

ON TRACK INNOVATIONS LTD

Form 10-Q

November 14, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended **September 30, 2017**

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from _____ to _____

Commission file number **000-49877**

ON TRACK INNOVATIONS LTD.

(Exact name of registrant as specified in its charter)

Israel

N/A

(State or other jurisdiction of
incorporation or organization)

(IRS Employer

Identification No.)

Z.H.R. Industrial Zone, P.O. Box 32, Rosh Pina, Israel 1200001

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(Address of principal executive offices)

+ 972-4-6868000

(Registrant's telephone number)

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 past 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 registration 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, smaller reporting company or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	Accelerated filer	Non-accelerated filer	Smaller reporting company
		(do not check if a smaller reporting company)	

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

State the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date:
41,134,378 Ordinary Shares outstanding as of November 6, 2017.

ON TRACK INNOVATIONS LTD.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.

ON TRACK INNOVATIONS LTD. AND ITS SUBSIDIARIES

INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

As of September 30, 2017

(Unaudited)

On Track Innovations Ltd.

and its Subsidiaries

Interim Unaudited Condensed Consolidated Financial Statements as of September 30, 2017

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On Track Innovations Ltd.

and its Subsidiaries

Interim Unaudited Condensed Consolidated Balance Sheets

US dollars in thousands except share and per share data

	September 30, 2017	December 31, 2016
Assets		
Current assets		
Cash and cash equivalents	\$ 6,000	\$ 5,952
Short-term investments	2,667	5,585
Trade receivables (net of allowance for doubtful accounts of \$638 and \$720 as of September 30, 2017 and December 31, 2016, respectively)	5,470	5,620
Other receivables and prepaid expenses	3,963	1,638
Inventories	3,818	3,069
Total current assets	21,918	21,864
Long-term restricted deposit for employees benefit	494	453
Severance pay deposits	353	322
Property, plant and equipment, net	5,824	5,788
Intangible assets, net	337	278
Total Assets	\$ 28,926	\$ 28,705

The accompanying notes are an integral part of these interim unaudited condensed consolidated financial statements.

On Track Innovations Ltd.

and its Subsidiaries

Interim Unaudited Condensed Consolidated Balance Sheets

US dollars in thousands except share and per share data

	September 30, 2017	December 31, 2016
Liabilities and Equity		
Current Liabilities		
Short-term bank credit and current maturities of long-term bank loans	\$ 4,389	\$ 4,369
Trade payables	6,898	6,957
Other current liabilities	2,482	2,822
Total current liabilities	13,769	14,148
Long-Term Liabilities		
Long-term loans, net of current maturities	889	1,215
Accrued severance pay	914	811
Deferred tax liability	477	373
Total long-term liabilities	2,280	2,399
Total Liabilities	16,049	16,547
Commitments and Contingencies		
Equity		
Shareholders' Equity		
Ordinary shares of NIS 0.1 par value:		
Authorized: 50,000,000 shares as of September 30, 2017 and December 31, 2016;		
issued: 42,313,077 and 42,243,075 shares as of September 30, 2017 and	1,063	1,061
December 31, 2016, respectively;		
outstanding: 41,134,378 and 41,064,376 shares as of September 30, 2017 and		
December 31, 2016, respectively		
Additional paid-in capital	224,676	224,415
Treasury shares at cost - 1,178,699 shares as of September 30, 2017 and December 31, 2016	(2,000)	(2,000)

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Accumulated other comprehensive loss	(876)	(1,236)
Accumulated deficit	(209,986)	(210,082)
Total Equity	12,877		12,158	
Total Liabilities and Equity	\$ 28,926		\$ 28,705	

The accompanying notes are an integral part of these interim unaudited condensed consolidated financial statements.

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On Track Innovations Ltd.

and its Subsidiaries

Interim Unaudited Condensed Consolidated Statements of Operations

US dollars in thousands except share and per share data

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Revenues				
Sales	\$3,445	\$3,463	\$11,871	\$10,409
Licensing and transaction fees	1,225	2,133	3,765	4,569
Total revenues	4,670	5,596	15,636	14,978
Cost of revenues				
Cost of sales	2,192	2,557	7,468	7,167
Total cost of revenues	2,192	2,557	7,468	7,167
Gross profit	2,478	3,039	8,168	7,811
Operating expenses				
Research and development	823	604	2,414	2,072
Selling and marketing	1,332	1,300	4,166	3,974
General and administrative	758	787	2,553	2,613
Other expenses	-	83	-	83
Total operating expenses	2,913	2,774	9,133	8,742
Operating (loss) income from continuing operations	(435	) 265	(965	) (931
Financial expenses, net	(126	) (30	) (236	) (185
Profit (loss) from continuing operations before taxes on income	(561	) 235	(1,201	) (1,116
Income tax	(12	) (28	) (68	) (60
Net (loss) income from continuing operations	(573	) 207	(1,269	) (1,176
Net income (loss) from discontinued operations	1,441	(279) 1,365	1,525
Net income (loss)	868	(72) 96	349

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Net loss attributable to noncontrolling interest	-	5	-	32
Net income (loss) attributable to shareholders	\$868	\$(67) \$96	\$381
Basic and diluted net gain (loss) attributable to shareholders per ordinary share				
From continuing operations	(0.01	) 0.01	(0.03	) (0.03
From discontinued operations	0.03	(0.01	) 0.03	0.04
	\$0.02	\$(*	) (*	) \$0.01
Weighted average number of ordinary shares used in computing basic net (loss) income per ordinary share	41,122,965	40,914,258	41,099,603	40,895,268
Weighted average number of ordinary shares used in computing diluted net (loss) income per ordinary share	41,122,965	41,667,258	41,099,603	40,895,268

(*) Less than \$0.01 per ordinary share.

The accompanying notes are an integral part of these interim unaudited condensed consolidated financial statements.

On Track Innovations Ltd.

and its Subsidiaries

Interim Unaudited Condensed Consolidated Statements of Comprehensive Income (Loss)

US dollars in thousands

	Three months ended September 30, 2017		Nine months ended September 30, 2016	
Total comprehensive income (loss):				
Net income (loss)	\$868	\$(72)	\$96	\$349
Foreign currency translation adjustments	28	110	360	88
Total comprehensive income	\$896	\$38	\$456	\$437
Comprehensive loss attributable to the non-controlling interest	-	5	-	32
Total comprehensive income attributable to shareholders	\$896	\$43	\$456	\$469

The accompanying notes are an integral part of these interim unaudited condensed consolidated financial statements.

On Track Innovations Ltd.

and its Subsidiaries

Interim Unaudited Condensed Consolidated Statements of Changes in Equity

US dollars in thousands except number of shares

	Number of Shares issued	Share capital	Additional paid-in capital	Treasury Shares (at cost)	Accumulated other comprehensive Income (loss)	Accumulated deficit	Noncontrolling interest	Total equity
Balance as of December 31, 2015	42,014,673	\$1,055	\$225,925	\$(2,000)	\$ (1,084)	\$ (209,254)	\$ (1,819)	\$12,823
Changes during the nine month period ended September 30, 2016:								
Stock-based compensation	15,000(**)	(*)	174	-	-	-	-	174
Exercise of options and warrants	90,402	2	35	-	-	-	-	37
Increase in the ownership rate in subsidiaries (***)	-	-	(1,920)	-	-	-	1,851	(69)
Foreign currency translation adjustments	-	-	-	-	88	-	-	88
Net income (loss)	-	-	-	-	-	381	(32)	349
Balance as of September 30, 2016	42,120,075	\$1,057	\$224,214	\$(2,000)	\$ (996)	\$ (208,873)	\$ -	\$13,402
Balance as of December 31, 2016	42,243,075	\$1,061	\$224,415	\$(2,000)	\$ (1,236)	\$ (210,082)	\$ -	\$12,158

Changes during the
nine month period
ended September 30,
2017:

Stock-based compensation	45,000(**)	2	236	-	-	-	-	238
Exercise of options	25,002	(*)	25	-	-	-	-	25
Foreign currency translation adjustments	-	-	-	-	360	-	-	360
Net income	-	-	-	-	-	96	-	96
Balance as of September 30, 2017	42,313,077	\$1,063	\$224,676	\$(2,000)	\$(876)	\$(209,986)	\$-	\$12,877

(*) Less than \$1.

(**) See Note 8C.

(***) See Note 1C(2).

The accompanying notes are an integral part of these interim unaudited condensed consolidated financial statements.

On Track Innovations Ltd.

and its Subsidiaries

Interim Unaudited Condensed Consolidated Statements of Cash Flows

US dollars in thousands

	Nine months ended September 30, 2017	2016
Cash flows from continuing operating activities		
Net loss from continuing operations	\$ (1,269)	\$ (1,176)
Adjustments required to reconcile net loss to net cash used in continuing operating activities:		
Stock-based compensation related to options and shares issued to employees and others	238	174
Depreciation	878	911
Deferred tax, net	37	60
(Gain) loss on sale of property and equipment	(9)	83
Accrued interest and linkage differences, net	(41)	19
Changes in operating assets and liabilities:		
Accrued severance pay, net	72	(152)
	187	(1,376)

Decrease (increase) in trade receivables, net				
(Increase) in other receivables and prepaid expenses	(435	)	(16)
(Increase) decrease in inventories	(710	)	246	
(Decrease) increase in trade payables	(611	)	1,024	
(Decrease) in other current liabilities	(777	)	(408)
Net cash used in continuing operating activities	(2,440	)	(611)
Cash flows from continuing investing activities				
Purchase of property and equipment	(160	)	(185)
Proceeds from sale of property and equipment	14		1,779	
Change in short-term investments, net	2,917		(502)
Investment in capitalized product costs	(185	)	(139)
Proceeds from restricted deposit for employees benefit	44		142	
Net cash provided by continuing investing activities	2,630		1,095	
Cash flows from continuing financing activities				
(Decrease) increase in short-term bank credit, net	(72	)	287	
Proceeds from long-term bank loans	-		27	
Repayment of long-term bank loans	(469	)	(1,368)
Proceeds from exercise of options and warrants	25		37	
Net cash used in continuing financing	(516	)	(1,017)

activities

Cash flows from
discontinued
operations

Net cash used in discontinued operating activities	(86))	(183))
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Net cash provided by discontinued investing activities	-		2,152	
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Total net cash (used in) provided by discontinued operations	(86))	1,969	
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Effect of exchange rate changes on cash and cash equivalents	460		51	
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Increase in cash and cash equivalents	48		1,487	
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Cash and cash equivalents at the beginning of the period	5,952		5,450	
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Cash and cash equivalents at the end of the period	\$	6,000	\$	6,937
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The accompanying notes are an integral part of these interim unaudited condensed consolidated financial statements.

On Track Innovations Ltd.

and its Subsidiaries

Interim Unaudited Condensed Consolidated Statements of Cash Flows (cont'd)

US dollars in thousands

	Nine months ended September 30, 2017 2016	
Supplementary cash flows activities:		
Cash paid during the period for:		
Interest paid	\$ 140	\$ 148
Income taxes paid	\$ 31	\$ -

The accompanying notes are an integral part of these interim unaudited condensed consolidated financial statements.

On Track Innovations Ltd.

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Notes to the Interim Unaudited Condensed Consolidated Financial Statements

US dollars in thousands

Note 1 - Organization and Basis of Presentation

A. Description of business

On Track Innovations Ltd. (the “Company”) was founded in 1990, in Israel. The Company and its subsidiaries (together, the “Group”) are principally engaged in the field of design and development of cashless payment solutions. During the nine-month period ended September 30, 2017, the Company completed the liquidation of its wholly-owned subsidiaries, Softchip Israel Ltd. and Softchip Technologies (3000) Ltd., and these entities are no longer part of the Group.

The Company’s shares are listed for trading on the NASDAQ Capital Market (formerly listed on the NASDAQ Global Market until April 13, 2016).

B. Interim Unaudited Financial Information

The accompanying unaudited consolidated financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements and therefore should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended December 31, 2016.

In the opinion of management, all adjustments considered necessary for a fair presentation, consisting of normal recurring adjustments, have been included. Operating results for the nine-month period ended September 30, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017.

Use of Estimates:

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the assets, liabilities, revenue, costs, expenses and accumulated other comprehensive income/(loss) that are reported in the Interim Consolidated Financial Statements and accompanying disclosures. These estimates are based on management's best knowledge of current events, historical experience, actions that the Company may undertake in the future and on various other assumptions that are believed to be reasonable under the circumstances. As a result, actual results may be different from these estimates.

C. Divestiture of operations

In December 2013, the Company completed the sale of certain assets, subsidiaries and intellectual property ("IP") relating to its Smart ID division to SuperCom Ltd. ("SuperCom"). Accordingly, the results and the cash flows of this¹ operation for all reporting periods are presented in the statements of operations and in the statements of cash flows, respectively, as discontinued operations separately from continuing operations.

On Track Innovations Ltd.

and Subsidiaries

Notes to the Interim Unaudited Condensed Consolidated Financial Statements

US dollars in thousands

Note 1 - Organization and Basis of Presentation (cont'd)

C.Divestiture of operations (cont'd)

On September 14, 2016, the Company completed the sale of certain assets and IP related to its former parking segment. The Company has determined that the sale qualifies as a discontinued operation. Accordingly, the results and the cash flows of these operations for all reporting periods are presented in the statements of operations and in the statements of cash flows, respectively, as discontinued operations separately from continuing operations.

Note 2 - Significant Accounting Policies

These interim unaudited condensed consolidated financial statements have been prepared according to the same accounting policies as those discussed in the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

Recent accounting pronouncements

1. In May 2017, the Financial Accounting Standard Board issued Accounting Standards Update ("ASU") 2017-09, "Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting." The ASU amends the scope of modification accounting for share-based payment arrangements, provides guidance on the types of changes to the terms or conditions of share-based payment awards to which an entity would be required to apply modification accounting. The new guidance will allow companies to make certain changes to awards without accounting for them

as modifications. It does not change the accounting for modifications. ASU 2017-09 is effective for all entities for annual reporting periods beginning after December 15, 2017, with early adoption permitted, including adoption in any interim period for which financial statements have not yet been issued. The Company does not expect that the adoption of ASU 2017-09 will have a material impact on the Company's results of operations and financial condition.

In connection with other recent accounting pronouncements and the Company's assessment of the impacts they will have on the ongoing financial reporting, see Note 2W in the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

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On Track Innovations Ltd.

and Subsidiaries

Notes to the Interim Unaudited Condensed Consolidated Financial Statements

US dollars in thousands

Note 3 - Other Receivables and Prepaid Expenses

	September 30, 2017	December 31, 2016
Government institutions	\$ 476	\$ 322
Prepaid expenses	412	526
Receivables under contractual obligations to be transferred to others (*)	383	346
Other receivables (see also Note 6).	2,692	444
	\$ 3,963	\$ 1,638

(*) The Company's subsidiary in Poland is required to collect certain fees that are to be transferred to local authorities.

Note 4 - Other Current Liabilities

	September 30, 2017	December 31, 2016
Employees and related expenses	\$ 592	\$ 1,011
Accrued expenses	1,430	1,473
Customer advances	224	249
Other current liabilities	236	89
	\$ 2,482	\$ 2,822

On Track Innovations Ltd.

and Subsidiaries

Notes to the Interim Unaudited Condensed Consolidated Financial Statements

US dollars in thousands

Note 5 - Commitments and Contingencies

A. Legal claims

In June 2013, prior to the Company's divestiture of its SmartID division, Merwell Inc. ("Merwell") filed a claim against the Company before an agreed-upon arbitrator alleging breach of contract in connection with certain commissions claimed to be owed to Merwell with respect to the division's activities in Tanzania. These activities, along with all other activities of the SmartID division, were later assigned to and assumed by SuperCom Ltd. ("SuperCom") in its purchase of the division. SuperCom undertook to indemnify the Company and hold it harmless against any liabilities the Company may incur in connection with Merwell's consulting agreement and the arbitration. An arbitration decision was issued on February 21, 2016, awarding Merwell approximately \$855 for outstanding commissions. The arbitration decision is being appealed and is thus not yet ripe for enforcement. As mentioned above, based on the agreement with SuperCom, SuperCom is liable for the costs and liabilities arising out of this claim. Therefore, the financial statements do not include any provision for this claim.

On October 3, 2013, a financial claim was filed against the Company and its then French subsidiary, Parx France (in this paragraph, together, the "Defendants"), in the Commercial Court of Paris, France (in this paragraph, the "Court"). The sum of the claim is € 1,500 (approximately \$1,773), and is based on the allegation that the plaintiff sustained certain losses in connection with Defendants not granting the plaintiff exclusive marketing rights to distribute and operate the Defendants' PIAF Parking System in Paris and the Ile of France. On October 25, 2017, the Paris Commercial Court issued its ruling in this matter dismissing all claims against the Company but ordering Parx France to pay the plaintiff €50 plus interest in damages plus another approximately €5 in other fees and penalties.

On March 1, 2017, a claim (the "USAT Claim") was filed in the U.S. District Court, Eastern District of Pennsylvania against the Company and its U.S. subsidiary, OTI America Inc. by USA Technologies Inc. ("USAT"). The USAT Claim asserted, among other things, that products sold by the Company to USAT's manufacturing subcontractor, Masterwork Electronics, Inc. ("Masterwork"), failed to conform to promised specifications. USAT sought payment of

\$4,913 plus interest and costs, comprised of \$729 to cover payment for alternative products, and \$4,184 to cover costs of replacing the allegedly non-conforming products already installed. On March 3, 2017, the Company filed a lawsuit (the “OTI Claim”) against Masterwork in the U.S. District Court for the Northern District of California. The Company sought payment of \$2,518 plus interest and costs as a result of Masterwork’s refusal to perform its obligations in connection with a purchase order supplied by Masterwork to the Company, based on Masterwork’s allegations that its customer, USAT, had apparently claimed that the products are not conforming. On July 20, 2017, the OTI Claim was transferred to the Eastern District of Pennsylvania and on August 23, 2017, the USAT Claim and OTI Claim were consolidated into a single action. On November 1, 2017, all parties to these proceedings entered into a settlement agreement resolving their disputes and have, accordingly, dismissed all litigation on November 1, 2017.

On Track Innovations Ltd.

and Subsidiaries

Notes to the Interim Unaudited Condensed Consolidated Financial Statements

US dollars in thousands

Note 5 - Commitments and Contingencies (cont'd)

B. Guarantees

As of September 30, 2017, the Company has granted performance guarantees and guarantees to secure customer advances in the sum of \$352. The expiration dates of the guarantees range from October 2017 to June 2019.

Note 6 - Discontinued operations

As described in Note 1C, the Company divested its interest in the SmartID division and its parking segment, and presented these activities as discontinued operations.

Set forth below are the results of the discontinued operations:

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Revenues	-	184	-	768
Expenses	(11)	(327)	(94)	(1,246)

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Other (expenses) income, net	1,452(*)	(136)	1,459(*)	2,003
Net profit (loss) from discontinued operations	1,441	(279)	1,365	1,525

(*) On August 23, 2017, a judgment was issued by the Israeli Central District Court regarding the Company's lawsuit against Harel Insurance Company Ltd. ("Harel") for damages incurred by the Company due to flooding in a subcontractor's manufacturing site. The judgment determined that an amount of \$1,600, net be awarded to cover the Company's damages. On October 10, 2017, Harel submitted its appeal of the judgment to the Israeli Supreme Court as well as a request for stay of judgment. On October 30, 2017, the Court denied the requested stay. Based on the advice of counsel, the Company currently believes that there are sufficient grounds on which to uphold the District Court's ruling and, as such, Harel's appeal will be denied.

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On Track Innovations Ltd.

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Notes to the Interim Unaudited Condensed Consolidated Financial Statements

US dollars in thousands

Note 7 - Fair Value of Financial Instruments

The Company's financial instruments consist mainly of cash and cash equivalents, short-term interest bearing investments, accounts receivable, restricted deposits for employee benefits, accounts payable and short-term and long-term loans.

Fair value for the measurement of financial assets and liabilities is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. The Company utilizes a valuation hierarchy for disclosure of the inputs for fair value measurement. This hierarchy prioritizes the inputs into three broad levels as follows:

Level 1 Inputs: Unadjusted quoted prices in active markets for identical assets or liabilities accessible to the reporting entity at the measurement date.

Level 2 Inputs: Other than quoted prices included in Level 1 inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability.

Level 3 Inputs: Unobservable inputs for the asset or liability used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at measurement date.

By distinguishing between inputs that are observable in the market place, and therefore more objective, and those that are unobservable and therefore more subjective, the hierarchy is designed to indicate the relative reliability of the fair value measurements. A financial asset or liability's classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

The Company, in estimating fair value for financial instruments, used the following methods and assumptions:

The carrying amounts of cash and cash equivalents, short-term interest bearing investments, trade receivables, short-term bank credit and trade payables are equivalent to, or approximate their fair value due to the short-term maturity of these instruments.

The carrying amounts of variable interest rate long-term loans are equivalent or approximate to their fair value as they bear interest at approximate market rates. As of September 30, 2017, the fair value of bank loans with fixed interest rates did not differ materially from the carrying amount.

As of September 30, 2017, the Company held approximately \$2,667 of short-term bank deposits (as of December 31, 2016, \$5,585). As of September 30, 2017 and December 31, 2016, short-term deposits in the amount of \$1,548 have been pledged as security in respect of guarantees granted in respect of performance guarantees, loans and credit lines received from a bank and cannot be pledged to others or withdrawn without the consent of the bank.

On Track Innovations Ltd.

and Subsidiaries

Notes to the Interim Unaudited Condensed Consolidated Financial Statements

US dollars in thousands

Note 8 - Equity

A. Stock option plans

During the nine months ended September 30, 2017 and September 30, 2016, 100,000 and 270,000 options were granted, respectively. The vesting period for the options ranges from one year to four years. The exercise prices for the options range from \$0.44 to \$1.58. Those options expire up to five years after the date of the grant. Any options which are forfeited or cancelled before expiration become available for future grants under the Company's option plan.

The fair value of each option granted to employees and non-employees during the nine months ended September 30, 2017 and September 30, 2016, was estimated on the date of grant, using the Black-Scholes model and the following assumptions:

1. Dividend yield of zero percent for all periods.

2. Risk-free interest rate of 1.35% and 1.18% for grants during the nine months ended September 30, 2017 and September 30, 2016, respectively, based on U.S. Treasury yield curve in effect at the time of grant.

3. Estimated expected lives of 3.50 and 3.56 years for grants during the nine months ended September 30, 2017 and September 30, 2016, respectively, using the simplified method.

4.

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Expected average volatility of 74% and 72% for grants during the nine months ended September 30, 2017 and September 30, 2016, respectively, which represent a weighted average standard deviation rate for the price of the Company's Ordinary Shares on the NASDAQ Global Market and NASDAQ Capital Market.

The Company's options activity (including options to non-employees) during the nine months ended September 30, 2017 and options outstanding and options exercisable as of December 31, 2016 and September 30, 2017, are summarized in the following table:

	Number of options outstanding	Weighted average exercise price per share
Outstanding – December 31, 2016	1,604,836	\$ 1.36
Options granted	100,000	1.58
Options expired or forfeited	(286,334)	1.89
Options exercised	(25,002)	0.92
Outstanding – September 30, 2017	1,393,500	\$ 1.27
Exercisable as of:		
December 31, 2016	591,017	\$ 1.83
September 30, 2017	605,167	\$ 1.57

On Track Innovations Ltd.

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Notes to the Interim Unaudited Condensed Consolidated Financial Statements

US dollars in thousands

Note 8 - Equity (cont'd)

A. Stock option plans (cont'd)

The weighted average fair value of options granted during the nine months ended September 30, 2017 and during the nine months ended September 30, 2016 is \$0.93 and \$0.41, respectively, per option. The aggregate intrinsic value of outstanding options as of September 30, 2017 and December 31, 2016 is approximately \$465 and \$909, respectively. The aggregate intrinsic value of exercisable options as of September 30, 2017 and December 31, 2016 is approximately \$168 and \$166, respectively.

The following table summarizes information about options outstanding and exercisable (including options to non-employees) as of September 30, 2017:

Range of exercise price	Options outstanding			Options Exercisable		
	Number outstanding as of September 30, 2017	Weighted average contractual life (years) remaining	Weighted Average Exercise Price	Number Outstanding As of September 30, 2017	Weighted average contractual life (years) remaining	Weighted Average Exercise Price
\$0.44-0.90	585,000	3.05	\$0.77	281,667	2.78	\$0.77
1.07-1.46	420,000	3.77	1.12	50,000	0.80	1.46
1.58-1.68	115,000	4.08	1.59	10,000	2.25	1.68
2.32-2.36	233,500	1.59	2.35	233,500	1.59	2.35
\$3.03	40,000	1.98	\$ 3.03	30,000	1.98	\$ 3.03
	1,393,500	3.08		605,167	2.11	

As of September 30, 2017, there was approximately \$354 of total unrecognized compensation cost related to non-vested stock-based compensation arrangements. That cost is expected to be recognized over a weighted-average period of approximately 1.1 year.

During the nine months ended September 30, 2017 and September 30, 2016, the Company recorded stock-based compensation expenses in the amount of \$238 and \$174, respectively, in accordance with ASC 718 “Compensation-Stock Compensation.”

B. Warrants

As of September 30, 2017, there are remaining 40,000 outstanding warrants with a per share exercise price of \$0.95. The warrants expire during 2019.

During the nine months ended September 30, 2017, the Company issued 45,000 ordinary shares to one of its **C.**consultants. The expenses that are recognized due to this issuance are presented within ‘stock based compensation’ in the statement of changes in equity for the nine months ended September 30, 2017.

On Track Innovations Ltd.

and Subsidiaries

Notes to the Interim Unaudited Condensed Consolidated Financial Statements

US dollars in thousands

Note 9 - Operating segments

For the purposes of allocating resources and assessing performance in order to improve profitability, the Company's chief operating decision maker ("CODM") examines two segments which are the Company's strategic business units: (1) Retail and Mass Transit Ticketing; and (2) Petroleum. In addition to its two reportable segments, certain products for the medical industry and other secure smart card solutions are classified under the Company's "Other" segment.

Information regarding the results of each reportable segment is included below based on the internal management reports that are reviewed by the CODM.

	Three months ended September 30, 2017			
	Retail and Mass Transit Ticketing			
	Petroleum	Mass Transit Ticketing	Other	Consolidated
Revenues	\$917	\$ 3,231	\$ 522	\$ 4,670
Reportable segment gross profit (*)	493	1,859	325	2,677
Reconciliation of reportable segment gross profit to gross profit for the period				
Depreciation			(199))

Stock-based compensation	-
(*) Gross profit for the period	\$ 2,478

Three months ended
September 30, 2016

**Retail
and**

Petroleum**Mass** Other Consolidated
Transit

Ticketing

Revenues	\$ 1,056	\$ 3,891(**)	\$ 649	\$ 5,596
Reportable segment gross profit (*)	638	2,238	326	3,202
Reconciliation of reportable segment gross profit to gross profit for the period				
Depreciation			(161)
Stock-based compensation			(2)
(*) Gross profit for the period			\$ 3,039	

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On Track Innovations Ltd.

and Subsidiaries

Notes to the Interim Unaudited Condensed Consolidated Financial Statements

US dollars in thousands

Note 9 - Operating segments (cont'd)

	Nine months ended September 30, 2017			
	Retail and			
	Petroleum	Mass Transit	Other	Consolidated
	Ticketing			
Revenues	\$3,645	\$ 10,654	\$ 1,337	\$ 15,636
Reportable segment gross profit (*)	1,889	6,068	794	8,751
Reconciliation of reportable segment gross profit to profit for the period				
Depreciation				(582)
Stock-based compensation				(1)
(*) Gross profit for the period				\$ 8,168

	Nine months ended September 30, 2016			
	Retail and			
	Petroleum	Mass Transit	Other	Consolidated
	Ticketing			
Revenues	\$2,996	\$ 10,029(**)	\$ 1,953	\$ 14,978
Reportable segment gross profit (*)	1,836	5,568	968	8,372

Reconciliation of reportable segment gross profit to profit for the period

Depreciation	(559)
Stock-based compensation	(2)
(*) Gross profit for the period	\$ 7,811	

(*) Gross profit as reviewed by the CODM, represents gross profit, adjusted to exclude depreciation and stock-based compensation.

(**) The revenues from retail and mass transit ticketing segment for the three months and nine months ended September 30, 2016 include revenues derived from a litigation settlement with a perpetual license agreement. Those revenues are presented within revenues from 'licensing and transaction fees' in the statements of operations.

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

Forward - Looking Statements

The statements contained in this Quarterly Report on Form 10-Q, or Quarterly Report, that are not historical facts are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 and other federal securities laws. Such forward-looking statements may be identified by, among other things, the use of forward-looking terminology such as "believes", "intends", "plans", "expects", "may", "will", "should", or "anticipates" or the negative thereof or other variations thereon or comparable terminology, and similar expressions are intended to identify forward-looking statements. We remind readers that forward-looking statements are merely predictions and therefore are inherently subject to uncertainties and other factors and involve known and unknown risks that could cause the actual results, performance, levels of activity, or our achievements, or industry results, to be materially different from any actual future results, performance, levels of activity, or our achievements, or industry results, expressed or implied by such forward-looking statements. Such forward-looking statements may appear in this Item 2 "Management's Discussion and Analysis of Financial Condition and Results of Operations" as well as elsewhere in this Quarterly Report and include, among other statements, statements regarding the following:

our expectations regarding the growth of the near-field communication, or NFC, market;

the expected development and potential benefits from our existing or future products or our intellectual property, or IP;

increased generation of revenues from licensing, transaction fees and/or other arrangements;

future sources of revenue, ongoing relationships with current and future business partners, distributors, suppliers, customers, end-user customers and resellers;

our intention to generate additional recurring revenues, licensing and transaction fees;

future costs and expenses and adequacy of capital resources;

our intention to continue to expand our market presence via strategic partnerships around the globe;

our expectations that revenues from our business will grow in the next years, and the expected reasons for that growth;

our expectations regarding our short-term and long-term capital requirements;

our intention to continue to invest in research and development;

our outlook for the coming months; and

information with respect to any other plans and strategies for our business.

The factors discussed herein, including those risk factors expressed from time to time in our press releases or filings with the Securities and Exchange Commission, or the SEC, could cause actual results and developments to be materially different from those expressed in or implied by such statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak and are made only as of the date of this filing.

Our business and operations are subject to substantial risks, which increase the uncertainty inherent in the forward-looking statements contained in this Quarterly Report. Except as required by law, we undertake no obligation to release publicly the result of any revision to these forward-looking statements that may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. Further information on potential factors that could affect our business is described among others under the heading “Risk Factors” in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2016 filed with SEC. Readers are also urged to carefully review and consider the various disclosures we have made in that report.

As used in this Quarterly Report, the terms "we", "us", "our", "the Company", and "OTI" mean On Track Innovations Ltd. and our subsidiaries and affiliates, unless otherwise indicated or as otherwise required by the context.

All figures in this Quarterly Report are stated in United States dollars, unless otherwise specified in.

Overview

We are a pioneer and leading developer of cutting-edge secure cashless payment solutions, providing global enterprises with innovative technology for over two decades. We currently operate in two main segments: (1) Retail and Mass Transit Ticketing; and (2) Petroleum (following the divestiture of our parking business as specified below). In addition to our two reportable segments, certain products for the medical industry and other secure smart card solutions are classified under “Other” in segment analyses appearing in this Quarterly Report.

Our field-proven suite of cashless payment solutions is based on an extensive IP portfolio, including registered patents and patent applications worldwide. Since our incorporation in 1990, we have built an international reputation for reliability and innovation, deploying a large number of solutions for the unattended retail, mass transit, banking, medical and petroleum industries.

We operate a global network of regional offices, distributors and partners to support various solutions deployed across the globe.

We focus our efforts on our core business of providing innovative cashless payment solutions based among other things on our contactless NFC technology. To this end, and in line with our efforts to focus on our core business, in September 2016 we completed the sale of the operations, including our employees, as well as IP directly related to our parking business. We have increased our efforts to further develop existing and new products and solutions, including

among others by the introduction of our new products and solutions for the unattended payment market and Internet of Payment Things technology. We have also increased our sales and marketing activities and resources.

This discussion and analysis should be read in conjunction with our interim condensed consolidated financial statements and notes thereto contained in “Item 1. Financial Statements” of this Quarterly Report.

Results of Operations

Discontinued operations. In September 2016 we completed the sale of certain assets and IP related to our parking business. In December 2013, we completed the sale of certain assets, certain subsidiaries and IP directly related to our SmartID division. The results from such operations and the cash flows for the reporting periods are presented in the statements of operations and in the statements of cash flows, respectively, as discontinued operations separately from continuing operations. All the data in this Quarterly Report that are derived from our financial statements, unless otherwise specified, exclude the results of those discontinued operations.

Three months ended September 30, 2017, compared to the three months ended September 30, 2016

Sources of Revenue

We have historically derived a substantial majority of our revenues from the sale of our products, including both complete systems and original equipment manufacturer components. In addition, we generate revenues from licensing and transaction fees, and also, less significantly, from engineering services, customer services and technical support. During the three months ended September 30, 2017 and September 30, 2016, the revenues that we derived from sales and licensing and transaction fees were as follows (in thousands):

	Three months ended	
	September 30,	
	2017	2016
Sales	\$3,445	\$3,463
Licensing and transaction fees	\$1,225	\$2,133
Total revenues	\$4,670	\$5,596

Sales. Sales in the three months ended September 30, 2017, compared to the three months ended September 30, 2016, remained consistent.

Licensing and transaction fees. Licensing and transaction fees include single and periodic payments for distribution rights for our products. Transaction fees are paid by customers based on the volume of transactions processed by systems that contain our products. Our licensing and transaction fees in the three months ended September 30, 2017, compared to the three months ended September 30, 2016, decreased by \$908,000, or 43%. This decrease was mainly due to a decrease in licensing of our IP rights to third parties in the United States (including licenses granted pursuant to settlements of legal actions to enforce patent rights).

We have historically derived revenues from different geographical areas. The following table sets forth our revenues (in thousands) and as a percentage of revenues in different geographical areas, in the three months ended September 30, 2017 and September 30, 2016:

Three months ended September 30,	Africa	Europe	APAC	Americas
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2017	\$999	21 %	\$1,421	30 %	\$73	2 %	\$2,177	47 %
2016	\$1,081	19 %	\$1,653	30 %	\$289	5 %	\$2,573	46 %

Our revenues from sales in Africa decreased by \$82,000, or 8%, in the three months ended September 30, 2017, compared to the three months ended September 30, 2016, mainly due to a decrease in sales of Petroleum products.

Our revenues from sales in Europe decreased by \$232,000, or 14%, in the three months ended September 30, 2017, compared to the three months ended September 30, 2016, mainly due to a decrease in sales of Retail and Mass Transit Ticketing segment products.

Our revenues from sales in APAC decreased by \$216,000, or 75%, in the three months ended September 30, 2017, compared to the three months ended September 30, 2016, mainly due to a decrease in sales of access control products.

Our revenues from sales in Americas decreased by \$396,000, or 15%, in the three months ended September 30, 2017, compared to the three months ended September 30, 2016, mainly due to a decrease in licensing of our intellectual property rights to third parties in the United States (including licenses granted pursuant to settlements of legal actions to enforce patent rights) partially offset by an increase in sales of readers in the United States.

Our revenues derived from outside the United States, which are primarily received in currencies other than the U.S. dollar, will have a varying impact upon our total revenues, as a result of fluctuations in such currencies' exchange rates versus the U.S. dollar.

The following table sets forth our revenues (in thousands) and as a percentage of revenues by segments, during the three months ended September 30, 2017 and September 30, 2016:

Three months ended September 30,	Petroleum		Retail and Mass Transit Ticketing		Other	
2017	\$917	20%	\$3,231	69%	\$522	11%
2016	\$1,056	19%	\$3,891	69%	\$649	12%

Our revenues in the three months ended September 30, 2017, from Petroleum decreased by \$139,000, or 13%, compared to the three months ended September 30, 2016, mainly due to a decrease in sales of Petroleum products in Africa.

Our revenues from Retail and Mass Transit Ticketing in the three months ended September 30, 2017, decreased by \$660,000, or 17%, compared to the three months ended September 30, 2016, mainly due to a decrease in licensing of our intellectual property rights to third parties in the United States (including licenses granted pursuant to settlements of legal actions to enforce patent rights) partially offset by an increase in sales of readers in the United States.

Our revenues in the three months ended September 30, 2017, from our Other segment decreased by \$127,000, or 20%, compared to the three months ended September 30, 2016, mainly due to a decrease in sales of access control products in APAC partially offset by an increase in sales of our MediSmart products in Africa.

Cost of Revenues and Gross Margin

Our cost of revenues, presented by gross profit and gross margin percentage, in the three months ended September 30, 2017 and September 30, 2016, were as follows (in thousands):

Cost of revenues	Three months ended	
	September 30, 2017	September 30, 2016
Cost of sales	\$2,192	\$2,557
Gross profit	\$2,478	\$3,039
Gross margin percentage	53%	54%

Cost of sales. Cost of sales consists primarily of materials, as well as salaries, fees to subcontractors and related costs of our technical staff that assemble our products. The decrease of \$365,000, or 14%, in the three months ended September 30, 2017, compared to the three months ended September 30, 2016, resulted primarily from a decrease in revenues.

Gross margin. The decrease in gross margin in the three months ended September 30, 2017, compared to the three months ended September 30, 2016, is mainly attributed to a change in our revenue mix and the decrease in sales.

Operating expenses

Our operating expenses in the three months ended September 30, 2017 and September 30, 2016, were as follows (in thousands):

Operating expenses	Three months ended	
	September 30, 2017	September 30, 2016
Research and development	\$823	\$604
Selling and marketing	\$1,332	\$1,300
General and administrative	\$758	\$787
Other expenses	\$-	\$83
Total operating expenses	\$2,913	\$2,774

Research and development. Our research and development expenses consist primarily of the salaries and related expenses of our research and development staff, as well as subcontracting expenses. The increase of \$219,000, or 36%, in the three months ended September 30, 2017, compared to the three months ended September 30, 2016, is primarily attributed to an increase in the number of research and development employees.

Selling and marketing. Our selling and marketing expenses consist primarily of salaries and substantially all of the expenses of our sales and marketing subsidiaries and offices in the United States, South Africa and Europe, as well as expenses related to advertising, professional expenses and participation in exhibitions and tradeshow. Our selling and marketing expenses, in the three months ended September 30, 2017, compared to the three months ended September 30, 2016, remained consistent.

General and administrative. Our general and administrative expenses consist primarily of salaries and related expenses of our executive management and financial and administrative staff. These expenses also include costs of our professional advisors (such as lawyers and accountants), office expenses, insurance, general and administrative expenses and provision for doubtful accounts. The decrease of \$29,000, or 4%, in the three months ended September 30, 2017, compared to the three months ended September 30, 2016, is primarily attributed to income from our lawsuit against Harel Insurance Company Ltd., or Harel, for damages incurred by us due to flooding in a subcontractor's manufacturing site, partially offset by an increase in salaries and employees' benefit and an increase in professional expenses.

Other expenses. Our other expenses in the three months ended September 30, 2016 consist a loss of \$83 related to the sale of our headquarters building in Rosh Pina, Israel to a third party.

Financing expenses, net

Our financing expenses, net, in the three months ended September 30, 2017 and September 30, 2016, were as follows (in thousands):

	Three months ended September 30,	
	2017	2016
Financing expenses, net	\$ (126)	\$ (30)

Financing expenses consist primarily of interest payable on bank loans, bank commissions and foreign exchange losses. Financing income consists primarily of foreign exchange gains and interest earned on investments in short-term deposits. The increase in financing expenses, net in the three months ended September 30, 2017, compared to the three months ended September 30, 2016, of \$96,000, or 320%, is mainly due to exchange rate differentials.

Net (loss) income from continuing operations

Our net (loss) income from continuing operations in the three months ended September 30, 2017 and September 30, 2016, was as follows (in thousands):

	Three months ended	
	September 30,	
	2017	2016
Net (loss) income from continuing operations	\$ (573)	\$ 207

The change of \$780,000, in the three months ended September 30, 2017, compared to the three months ended September 30, 2016 is due to a decrease in our sales, a decrease in our gross profit, an increase in our operating expenses and an increase in financing expenses, net, as described above.

Net income (loss) from discontinued operations

Our net income (loss) from discontinued operations in the three months ended September 30, 2017 and September 30, 2016, was as follows (in thousands):

	Three months ended	
	September 30,	
	2017	2016
Net income (loss) from discontinued operations	\$ 1,441	\$ (279)

In September 2016, we completed the sale of certain assets and IP related to our parking business. In December 2013, we completed the sale of certain assets, certain subsidiaries and IP directly related to our SmartID division.

The results from these operations for the reporting periods are presented in the statements of operations as discontinued operations separately from continuing operations.

The increase in net profit from discontinued operations of \$1.7 million in the three months ended September 30, 2017, compared to the three months ended September 30, 2016, is mainly attributed to \$1.6 million net, recovered by us pursuant to the August 23, 2017 judgment of the Israeli Central District Court in a lawsuit against Harel Insurance Company Ltd., or Harel for damages incurred by us due to flooding in a subcontractor's manufacturing site. Appeal of this judgment by Harel is pending before the Israeli Supreme Court. Based on the advice of counsel, the Company currently believes that there are sufficient grounds on which to uphold the District Court's ruling and, as such, Harel's appeal will be denied.

Net income (loss)

Our net income (loss) in the three months ended September 30, 2017 and September 30, 2016, was as follows (in thousands):

	Three months ended	
	September 30,	
	2017	2016
Net income (loss)	\$868	\$(72)

The increase in net income (loss) of \$940,000 in the three months ended September 30, 2017, compared to the three months ended September 30, 2016, is due to an increase in net income from discontinued operations which was offset by a decrease in our revenues and gross profit, an increase in our operating expenses and an increase in financing expenses, net as described above.

Nine months ended September 30, 2017, compared to the nine months ended September 30, 2016

Sources of Revenue

During the nine months ended September 30, 2017 and September 30, 2016, the revenues that we derived from sales and licensing and transaction fees were as follows (in thousands):

	Nine months ended	
	September 30,	
	2017	2016
Sales	\$11,871	\$10,409
Licensing and transaction fees	\$3,765	\$4,569
Total revenues	\$15,636	\$14,978

Sales. Sales increased by \$1.5 million, or 14%, in the nine months ended September 30, 2017, compared to the nine months ended September 30, 2016. The increase is mainly attributed to an increase in Retail and Mass Transit Ticketing segment sales in Japan, to an increase in Petroleum segment sales in Africa and to an increase in sales of our otiMetry solution in Europe partially offset by a decrease in sales of readers to the U.S. market and to a decrease in our Other segment sales.

Licensing and transaction fees. Our licensing and transaction fees in the nine months ended September 30, 2017, compared to the nine months ended September 30, 2016, decreased by \$804,000, or 18%. This was mainly due to a decrease in licensing of our intellectual property rights to third parties in the United States (including licenses granted pursuant to settlements of legal actions to enforce patent rights).

We have historically derived revenues from different geographical areas. The following table sets forth our revenues (in thousands) and as a percentage of revenues in different geographical areas, in the nine months ended September 30, 2017 and September 30, 2016:

Nine months ended September 30,	Africa		Europe		APAC		Americas	
2017	\$3,352	21 %	\$5,355	34 %	\$1,807	12 %	\$5,122	33 %
2016	\$3,048	20 %	\$4,583	31 %	\$522	3 %	\$6,825	46 %

Our revenues from sales in Africa increased by \$304,000, or 10%, in the nine months ended September 30, 2017, compared to the nine months ended September 30, 2016, mainly due to an increase in our sales in our Petroleum segment partially offset by a decrease in sales of our MediSmart products.

Our revenues from sales in Europe increased by \$772,000, or 17%, in the nine months ended September 30, 2017, compared to the nine months ended September 30, 2016, mainly due to an increase in sales in our Retail and Mass Transit Ticketing segment and to an increase in our otiMetry solution in the European market.

Our revenues from sales in APAC increased by \$1.3 million, or 246%, in the nine months ended September 30, 2017, compared to the nine months ended September 30, 2016, mainly due to an increase in our Uno Plus and GoBox products in Japan.

Our revenues from sales in Americas decreased by \$1.7 million, or 25%, in the nine months ended September 30, 2017, compared to the nine months ended September 30, 2016, mainly due to a decrease in sales of readers and licensing of our intellectual property rights to third parties in the United States (including licenses granted pursuant to settlements of legal actions to enforce patent rights).

Our revenues derived from outside the United States, which are primarily received in currencies other than the U.S. dollar, will have a varying impact upon our total revenues, as a result of fluctuations in such currencies' exchange rates versus the U.S. dollar.

The following table sets forth our revenues (in thousands) and as a percentage of revenues by segments, during the nine months ended September 30, 2017 and September 30, 2016:

Nine months ended September 30,	Petroleum		Retail and Mass Transit Ticketing		Other	
2017	\$3,645	23 %	\$10,654	68 %	\$1,337	9 %
2016	\$2,996	20 %	\$10,029	67 %	\$1,953	13 %

Our revenues in the nine months ended September 30, 2017, from Petroleum increased by \$649,000, or 22%, compared to the nine months ended September 30, 2016 due to an increase in products sales in Africa.

Our revenues from Retail and Mass Transit Ticketing in the nine months ended September 30, 2017, increased by \$625,000, or 6%, compared to the nine months ended September 30, 2016, mainly due to an increase in sales in the Japanese market and an increase in readers and otiMetry solution sales in Europe partially offset by a decrease in sales of readers in the United States.

Our revenues in the nine months ended September 30, 2017, from our Other segment decreased by \$616,000, or 32%, compared to the nine months ended September 30, 2016, mainly due to a decrease in sales of MediSmart products in East Africa.

Cost of Revenues and Gross Margin

Our cost of revenues, presented by gross profit and gross margin percentage, in the nine months ended September 30, 2017 and September 30, 2016, were as follows (in thousands):

Cost of revenues	Nine months ended September 30, 2017 2016	
Cost of sales	\$7,468	\$7,167
Gross profit	\$8,168	\$7,811
Gross margin percentage	52%	52%

Cost of sales. The increase of \$301,000, or 4%, in the nine months ended September 30, 2017, compared to the nine months ended September 30, 2016, resulted primarily from an increase in revenues.

Gross margin. Our gross margin, in the nine months ended September 30, 2017, compared to the nine months ended September 30, 2016, remained consistent.

Operating expenses

Our operating expenses in the nine months ended September 30, 2017 and September 30, 2016, were as follows (in thousands):

Operating expenses	Nine months ended	
	September 30, 2017	September 30, 2016
Research and development	\$2,414	\$2,072
Selling and marketing	\$4,166	\$3,974
General and administrative	\$2,553	\$2,613
Other expenses	\$-	\$83
Total operating expenses	\$9,133	\$8,742

Research and development. The increase of \$342,000, or 17%, in the nine months ended September 30, 2017, compared to the nine months ended September 30, 2016, is primarily attributed to an increase in the number of research and development employees and to an increase in subcontractor expenses.

Selling and marketing. The increase of \$192,000, or 5%, in the nine months ended September 30, 2017, compared to the nine months ended September 30, 2016, is primarily attributed to an increase in employment expenses of selling and marketing employees and to an increase in marketing and advertising expenses.

General and administrative. Our general and administrative expenses, in the nine months ended September 30, 2017, compared to the nine months ended September 30, 2016, remained consistent.

Other expenses. Our other expenses in the nine months ended September 30, 2016 consist a loss of \$83 related to the sale of our headquarters building in Rosh Pina, Israel to a third party.

Financing expenses, net

Our financing expenses, net, in the nine months ended September 30, 2017 and September 30, 2016, were as follows (in thousands):

	Nine months ended September 30, 2017 2016	
Financing expenses, net	\$ (236)	\$ (185)

The increase of financing expenses, net in the nine months ended September 30, 2017, compared to the nine months ended September 30, 2016, of \$51,000, or 28%, is mainly due to exchange rate differentials offset by an increase in interest earned on investments in short-term deposits, a decrease in interest expenses on bank loans and a decrease in bank commissions.

Net loss from continuing operations

Our net loss from continuing operations in the nine months ended September 30, 2017 and September 30, 2016, was as follows (in thousands):

	Nine months ended	
	September 30,	
	2017	2016
Net loss from continuing operations	\$(1,269)	\$(1,176)

The increase in net loss from continuing operations of \$93,000, or 8%, in the nine months ended September 30, 2017, compared to the nine months ended September 30, 2016, is primarily due to an increase in our operating expenses and an increase in financing expenses, net, offset by an increase in our revenues and gross profit as described above.

Net income from discontinued operations

Our net income from discontinued operations in the nine months ended September 30, 2017 and September 30, 2016, was as follows (in thousands):

	Nine months ended	
	September 30,	
	2017	2016
Net income from discontinued operations	\$1,365	\$1,525

Net income from discontinued operations decreased by \$160,000, or 10%. Net income from discontinued operations in the nine months ended September 30, 2016, included a \$2.1 million settlement fee paid to us in May 2016, in connection with a litigation with SuperCom Ltd. relating to the sale of our SmartID division, partially offset by a loss from discontinued operations activity related to the sale of certain assets and IP of our previous parking business. Net income from discontinued operations in the nine months ended September 30, 2017, included a \$1.6 million net, recovered by us pursuant to the August 23, 2017 judgment of the Israeli Central District Court in a lawsuit against Harel for damages incurred by us due to flooding in a subcontractor's manufacturing site. Appeal of this judgment by Harel is pending before the Israeli Supreme Court (the Company currently believes that there are sufficient grounds on which to uphold the District Court's ruling and, as such, Harel's appeal will be denied), partially offset by a loss from decreasing court bonds related to Harel.

Net income

Our net income in the nine months ended September 30, 2017 and September 30, 2016, was as follows (in thousands):

	Nine months ended	
	September 30,	
	2017	2016
Net income	\$ 96	\$ 349

The decrease in net income of \$253,000, in the nine months ended September 30, 2017, compared to the nine months ended September 30, 2016, is primarily due to an increase in operating expenses, an increase in financing expenses net and a decrease in net profit from discontinued operations, partially offset by an increase in revenues and gross profit, as described above.

Liquidity and Capital Resources

Our principal sources of liquidity since our inception have been sales of equity securities, borrowings from banks, cash from the exercise of options and warrants and proceeds from divestitures of parts of our businesses. We had cash, cash equivalents and short-term investments representing bank deposits of \$8.7 million as of September 30, 2017 (of which an amount of \$1.5 million has been pledged to secure performance guarantees granted to third parties and guarantees to secure customer advances, loans and credit lines received from a bank), and \$11.5 million as of December 31, 2016 (of which an amount of \$1.5 million had then been pledged to secure performance guarantees granted to third parties and guarantees to secure customer advances, loans and credit lines received from a bank). We

believe that we have sufficient capital resources to fund our operations in the next 12 months. We adhere to an investment policy which is intended to enable the Company to avoid being classified as a “passive foreign investment company,” or PFIC, under U.S. law. That said, we cannot provide complete assurance that PFIC status will be avoided in the future. In addition, our investment policy requires investment in high-quality investment-grade securities. As of September 30, 2017, our long-term bank loans are denominated in the following currencies: Polish Zloty (\$856,000, with maturity dates ranging from 2017 through 2019) and South African Rand (\$597,000, with maturity dates ranging from 2017 through 2023). As of September 30, 2017, these loans bear interest at rates ranging from 3.2%-10.5% per annum.

Our composition of long-term loans as of September 30, 2017, was as follows (in thousands):

	September 30, 2017
Long-term loans	\$ 1,453
Less - current maturities	564
	\$ 889

Our composition of short-term loans, bank credit and current maturities of long-term loans as of September 30, 2017, were as follows (in thousands):

	September 30, 2017	
	Interest rate	
In U.S. dollars	4.21 %	\$1,910
In Polish Zloty	3.63 %	1,082
In NIS	3.60 %	833
		3,825
Current maturities of long-term loans		564
		\$4,389

Our and certain of our subsidiaries' manufacturing facilities and certain equipment have been pledged as security in respect of a loan received from a bank. Our short term deposits in the amount of \$1.5 million have been pledged as security in respect of guarantees granted to third parties, loans and credit lines received from a bank. Such deposits cannot be pledged to others or withdrawn without the consent of the bank.

As of September 30, 2017, we granted guarantees to third parties including performance guarantees and guarantees to secure customer advances in the sum of \$352,000. The expiration dates of the guarantees range from October 2017 to June 2019.

Operating activities related to continuing operations

For the nine months ended September 30, 2017, net cash used in continuing operating activities was \$2,440,000, primarily due to a \$1.3 million net loss from continuing operations, a \$777,000 decrease in other current liabilities, a \$710,000 increase in inventory, a \$611,000 decrease in trade payables, a \$435,000 increase in other receivables and prepaid expenses, a \$41,000 decrease in accrued interest and a \$9,000 gain on sale of property and equipment, partially offset by depreciation expenses of \$878,000, a \$238,000 expense due to stock-based compensation issued to employees, a \$187,000 decrease in trade receivables, a \$72,000 increase in accrued severance pay and a \$37,000 deferred tax expense.

For the nine months ended September 30, 2016, net cash used in continuing operating activity was \$611,000, primarily due to a \$1.2 million net loss from continuing operations, a \$1.4 million increase in trade receivables, a \$408,000 decrease in other current liabilities, a \$152,000 decrease in accrued severance pay and a \$16,000 increase in

other receivables and prepaid expenses, partially offset by a \$1 million increase in trade payables, depreciation expenses of \$911,000, a \$246,000 decrease in inventory, a \$174,000 expense due to stock-based compensation issued to employees, a \$83,000 loss on sale of property and equipment, a \$60,000 deferred tax expense and a \$19,000 accrued interest expense.

Operating activities related to discontinued operations

For the nine months ended September 30, 2017, net cash used in discontinued operating activities was \$86,000, related to the SmartID division and previous parking business.

For the nine months ended September 30, 2016, net cash used in discontinued operating activities was \$183,000, related to our SmartID division and previous parking business.

Investing and financing activities related to continuing operations

For the nine months ended September 30, 2017, net cash provided by continuing investing activities was \$2.6 million, mainly due to a \$2,917,000 proceeds of short-term investments, a \$44,000 in proceeds from restricted deposits for employee benefits and a \$14,000 in proceeds from the sale of property and equipment partially offset by a \$185,000 investment in capitalized product costs and a \$160,000 purchase of property and equipment.

For the nine months ended September 30, 2016, net cash provided by continuing investing activities was \$1.1 million, mainly due to a \$1.8 million in proceeds from the sale of property and equipment and a \$142,000 in proceeds from restricted deposits for employee benefits, partially offset by a \$502,000 purchase of short-term investments, a \$185,000 purchase of property and equipment and a \$139,000 investment in capitalized product costs.

For the nine months ended September 30, 2017, net cash used in continuing financing activities was \$516,000, mainly due to a repayment of \$469,000 of long-term bank loans and a \$72,000 decrease in short-term bank credit, partially offset by proceeds of \$25,000 from the exercise of options.

For the nine months ended September 30, 2016, net cash used in continuing financing activities was \$1 million, mainly due to a repayment of \$1.4 million of long-term bank loans, partially offset by a \$287,000 increase in short-term bank credit, proceeds of \$37,000 from the exercise of options and warrants and proceeds of \$27,000 from long-term bank loans.

Investing and financing activities related to discontinued operations

We had no cash flows provided by or used in discontinued investing activities in the nine months ended September 30, 2017.

For the nine months ended September 30, 2016, net cash provided by discontinued investing activities was \$2.2 million, due to contingent consideration received related to the Smart ID division divestiture and consideration derived from the divestiture of our parking business.

We had no cash flows provided by or used in discontinued financing activities in the nine months ended September 30, 2017 and September 30, 2016.

Off Balance Sheet Arrangements

We have no off balance sheet arrangements.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures - We maintain a system of disclosure controls and procedures that are designed for the purposes of ensuring that information required to be disclosed in our SEC reports is recorded,

processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer, or CEO and our Chief Financial Officer, or CFO, as appropriate to allow timely decisions regarding required disclosures.

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our CEO and our CFO, of the effectiveness of our disclosure controls and procedures as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended. Based on that evaluation, our CEO and CFO concluded that our disclosure controls and procedures are effective.

Changes in Internal Control Over Financial Reporting - There has been no change in our internal control over financial reporting during the third quarter of fiscal 2017 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

As previously reported in our Annual Report on Form 10-K filed with the SEC on March 28, 2017, on March 1, 2017, USA Technologies Inc., or USAT, filed a claim against us and our U.S. subsidiary, OTI America Inc., or OTI America, in the U.S. District Court, Eastern District of Pennsylvania, hereafter referred to as the USAT Claim. The USAT Claim asserted, among other things, that products sold by us to USAT's manufacturing subcontractor, Masterwork Electronics, Inc., or Masterwork, failed to conform to certain promised specifications. USAT sought payment of \$4,912,600 plus interest and costs, comprised of \$728,800 to cover payment for alternative products, and \$4,183,800 to cover costs of replacing the allegedly non-conforming products already installed. As also previously reported in our Annual Report on Form 10-K filed with the SEC on March 28, 2017, on March 3, 2017, we filed a claim against Masterwork in the U.S. District Court for the Northern District of California, hereafter referred to as the OTI Claim. We sought payment of \$2,518,000 plus interest and costs as a result of Masterwork's refusal to perform its obligations in connection with a purchase order supplied by Masterwork to us, based on Masterwork's allegations that its customer, USAT, had apparently claimed that the products are not conforming. On July 20, 2017, the OTI Claim was transferred to the Eastern District of Pennsylvania and on August 23, 2017, the USAT Claim and OTI Claim were consolidated into a single action. On November 1, 2017, all parties to these proceedings entered into a settlement agreement resolving their disputes and have, accordingly, dismissed all litigation on November 1, 2017.

On October 3, 2013, a financial claim was filed against us and our then-subsubsidiary, Parx France (referred to in this paragraph, collectively, as the Defendants), in the Commercial Court of Paris, France. The sum of the claim is €1,500,000 (approximately \$1,773,000), and is based on the allegation that the plaintiff sustained certain losses in connection with Defendants not granting the plaintiff exclusive marketing rights to distribute and operate the Defendants' PIAF Parking System in Paris and the Ile of France. On October 25, 2017, the Paris Commercial Court issued its ruling in this matter dismissing all claims against us but ordered Parx France to pay the plaintiff €50,000 (plus interest) in damages plus another approximately €5,000 in other fees and penalties.

Item 6. Exhibits.

- 3.1 Amended and Restated Articles of Incorporation (incorporated by reference to the Company's Report on Form 6-K filed with the SEC on October 31, 2013).
- 3.2 Memorandum of Association, dated February 14, 1990 (incorporated by reference to the Company's Registration Statement on Form F-1, filed with the SEC on June 14, 2002).
- 31.1* Rule 13a-14(a) Certification of Chief Executive Officer.

31.2* Rule 13a-14(a) Certification of Chief Financial Officer.

32.1**Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350.

32.2**Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350.

101* The following materials from our Quarterly Report on Form 10-Q for the quarter ended September 30, 2017 formatted in XBRL (eXtensible Business Reporting Language): (i) the Interim Condensed Consolidated Balance Sheets, (ii) the Interim Condensed Consolidated Statements of Operations, (iii) the Interim Condensed Consolidated Statements of Comprehensive Loss, (iv) the Interim Condensed Statements of Changes in Equity, (v) the Interim Condensed Consolidated Statements of Cash Flows, and (vi) the Notes to Interim Condensed Consolidated Financial Statements, tagged as blocks of text and in detail.

* Filed herewith.

** Furnished herewith.

SIGNATURES

In accordance with 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.

ON TRACK INNOVATIONS LTD.

By: /s/ Shlomi Cohen
Shlomi Cohen, Chief Executive Officer
(Principal Executive Officer)

Dated: November 14, 2017

By: /s/ Yishay Curelaru
Yishay Curelaru, Chief Financial Officer
(Principal Financial and Accounting Officer)

Dated: November 14, 2017