ORMAT TECHNOLOGIES, INC.
Form 10-Q
November 08, 2016

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended September 30, 2016

or

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

For the transition period from to

Commission file number: 001-32347

ORMAT TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**88-0326081**
(State or other jurisdiction of	*(I.R.S. Employer*
incorporation or organization)	*Identification Number)*

6225 Neil Road, Reno, Nevada	**89511-1136**
(Address of principal executive offices)	*(Zip Code)*

(775) 356-9029

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: As of November 09, 2016, the number of outstanding shares of common stock, par value $0.001 per share, was 49,634,659.

ORMAT TECHNOLOGIES, INC.

FORM 10-Q

FOR THE QUARTER ENDED SEPTEMBER 30, 2016

Certain Definitions

Unless the context otherwise requires, all references in this quarterly report to “Ormat”, “the Company”, “we”, “us”, “our company”, “Ormat Technologies” or “our” refer to Ormat Technologies, Inc. and its consolidated subsidiaries.

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ORMAT TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

	September 30, 2016	December 31, 2015
	(Dollars in thousands)	
ASSETS		
Current assets:		
Cash and cash equivalents	$90,066	$185,919
Restricted cash and cash equivalents (all related to VIEs)	50,525	49,503
Receivables:		
Trade	65,198	55,301
Other	13,645	7,885
Inventories	12,973	18,074
Costs and estimated earnings in excess of billings on uncompleted contracts	38,025	25,120
Prepaid expenses and other	38,940	33,334
Total current assets	309,372	375,136
Deposits and other	18,738	17,968
Deferred charges	40,690	42,811
Property, plant and equipment, net ($1,499,112 and $1,481,258 related to VIEs, respectively)	1,570,307	1,559,335
Construction-in-process ($82,476 and $129,165 related to VIEs, respectively)	271,853	248,835
Deferred financing and lease costs, net	5,188	4,022
Intangible assets, net	56,052	25,875
Goodwill	7,071	—
Total assets	$2,279,271	$2,273,982
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$102,854	$91,955
Billings in excess of costs and estimated earnings on uncompleted contracts	37,134	33,892
Current portion of long-term debt:		
Limited and non-recourse (all related to VIEs):		
Senior secured notes	28,121	29,930
Other loans	21,494	21,495
Full recourse	12,302	11,229
Total current liabilities	201,905	188,501
Long-term debt, net of current portion:		
Limited and non-recourse (all related to VIEs):		
Senior secured notes (less deferred financing costs of $9,957 and $10,852, respectively)	273,017	294,476
Other loans (less deferred financing costs of $6,821 and $7,492, respectively)	267,210	275,888
Full recourse:		

Senior unsecured bonds (plus unamortized premium based upon 7% of $0 and $513, respectively and less deferred financing costs of $849 and $283, respectively)	203,483	249,698
Other loans (less deferred financing costs of $290 and $435, respectively)	12,373	18,687
Accumulated losses of unconsolidated company in excess of investment	16,664	8,100
Liability associated with sale of tax benefits	1,043	11,665
Deferred lease income	55,460	58,099
Deferred income taxes	34,961	32,654
Liability for unrecognized tax benefits	10,260	10,385
Liabilities for severance pay	19,020	19,323
Asset retirement obligation	22,099	20,856
Other long-term liabilities	20,862	1,776
Total liabilities	1,138,357	1,190,108
Commitments and contingencies (Note 10)		
Reedemable noncontrolling interest	4,972	—
Equity:		
The Company's stockholders' equity:		
Common stock, par value $0.001 per share; 200,000,000 shares authorized; 49,634,659 and 49,107,901 shares issued and outstanding as of September 30, 2016 and December 31, 2015, respectively	50	49
Additional paid-in capital	859,855	849,223
Retained earnings	191,627	148,396
Accumulated other comprehensive income	(11,503)	(7,667)
	1,040,029	990,001
Noncontrolling interest	95,913	93,873
Total equity	1,135,942	1,083,874
Total liabilities and equity	$2,279,271	$2,273,982

The accompanying notes are an integral part of the consolidated financial statements.

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ORMAT TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND

COMPREHENSIVE INCOME

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(Dollars in thousands, except per share data)		(Dollars in thousands, except per share data)	
Revenues:				
Electricity	$109,795	$97,245	$321,664	$278,124
Product	74,822	65,607	174,408	145,446
Total revenues	184,617	162,852	496,072	423,570
Cost of revenues:				
Electricity	66,481	61,501	192,410	179,604
Product	43,647	42,019	99,504	89,826
Total cost of revenues	110,128	103,520	291,914	269,430
Gross margin	74,489	59,332	204,158	154,140
Operating expenses:				
Research and development expenses	1,086	335	2,030	1,112
Selling and marketing expenses	4,793	4,383	12,136	12,099
General and administrative expenses	19,093	7,950	36,625	25,597
Write-off of unsuccessful exploration activities	1,294	185	2,714	359
Operating income	48,223	46,479	150,653	114,973
Other income (expense):				
Interest income	266	53	831	106
Interest expense, net	(17,137)	(17,748)	(51,561)	(54,435)
Derivatives and foreign currency transaction gains (losses)	(222)	1,296	(2,592)	(641)
Income attributable to sale of tax benefits	3,463	8,634	12,380	18,917
Other non-operating income (expense), net	(5,546)	(131)	(5,306)	(1,523)
Income from continuing operations before income taxes and equity in losses of investees	29,047	38,583	104,405	77,397
Income tax (provision) benefit	(11,988)	38,211	(29,387)	26,696
Equity in losses of investees, net	(2,653)	(3,133)	(4,734)	(4,892)
Income from continuing operations	14,406	73,661	70,284	99,201
Net income attributable to noncontrolling interest	(2,326)	(1,522)	(4,584)	(2,616)
Net income attributable to the Company's stockholders	$12,080	$72,139	$65,700	$96,585
Comprehensive income:				

Net income	14,406	73,661	70,284	99,201
Other comprehensive income (loss), net of related taxes:				
Change in unrealized gains or losses in respect of the Company's share in derivatives instruments of unconsolidated investment	1,337	(4,318)	(3,829)	(4,154)
Loss in respect of derivative instruments designated for cash flow hedge	22	22	65	68
Amortization of unrealized gains in respect of derivative instruments designated for cash flow hedge	(24)	(29)	(72)	(90)
Comprehensive income	15,741	69,336	66,448	95,025
Comprehensive income attributable to noncontrolling interest	(2,326)	(1,522)	(4,584)	(2,616)
Comprehensive income attributable to the Company's stockholders	$13,415	$67,814	$61,864	$92,409
Earnings per share attributable to the Company's stockholders:				
Basic:				
Net income	$0.24	$1.47	$1.33	$2.00
Diluted:				
Net income	$0.24	$1.41	$1.31	$1.93
Weighted average number of shares used in computation of earnings per share attributable to the Company's stockholders:				
Basic	49,599	49,023	49,410	48,388
Diluted	50,289	51,113	50,097	50,011
Dividend per share declared	$0.07	$0.06	$0.45	$0.20

The accompanying notes are an integral part of the consolidated financial statements.

ORMAT TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EQUITY

(Unaudited)

	The Company's Stockholders' Equity							
	Common Stock Shares	Amount	Additional Paid-in Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Income (Loss)	Total	Noncontrolling Interest	Total Equity
	(Dollars in thousands, except per share data)							
Balance at December 31, 2014	45,537	$ 46	$ 742,006	$ 41,539	$ (8,668)	$ 774,923	$ 11,823	$ 786,746
Stock-based compensation	—	—	3,077	—	—	3,077	—	3,077
Exercise of options by employees and directors	502	—	4,612	—	—	4,612	—	4,612
Share exchange with Parent	2,996	3	26,012	—	—	26,015	—	26,015
Cash paid to non controlling interest	—	—	—	—	—	—	(4,507)	(4,507)
Cash dividend declared, $0.2 per share	—	—	—	(9,772)	—	(9,772)	—	(9,772)
Issuance of shares to noncontrolling interest, net of transaction costs	—	—	71,291	—	—	71,291	85,470	156,761
Net income	—	—	—	96,585	—	96,585	2,616	99,201
Other comprehensive income (loss), net of related taxes:								
cash flow hedge (net of related tax of $42)	—	—	—	—	68	68	—	68
Change in unrealized gains or losses in respect of the Company's share in derivative	—	—	—	—	(4,154)	(4,154)	—	(4,154)

instruments of unconsolidated investment (net of related tax of $0)								
Amortization of unrealized gains in respect of derivative instruments designated for cash flow hedge (net of related tax of $56)	—	—	—	—	(90)	(90)	—	(90)
Balance at September 30, 2015	49,035	$ 49	$ 846,998	$ 128,352	$ (12,844)	$ 962,555	$ 95,402	$ 1,057,957
Balance at December 31, 2015	49,107	$ 49	$ 849,223	$ 148,396	$ (7,667)	$ 990,001	$ 93,873	$ 1,083,874
Stock-based compensation	—	—	3,383	—	—	3,383	—	3,383
Exercise of options by employees and directors	528	1	7,249	—	—	7,250	—	7,250
Cash paid to noncontrolling interest	—	—	—	—	—	—	(10,622)	(10,622)
Cash dividend declared, $0.45 per share	—	—	—	(22,469)	—	(22,469)	—	(22,469)
Increase in noncontrolling interest in GB	—	—	—	—	—	—	8,272	8,272
Net income	—	—	—	65,700	—	65,700	4,390	70,090
Other comprehensive income (loss), net of related taxes:								
Loss in respect of derivative instruments designated for cash flow hedge (net of related tax of $40)	—	—	—	—	65	65	—	65
Change in unrealized gains or losses in respect of the Company's share in derivative instruments of unconsolidated investment (net of related tax of $0)	—	—	—	—	(3,829)	(3,829)	—	(3,829)

Amortization of unrealized gains in respect of derivative instruments designated for cash flow hedge (net of related tax of $44)	—	—	—	—	(72)	(72)	—	(72)
Balance at September 30, 2016	49,635	$ 50	$ 859,855	$ 191,627	$ (11,503)	$ 1,040,029	$ 95,913	$ 1,135,942

The accompanying notes are an integral part of the consolidated financial statements.

ORMAT TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine Months Ended September 30,	
	2016	2015
	(Dollars in thousands)	
Cash flows from operating activities:		
Net income	$70,284	$99,201
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	77,565	80,463
Amortization of premium from senior unsecured bonds	(513)	(230)
Accretion of asset retirement obligation	1,243	1,140
Stock-based compensation	3,383	3,077
Amortization of deferred lease income	(2,014)	(2,014)
Income attributable to sale of tax benefits, net of interest expense	(5,920)	(13,068)
Equity in losses of investees	4,735	4,893
Mark-to-market of derivative instruments	(381)	3,906
Loss on disposal of property, plant and equipment	—	531
Write-off of unsuccessful exploration activities	2,714	360
Gain on severance pay fund asset	(690)	(102)
Deferred income tax provision	20,742	(34,613)
Liability for unrecognized tax benefits	(125)	(399)
Deferred lease revenues	(625)	(221)
Other	—	484
Changes in operating assets and liabilities, net of amounts acquired:		
Receivables	(13,711)	(2,879)
Costs and estimated earnings in excess of billings on uncompleted contracts	(12,905)	13,334
Inventories	5,339	335
Prepaid expenses and other	(5,364)	(3,033)
Deposits and other	(867)	(294)
Accounts payable and accrued expenses	10,463	(21,904)
Due from/to related entities, net	—	451
Billings in excess of costs and estimated earnings on uncompleted contracts	3,242	(2,108)
Liabilities for severance pay	(369)	(1,573)
Other long-term liabilities	1,801	(2,259)
Due from/to Parent	—	(513)
Net cash provided by operating activities	158,027	122,965
Cash flows from investing activities:		
Cash acquired in organizational restructuring and share exchange with parent	—	15,391
Net change in restricted cash, cash equivalents and marketable securities	(1,022)	22,725
Capital expenditures	(107,951)	(117,588)
Cash paid for acquisition of controlling interest in a subsidiary, net of cash acquired	(18,135)	—
Decrease in severance pay fund asset, net of payments made to retired employees	1,919	2,934
Net cash used in investing activities	(125,189)	(76,538)
Cash flows from financing activities:		

Proceeds from exercise of options by employees	7,250	4,612
Proceeds from issuance of senior unsecured notes, net of transaction costs	203,483	—
Purchase of Senior unsecured notes	(249,468)	—
Purchase of OFC Senior Secured Notes	(6,815)	(30,638)
Proceeds from sale of membership interests to uncontrolling interest, net of transaction costs	—	156,761
Proceeds from long-term loans, net at transaction costs	—	42,000
Proceeds from revolving credit lines with banks	259,900	598,800
Repayment of revolving credit lines with banks	(259,900)	(619,100)
Cash received from non-controlling interest	1,972	1,654
Repayments of long-term debt	(40,997)	(40,532)
Cash paid to noncontrolling interest	(17,296)	(13,863)
Payments of capital leases	(845)	—
Deferred debt issuance costs	(3,506)	(5,038)
Cash dividends paid	(22,469)	(9,772)
Net cash provided by (used in) financing activities	(128,691)	84,884
Net change in cash and cash equivalents	(95,853)	131,311
Cash and cash equivalents at beginning of period	185,919	40,230
Cash and cash equivalents at end of period	$90,066	$171,541
Supplemental non-cash investing and financing activities:		
Increase (decrease) in accounts payable related to purchases of property, plant and equipment	$(4,517)	$18,930
Accrued liabilities related to financing activities	$6,291	$—

The accompanying notes are an integral part of the consolidated financial statements.

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ORMAT TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1 — GENERAL AND BASIS OF PRESENTATION

These unaudited condensed consolidated interim financial statements of Ormat Technologies, Inc. and its subsidiaries (collectively, the "Company") have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") and pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") for interim financial statements. Accordingly, they do not contain all information and notes required by U.S. GAAP for annual financial statements. In the opinion of management, these unaudited condensed consolidated interim financial statements reflect all adjustments, which include normal recurring adjustments, necessary for a fair statement of the Company's consolidated financial position as of September 30, 2016, the consolidated results of operations and comprehensive income (loss) for the nine-month periods ended September 30, 2016 and 2015 and the consolidated cash flows for the nine-month periods ended September 30, 2016 and 2015.

The financial data and other information disclosed in the notes to the condensed consolidated financial statements related to these periods are unaudited. The results for the nine-month period ended September 30, 2016 are not necessarily indicative of the results to be expected for the year ending December 31, 2016.

These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 2015. The condensed consolidated balance sheet data as of December 31, 2015 was derived from the Company's audited consolidated financial statements for the year ended December 31, 2015, but does not include all disclosures required by U.S. GAAP.

Dollar amounts, except per share data, in the notes to these financial statements are rounded to the closest $1,000.

Issuance of Senior Unsecured Bonds

On September 11, 2016, the Company concluded an auction tender and accepted subscriptions for $204 million aggregate principal amount of two tranches (approximately $67 million principal amount of Series 2 and approximately $137 million principal amount of Series 3) of senior unsecured bonds (Series 2 Bonds, Series 3 Bonds and, collectively, "Bonds"). The Bonds were issued in an unregistered offering outside the United States to investors who are not "U.S. persons",as such term is defined in Regulation S under the Securities Act of 1933, as amended (the "Securities Act"), and otherwise subject to the requirements of Regulation S. The "Series 2 Bonds" will mature in September 2020 and bear interest at a fixed rate of 3.7% per annum, payable semi-annually. The "Series 3 Bonds" will mature in September 2022 and bear interest at a fixed rate of 4.45% per annum, payable semi-annually. The Bonds will be repaid at maturity in a single bullet payment, unless earlier prepaid by Ormat pursuant to the terms and conditions of the trust instrument that governs the Bonds. Both tranches received a rating of ilA+ from Maloot S&P in Israel with a stable outlook. The Company used the proceeds from the offering and sale of the Bonds to fully prepay its existing senior unsecured bonds in the amount of $250 million. As a result of the prepayment, the Company recognized a loss in the amount of $5 million, including prepayment fees of approximately $5 million and amortization of premium of $0.3 million, which was included in other non-operating income (expense), net in the consolidated statements of operations and comprehensive income for the three and nine months ended September 30, 2016.

Guadeloupe power plant transaction

In July 2016, we announced that we closed the previously announced acquisition of Geothermie Bouillante SA (“GB”). GB owns and operates the 14.75 MW Bouillante geothermal power plant located in Guadeloupe Island, a French territory in the Caribbean, which currently generates approximately 13 MW. GB also owns two exploration licenses providing an expansion potential of up to 45 MW of capacity.

Pursuant to the terms of an Amended and Restated Investment Agreement (“Investment Agreement”) and Shareholders Agreement with Sageos Holding (“Sageos”), a wholly owned subsidiary of Bureau de Recherches Géologiques et Minières (“BRGM”), the Company together with Caisse des Dépôts et Consignations (“CDC”), a French state-owned financial organization, acquired an approximately 80% interest in GB, allocated 75% to the Company and 25% to CDC. The Company and CDC will gradually increase their combined interest in GB to 85% and Sageos will hold the remaining balance. As part of the agreement, CDC will pay the Company a premium.

Pursuant to the agreements, the Company paid approximately $20.6 million (of which approximately $2.0 million was paid in October 2016 as a subsequent adjustment to the purchase price) to Sageos for its approximately 60% interest in GB. In addition, the Company is committed to further invest $8.4 million (approximately €7.5 million) in the next two years, which will increase the Company’s interest to 63.75%. The cash will be used mainly for the enhancement of the power plant.

ORMAT TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The Company has planned modifications to the existing equipment as well as to further develop the asset, with a potential of reaching a total of 45 MW in phased development by 2021. Under the Investment Agreement, the Company will pay Sageos an additional amount of up to $13.4 million (approximately €12 million) subject to the achievement of agreed production thresholds and capacity expansion within a defined time period.

The Bouillante power plant sells its electricity under a 15-year PPA that was entered into in February 2016 with Électricité de France S.A. ("EDF"), the French electric utility. The Company plans to optimize the use of the resource at the existing facilities and recover its current production to its design capacity of 14.75 MW by mid-2017.

The Company accounted for the transaction based on the provision of Accounting Standard Codification 805, Business Combinations, and consequently recorded intangible asset of $33.0 million pertaining to the 15-year PPA with EDF and $7.1 million of goodwill. Additionally, following the transaction, the Company gained control over GB effective July 5, 2016 and consolidated the entity with redeemable noncontrolling interest of $5.0 million and noncontrolling interest of $8.3 million being recorded. The redeemable noncontrolling interest pertains to Sageos right to sell its equity interest in GB to the Company for cash considerations. The noncontrolling interest pertains to CDC and was included under noncontrolling interest in the consolidated statements of equity.

The revenues of GB of approximately $4.1 million were included in the Company's consolidated statements of operations and comprehensive income for the three and nine months ended September 2016.

Alevo transaction

On March 30, 2016, the Company signed an agreement with a subsidiary of Alevo Group SA ("Alevo"), a leading provider of energy storage systems, to jointly build, own and operate the Rabbit Hill Energy Storage Project ("Rabbit Hill") located in Georgetown, Texas. The Company will own and fund the majority of the costs associated with Rabbit Hill and, under the terms of the agreement, will provide engineering and construction services and balance of plant equipment. Alevo will provide its innovative GridBank™ inorganic lithium ion energy storage system in conjunction with the power conversion systems. In addition, Alevo will provide ongoing management and operations and maintenance services for the life of the project. The Company will hold an 85% interest in the Rabbit Hill project entity which will decrease to 50.1% after reaching certain internal rate of return ("IRR") targets. The Company will consolidate Rabbit Hill as a majority owned indirect subsidiary.

Northleaf Transaction

On April 30, 2015, Ormat Nevada Inc. ("Ormat Nevada"), a wholly-owned subsidiary of the Company, closed the sale of approximately 36.75% of the aggregate membership interests in ORPD LLC ("ORPD"), a holding company and subsidiary of Ormat Nevada that indirectly owns the Puna geothermal power plant in Hawaii, the Don A. Campbell geothermal power plant in Nevada, and nine power plant units across three recovered energy generation assets known as OREG 1, OREG 2 and OREG 3, to Northleaf Geothermal Holdings, LLC ("Northleaf").

We are currently finalizing the documentation related to the sale of a minority interest in the second phase of the Don A. Campbell power plant. Upon Ormat Nevada's contribution of the project to ORPD, Northleaf will pay to Ormat Nevada an amount equal to Northleaf proportionate interest in ORPD multiplied by the value of the project to be contributed. We estimate that Ormat Nevada will receive approximately $43 million cash in connection with the contribution, which is expected in the fourth quarter of 2016.

Deferred tax asset in Kenya

On September 11, 2015, Kenya's Income Tax Act was amended pursuant to certain provisions of the recently adopted Finance Act, 2015. Among other matters, these amendments retain the enhanced investment deduction of 150% under Section 17B of the Income Tax Act, extend the period for deduction of tax losses from 5 years to 10 years under Sections 15(4) and 15(5) of the Income Tax Act, and amend the effective date from January 1, 2016 to January 1, 2015 under Sections 15(4) and 15(5) of the Income Tax Act.

Previously, the Company had a valuation allowance for the additional 50% investment deduction reducing its deferred tax asset in Kenya as the utilization of the related tax losses was not probable within the original five year carryforward period. As a result of the change in legislation and the expected continued profitability during the extended carryforward period, the Company expects that it will be able to fully utilize the carryforward tax losses within the ten year period and as such released the valuation allowance in Kenya, resulting in $49.4 million of tax benefits in the three month period ended September 30, 2015.

OFC Senior Secured Notes prepayment

In September 2016, the Company repurchased $6.8 million aggregate principal amount of its OFC Senior Secured Notes from the OFC noteholders. As a result of the repurchase, the Company recognized a loss of $0.6 million, including amortization of deferred financing costs, which was included in other non-operating income (expense), net in the consolidated statements of operations and comprehensive income for the three and nine months ended September 30, 2016.

ORMAT TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

In June 2015, the Company repurchased $30.6 million aggregate principal amount of its OFC Senior Secured Notes from the OFC noteholders. As a result of the repurchase, the Company recognized a loss of $1.7 million, including amortization of deferred financing costs of $0.5 million, which was included in other non-operating income (expense), net in the consolidated statements of operations and comprehensive income for the nine months ended September 30, 2015.

Other comprehensive income

For the nine months ended September 30, 2016 and 2015, the Company classified $7,000 and $22,000, respectively, from accumulated other comprehensive income, of which $11,000 and $35,000, respectively, were recorded to reduce interest expense and $4,000 and $13,000, respectively, were recorded against the income tax provision, in the condensed consolidated statements of operations and comprehensive income. For the three months ended September 30, 2016 and 2015, the Company classified $2,000 and $7,000, respectively, related to derivative instruments designated as cash flow hedges, from accumulated other comprehensive income, of which $3,000 and $10,000, respectively, were recorded to reduce interest expense and $1,000 and $3,000, respectively, were recorded against the income tax provision, in the condensed consolidated statements of operations and comprehensive income. The accumulated net loss included in other comprehensive income as of September 30, 2016, is $582,000

Write-offs of unsuccessful exploration activities

Write-offs of unsuccessful exploration activities for the nine and three months ended September 30, 2016, were $2.7 million and $1.3 million, respectively, and $0 million for the nine and three months ended September 30, 2015. These write-offs of exploration costs are related to the Company's exploration activities in The United States and Chile, which the Company determined would not support commercial operations.

Concentration of credit risk

Financial instruments that potentially subject the Company to a concentration of credit risk consist principally of temporary cash investments and accounts receivable.

The Company places its temporary cash investments with high credit quality financial institutions located in the United States ("U.S.") and in foreign countries. At September 30, 2016 and December 31, 2015, the Company had deposits totaling $35.2 million and $19 million, respectively, in seven U.S. financial institutions that were federally insured up to $250,000 per account. At September 30, 2016 and December 31, 2015, the Company's deposits in foreign countries amounted to approximately $72.4 million and $181.0 million, respectively.

At September 30, 2016 and December 31, 2015, accounts receivable related to operations in foreign countries amounted to approximately $36.3 million and $27.8 million, respectively. At September 30, 2016 and December 31, 2015, accounts receivable from the Company's primary customers amounted to approximately 60% and 66%, respectively, of the Company's accounts receivable.

Sierra Pacific Power Company and Nevada Power Company (subsidiaries of NV Energy, Inc.) accounted for 14.4% and 15.3% of the Company's total revenues for the three months ended September 30, 2016 and 2015, respectively, and 18.6% and 19.3% for the nine months ended September 30, 2016 and 2015, respectively.

Kenya Power and Lighting Co. Ltd. accounted for 15.1% and 13.5% of the Company's total revenues for the three months ended September 30, 2016 and 2015, respectively, and 16.4% and 15.4% for the nine months ended September 30, 2016 and 2015, respectively.

Southern California Public Power Authority accounted for 7.7% and 3.3% of the Company's total revenues for the three months ended September 30, 2016 and 2015, respectively, and 9.9% and 4.3% for the nine months ended September 30, 2016 and 2015, respectively.

Hyundai (Sarulla geothermal power project) accounted for 24% and 22% of the Company's total revenues for the three months ended September 30, 2016 and 2015, respectively, and 14% and 16% for the nine months ended September 30, 2016 and 2015, respectively.

The Company performs ongoing credit evaluations of its customers' financial condition. The Company has historically been able to collect on all of its receivable balances, and accordingly, no provision for doubtful accounts has been made.

ORMAT TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

NOTE 2 — NEW ACCOUNTING PRONOUNCEMENTS

New accounting pronouncements effective in the nine-month period ended September 30, 2016

Amendments to Fair Value Measurement

In June 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2015-10, Amendment to Fair Value Measurement, Subtopic 820-10. The amendment provides that the reporting entity shall disclose for each class of assets and liabilities measured at fair value in the statement of financial position the following information: for recurring fair value measurements, the fair value measurement at the end of the reporting period, and for non-recurring fair value measurement, the fair value measurement at the relevant measurement date and the reason for the measurement. The amendments in this update are effective for annual reporting periods beginning after December 15, 2015, including interim periods within those reporting periods. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

Amendments to the Consolidation Analysis

In February 2015, the FASB issued ASU 2015-02, Amendments to the Consolidation Analysis, Topic 810. The update provides that all reporting entities that hold a variable interest in other legal entities will need to re-evaluate their consolidation conclusions and potentially revise their disclosures. This amendment affects both variable interest entity ("VIE") and voting interest entity ("VOE") consolidation models. The update does not change the general order in which the consolidation models are applied. A reporting entity that holds an economic interest in, or is otherwise involved with, another legal entity (i.e. has a variable interest) should first determine if the VIE model applies, and if so, whether it holds a controlling financial interest under that model. If the entity being evaluated for consolidation is not a VIE, then the VOE model should be applied to determine whether the entity should be consolidated by the reporting entity. Since consolidation is only assessed for legal entities, the determination of whether there is a legal entity is important. It is often clear when the entity is incorporated, but unincorporated structures can also be legal entities and judgment may be required to make that determination. The update contains a new example that highlights the discretion used to make this legal entity determination. The update is effective for annual reporting periods beginning after December 15, 2015, including interim periods within those reporting periods. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

Simplifying the Presentation of Debt Costs

In August 2015, the FASB issued ASU 2015-15, Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements, Subtopic 835-30. The update clarifies that given the absence of authoritative guidance within Update 2015-03 for debt issuance costs described below, debt issuance costs related to line-of-credit arrangements can be deferred and presented as assets and subsequently amortized ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings under the line-of-credit arrangement. The amendments in this update are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. The Company adopted this update in its interim period beginning January 1, 2016 and continues to present debt issuance costs related to such line-of-credit arrangements as assets amortized ratably over the respective term of the line-of credit arrangements. Debt issuance costs related to such line-of-credit arrangements as of September 30, 2016 and December 31, 2015, totaled $2.6 million and $1.0 million, respectively.

In April 2015, the FASB issued ASU 2015-03, Interest-Imputation of Interest: Simplifying the Presentation of Debt Costs, Subtopic 835-30. The update provides that debt issuance costs related to a recognized debt liability be presented in the balance sheet as direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The amendments in this update are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. The Company retrospectively adopted this update in its interim period beginning January 1, 2016. The impact of the adoption resulted in a reclassification of debt issuance costs totaling $17.9 million and $19.1 million as of September 30, 2016 and December 31, 2015, respectively.

ORMAT TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

New accounting pronouncements effective in future periods

Improvement to Employee Share-Based Payment Accounting

In March 2016, the FASB issued ASU 2016-09, Improvement to Employee Share-Based Payment Accounting, an update to the guidance on stock-based compensation. Under the new guidance, all excess tax benefits and tax deficiencies will be recognized in the income statement as they occur. This will replace the current guidance, which requires tax benefits that exceed compensation cost (windfalls) to be recognized in equity. It will also eliminate the need to maintain a "windfall pool," and will remove the requirement to delay recognizing a windfall until it reduces current taxes payable. The new guidance will also change the cash flow presentation of excess tax benefits, classifying them as operating inflows, consistent with other cash flows related to income taxes. Today, windfalls are classified as financing activities. Also, this will affect the dilutive effects in earnings per share, as there will no longer be excess tax benefits recognized in additional paid in capital. Today those excess tax benefits are included in assumed proceeds from applying the treasury stock method when computing diluted EPS. Under the amended guidance, companies will be able to make an accounting policy election to either (1) continue to estimate forfeitures or (2) account for forfeitures as they occur. This updated guidance is effective for annual and interim periods beginning after December 15, 2016. Early adoption is permitted. The Company is currently evaluating the potential impact, if any, of the adoption of this update on its consolidated financial statements.

Revenues from Contracts with Customers

In May 2014, the FASB issued ASU 2014-09, Revenues from Contracts with Customers, Topic 606, which was a joint project of the FASB and the International Accounting Standards Board to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and International Financial Reporting Standards. The update provides that an entity should recognize revenue in connection with the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Specifically, an entity is required to apply each of the following steps: (1) identify the contract(s) with the customer; (2) identify the performance obligations in the contracts; (3) determine the transaction price; (4) allocate the transaction price to the performance obligation in the contract; and (5) recognize revenue when (or as) the entity satisfies a performance obligation. The amendments in this update are effective for annual reporting periods beginning after December 15, 2017, including interim periods within those reporting periods. Early adoption is permitted no earlier than 2017 for calendar fiscal year entities. The Company is currently evaluating the potential impact, if any, of the adoption of these amendments on its consolidated financial statements.

In March 2016, the FASB issued ASU 2016-08, Principal versus Agent Considerations. The amendment in this Update do not change the core principal of the guidance and are intended to improve the operability and understandability of the implementation guidance on principal versus agent considerations. When another entity is involved in providing goods or services to a customer, an entity is required to determine if the nature of its promise is to provide the specific good or service itself (that is, the entity is a principal) or to arrange for that good or service to be provided by the other party (that is, the entity is an agent). The guidance includes indicators to assist an entity in determining whether it acts as a principal or agent in a specified transaction. The amendments in this update are effective for annual reporting periods beginning after December 15, 2017, including interim periods within those reporting periods. Early adoption is permitted no earlier than 2017 for calendar fiscal year entities. The Company is currently evaluating the potential impact, if any, of the adoption of these amendments on its consolidated financial statements.

Leases

In February 2016, the FASB issued ASU 2016-02, Leases, Topic 842. The amendment in this Update introduce a number of changes and simplifications from previous guidance, primarily the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases. The Update retains the distinction between finance leases and operating leases and the classification criteria between the two types remain substantially similar. Also, lessor accounting remains largely unchanged from previous guidance, however, key aspects in the Update were aligned with the revenue recognition guidance in Topic 606. Additionally, the Update defines a lease as a contract, or part of a contract, that conveys the right to control the use of identified asset for a period of time in exchange for considerations. Control over the use of the identified means that the customer has both (a) the right to obtain substantially all of the economic benefits from the use of the asset and (b) the right to direct the use of the asset. The amendments in this update are effective for annual reporting periods beginning after December 15, 2018, including interim periods within those reporting periods. Early adoption is permitted. The Company is currently evaluating the potential impact, if any, of the adoption of these amendments on its consolidated financial statements.

ORMAT TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

Recognition and Measurement of Financial Assets and Financial Liabilities

In January 2016, the FASB issued ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities. The update primarily requires that an entity should present separately, in other comprehensive income, the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk if the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. The application of this update should be by means of cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The amendments in this update are effective for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted as of the beginning of the fiscal year of adoption. The Company is currently evaluating the potential impact, if any, of the adoption of this update on its consolidated financial statements.

Simplifying the Measurement of Inventory

In July 2015, the FASB issued ASU 2015-11, Simplifying the Measurement of Inventory, Topic 330. The update contains no amendments to disclosure requirements, but replaces the concept of 'lower of cost or market' with that of 'lower of cost and net realizable value'. The amendments in this update are effective for annual reporting periods beginning after December 15, 2016, including interim periods within those reporting periods. The amendments should be applied prospectively with early adoption permitted. The Company is currently evaluating the potential impact, if any, of the adoption of this update on its consolidated financial statements.

NOTE 3 — INVENTORIES

Inventories consist of the following:

	September 30, 2016	December 31, 2015
	(Dollars in thousands)	
Raw materials and purchased parts for assembly	$2,915	$ 8,819
Self-manufactured assembly parts and finished products	10,058	9,255
Total	$12,973	$ 18,074

ORMAT TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

NOTE 4 — UNCONSOLIDATED INVESTMENTS

Unconsolidated investments consist of the following:

	September 30, 2016	December 31, 2015
	(Dollars in thousands)	
Sarulla	$(16,664)	$ (8,100)

The Sarulla Project

The Company holds a 12.75% equity interest in a consortium which is in the process of developing the Sarulla geothermal power project in Indonesia with an expected generating capacity of approximately 330 megawatts (“MW”). The Sarulla project is located in Tapanuli Utara, North Sumatra, Indonesia and will be owned and operated by the consortium members under the framework of a Joint Operating Contract (“JOC”) and Energy Sales Contract (“ESC”) that were signed on April 4, 2013. Under the JOC, PT Pertamina Geothermal Energy (“PGE”), the concession holder for the project, has provided the consortium with the right to use the geothermal field, and under the ESC, PT PLN, the state electric utility, will be the off-taker at Sarulla for a period of 30 years. In addition to its equity holdings in the consortium, the Company designed the Sarulla plant and will supply its Ormat Energy Converters (“OECs”) to the power plant, as further described below.

The project is being constructed in three phases of approximately 110 MW each, utilizing both steam and brine extracted from the geothermal field to increase the power plant’s efficiency. The first phase is currently in the commissioning and fine tuning stage but commercial operation date is expected to be delayed by few weeks. The delay is a result of local riots protesting the EPC contractor that caused a work stoppage. Work has resumed and we currently expect commercial operation of the first phase to begin in January 2017. For the second phase, engineering and procurement has been substantially completed, site construction is in progress and all of the equipment to be supplied by Ormat was delivered. For the third phase, engineering and procurement is still in progress, Construction work at the site is in progress and manufacturing of equipment to be supplied by Ormat is underway as planned. Drilling activities for the second and third phases are still ongoing and the project has achieved to date, based on preliminary estimates, approximately 80% of the required production capacity and approximately 80% of the required injection capacity. The project has missed a few milestones defined under the loan documents, but has received waivers from the lenders and commercial operation of the second and third phases is still expected to commence within 18 months after commercial operation of the first phase. As of September 30, 2016, the project is in compliance with milestones agreed with the lenders. The project is experiencing delays in the field development and certain cost overruns resulting from delays and excess drilling costs. Although estimated cost at completion is still within the approved budget (including contingencies), the lenders have requested that the sponsors commit additional equity. The sponsors have agreed and financing documents were revised to reflect this request. With respect to Ormat's role as a supplier, all contractual milestones under the supply agreement were achieved.

On May 16, 2014, the consortium closed $1.17 billion in financing for the development of the Sarulla project with a consortium of lenders comprised of Japan Bank for International Cooperation ("JBIC"), the Asian Development Bank and six commercial banks and obtained construction and term loans on a limited recourse basis backed by a political risk guarantee from JBIC. Of the $1.17 billion, $0.1 billion (which was drawn down by the Sarulla project company on May 23, 2014) bears a fixed interest rate and $1.07 billion bears interest at a rate linked to LIBOR.

The Sarulla consortium entered into interest rate swap agreements with various international banks in order to fix the Libor interest rate on up to $0.96 billion of the $1.07 billion credit facility at a rate of 3.4565%. The interest rate swap became effective as of June 4, 2014 along with the second draw-down by the project company of $50.0 million.

The Sarulla project company accounted for the interest rate swap as a cash flow hedge upon which changes in the fair value of the hedging instrument, relative to the effective portion, will be recorded in other comprehensive income (loss). During the three and nine months ended September 30, 2016, the project recorded a gain equal to $10.5 million and a loss of $30 million, respectively, net of deferred tax of $5.4 million and $15.4 million, respectively, of which the Company's share was $1.3 million and $3.8 million, respectively, which were recorded in other comprehensive income (loss). The related accumulated loss recorded by the Company in other comprehensive income (loss) as of September 30, 2016 is $10.9 million.

ORMAT TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

Pursuant to a supply agreement that was signed in October 2013, the Company is supplying its OECs to the power plant and has added the $255.6 million supply contract to its Product Segment backlog. The Company started to recognize revenue from the project during the third quarter of 2014 and will continue to recognize revenue over the course of the next two years. The Company has eliminated the related intercompany profit of $10.8 million against equity in loss of investees.

During the nine months ended September 30, 2016, the Company did not make any additional cash equity investments in the Sarulla project.

NOTE 5— FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value measurement guidance clarifies that fair value is an exit price, representing the amount that would be received upon selling an asset or paid upon transferring a liability in an orderly transaction between market participants. 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 guidance establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under the fair value measurement guidance are described below:

Level 1 — Unadjusted quoted prices in active markets that are accessible at the measurement date for identical assets or liabilities;

Level 2 — Quoted prices in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability;

Level 3 — Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (supported by little or no market activity).

ORMAT TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

The following table sets forth certain fair value information at September 30, 2016 and December 31, 2015 for financial assets and liabilities measured at fair value by level within the fair value hierarchy, as well as cost or amortized cost. As required by the fair value measurement guidance, assets and liabilities are classified in their entirety based on the lowest level of inputs that is significant to the fair value measurement.

		September 30, 2016			
		Fair Value			
	Carrying Value at September 30, 2016	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)				
Assets:					
Current assets:					
Cash equivalents (including restricted cash accounts)	$12,635	$12,635	$12,635	$—	$ —
Derivatives:					
Currency forward contracts [2]	249	249	—	249	—
Liabilities:					
Current liabilities:					
Derivatives:					
Call and put options on oil price [1]	$(1,776)	$(1,776)	$—	$(1,776)	$ —
Call option on natural gas price [1]	(1,534)	(1,534)	—	(1,534)	—
Currency forward contracts [2]	(30)	(30)	—	(30)	—
	$9,544	$9,544	$12,635	$(3,091)	$ —

		December 31, 2015	
		Fair Value	
	Carrying	Total	Level 1

	Value at December 31, 2015 (Dollars in thousands)			**Level 2**	**Level 3**
Assets					
Current assets:					
Cash equivalents (including restricted cash accounts)	$31,428	$31,428	$31,428	$—	$ —
Derivatives:					
Currency forward contracts [2]	7	7	—	7	—
Liabilities:					
Current liabilities:					
Derivatives:					
Currency forward contracts [2]	(169)	(169)	—	(169)	—
	$31,266	$31,266	$31,428	$(162)	$ —

(1) These amounts relate to call and put option transactions on oil and natural gas prices, valued primarily based on observable inputs, including spot prices for related commodity indices, and is included within “Accounts payable and accrued expenses” on September 30, 2016 in the consolidated balance sheets with the corresponding gain or loss being recognized within “Derivatives and foreign currency transaction gains (losses)” in the consolidated statement of operations and comprehensive income.

(2) These amounts relate to derivatives which represent currency forward contracts valued primarily based on observable inputs, including forward and spot prices for currencies, netted against contracted rates and then multiplied against notional amounts, and are included within “prepaid expenses and other” and “accounts payable and accrued expenses” on September 30, 2016 and December 31, 2015, in the consolidated balance sheet with the corresponding gain or loss being recognized within “Derivatives and foreign currency transaction gains (losses)” in the consolidated statement of operations and comprehensive income.

The amounts set forth in the tables above include investments in debt instruments and money market funds (which are included in cash equivalents). Those securities and deposits are classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices in an active market.

ORMAT TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

The following table presents the amounts of gain (loss) recognized in the consolidated statements of operations and comprehensive income on derivative instruments not designated as hedges:

		Amount of recognized gain (loss)			
		Three Months Ended September 30,		Nine Months Ended September 30,	
Derivatives not designated as hedging instruments	**Location of recognized gain (loss)**	**2016**	**2015**	**2016**	**2015**
Call options on natural gas price	Derivatives and foreign currency transaction gains (losses)	32	—	(1,114)	—
Call and put options on oil price	Derivatives and foreign currency transaction gains (losses)	230	—	(1,312)	—
Swap transactions on natural gas price	Electricity revenue	—	369	—	767
Currency forward contracts	Derivatives and foreign currency and transaction gains (losses)	689	869	1,154	(1,349)
		$951	$1,238	$(1,272)	$(582)

On March 6, 2014, the Company entered into a Natural Gas Index (“NGI”) swap contract with a bank covering a notional quantity of approximately 2.2 million British Thermal Units (“MMbtu”) for settlement effective January 1, 2015 until March 31, 2015, and covering a notional amount of approximately 2.4 MMbtu for settlement effective June 1, 2015 until December 31, 2015, in order to reduce its exposure to fluctuations in natural gas prices under its power purchase agreements (“PPAs”) with Southern California Edison to below $4.95 per MMbtu and below $3.00 per MMbtu, respectively. The swap contracts did not have any up-front costs. Under the terms of these contracts, the Company made floating rate payments to the bank and received fixed rate payments from the bank on each settlement date. The swap contracts had monthly settlements whereby the difference between the fixed price and the market price on the first commodity business day on which the relevant commodity reference price was published in the relevant calculation period (January 1, 2015 to March 1, 2015 and June 1, 2015 to December 31, 2015) was settled on a cash basis.

On February 2, 2016, the Company entered into Henry Hub Natural Gas Future contracts under which it has written a number of call options covering a notional quantity of approximately 4.1 MMbtu with exercise prices of $2 and expiration dates ranging from February 24, 2016 until December 27, 2016 in order to reduce its exposure to fluctuations in natural gas prices under its PPAs with Southern California Edison. The Company received an aggregate premium of approximately $1.9 million from these call options. The call option contracts have monthly expiration dates at which the options can be called and the Company would have to settle its liability on a cash basis.

On February 24, 2016, the Company entered into Brent Oil Future contracts under which it has written a number of call options covering a notional quantity of approximately 185,000 barrels (“BBL”) of Brent with exercise prices of $32.80 to $35.50 and expiration dates ranging from March 24, 2016 until December 22, 2016 in order to reduce its exposure to fluctuations in Brent prices under its PPA with HELCO. The Company received an aggregate premium of approximately $1.1 million from these call options. The call option contracts have monthly expiration dates whereby the options can be called and the Company would have to settle its liability on a cash basis. Moreover, during March 2016, the Company rolled 2 existing call options covering a total notional quantity of 31,800 BBL of Brent in order to limit its exposure to $41 to $42.50 instead of $32.80 to $33.50. In addition, the Company entered into short risk reversal transactions (sell call and buy put options) by rolling existing call options covering notional quantities of 16,500 BBL and 17,000 BBL in order to limit its exposure from the outstanding call options originally entered into in February 2016 to a range of $28.50 to $37.50 and $28 to $38.50, respectively.

ORMAT TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

The foregoing future, forward and swap transactions were not designated as hedge transactions and are marked to market with the corresponding gains or losses recognized within “Derivatives and foreign currency transaction gains (losses)” and “Electricity revenues” in the consolidated statements of operations and comprehensive income, respectively. The Company recognized a net gain from these transactions of $1.0 million and a net loss of $1.3 million in the three and nine months ended September 30, 2016, respectively, compared to a net gain of $0.9 million and a net loss of $1.3 million in the three and nine months ended September 30, 2015, under Derivatives and foreign currency transaction gains (losses), and a net gain of $0.4 million and a $0.8 million, in the three and nine months ended September 30, 2015, respectively, under Electricity revenues.

There were no transfers of assets or liabilities between Level 1, Level 2 and Level 3 during the nine months ended September 30, 2016.

The fair value of the Company’s long-term debt approximates its carrying amount, except for the following:

	Fair Value		**Carrying Amount**	
	September 30, 2016	**December 31, 2015**	**September 30, 2016**	**December 31, 2015**
	(Dollars in millions)		**(Dollars in millions)**	
Olkaria III Loan - DEG	$20.8	$ 24.2	$19.7	$ 23.7
Olkaria III Loan - OPIC	257.3	262.6	251.1	264.6
Amatitlan Loan	38.5	41.7	37.6	40.3
Senior Secured Notes:				
Ormat Funding Corp. ("OFC")	19.6	30.0	19.7	30.0
OrCal Geothermal Inc. ("OrCal")	41.6	43.8	40.1	43.3
OFC 2 LLC ("OFC 2")	231.0	231.1	251.3	262.0
Senior Unsecured Bonds	201.0	264.5	204.3	250.0
Other long-term debt	7.2	—	8.7	—

The fair value of OFC Senior Secured Notes is determined using observable market prices as these securities are traded. The fair value of all the other long-term debt is determined by a valuation model, which is based on a conventional discounted cash flow methodology and utilizes assumptions of current borrowing rates. The fair value of revolving lines of credit is determined using a comparison of market-based price sources that are reflective of similar credit ratings to those of the Company.

The carrying value of other financial instruments, such as revolving lines of credit, deposits, and other long-term debt approximates fair value.

The following table presents the fair value of financial instruments as of September 30, 2016:

	Level 1	**Level 2**	**Level 3**	**Total**
	(Dollars in millions)			
Olkaria III - DEG	$—	$—	$20.8	$20.8
Olkaria III - OPIC	—	—	257.3	257.3
Amatitlan loan	—	38.5	—	38.5
Senior Secured Notes:				
OFC	—	19.6	—	19.6
OrCal	—	—	41.6	41.6
OFC 2	—	—	231.0	231.0
Senior unsecured bonds	—	—	201.0	201.0
Other long-term debt	—	—	7.2	7.2
Deposits	14.5	—	—	14.5

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

The following table presents the fair value of financial instruments as of December 31, 2015:

	Level 1	Level 2	Level 3	Total
	(Dollars in millions)			
Olkaria III Loan - DEG	$—	$—	$24.2	$24.2
Olkaria III Loan - OPIC	—	—	262.6	262.6
Amatitlan Loan	—	41.7	—	41.7
Senior Secured Notes:				
OFC	—	30.0	—	30.0
OrCal	—	—	43.8	43.8
OFC 2	—	—	231.1	231.1
Senior unsecured bonds	—	—	264.5	264.5
Other long-term debt	—	6.7	—	6.7
Deposits	15.9	—	—	15.9

NOTE 6 — STOCK-BASED COMPENSATION

The 2004 Incentive Compensation Plan

In 2004, the Company's Board of Directors (the "Board") adopted the 2004 Incentive Compensation Plan ("2004 Incentive Plan"), which provides for the grant of the following types of awards: incentive stock options, non-qualified stock options, restricted stock, stock appreciation rights ("SARs"), stock units, performance awards, phantom stock, incentive bonuses, and other possible related dividend equivalents to employees of the Company, directors and independent contractors. Under the 2004 Incentive Plan, a total of 3,750,000 shares of the Company's common stock were reserved for issuance, all of which could be issued as options or as other forms of awards. Options and SARs granted to employees under the 2004 Incentive Plan cliff vest and are exercisable from the grant date as follows: 25%

after 24 months, 25% after 36 months, and the remaining 50% after 48 months. Options granted to non-employee directors under the 2004 Incentive Plan cliff vest and are exercisable one year after the grant date. Vested stock-based awards may be exercised for up to ten years from the grant date. The shares of common stock will be issued from the Company's authorized share capital upon exercise of options or SARs. The 2004 Incentive Plan expired in May 2012 upon adoption of the 2012 Incentive Compensation Plan ("2012 Incentive Plan"), except as to share based awards outstanding under the 2004 Incentive Plan on that date.

The 2012 Incentive Compensation Plan

In May 2012, the Company's shareholders adopted the 2012 Incentive Plan, which provides for the grant of the following types of awards: incentive stock options, non-qualified stock options, restricted stock, SARs, stock units, performance awards, phantom stock, incentive bonuses, and other possible related dividend equivalents to employees of the Company, directors and independent contractors. Under the 2012 Incentive Plan, a total of 4,000,000 shares of the Company's common stock have been reserved for issuance, all of which could be issued as options or as other forms of awards. Options and SARs granted to employees under the 2012 Incentive Plan typically vest and become exercisable as follows: 25% vest 24 months after the grant date, an additional 25% vest 36 months after the grant date, and the remaining 50% vest 48 months after the grant date. Options granted to non-employee directors under the 2012 Incentive Plan will vest and become exercisable one year after the grant date. The term of stock-based awards typically ranges from six to ten years from the grant date. The shares of common stock will be issued from the Company's authorized share capital upon exercise of options or SARs.

The 2012 Incentive Plan empowers the Board, in its discretion, to amend the 2012 Incentive Plan in certain respects. Consistent with this authority, in February 2014 the Board adopted and approved certain amendments to the 2012 Incentive Plan. The key amendments are as follows:

Increase of per grant limit: Section 15(a) of the 2012 Incentive Plan was amended to allow the grant of up to 400,000 shares of the Company's common stock with respect to the initial grant of an equity award to newly hired executive officers in any calendar year; and

Acceleration of vesting: Section 15(l) of the 2012 Incentive Plan was amended to clarify the Company's ability to provide in the applicable award agreement that part and/or all of the award will be accelerated upon the occurrence of certain predetermined events and/or conditions, such as a "change in control" (as defined in the 2012 Incentive Plan, as amended).

ORMAT TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

On June 13, 2016, the Company granted its employees, in aggregated 1,080,000 SAR under the Company's 2012 Incentive Plan. The exercise price of each SAR is $42.87, which represented the fair market value of the Company's common stock on the grant date. Such SARs will expire six years from the date of the grant and will vest over 4 years as follows: 50% after two years; an additional 25% after three years and the remaining 25% after four years from the grant date.

The fair value of each SAR on the grant date was $11.98 for senior management and $11.42 for other employees. The Company calculated the fair value of each SAR on the grant date using the Exercise Multiple-Based Lattice SAR-Pricing model based on the following assumptions:

Risk-free interest rate	1.29%
Expected life (in years)	6
Dividend yield	1.14
Expected volatility	30.7%
Forfeiture rate:	
Senior management	0.0 %
Other employees	10.5%
Sub-Optimal Exercise Factor:	
Senior management	2.5
Other employees	2.0

NOTE 7 — INTEREST EXPENSE, NET

The components of interest expense are as follows:

	Three Months Ended	**Nine Months Ended**
	September 30,	**September 30,**

	2016	2015	2016	2015
Interest related to sale of tax benefits	$2,565	$2,375	$6,269	$7,062
Interest expense	15,726	16,510	47,214	50,430
Less — amount capitalized	(1,154)	(1,137)	(1,922)	(3,057)
	$17,137	$17,748	$51,561	$54,435

NOTE 8 — EARNINGS PER SHARE

Basic earnings per share attributable to the Company's stockholders is computed by dividing net income or loss attributable to the Company's stockholders by the weighted average number of shares of common stock outstanding for the period. The Company does not have any equity instruments that are dilutive, except for employee stock-based awards.

ORMAT TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

The table below shows the reconciliation of the number of shares used in the computation of basic and diluted earnings per share:

	Three Months Ended		**Nine Months Ended**	
	September 30,		**September 30,**	
	2016	**2015**	**2016**	**2015**
Weighted average number of shares used in computation of basic earnings per share	49,599	49,023	49,410	48,388
Add:				
Additional shares from the assumed exercise of employee stock options	690	2,090	687	1,626
Weighted average number of shares used in computation of diluted earnings per share	50,289	51,113	50,097	50,014

The number of stock-based awards that could potentially dilute future earnings per share and that were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive was 225,191 and 341,946 for the three months ended September 30, 2016 and 2015, respectively, and 116,641 and 600,169 for the nine months ended September 30, 2016 and 2015, respectively.

NOTE 9 — BUSINESS SEGMENTS

The Company has two reporting segments: the Electricity segment and the Product segment. These segments are managed and reported separately as each offers different products and serves different markets. The Electricity segment is engaged in the sale of electricity from the Company’s power plants pursuant to PPAs. The Product segment is engaged in the manufacture, including design and development, of turbines and power units for the supply of electrical energy and in the associated construction of power plants utilizing the power units manufactured by the

Company to supply energy from geothermal fields and other alternative energy sources. Transfer prices betw