preparation of these financial statements requires Microbot to make estimates and judgments that affect the reported amounts of assets, liabilities, and expenses and the disclosure of contingent assets and liabilities at the date of the financial statements. On an ongoing basis, Microbot evaluates its estimates and judgments, including those related to accrued research and development expenses. Microbot bases its estimates on historical experience, known trends and events, and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ materially from these estimates under different assumptions or conditions.

While Microbot's significant accounting policies are described in more detail in the notes to its financial statements, Microbot believes the following accounting policies are the most critical for fully understanding and evaluating its financial condition and results of operations.

Foreign Currency Translation

Microbot's functional currency is the U.S. dollars, and its reporting currency is the U.S. dollar.

Government Grant and Input Tax Credit Recoveries

Microbot from time to time has received, and may in the future continue to receive, grants from the Israeli Innovation Authority to cover eligible company expenditures. These are deducted from research and development expenses and therefore research and development expenses are presented in the net amount. The recoveries are recognized in the corresponding period when such expenses are incurred.

Results of Operations

Comparison of Six Months Ended June 30, 2017 and 2016

The following table sets forth the key components of Microbot's results of operations for the six months periods ended June 30, 2017 and 2016 (in thousands):

	Six months ended June 30, 2017	**2016**	**Increase/ (Decrease)**	**Three months ended June 30, 2017**	**2016**	**Increase/ (Decrease)**
Research and development expenses, net	$561	$263	$ 298	$377	$44	$ 333
General and administrative expenses	1,934	140	1,794	885	74	811
Financing income (expenses), net	(2,320)	(37)	2,283	(2,246)	(46)	2,200

Research and Development Expenses. Microbot's research and development expenses for the six and three months period ended June 30, 2017 were approximately $561,000 and $377,000, respectively, compared to approximately $263,000 and $44,000, respectively, for the six and three months period ended June 30, 2016. The increase in research and development expenses for the six months and three months period ended June 30, 2017 was primarily due to payroll, materials and professional services. Microbot expects its research and development expenses to increase over time as Microbot advances its development programs and begins pre-clinical and clinical trials for SCS and TipCAT.

General and Administrative Expenses. General and administrative expenses for the six and three months period ended June 30, 2017 were approximately $1,934,000 and $885,000, respectively, compared to approximately $140,000 and $ 74,000, respectively, for the six and three months period ended June 30, 2016. The increase in general and administrative expenses for the six months and three months period ended June 30, 2017 was primarily due to Microbot becoming a public company and therefore incurring higher professional fees and public company fees. Microbot believes its general and administrative expenses may increase over time as it advances its programs, increases its headcount and operating activities and incurs expenses associated with being a public company.

Financing Expenses. Financing expenses for the six and three months period ended June 30, 2017 were approximately $2,320,000 and $2,246,000 compared to approximately $37,000 and $ 46,000 for the six and three months period ended June 30,2016. The increase in financial expenses for the six months and three months period ended June 30, 2017 was primarily due to revaluation and extinguishment of the convertible note and change in fair value of derivative warrant liabilities. As a result of the extinguishment of the convertible note and issuance of the Series A preferred stock, the Company recorded a financial loss in the amount of $2.36 million.

Liquidity and Capital Resources

Microbot has incurred losses since inception and negative cash flows from operating activities for the three and six months periods ended June 30, 2017 and 2016. As of June 30, 2017, Microbot had a net working capital of approximately $12,855,000, consisting primarily of cash and cash equivalents. Microbot anticipates that it will continue to incur net losses for the foreseeable future as it continues research and development efforts of its product candidates, hires additional staff, including clinical, scientific, operational, financial and management personnel, and incurs additional costs associated with being a public company.

Microbot has funded its operations through the issuance of capital stock, grants from the Israeli Innovation Authority, and convertible debt. As of June 30, 2017, Microbot raised total cash proceeds of approximately $18,000,000, and incurred a total cumulative loss of approximately $17,856,000 from inception (November 2010) to June 30, 2017.

Furthermore, as a result of the sale of certain of the assets of StemCells, Inc., Microbot's predecessor company, on November 29, 2016, Microbot raised approximately $3,100,000 in cash, after taking into account the payment of $495,000 to certain StemCells employees but excluding $400,000 held in escrow to satisfy any indemnification claims of the buyer of the assets. Additionally, in January and June 2017, we sold an aggregate of 700,000 and 3,750,000 shares, respectively, of our common stock for aggregate net proceeds, after deducting placement agent fees and expenses, of approximately $12,701,000. As a result of such cash, Microbot believes that its net cash will be sufficient to fund its operations for at least 12 months and fund operations necessary to continue development activities of the SCS and TipCAT.

Microbot plans to continue to fund its research and development and other operating expenses, other development activities relating to additional product candidates it may develop internally or through acquisitions, and the associated losses from operations, through future issuances of debt and/or equity securities and possibly additional grants from the Israeli Innovation Authority. The capital raises from issuances of convertible debt and equity securities could result in additional dilution to Microbot's shareholders. In addition, to the extent Microbot determines to incur additional indebtedness, Microbot's incurrence of additional debt could result in debt service obligations and operating and financing covenants that would restrict its operations. Microbot can provide no assurance that financing will be available in the amounts it needs or on terms acceptable to it, if at all. If Microbot is not able to secure adequate additional working capital when it becomes needed, it may be required to make reductions in spending, extend payment terms with suppliers, liquidate assets where possible and/or suspend or curtail planned research programs. Any of these actions could materially harm Microbot's business.

Cash Flows

The following table provides a summary of the net cash flow activity for each of the periods set forth below (in thousands):

	Six months ended June 30,	
	2017	2016
Net cash used in operating activities	$(2,198)	$(346)
Net cash used in investing activities	(55)	–
Net cash provided by financing activities	12,622	750
Net increase in cash and cash equivalents	$10,396	$404

Cash used in operating activities for the six months ended June 30, 2017 was approximately $2,198,000, calculated by adjusting net loss from operations by approximately $2,623,000 to eliminate non-cash and expense items not involving cash flows such as depreciation and accumulated interest on convertible loans, as well as other changes in assets and liabilities resulting in non-cash adjustments in the income statement. Cash used in operating activities for the six months ended June 30, 2016 was approximately $346,000, similarly adjusted by approximately $94,000.

Net cash used in investing activities for the six months ended June 30, 2017 was approximately $55,000, consisting of purchase of property and equipment and restricted cash which was deposited for the benefit of lease agreements, compared to approximately $0 for the six months ended June 30, 2016.

Net cash provided by financing activities of approximately $12,622,000 for the six months ended June 30, 2017 consisted of issuance of common stock and outflow amounts related to the merger recapitalization, compared to approximately $750,000 in the six months ended June 30, 2016.

Off-Balance Sheet Arrangements

Microbot has no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on its financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk

Microbot’s cash and cash equivalents as of June 30, 2017 consisted of readily available checking and money market funds. Microbot’s primary exposure to market risk is interest income sensitivity, which is affected by changes in the general level of U.S. interest rates. However, because of the short-term nature of the instruments in Microbot’s portfolio, a sudden change in market interest rates would not be expected to have a material impact on Microbot’s financial condition and/or results of operations. Microbot does not believe that its cash or cash equivalents have significant risk of default or illiquidity. While Microbot believes its cash and cash equivalents do not contain excessive risk, Microbot cannot provide absolute assurance that in the future its investments will not be subject to adverse changes in market value. In addition, Microbot maintains significant amounts of cash and cash equivalents at one or more financial institutions that are in excess of federally insured limits.

Foreign Exchange Risks

Our financial statements are denominated in U.S. dollars and financial results are denominated in U.S. dollars, while a significant portion of our business is conducted, and a substantial portion of our operating expenses are payable, in currencies other than the U.S. dollar.

Exchange rate fluctuations may have an adverse impact on our future revenues, if any, or expenses as presented in the financial statements. We may in the future use financial instruments, such as forward foreign currency contracts, in our management of foreign currency exposure. These contracts would primarily require us to purchase and sell certain foreign currencies with or for U.S. dollars at contracted rates. We may be exposed to a credit loss in the event of non-performance by the counterparties of these contracts. In addition, these financial instruments may not adequately manage our foreign currency exposure. Our results of operations could be adversely affected if we are unable to successfully manage currency fluctuations in the future.

Effects of Inflation

Inflation generally affects Microbot by increasing its clinical trial costs. Microbot does not believe that inflation and changing prices had a significant impact on its results of operations for any periods presented herein.

Item 4. Controls and Procedures.

Disclosure Controls and Procedures

We maintain a system of disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act). As required by Rule 13a-15(b) under the Exchange Act, management of the Company, under the direction of our Chief Executive Officer and Chief Financial Officer, reviewed and performed an evaluation of the effectiveness of design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) as of June 30, 2017. Based on that review and evaluation, the Chief Executive Officer and Chief Financial Officer, along with the management of the Company, have determined that as of June 30, 2017, the disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and were effective to provide reasonable assurance that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosures.

Management's Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining effective internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act). There are inherent limitations to the effectiveness of any internal control, including the possibility of human error and the circumvention or overriding of controls. Accordingly, even effective internal controls can provide only reasonable assurance with respect to financial statement preparation. Further, because of changes in conditions, the effectiveness of internal control may vary over time. We have assessed the effectiveness of our internal controls over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) as of June 30, 2017, and have concluded that, as of June 30, 2017, our internal control over financial reporting was effective.

This quarterly report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting, pursuant to applicable rules of the Securities and Exchange Commission.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting, identified in connection with the evaluation of such internal control that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II

OTHER INFORMATION

Item 1. Legal Proceedings.

Microbot Medical Inc. is named as the defendant in a lawsuit, captioned Sabby Healthcare Master Fund Ltd. and Sabby Volatility Warrant Master Fund Ltd., Plaintiffs, against Microbot Medical Inc., Defendant, pending in the Supreme Court of the State of New York, County of New York. The complaint alleges, among other things, that Microbot Medical Inc. breached multiple representations and warranties contained in the Securities Purchase Agreement (the “SPA”) related to the June 8, 2017 equity financing of the Company (the “Financing”), of which the Plaintiffs participated. The complaint seeks rescission of the SPA and return of the Plaintiffs’ $3,375,000 purchase price with respect to the Financing, and damages in an amount to be determined at trial, but to exceed $1 million.

We believe that the claims are without merit and intend to defend the action vigorously. However, due to the early stage in the ligation process, management is unable to assess the likelihood of the claim and the amount of potential damages, if any, to be awarded. Accordingly, no assurance can be given that any adverse outcome would not be material to our consolidated financial position.

Item 1A. Risk Factors.

Not required for a Smaller Reporting Company.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

None.

Item 6. Exhibits

The exhibits listed below are hereby furnished to the SEC as part of this report:

31.1	Certification of Harel Gadot, Chairman, President and Chief Executive Officer
31.2	Certification of David Ben Naim, Chief Financial Officer
32.1	Certification of Harel Gadot, Chairman, President and Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of David Ben Naim, Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.1	XBRL Instance.
101.SCH	XBRL Taxonomy Extension Schema.
101.CAL	XBRL Taxonomy Extension Calculation.
101.DEF	XBRL Taxonomy Extension Definition.
101.LAB	XBRL Taxonomy Extension Labels.
101.PRE	XBRL Taxonomy Extension Presentation.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, this 14th day of August 2017.

MICROBOT MEDICAL INC.

By: */s/ Harel Gadot*
Name: Harel Gadot
Title: Chairman, President and Chief Executive Officer
(Principal Executive Officer)

By: */s/ David Ben Naim*
Name: David Ben Naim
Title: Chief Financial Officer
(Principal Financial and Accounting Officer)