

ORMAT TECHNOLOGIES, INC.

FORM S-1/A (Securities Registration Statement)

Filed 11/5/2004

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Fiscal Year	12/31

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

**AMENDMENT NO. 3 TO
FORM S-1**

**REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933**

ORMAT TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or Other Jurisdiction of
Incorporation of Organization)

4911
(Primary Standard Industrial
Classification Code Number)

88-0326081
(I.R.S. Employer
Identification Number)

980 Greg Street, Sparks, Nevada 89431
(775) 356-9029

(Address, including zip code, and telephone number including
area code, of registrant's principal executive offices)

Connie Stechman
Ormat Technologies, Inc.
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(Name, address, including zip code, and telephone number including area code, of agent for service)

[REDACTED]

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[REDACTED]

Approximate date of commencement of proposed sale to the public:
As soon as practicable after this registration statement becomes effective.

[REDACTED]

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, as amended (the "Securities Act") check the following box.

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box.

CALCULATION OF REGISTRATION FEE

[REDACTED]

Title of each class of securities to be registered	Proposed maximum aggregate Offering price(1)(2)	Amount of Registration fee
Common Stock, par value \$0.001 per share (and associated preferred share purchase right)(3)	\$ 115,000,000	\$ 14,571(4)
Total	\$ 115,000,000	\$ 14,571

[REDACTED]

(1) Estimated solely for the purpose of calculating the registration fee pursuant to Rule 457(o) of the Securities Act.

(2) Includes shares which the underwriters have the option to purchase to cover over-allotments, if any.

(3) The rights will initially trade together with the common stock. The value attributable to the rights, if any, is reflected in the market price of the common stock.

(4) The registrant previously paid a fee of \$14,751 in connection with the initial filing of the registration statement.



The Registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act, or until the registration statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.



The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and is not soliciting offers to buy these securities in any state where the offer or sale is not permitted.

Subject to Completion, dated November 5, 2004

PROSPECTUS

6,250,000 Shares



Ormat Technologies, Inc.

Common Stock



We are offering 6,250,000 shares of our common stock in this initial public offering. No public market currently exists for our common stock.

We intend to list our common stock on the New York Stock Exchange under the symbol "ORA." We anticipate that the initial public offering price will be between \$15 and \$17 per share.

Investing in our common stock involves risks. See "Risk Factors" beginning on page 10.

	<u>Per Share</u>	<u>Total</u>
Public offering price	\$	
Underwriting discount	\$	

Proceeds to Ormat Technologies, Inc. (before expenses). \$

We have granted the underwriters a 30-day option to purchase up to 937,500 additional shares of common stock at the public offering price less the underwriting discount to cover over-allotments.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

Lehman Brothers, on behalf of the underwriters, expects to deliver the shares on or about , 2004.



L E H M A N B R O T H E R S

D E U T S C H E B A N K S E C U R I T I E S

R B C C A P I T A L M A R K E T S

W E L L S F A R G O S E C U R I T I E S

, 2004



Meeting the Needs of Customers in 71 Countries



Remote Reliable Power
Transibuka Pipeline, Alaska



Geothermal Power Plants
Upper Mahao, Philippines



Recovered Energy Power Plants
Enterprise, Louisiana



Installed Gross Capacity of over 700 MW of Geothermal and Recovered Energy Power Plants

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Until _____, 2004 (25 days after the commencement of this offering), all dealers that effect transactions in our common stock, whether or not participating in this offering, may be required to deliver a prospectus. This is in addition to the dealer's obligation to deliver a prospectus when acting as an underwriter and with respect to unsold allotments or subscriptions.

PROSPECTUS SUMMARY

This summary highlights the material information contained elsewhere in this prospectus. This summary may not contain all of the information that may be important to you. We urge you to read this entire prospectus carefully, including the more detailed information about us and about the shares of our common stock being sold in this offering and our consolidated financial statements and related notes appearing elsewhere in this prospectus, the "Risk Factors" section, and the documents to which we refer, before making an investment decision. Unless the context otherwise requires, all references in this prospectus to "Ormat," "the Company," "we," "us," "our company" or "our" refer to Ormat Technologies, Inc. and its consolidated subsidiaries. As used in this prospectus, "pro forma" information is information presented giving effect to the acquisition of the Heber 1 and Heber 2 projects and our 50% ownership interest in the Mammoth project that was consummated on December 18, 2003 and the acquisition of the Puna project that was consummated on June 3, 2004, as if such acquisitions were consummated on January 1, 2003, but not including the acquisitions of the Steamboat 2/3 project and the Steamboat Hills project that were consummated on February 13 and May 20, 2004, respectively.

Ormat Technologies, Inc.

We are a leading vertically integrated company engaged in the geothermal and recovered energy power business. We design, develop, build, own and operate clean, environmentally friendly geothermal power plants, and we also design, develop and build, and plan to own and operate, recovered energy-based power plants, in each case using equipment that we design and manufacture. We conduct our business activities in two business segments. We develop, build, own and operate geothermal power plants in the United States and other countries around the world and sell the electricity they generate. In addition, we design, manufacture and sell power units

for geothermal and recovered energy-based electricity generation and other power generating equipment and provide services relating to the engineering, procurement, construction, operation and maintenance of geothermal and recovered energy power plants. As we manufacture and design the equipment used in our power plants, we are able to operate and maintain our projects efficiently and to respond to operational issues in a timely and cost-efficient manner.

All of the projects that we currently own or operate produce electricity from geothermal energy sources. Geothermal energy is a clean, renewable and generally sustainable form of energy derived from the natural heat of the earth. Unlike electricity produced by burning fossil fuels, electricity produced from geothermal energy sources is produced without emissions of certain pollutants such as nitrogen oxide, and with far lower emissions of other pollutants such as carbon dioxide. Therefore, electricity produced from geothermal energy sources contributes significantly less to local and regional incidences of acid rain and global warming than energy produced by burning fossil fuels. Geothermal energy is also an attractive alternative to other sources of energy as part of a national diversification strategy to avoid dependence on any one energy source or politically sensitive supply sources. In addition, a geothermal power plant does not need to purchase fuel (such as coal, natural gas, or fuel oil) in order to generate electricity. Thus, once the drilling of geothermal wells is complete, the plant is not exposed to fuel price or fuel delivery risk. These characteristics give us a competitive advantage over fossil fuel-based electricity generation as countries increasingly seek to balance environmental concerns with demands for reliable sources of electricity.

In addition to our geothermal energy power generation business, we have developed and continue to develop products that produce electricity from recovered energy or so-called "waste heat." Recovered energy or waste heat represents residual heat that is generated as a by-product of gas turbine-driven compressor stations and in a variety of industrial processes, such as cement manufacturing, and is not otherwise used for any purpose. Such residual heat, that would otherwise be wasted, is captured in the recovery process and is used by recovered energy power plants to generate electricity without burning additional fuel and without emissions.

Our Power Generation Business

We are the fastest growing geothermal power generation company in the United States measured by growth in generating capacity. We increased our net ownership interest in generating capacity by 164 megawatts (MW) between December 31, 2002 and June 30, 2004, of which 152 MW was attributable to our acquisition of geothermal power plants from third parties and 12 MW was attributable to increased generating capacity of our existing geothermal power plants resulting from plant technology upgrades and improvements to our geothermal reservoir operations. We also own and operate or control and operate geothermal projects in Guatemala, Kenya, Nicaragua and the Philippines and continue to pursue opportunities to acquire and develop similar projects elsewhere in the world, including in the United States. Most of our projects are located in regions where there is, or is expected to be, demand for additional generating capacity.

In 2003, pro forma revenues from the sale of electricity by our domestic projects were \$128.7 million, constituting approximately 79.2% of our total pro forma revenues from the sale of electricity, and pro forma revenues from the sale of electricity by our foreign projects were \$33.9 million, constituting approximately 20.8% of our total pro forma revenues from the sale of electricity. In 2003, our actual revenues from the sale of electricity by our domestic projects were \$43.8 million and by our foreign projects were \$33.9 million, respectively. Pro forma revenues from the sale of electricity constituted approximately 79.6% of our total pro forma revenues in 2003. Such pro forma revenues do not include revenues generated from the Steamboat 2/3 project and Steamboat Hills project, two additional domestic projects that were acquired this year.

All of the revenues that we derive from the sale of electricity are from fully-contracted payments under long-term power purchase agreements, providing generally predictable cash flows. All of our geothermal power plants supply a part of the baseload capacity of the electric system in their respective markets, meaning that they operate to serve all or a part of the minimum power requirements of the electric system in such market on an around-the-clock basis and are only marginally weather dependent. In the United States, the power purchasers under such agreements are all investor-owned electric utilities. More than 70% of our total pro forma revenues for 2003 from the sale of electricity by our domestic projects were derived from power purchasers that currently have investment grade credit rating. The purchasers of electricity from our foreign projects are either state-owned entities or recently privatized state-owned entities. We have obtained political risk insurance from the Multilateral Investment Guarantee Agency of the World Bank group for all of our foreign projects (other than the

Leyte project) in order to cover a portion of any loss that we may suffer upon the occurrence of certain political events covered by such insurance.

Development, Construction and Acquisition. We have experienced significant growth in recent years, principally through the acquisition of geothermal power plants from third parties and the expansion and enhancement of our existing projects. In December 2003, we acquired the Heber 1 and Heber 2 projects and our 50% ownership interest in the Mammoth project; in February 2004, we acquired the Steamboat 2/3 project; in May 2004, we acquired the Steamboat Hills project and in June 2004, we acquired the Puna project. In total, we have increased our net ownership interest in generating capacity from 94 MW as of December 31, 2001 to 305 MW as of June 30, 2004. We currently expect to continue growing our power generation business through:

- the development and construction of new geothermal and recovered energy-based power plants;
- the expansion and enhancement of our existing projects; and
- the acquisition of additional geothermal and other renewable assets from third parties.

As part of these efforts, we regularly monitor requests for proposals from, and submit bids to, investor-owned electric utilities in the United States to provide additional generating capacity, primarily in the western United States where geothermal resources are generally concentrated. We also respond to international tenders issued by foreign state-owned electric utilities for the

development, construction and operation of new geothermal power plants. In addition, we apply our technological expertise to upgrade the facilities of our existing geothermal power plants and to continuously monitor and manage our existing geothermal resources in order to increase the efficiency and generating capacity of such facilities.

We are currently in varying stages of development or construction of new projects and enhancement of existing projects. Based on our current development and construction schedule, which is subject to change at any time and which we may not achieve, we expect to have approximately 66 additional MW in generating capacity in the United States by the end of 2006 and approximately 20 additional MW in Guatemala by June 2006. We are also currently in discussions with the Kenyan government and Kenya Power & Lighting Co. Ltd. regarding, among other things, the construction of Phase II of the Olkaria III project in Kenya which, if completed, we expect would add approximately 35 MW in generating capacity to the current Olkaria III project. We are also in the early development stage of a project in China. We intend to pursue these opportunities to the extent they continue to meet our investment criteria and business strategy.

Our Products Business

We design, manufacture and sell the following products for electricity generation and provide the following services:

Power Units for Geothermal Power Plants. We design, manufacture and sell power units for geothermal electricity generation, which we refer to as Ormat Energy Converters or OECs. Our customers include contractors and geothermal plant owners and operators.

Power Units for Recovered Energy-Based Power Generation. We design, manufacture and sell power units used to generate electricity from recovered energy or so-called "waste heat" that is generated as a residual by-product of gas turbine-driven compressor stations and a variety of industrial processes, such as cement manufacturing, and is not otherwise used for any purpose. Our existing and target customers include interstate natural gas pipeline owners and operators, gas processing plant owners and operators, cement plant owners and operators, and other companies engaged in other energy-intensive industrial processes.

Remote Power Units and other Generators. We design, manufacture and sell fossil fuel powered turbo-generators with a capacity ranging between 200 watts and 5,000 watts, which operate unattended in extreme climate conditions, whether hot or cold. Our customers include contractors installing gas pipelines in remote

areas. In addition, we design, manufacture and sell generators for various other uses, including heavy duty direct current generators.

Engineering, Procurement and Construction of Power Plants. We engineer, procure and construct (EPC), as an EPC contractor, geothermal and recovered energy power plants on a turnkey basis, using power units we design and manufacture. Our customers are geothermal power plant owners as well as the same customers described above that we target for the sale of our power units for recovered energy-based power generation. Unlike many other companies that provide EPC services, we believe we have an advantage in that we are using our own manufactured equipment and thus have better control over the timing and delivery of required equipment and its costs.

Operation and Maintenance of Power Plants. We provide operation and maintenance services for geothermal power plants owned by us and by third parties.

In 2003, our actual revenues from our products business were \$41.7 million, constituting approximately 20.4% of our total pro forma revenues and approximately 34.9% of our actual revenues.

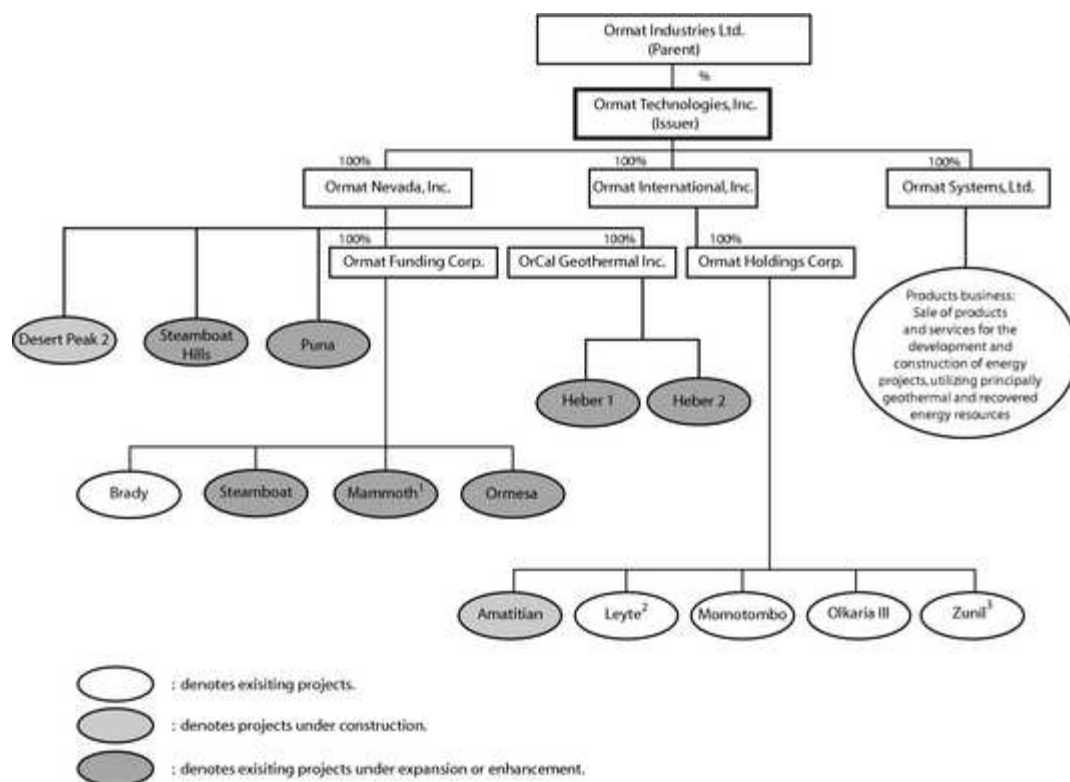
History




Ormat Industries is our parent company. Ormat Industries is an international power systems company whose predecessor, Ormat Turbines Ltd., was founded in 1965 by Lucien and Yehudit Bronicki for the principal purpose of developing equipment for the production of clean, renewable energy. Lucien and Yehudit Bronicki continue to be Ormat Industries' controlling shareholders. Ormat Industries and its subsidiaries have developed geothermal power plants, remote power units, industrial recovered energy systems and solar energy plants worldwide. At December 31, 2003, Ormat Industries and its subsidiaries had more than 600 employees worldwide, and had revenues of approximately \$119.8 million. Ormat Industries is listed on the Tel Aviv Stock Exchange under the symbol "ORMT." Ormat Industries and its subsidiaries have supplied, developed, constructed or rehabilitated gross installed capacity of approximately 700 MW of geothermal power plants (or over 700 MW including recovered energy power plants) in 22 countries, constituting approximately 9% of geothermal installed capacity worldwide.

We were formed by Ormat Industries in 1994 for the purpose of investing and holding ownership interests in power projects, as well as constructing and operating power plants owned by us and by third parties. We have served as the holding company for all of Ormat Industries' geothermal power projects. In December 2003, we acquired the Heber 1 and Heber 2 projects and our 50% ownership interest in the Mammoth project; in February 2004, we acquired the Steamboat 2/3 project; in May 2004, we acquired the Steamboat Hills project and in June 2004, we acquired the Puna project. On February 13, 2004, Ormat Funding, our wholly owned subsidiary, completed an offering of senior secured notes that raised gross proceeds of \$190 million. Pursuant to the terms of such offering, Ormat Funding is required to exchange the senior secured notes it issued thereunder for senior secured notes registered under the Securities Act of 1933, as amended, no later than January 2005. Effective as of July 1, 2004, Ormat Industries sold to us its business relating to the manufacturing and sale of energy-related equipment and services, which is based in Israel. Following this sale, we now hold all of Ormat Industries' power generation products business, and had, as of July 1, 2004, 676 employees. Upon completion of this offering, Ormat Industries will own approximately 79.6% of our outstanding common stock.

Corporate Structure

A summary chart of our corporate structure showing our main subsidiaries and assets following the completion of this offering is depicted below.



-  : denotes existing projects.
-  : denotes projects under construction.
-  : denotes existing projects under expansion or enhancement.

- 1 We own a 50% ownership interest in the Mammoth project.
- 2 We own an 80% ownership interest in the Leyte project.
- 3 We own a 21% ownership interest in the Zunil project.

The Offering

Issuer	Ormat Technologies, Inc.
Common stock offered by Ormat Technologies, Inc.	6,250,000 shares
Underwriters' option to purchase additional shares	937,500 shares
Common stock outstanding after giving effect to this offering	30,624,996 shares
Use of proceeds	We estimate that the net proceeds we will receive from this offering will be approximately \$89.9 million, or approximately \$103.8 million if the underwriters exercise their over-allotment option in full, in each case after deducting the underwriting discounts and commissions and estimated expenses of this offering payable by us. We expect to use all of the net proceeds from this offering for general corporate purposes, which may include making investments or acquisitions. We have no present understanding or agreement relating to any specific acquisition. Accordingly, management will have

significant flexibility in applying the net proceeds of the offering. Pending the use of such proceeds as described above, we intend to invest such proceeds in interest-bearing investment-grade instruments and bank deposits. See "Use of Proceeds."

Proposed New York Stock Exchange symbol ORA

Except as otherwise indicated, all common stock information in this prospectus is based on the number of shares of common stock outstanding on October 15, 2004 after giving effect to the 1 for 1.325444 reverse stock split effected on October 21, 2004 in connection with this offering and:

- assumes an initial public offering price of \$16 per share, the mid-point of the range on the cover of the prospectus;
- excludes 230,000 shares of common stock issuable upon the exercise of stock options that will be outstanding as of the effective date of the registration statement at a weighted average exercise price of \$16 per share;
- excludes 1,020,000 shares of common stock reserved for future issuance under our 2004 Incentive Compensation Plan; and
- excludes the 937,500 shares of common stock subject to the option granted to the underwriters to purchase additional shares of common stock in this offering to cover over-allotments.

Dividend Policy

We have adopted a dividend policy pursuant to which we currently expect, commencing with the first full fiscal quarter following the consummation of this offering, to distribute at least 20% of our annual profits available for distribution by way of quarterly dividends. Notwithstanding this policy, dividends will be paid only when, as and if determined by our board of directors out of funds legally available therefor. Our board of directors may, from time to time, examine our dividend policy and may, in their absolute discretion, change such policy.

Risk Factors

Investing in our common stock involves a number of material risks. For a discussion of certain risk factors that should be considered in connection with your investment in our common stock, see "Risk Factors" beginning on page 10.

Corporate Information

Our principal executive offices are located at 980 Greg Street, Sparks, Nevada 89431. Our telephone number is (775) 356-9029. The majority of our senior management and all of our production and manufacturing facilities are located in Yavne, Israel.

Information in Prospectus

You should rely only on the information contained in this prospectus. We have not authorized anyone to provide you with information that is different from that contained in this prospectus. This prospectus is not an

offer to sell or a solicitation of an offer to buy shares of our common stock in any jurisdiction where such offer or any sale of shares of our common stock would be unlawful. The information in this prospectus is complete and accurate only as of the date on the front cover regardless of the time of delivery of this prospectus or of any sale of shares of our common stock.

Summary Historical and Unaudited Pro Forma Condensed Consolidated Financial Data

The following table sets forth our summary historical and unaudited pro forma condensed consolidated financial data for the periods ended and at the dates indicated in such table. We have derived the historical consolidated financial data as of and for the periods ended December 31, 2001, 2002 and 2003 from our audited consolidated financial statements included elsewhere in this prospectus. We have derived the historical consolidated financial data as of and for the six months ended June 30, 2003 and June 30, 2004 from our unaudited consolidated financial statements included elsewhere in this prospectus. In the opinion of our management, our unaudited historical consolidated financial statements contain all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of our financial position, results of operations and cash flows. The results of operations for the six-month periods ended June 30, 2003 and June 30, 2004 are not necessarily indicative of the operating results to be expected for the full fiscal years encompassing such periods. The pro forma data for the fiscal year ended December 31, 2003 is derived from the unaudited pro forma financial statements included elsewhere in this prospectus and gives effect to the acquisition of the Heber 1 and Heber 2 projects and our 50% ownership interest in the Mammoth project that was consummated on December 18, 2003 and the acquisition of the Puna project that was consummated on June 3, 2004, as if such acquisitions were consummated on January 1, 2003, but not including the acquisitions of the Steamboat 1/1A project, Steamboat 2/3 project and the Steamboat Hills project that were consummated on June 30, 2003, February 13, 2004 and May 20, 2004, respectively. The pro forma data also gives effect to (i) Ormat Funding's issuance of 8¼% senior secured notes in the amount of \$190 million, which offering was completed on February 13, 2004, and (ii) OrCal Geothermal's loan agreement with Beal Bank in the amount of \$154.5 million in connection with the acquisition of the Heber 1 and Heber 2 projects and our 50% ownership interest in the Mammoth projects.

The information set forth below should be read in conjunction with "Unaudited Pro Forma Condensed Financial Data", "Selected Historical Financial Data", "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and the financial statements relating to the Heber 1, Heber 2, Mammoth and Puna projects included elsewhere in this prospectus.

Summary Historical and Unaudited Pro Forma Condensed Consolidated Financial Data

	Year Ended December 31,			Six Months Ended June 30,		
	2001	2002	2003	Pro Forma 2003	2003	2004
	(in thousands, except per share data)			(unaudited)	(in thousands, except per share data) (unaudited)	
Statement of Operations Data:						
Revenues:						
Electricity Segment	\$ 33,956	\$ 65,491	\$ 77,752	\$ 162,620	\$ 35,651	\$ 70,215
Products Segment	13,959	20,138	41,688	41,688	16,022	29,491
	<u>47,915</u>	<u>85,629</u>	<u>119,440</u>	<u>204,308</u>	<u>51,673</u>	<u>99,706</u>
Cost of Revenues:						

Electricity Segment	12,536	33,482	46,726	98,901	22,165	40,612
Products Segment	<u>17,454</u>	<u>17,293</u>	<u>29,494</u>	<u>29,494</u>	<u>10,306</u>	<u>23,122</u>
	<u>29,990</u>	<u>50,775</u>	<u>76,220</u>	<u>128,395</u>	<u>32,471</u>	<u>63,734</u>
Gross margin	17,925	34,854	43,220	75,913	19,202	35,972
Operating income	4,217	20,227	25,490	56,549	11,612	25,605
Interest expense	(4,333)	(6,179)	(8,120)	(40,363)	(3,835)	(19,475)
Income (loss) from continuing operations	(1,732)	8,514	15,659	33,500	5,819	6,279
Discontinued operations	(4,681)	(9,558)	—	—	—	—
Net income (loss)	<u>\$ (6,413)</u>	<u>\$ (1,044)</u>	<u>\$ 15,454</u>	<u>\$ 33,500</u>	<u>\$ 5,614</u>	<u>\$ 6,279</u>
Basic and diluted income (loss) per share	<u>\$ (0.27)</u>	<u>\$ (0.04)</u>	<u>\$ 0.66</u>	<u>\$ 1.44</u>	<u>\$ 0.24</u>	<u>\$ 0.27</u>
Income (loss) from continuing operations	\$ (0.07)	\$ 0.37	\$ 0.66	\$ 1.44	\$ 0.25	\$ 0.27
Loss from discontinued operations	(0.20)	(0.41)	—	—	—	—
Net income (loss)	(0.27)	(0.04)	0.66	1.44	0.24	0.27
Weighted average number of shares outstanding	<u>23,214,281</u>	<u>23,214,281</u>	<u>23,214,281</u>	<u>23,214,281</u>	<u>23,214,281</u>	<u>23,227,036</u>

June 30, 2004
(Unaudited)

Balance Sheet Data:

Cash and cash equivalents	\$ 21,170
Working capital	11,124
Property, plant and equipment, net	472,217
Total assets	778,183
Long-term debt	442,300
Notes payable to Parent	193,852
Stockholder's equity	63,232

RISK FACTORS

You should carefully consider the risks described below together with the other information included in this Prospectus before deciding to invest in our common stock. Our business, financial condition, or results of operations could be adversely affected by any of these risks. If any of these risks occur, the value of our common stock could decline and you might lose all or part of your investment.

Risks Relating to Our Business and Industry

Our financial performance depends on the successful operation of our geothermal power plants, which is subject to various operational risks.

We depend upon the successful operation of our subsidiaries' geothermal power plants. In connection with such operations, we derived approximately 70.4% of our total revenues for the six months ended June 30, 2004 from the sale of electricity. The cost of operation and maintenance and the operating performance of geothermal power plants may be adversely affected by a variety of factors, including some which are discussed elsewhere in these risk factors and the following:

- regular and unexpected maintenance and replacement expenditures;
- shutdowns due to the breakdown or failure of our equipment or the equipment of the transmission serving utility;
- labor disputes;
- the presence of hazardous materials on our project sites; and
- catastrophic events such as fires, explosions, earthquakes, floods, releases of hazardous materials, severe storms or similar occurrences affecting our projects or any of the power purchasers or other third parties providing services to our projects.

Any of these events could significantly increase the expenses incurred by our projects or reduce the overall generating capacity of our projects and could significantly reduce or entirely eliminate the revenues generated by one or more of our projects, which in turn would reduce our net income and could materially and adversely affect our business, financial condition, future results and cash flow.

Our exploration, development, and operation of geothermal energy resources is subject to geological risks and uncertainties, which may result in decreased performance or increased costs for our projects.

Our business involves the exploration, development and operation of geothermal energy resources. These activities are subject to uncertainties, which vary among different geothermal reservoirs and are in some respects similar to those typically associated with oil and gas exploration, development and exploitation, such as dry holes, uncontrolled releases and pressure and temperature decline, all of which can increase our operating costs and capital expenditures or reduce the efficiency of our power plants. Prior to our acquisition of the Steamboat Hills project, one of the wells related to the project experienced an uncontrolled release. In addition, the high temperature and high pressure in the Puna project's geothermal energy resource requires special reservoir management and monitoring. Further, since the commencement of their operations, several of our projects have experienced geothermal resource cooling in the normal course of operations. The temperature of the geothermal resource at our Heber 1 project has declined since the project commenced operations and, as a result, the project currently operates at a level that is close to the minimum performance requirements set forth in the project's power purchase agreement. Because geothermal reservoirs are complex geological structures, we can only estimate their geographic area and sustainable output. The viability of geothermal projects depends on different factors directly related to the geothermal resource, such as the heat content (the relevant composition of temperature and pressure) of the geothermal reservoir, the useful life (commercially exploitable life) of the reservoir and operational factors relating to the extraction of geothermal fluids. Our geothermal energy projects may suffer an unexpected decline in the capacity of their respective geothermal wells and are exposed to a risk of geothermal reservoirs not being sufficient for sustained generation of the electrical power capacity

desired over time. In addition, we may fail to find commercially viable geothermal resources in the expected quantities and temperatures, which would adversely affect our development of geothermal power projects.

Additionally, geothermally active areas, such as the areas in which our projects are located, are subject to frequent low-level seismic disturbances. Serious seismic disturbances are possible and could result in damage to our projects or equipment or degrade the quality of our geothermal resources to such an extent that we could not perform under the power purchase agreement for the affected project, which in turn could reduce our net income and materially and adversely affect our business, financial condition, future results and cash flow. If we suffer a serious seismic disturbance, our business interruption and property damage insurance may not be adequate to cover all losses sustained as a result thereof. In addition, insurance coverage may not continue to be available in the future in amounts adequate to insure against such seismic disturbances.

Our business development activities may not be successful and our projects under construction may not commence operation as scheduled despite the expenditure of significant amounts of capital.

We are currently in the process of developing and constructing a number of new power plants. Our success in developing a particular project is contingent upon, among other things, negotiation of satisfactory engineering and construction agreements and power purchase agreements, receipt of required governmental permits, obtaining adequate financing, and the timely implementation and satisfactory completion of construction. We may be unsuccessful in accomplishing any of these matters or doing so on a timely basis. Although we may attempt to minimize the financial risks attributable to the development of a project by securing a favorable power purchase agreement, obtaining all required governmental permits and approvals and arranging adequate financing prior to the commencement of construction, the development of a power project may require us to incur significant expenses for preliminary engineering, permitting and legal and other expenses before we can determine whether a project is feasible, economically attractive or capable of being financed.

Currently, we have power plants under development or construction in the United States, Kenya, Guatemala, China and El Salvador, and we intend to pursue the expansion of some of our existing plants and the development of other new plants. Our completion of these facilities is subject to substantial risks, including:

- unanticipated cost increases;
- shortages and inconsistent qualities of equipment, material and labor;
- work stoppages;
- inability to obtain permits and other regulatory matters;
- failure by key contractors and vendors to timely and properly perform;
- adverse environmental and geological conditions (including inclement weather conditions); and
- our attention to other projects,

any one of which could give rise to delays, cost overruns, the termination of the plant expansion, construction or development or the loss (total or partial) of our interest in the project under development, construction or expansion.

We may be unable to obtain the financing we need to pursue our growth strategy and any future financing we receive may be less favorable to us than our current financing arrangements, either of which may adversely affect our ability to expand our operations.

Our geothermal power plants generally have been financed using leveraged financing structures, consisting of non-recourse or limited recourse debt obligations. As of June 30, 2004, we had approximately \$636.2 million of total consolidated indebtedness (including indebtedness to our parent

company in the amount of \$193.9 million), of which approximately 59.2% represented non-recourse debt and limited recourse debt held by our subsidiaries. Each of our projects under development or construction and those projects and businesses we may seek to acquire or construct will require substantial capital investment. Our continued access to capital with acceptable terms is necessary for the success of our growth strategy. Our attempts to obtain future financings may not be successful or on favorable terms.

Market conditions and other factors may not permit future project and acquisition financings on terms similar to those our subsidiaries have previously received. Our ability to arrange for financing on a substantially non-recourse or limited recourse basis and the costs of such capital are dependent on numerous factors, including general economic and capital market conditions, credit availability from banks, investor confidence, the

continued success of current projects, the credit quality of the projects being financed, the political situation in the country where the project is located and the continued existence of tax and securities laws which are conducive to raising capital. If we are not able to obtain financing for our projects on a substantially non-recourse or limited recourse basis, we may have to finance them using recourse capital such as direct equity investments, parent company loans or the incurrence of additional debt by us.

Also, in the absence of favorable financing options, we may decide not to build new plants or acquire facilities from third parties. Any of these alternatives could have a material adverse effect on our growth prospects.

Our foreign projects expose us to risks related to the application of foreign laws, taxes, economic conditions, labor supply and relations, political conditions and policies of foreign governments, any of which risks may delay or reduce our ability to profit from such projects.

We have substantial operations outside of the United States that generated revenues in the amount of \$42.0 million for the six-month period ended June 30, 2004, which represented 42.1% of our total revenues for such six-month period. Our pro forma revenues from the sale of electricity by our foreign projects constituted approximately 20.8% of our total pro forma revenues from the sale of electricity in 2003. Our foreign operations are subject to regulation by various foreign governments and regulatory authorities and are subject to the application of foreign laws. Such foreign laws or regulations may not provide for the same type of legal certainty and rights, in connection with our contractual relationships in such countries, as are afforded to our projects in the United States, which may adversely affect our ability to receive revenues or enforce our rights in connection with our foreign operations. In addition, the laws and regulations of some countries may limit our ability to hold a majority interest in some of the projects that we may develop or acquire, thus limiting our ability to control the development, construction and operation of such projects. Our foreign operations are also subject to significant political, economic and financial risks, which vary by country, and include:

- changes in government policies or personnel;
- changes in general economic conditions;
- restrictions on currency transfer or convertibility;
- changes in labor relations;
- political instability and civil unrest;
- changes in the local electricity market;
- breach or repudiation of important contractual undertakings by governmental entities; and
- expropriation and confiscation of assets and facilities.

In particular, the Philippines is in the midst of an ongoing privatization of the electric industry, and in Guatemala the electricity sector was partially privatized and it is currently unclear whether further privatization will occur in the future. Such developments may affect our existing Leyte and Zunil projects and the Amatitlan project currently under construction if, for example, they result in

Momotombo project. In Kenya, the new government elected in 2002 is making an effort to deliver on campaign promises to reduce the price of electricity and is applying pressure on independent power producers, such as our Olkaria III project, to lower their tariffs. In addition, Kenya's new government is considering a further restructuring and privatization of the electricity industry and may divide Kenya Power & Lighting Co. Ltd., the power purchaser for our Olkaria III project, into separate entities and then privatize one or more of such resulting entities. A material tariff reduction or any break-up and potential privatization of Kenya Power & Lighting Co. Ltd. may adversely affect our Olkaria III project. We have recently held discussions with the Kenyan government and Kenya Power & Lighting Co. Ltd. regarding, among other things, the construction of Phase II of the Olkaria III project in Kenya and the provision of certain collateral and government support. We must notify Kenya Power & Lighting Co. Ltd., by April 17, 2005, whether we will proceed to construct Phase II of the Olkaria III project and, if we notify Kenya Power & Lighting Co. Ltd. that we will not proceed with such construction, then the portion of the current power purchase agreement applicable to Phase II of the Olkaria III project will be terminated (but the current portion applicable to Phase I will be unaffected). If we fail to provide such notification we will be required to construct Phase II and reach commercial operations by May 31, 2007 in order to avoid the application of financial penalties, or at the latest by April 17, 2008 in order to avoid termination of the entire power purchase agreement. In addition, if we do not proceed with the construction of Phase II, we may lose some or all of our investment relating to Phase II, which is approximately \$22.4 million as of June 30, 2004.

Although we generally obtain political risk insurance in connection with our foreign projects, such political risk insurance does not mitigate all of the above-mentioned risks. In addition, insurance proceeds received pursuant to our political risk insurance policies, where applicable, may not be adequate to cover all losses sustained as a result of any covered risks and may at times be pledged in favor of the lenders to a project as collateral. Also, insurance may not be available in the future with the scope of coverage and in amounts of coverage adequate to insure against such risks and disturbances.

Our foreign projects and foreign manufacturing operations expose us to risks related to fluctuations in currency rates, which may reduce our profits from such projects and operations.

Risks attributable to fluctuations in currency exchange rates can arise when any of our foreign subsidiaries borrow funds or incur operating or other expenses in one type of currency but receive revenues in another. In such cases, an adverse change in exchange rates can reduce such subsidiary's ability to meet its debt service obligations, reduce the amount of cash and income we receive from such foreign subsidiary or increase such subsidiary's overall expenses. In addition, the imposition by foreign governments of restrictions on the transfer of foreign currency abroad or restrictions on the conversion of local currency into foreign currency would have an adverse effect on the operations of our foreign projects and foreign manufacturing operations and may limit or diminish the amount of cash and income that we receive from such foreign projects and operations.

A significant portion of our net revenue is attributed to payments made by power purchasers under power purchase agreements. The failure of any such power purchaser to perform its obligations under the relevant power purchase agreement or the loss of a power purchase agreement due to a default would reduce our net income and could materially and adversely affect our business, financial condition, future results and cash flow.

A significant portion of our net revenue is attributed to revenues derived from power purchasers under the relevant power purchase agreements. Southern California Edison Company, Hawaii Electric Light Company, PNOG-Energy Development Corporation and Sierra Pacific Power Company have accounted for 48.3%, 9.2%, 6.2% and 5.6% of our pro forma revenues, respectively, for the fiscal year ended December 31, 2003. Neither we nor any of our affiliates make any representations as to the financial condition or creditworthiness of any purchaser under a power purchase agreement and nothing in this prospectus should be construed as such a representation.

There is a risk that any one or more of the power purchasers may not fulfill their respective payment obligations under their power purchase agreements. For example, as a result of the energy crisis in California, Southern California Edison Company withheld payments it owed under various of its power purchase agreements with a number of power generators (such as the Ormesa, Heber 1, Heber 2, and Mammoth projects) payable for certain energy delivered between November 2000 and March 2001 under such power purchase agreements until March 2002. In the case of our Ormesa project (which we acquired in April 2002), the payment withheld by Southern California Edison Company totaled \$21.2 million. If any of the power purchasers fails to meet its payment obligations under its power purchase agreements, it could materially and adversely affect our business,

financial condition, future results and cash flow.

In connection with the power purchase agreements for the Ormesa project, Southern California Edison Company has expressed its intent not to pay the contract rate for the power supplied by the GEM 2 and GEM 3 plants to the Ormesa project for auxiliary purposes. We have commenced discussions with Southern California Edison Company to resolve the dispute. In the interim period, Southern California Edison Company has tentatively agreed to pay a lower fixed price for such power. We cannot evaluate the potential long-term financial impact of a failure to reach a resolution with Southern California Edison Company, among other things because the current contract rates will fluctuate as of May 2007, however, financial loss at the reduced price paid by Southern California Edison Company for our fiscal year ended December 31, 2005 may be in the range of \$1 million.

Seasonal variations may cause significant fluctuations in our cash flows, which may cause the market price of our common stock to fall in certain periods.

Our results of operations are subject to seasonal variations. This is primarily because some of our domestic projects receive higher capacity payments under the relevant power purchase agreements during the summer months and due to the generally higher short run avoided costs in effect during the summer months. Some of our other projects may experience reduced generation during warm periods due to the lower heat differential between the geothermal fluid and the ambient surroundings. Such seasonal variations could materially and adversely affect our business, financial condition, future results and cash flow. If our operating results fall below the public's or analysts' expectations in some future period or periods, the market price of our common stock will likely fall in such period or periods.

Pursuant to the terms of some of our power purchase agreements with investor-owned electric utilities in states that have renewable portfolio standards, the failure to supply the contracted capacity thereunder may result in the imposition of penalties.

Pursuant to the terms of the Galena, Desert Peak 2 and Desert Peak 3 power purchase agreements that we have entered into and under which we will sell electricity from the Galena, Desert Peak 2 and Desert Peak 3 projects that are currently under development and construction, we may be required to make payments to the relevant power purchaser in an amount equal to such purchaser's replacement costs for renewable energy relating to any shortfall amount of renewable energy that we do not provide as required under the power purchase agreement and which such power purchaser is forced to obtain from an alternate source. These three power purchase agreements are expected to phase-in and commence generating revenues starting in 2006. When all three are generating revenues, measured against our revenues from the sale of electricity for the period ending June 30, 2004 and assuming no other changes in our revenues, the revenues from such agreements would have constituted, collectively, less than 8% of our total revenues from the sale of electricity. In addition, we may be required to make payments to the relevant power purchaser in an amount equal to its replacement costs relating to any renewable energy credits we do not provide as required under the relevant power purchase agreement. We may also be required to pay liquidated damages if certain minimum performance requirements are not met under certain of our power purchase agreements, all of which could materially and adversely affect our business, financial condition, future results and cash flow. The minimum performance requirements are described in "Description of Certain Material Agreements—Project-related Agreements." With respect to certain of our power purchase

agreements, we may also be required to pay liquidated damages to our power purchaser if the relevant project does not maintain availability of at least 85% during applicable peak periods. The maximum aggregate amount of such liquidated damages for the Steamboat 2 and Steamboat 3 power purchase agreements would be approximately \$1.5 million for each project. The Puna project was not in compliance with the minimum performance requirements of its power purchase agreement at the time we acquired such project and is currently not in compliance with such requirements. Such non-compliance has resulted in the imposition of sanctions that have reduced, and as long as such non-compliance continues to exist, will continue to reduce, the aggregate amount of revenues payable to us from the power purchaser by approximately \$6,000 per month. Further, the temperature of the geothermal resource at our Heber 1 project has declined from the date on which the project commenced operations and, as a result, the project currently operates at a level that is close to the minimum performance requirements set forth in the project's power purchase agreement. If we fail to upgrade the project's facilities and the project's performance deteriorates below the minimum capacity requirements, we will be obligated to pay a one-time penalty to the power purchaser of approximately \$500,000 per each MW of reduced

capacity.

The short run avoided costs for our power purchasers may decline, which would reduce our project revenues and could materially and adversely affect our business, financial condition, future results and cash flow.

Under the power purchase agreements for our projects in California, the price that Southern California Edison Company pays for energy is based upon its short run avoided costs, which are the incremental costs that it would have incurred had it generated the relevant electrical energy itself or purchased such energy from others. Under settlement agreements between Southern California Edison Company and a number of Qualifying Facility power generators in California, including our subsidiaries, the energy price component payable by Southern California Edison Company has been fixed through April 2007, and thereafter will be based on Southern California Edison Company's short run avoided costs, as determined by the California Public Utilities Commission, which we refer to as CPUC. These short run avoided costs are made available by Southern California Edison Company to the public and may vary substantially on a monthly basis, based primarily on gas prices and other factors. The levels of short run avoided cost prices paid by Southern California Edison Company may decline following the expiration date of the settlement agreements, which in turn would reduce our project revenues derived from Southern California Edison Company under our power purchase agreements with it and could materially and adversely affect our business, financial condition, future results and cash flow.

In addition, under certain of the power purchase agreements for our projects in Nevada, the price that Sierra Pacific Power Company pays for energy and capacity is based upon its short run avoided costs. These short run avoided costs, and in turn the rates payable by Sierra Pacific Power Company, may decline, which in turn would reduce the aggregate amount of project revenues recovered by our Nevada projects pursuant to the relevant power purchase agreements. Such a decrease in project revenues could adversely affect our business, financial condition, future results and cash flow.

In response to an order issued by a California State Court of Appeal, the CPUC has commenced an administrative proceeding in order to address short run avoided cost pricing for Qualifying Facilities for the period spanning from December 2000 to March 2001. The court directed the CPUC to modify short run avoided cost pricing on a retroactive basis to the extent that the CPUC determined that short run avoided cost prices were not sufficiently "accurate" or "correct." If the short run avoided cost prices charged during the period in question were determined by the CPUC not to be "accurate" or "correct," retroactive price adjustments could be required for any of our Qualifying Facilities in California whose payments are tied to short run avoided cost pricing, including the Heber 1, Mammoth and Ormesa projects. Currently, it is not possible to predict the outcome of such proceeding, however, any retroactive price adjustment required to be made in relation to any of our projects may require such projects to make refund payments or charge less for future sales, which could materially and adversely affect our business, financial condition, future results and cash flow.

If any of our domestic projects loses its Qualifying Facility status under PURPA, or if amendments to PURPA are enacted that substantially reduce the benefits currently afforded to our Qualifying Facilities, our domestic operations could be adversely affected.

The operations of most of our domestic projects are subject to, and benefit from, the Public Utility Regulatory Policies Act of 1978, as amended, which we refer to as PURPA, are subject to limited provisions of the Federal Power Act, which we refer to as FPA, and are potentially subject to the provisions of various other energy laws and regulations, including the Public Utility Holding Company Act of 1935, as amended, which we refer to as PUHCA, other provisions of the FPA and certain state and local laws and regulations regarding rates and financial and organizational requirements for electric utilities.

Qualifying Facility status under PURPA exempts our projects from PUHCA, most of the provisions of the FPA, and certain state laws concerning rates and the financial and organizational regulation of electric utilities. If any of our domestic projects in which we have an interest loses its Qualifying Facility status and no regulatory exemptions apply, or if amendments to PURPA are enacted that substantially reduce the benefits currently afforded Qualifying Facilities, our operations could be adversely affected.

In the event that one of our domestic projects loses its Qualifying Facility status, such project and we would become subject to PUHCA and such project would become subject to the full scope of the FPA and applicable state regulations unless an exemption or waiver applies, such as "exempt wholesale generator" ("EWG", as defined under PUHCA) status or "utility geothermal small power production facility" (as defined under PURPA

regulations) status, for such project. The application of PUHCA and such other regulations to our projects would require our operations to comply with an increasingly complex regulatory regime that may be costly and greatly reduce our operational flexibility. In the unlikely event that none of the PUHCA exemptions or waivers are available, we could become a public utility holding company under PUHCA, which could be deemed to occur prospectively or retroactively to the date that any of our projects lost its Qualifying Facility status. In addition, our other domestic projects could lose Qualifying Facility status because our interests in such projects could be considered to be electric utility holding company interests for purposes of the 50% limit on ownership of Qualifying Facilities by electric utilities or electric utility holding companies. As a result of such loss of Qualifying Facility status, and in the absence of an applicable exemption or waiver, the Federal Energy Regulatory Commission, which we refer to as FERC, or relevant state regulators, whichever has jurisdiction, may order partial refunds of past amounts paid by the relevant power purchaser or order a reduction of the rate pursuant to the power purchase agreement prospectively, or both, and thus could cause the loss of some or all of our revenues payable pursuant to the related power purchase agreement, result in significant liability for refunds of past amounts paid, or otherwise impair the value of our projects.

A loss of Qualifying Facility status also could permit the power purchaser, pursuant to the terms of the particular power purchase agreement, to cease taking and paying for electricity from the relevant project or, consistent with FERC precedent, to seek refunds of past amounts paid. This could cause the loss of some or all of our revenues payable pursuant to the related power purchase agreement, result in significant liability for refunds of past amounts paid, or otherwise impair the value of our project. If a power purchaser were to cease taking and paying for electricity or seek to obtain refunds of past amounts paid, there can be no assurance that the costs incurred in connection with the project could be recovered through sales to other purchasers or that we would have sufficient funds to make such payments. In addition, the loss of Qualifying Facility status would be an event of default under the financing arrangements currently in place for some of our projects, which would enable the lenders to exercise their remedies and enforce the liens on the relevant project.

The United States Congress is considering proposed legislation that would amend PURPA by limiting the mandatory purchase obligations of power purchasers under new power purchase agreements. The enactment of such legislation could adversely affect our new projects or enhancements of existing projects that do not have a current power purchase agreement.

An adverse FERC ruling related to the use by a project of power generated from another Qualifying Facility for auxiliary purposes may adversely affect our operations and financial results.

According to a recent FERC decision, a geothermal Qualifying Facility that obtains electricity for the operation of its reinjection pumps from an electric utility must reduce its net capacity available for sale by an equivalent amount. However, if the electricity for reinjection pumping is provided by Qualifying Facilities that are cogeneration or small power production facilities, no reduction in net capacity is required. Two of our projects obtain electricity from an electric utility for the operation of their reinjection pumps. In the past, these projects did not reduce their net capacity available for sale by an equivalent amount. The application of FERC's recent ruling to such projects could have an adverse effect on their revenues received from power sales and their operations and financial condition.

Our financial performance is significantly dependent on the successful operation of our projects, which is subject to changes in the legal and regulatory environment affecting our projects.

All of our projects are subject to extensive regulation and, therefore, changes in applicable laws or regulations, or interpretations of those laws and regulations, could result in increased compliance costs, the need for additional capital expenditures or the reduction of certain benefits currently available to our projects. The structure of federal and state energy regulation is currently, and may continue to be, subject to challenges, modifications, the imposition of additional regulatory requirements, and restructuring proposals. We and our power purchasers may not be able to obtain all regulatory approvals that may be required in the future, or any necessary modifications to existing regulatory approvals, or maintain all required regulatory approvals. In addition, the cost of operation and maintenance and the operating performance of geothermal power plants may be adversely affected by changes in certain laws and regulations, including tax laws.

The federal government also encourages production of electricity from geothermal resources through certain tax subsidies. We are permitted to claim in our consolidated federal tax returns approximately 10% of the construction cost of each new geothermal power plant as a credit against our consolidated federal income taxes.

We are also permitted to deduct, as a depreciation expense on our consolidated federal tax returns, up to 95% of the cost of the power plant over five years on an accelerated basis, which results in more of the cost being deducted in the first few years than during the remainder of the depreciation period. In addition, we have the ability to obtain value from these tax incentives through lease financing transactions even when we are not in a position to use them directly. Any reduction in such tax incentives or any restrictions on such lease financing transactions would materially and adversely affect our business, financial condition, future results and cash flow.

Any such changes could significantly increase the regulatory-related compliance and other expenses incurred by the projects and could significantly reduce or entirely eliminate the revenues generated by one or more of the projects, which in turn would reduce our net income and could materially and adversely affect our business, financial condition, future results and cash flow.

The costs of compliance with environmental laws, which currently are significant, may increase in the future and could materially and adversely affect our business, financial condition, future results and cash flow and any non-compliance with such laws or regulations may result in the imposition of liabilities which could materially and adversely affect our business, financial condition, future results and cash flow.

Our projects are required to comply with numerous domestic and foreign federal, regional, state and local statutory and regulatory environmental standards and to maintain numerous environmental permits and governmental approvals required for construction and/or operation. Some of the environmental permits and governmental approvals that have been issued to the projects contain conditions and restrictions, including restrictions or limits on emissions and discharges of pollutants and contaminants, or may have limited terms. If we fail to satisfy these conditions or comply with these restrictions, or with any statutory or regulatory environmental standards, we may become subject to regulatory enforcement action and the operation of the projects could be adversely affected or be subject to fines, penalties or additional costs. In addition, we may not be able to renew, maintain

or obtain all environmental permits and governmental approvals required for the continued operation or further development of the projects, as a result of which the operation of the projects may be limited or suspended. Environmental laws, ordinances and regulations affecting us can be subject to change and such change could result in increased compliance costs, the need for additional capital expenditures, or otherwise adversely affect us.

We could be exposed to significant liability for violations of hazardous substances laws because of the use or presence of such substances at our projects.

Our projects are subject to numerous domestic and foreign federal, regional, state and local statutory and regulatory standards relating to the use, storage and disposal of hazardous substances. We use isobutane, isopentane, industrial lubricants and other substances at our projects which are or could become classified as hazardous substances. If any hazardous substances are found to have been released into the environment at or by the projects, we could become liable for the investigation and removal of those substances, regardless of their source and time of release. If we fail to comply with these laws, ordinances or regulations (or any change thereto), we could be subject to civil or criminal liability, the imposition of liens or fines, and large expenditures to bring the projects into compliance. Furthermore, in the United States, we can be held liable for the cleanup of releases of hazardous substances at other locations where we arranged for disposal of those substances, even if we did not cause the release at that location. The cost of any remediation activities in connection with a spill or other release of such substances could be significant.

We believe that at one time there may have been a gas station located on the Mammoth project site, but because of significant surface disturbance and construction since that time further physical evaluation of the former gas station site has been impractical. There may be soil or groundwater contamination and related liability exposure of which we are unaware related to this site which may be significant and may adversely and materially affect our operations and revenues.

We may not be able to successfully integrate companies that we have acquired or which we may acquire in the future, which could materially and adversely affect our business, financial condition, future results and cash flow.

We recently acquired our Heber 1, Heber 2, Mammoth, Steamboat 2/3, Steamboat Hills and Puna projects. Our strategy is to continue to expand in the future, including through acquisitions. Integrating acquisitions is

often costly, and we may not be able to successfully integrate our acquired companies with our existing operations without substantial costs, delays or other adverse operational or financial consequences. Integrating our acquired companies involves a number of risks that could materially and adversely affect our business, including:

- failure of the acquired companies to achieve the results we expect;
- inability to retain key personnel of the acquired companies;
- risks associated with unanticipated events or liabilities; and
- the difficulty of establishing and maintaining uniform standards, controls, procedures and policies, including accounting controls and procedures.

If any of our acquired companies suffers customer dissatisfaction or performance problems, the same could adversely affect the reputation of our group of companies and could materially and adversely affect our business, financial condition, future results and cash flow.

The power generation industry is characterized by intense competition, and we encounter competition from electric utilities, other power producers, and power marketers that could materially and adversely affect our business, financial condition, future results and cash flow.

The power generation industry is characterized by intense competition from electric utilities, other power producers and power marketers. In recent years, there has been increasing competition in the sale of electricity, in part due to excess capacity in a number of U.S. markets and an emphasis on

short-term or "spot" markets, and competition has contributed to a reduction in electricity prices. For the most part, we expect that power purchasers interested in long-term arrangements with a capacity price component will engage in "competitive bid" solicitations to satisfy new capacity demands. This competition could adversely affect our ability to obtain power purchase agreements and the price paid for electricity by the relevant power purchasers. There is also increasing competition between electric utilities. This competition has put pressure on electric utilities to lower their costs, including the cost of purchased electricity, and increasing competition in the future will put further pressure on power purchasers to reduce the prices at which they purchase electricity from us.

The existence of a prolonged force majeure event or a forced outage affecting a project could reduce our net income and materially and adversely affect our business, financial condition, future results and cash flow.

If a project experiences a force majeure event, our subsidiary owning that project would be excused from its obligations under the relevant power purchase agreement. However, the relevant power purchaser may not be required to make any capacity and/or energy payments with respect to the affected project or plant so long as the force majeure event continues and, pursuant to certain of our power purchase agreements, will have the right to prematurely terminate the power purchase agreement. Additionally, to the extent that a forced outage has occurred, the relevant power purchaser may not be required to make any capacity and/or energy payments to the affected project, and if as a result the project fails to attain certain performance requirements under certain of our power purchase agreements, the purchaser may have the right to permanently reduce the contract capacity (and, correspondingly, the amount of capacity payments due pursuant to such agreements in the future), seek refunds of certain past capacity payments, and/or prematurely terminate the power purchase agreement. As a consequence, we may not receive any net revenues from the affected project or plant other than the proceeds from any business interruption insurance that applies to the force majeure event or forced outage after the relevant waiting period and may incur significant liabilities in respect of past amounts required to be refunded. Accordingly, our business, financial condition, future results and cash flows could be materially and adversely affected.

The existence of a force majeure event or a forced outage affecting the transmission system of the Imperial

Irrigation District could reduce our net income and materially and adversely affect our business, financial condition, future results and cash flow.

If the transmission system of the Imperial Irrigation District experiences a force majeure event or a forced outage which prevents it from transmitting the electricity from the Heber 1 and Heber 2 projects or the Ormesa project to the relevant power purchaser, the relevant power purchaser would not be required to make energy payments for such non-delivered electricity and may not be required to make any capacity payments with respect to the affected project so long as such force majeure event or forced outage continues. Our pro forma revenues in 2003 from the projects utilizing the Imperial Irrigation District transmission system were approximately \$98.6 million. The impact of such force majeure would depend on the duration thereof, with longer outages resulting in greater revenue loss.

Some of our leases will terminate if we do not extract geothermal resources in "commercial quantities," thus requiring us to enter into new leases or secure rights to alternate geothermal resources, none of which may be available on terms as favorable to us as any such terminated lease, if at all.

Most of our geothermal resource leases are for a fixed primary term, and then continue for so long as geothermal resources are extracted in "commercial quantities" or pursuant to other terms of extension. The land covered by some of our leases is undeveloped and has not yet produced geothermal resources in "commercial quantities." Leases that cover land which remains undeveloped and does not produce, or does not continue to produce, geothermal resources in commercial quantities and leases that we allow to expire, will terminate. In the event that a lease is terminated and we determine that we will need that lease once the applicable project is operating, we would need to enter into one or more new leases with the owner(s) of the premises that are the subject of the

terminated lease(s) in order to develop geothermal resources from or inject geothermal resources into such premises or secure rights to alternate geothermal resources or lands suitable for injection, all of which may not be possible or could result in increased cost to us, which could materially and adversely affect our business, financial condition, future results and cash flow.

Our Bureau of Land Management leases may be terminated if we fail to comply with any of the provisions of the Geothermal Steam Act of 1970 or if we fail to comply with the terms or stipulations of such leases, which may materially and adversely affect our business and operations.

Pursuant to the terms of our Bureau of Land Management (which we refer to as BLM) leases, we are required to conduct our operations on BLM-leased land in a workmanlike manner and in accordance with all applicable laws and BLM directives and to take all mitigating actions required by the BLM to protect the surface of and the environment surrounding the relevant land. Additionally, certain BLM leases contain additional requirements, some of which relate to the mitigation or avoidance of disturbance of any antiquities, cultural values or threatened or endangered plants or animals, the payment of royalties for timber and the imposition of certain restrictions on residential development on the leased land. In the event of a default under any BLM lease, or the failure to comply with such requirements, or any non-compliance with any of the provisions of the Geothermal Steam Act of 1970 or regulations issued thereunder, the BLM may, 30 days after notice of default is provided to our relevant project subsidiary, suspend operations until the requested action is taken or terminate the lease, either of which could materially and adversely affect our business, financial condition, future results and cash flows.

Some of our leases (or subleases) could terminate if the lessor (or sublessor) under any such lease (or sublease) defaults on any debt secured by the relevant property, thus terminating our rights to access the underlying geothermal resources at that location.

The fee interest in the land which is the subject of each of our leases (or subleases) may currently be or may become subject to encumbrances securing loans from third party lenders to the lessor (or sublessor). Our rights as lessee (or sublessee) under such leases (or subleases) are or may be subject and subordinate to the rights of any such lender. Accordingly, a default by the lessor (or sublessor) under any such loan could result in a foreclosure on the underlying fee interest in the property and thereby terminate our leasehold interest and result in the shutdown of the project located on the relevant property and/or terminate our right of access to the underlying geothermal resources required for our operations.

In addition, a default by a sublessor under its lease with the owner of the property that is the subject of our sublease could result in the termination of such lease and thereby terminate our sublease interest and our right to

access the underlying geothermal resources required for our operations.

We depend on key personnel for the success of our business.

Our success is largely dependent on the skills, experience and efforts of our senior management team and other key personnel. In particular, our success depends on the continued efforts of Lucien Bronicki, Yehudit Bronicki, Hezy Ram, Nadav Amir, Yoram Bronicki and other key employees. The loss of the services of any key employee could materially harm our business, financial condition, future results and cash flow. Although to date we have been successful in retaining the services of senior management and have entered into employment agreements with Lucien Bronicki, Yehudit Bronicki, Hezy Ram and Yoram Bronicki, such members of our senior management may terminate their employment agreements without cause and with notice periods ranging from 120 to 180 days. We may also not be able to locate or employ on acceptable terms qualified replacements for our senior management or key employees if their services were no longer available.

Our projects have generally been financed through a combination of parent company loans and limited- or non-recourse project finance debt. If our project subsidiaries default on their obligations under such limited- or non-recourse debt, we may be required to make certain payments to the relevant debt holders and if the collateral supporting such leveraged financing structures is foreclosed upon, we may lose certain of our projects.

Our projects have generally been financed using a combination of parent company loans and limited- or non-recourse project finance debt. Non-recourse project finance debt refers to debt that is repaid solely from the project's revenues and is secured by the project's physical assets, major contracts, cash accounts and, in many cases, our ownership interest in the project subsidiary. Limited- recourse project finance debt refers to our additional agreement, as part of the financing of a project, to provide limited financial support for the project subsidiary in the form of limited guarantees, indemnities, capital contributions and agreements to pay certain debt service deficiencies. If our project subsidiaries default on their obligations under the relevant debt documents, creditors of a limited-recourse project financing will have direct recourse to us, to the extent of our limited-recourse obligations, which may require us to use distributions received by us from other projects, as well as other sources of cash available to us, in order to satisfy such obligations. In addition, if our project subsidiaries default on their obligations under the relevant debt documents (or a default under such debt documents arises as a result of a cross-default to the debt documents of some of our other projects) and the creditors foreclose on the relevant collateral, we may lose our ownership interest in the relevant project subsidiary or our project subsidiary owning the project would only retain an interest in the physical assets, if any, remaining after all debts and obligations were paid in full.

Changes in costs and technology may significantly impact our business by making our power plants and products less competitive.

A basic premise of our business model is that generating baseload power at central geothermal power plants achieves economies of scale and produces electricity at a competitive price. However, traditional coal-fired systems and gas-fired systems may under certain economic conditions produce electricity at lower average prices than our geothermal plants. In addition, there are other technologies that can produce electricity, most notably fossil fuel power systems, hydroelectric systems, fuel cells, microturbines, windmills and photovoltaic (solar) cells. Some of these alternative technologies currently produce electricity at a higher average price than our geothermal plants; however, research and development activities are ongoing to seek improvements in such alternate technologies and their cost of producing electricity is gradually declining. It is possible that advances will further reduce the cost of alternate methods of power generation to a level that is equal to or below that of most geothermal power generation technologies. If this were to happen, the competitive advantage of our projects may be significantly impaired.

Our expectations regarding the market potential for the development of recovered energy-based power generation may not materialize, and as a result we may not derive any significant revenues from this line of business.

We have identified recovered energy-based power generation as a significant market opportunity for us. Demand for our recovered energy-based power generation units may not materialize or grow at the levels that we expect. We currently face competition in this market from manufacturers of conventional steam turbines and may face competition from other related technologies in the future. If this market does not materialize at the levels that we expect, such failure may materially and adversely affect our business, financial condition, future results and

cash flow.

Our intellectual property rights may not be adequate to protect our business.

Our intellectual property rights may not be adequate to protect our business. While we occasionally file patent applications, patents may not be issued on the basis of such applications or, if patents are issued, they may not be sufficiently broad to protect our technology. In addition, any patents issued to us or for which we have use rights may be challenged, invalidated or circumvented.

In order to safeguard our unpatented proprietary know-how, trade secrets and technology, we rely primarily upon trade secret protection and non-disclosure provisions in agreements with employees and others having access to confidential information. These measures may not adequately protect us from disclosure or misappropriation of our proprietary information.

Even if we adequately protect our intellectual property rights, litigation may be necessary to enforce these rights, which could result in substantial costs to us and a substantial diversion of management attention. Also, while we have attempted to ensure that our technology and the operation of our business do not infringe other parties' patents and proprietary rights, our competitors or other parties may assert that certain aspects of our business or technology may be covered by patents held by them. Infringement or other intellectual property claims, regardless of merit or ultimate outcome, can be expensive and time-consuming and can divert management's attention from our core business.

We are subject to risks associated with a changing economic and political environment, which may adversely affect our financial stability or the financial stability of our counterparties.

The risk of terrorist attacks in the United States or elsewhere continues to remain a potential source of disruption to the nation's economy and financial markets in general. The availability and cost of capital for our business and that of our competitors has been adversely affected by the bankruptcy of Enron Corp. and events related to the California electric market crisis. Additionally, the recent rise in fuel costs may make it more expensive for our customers to operate their businesses. These events could constrain the capital available to our industry and could adversely affect our financial stability and the financial stability of our counterparties in transactions.

Possible fluctuations in the cost of raw materials may materially and adversely affect our business, financial condition, future results and cash flow.

Our manufacturing operations are dependent on the supply of various raw materials, including primarily steel and aluminium, and on the supply of various industrial equipment components that we use. We currently obtain all such materials and equipment at prevailing market prices. We are not dependent on any one supplier and do not have any long-term agreements with any of our suppliers. Future cost increases of such raw materials and equipment, to the extent not otherwise passed along to our customers, could adversely affect our profit margins.

Conditions in Israel, where the majority of our senior management and all of our production and manufacturing facilities are located, may adversely affect our operations and may limit our ability to produce and sell our products or manage our projects.

Operations in Israel accounted for approximately 61.3%, 56.3%, and 51.0% of our operating expenses in fiscal year 2001, fiscal year 2002 and fiscal year 2003, respectively. Political, economic and security conditions in Israel directly affect our operations. Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors, and the continued state of hostility, varying in degree and intensity, has led to security and economic problems for Israel. Since October 2000, there has been a significant increase in violence, primarily in the West Bank and Gaza Strip, and more recently Israel has experienced a significant increase in terrorist incidents within its borders. As a result, negotiations between Israel and representatives of the Palestinian Authority have been sporadic and have failed to result in peace. We could be adversely affected by hostilities involving Israel, the interruption or curtailment of trade between Israel and its trading partners, or a significant downturn in the economic or financial condition of Israel. In addition, the sale of products manufactured in Israel may be adversely affected in certain countries by restrictive laws, policies or practices directed toward Israel or companies having operations in Israel.

In addition, some of our employees in Israel are subject to being called upon to perform military service in

Israel, and their absence may have an adverse effect upon our operations. Generally, unless exempt, male adult citizens of Israel under the age of 41 are obligated to perform up to 36 days of

military reserve duty annually. Additionally, all such citizens are subject to being called to active duty at any time under emergency circumstances.

These events and conditions could disrupt our operations in Israel, which could materially harm our business, financial condition, future results and cash flow.

Failure to comply with certain conditions and restrictions associated with tax benefits provided to Ormat Systems by the Government of Israel as an "approved enterprise" may require us to refund such tax benefits and pay future taxes in Israel at higher rates.

Our subsidiary, Ormat Systems, has received "approved enterprise" status under Israel's Law for Encouragement of Capital Investments, 1959, with respect to two of its investment programs. As an approved enterprise, our subsidiary is exempt from Israeli income taxes with respect to revenues derived from the approved investment program for a period of two years commencing on the year it first generates profits from the approved investment program, and thereafter such revenues are subject to reduced Israeli income tax rates of 25% for an additional five years. These benefits are subject to certain conditions set forth in the certificate of approval from Israel's Investment Center, which include, among other things, a requirement that Ormat Systems comply with Israeli intellectual property law, that all transactions between Ormat Systems and our affiliates be at arms length, and that there will be no change in control of, on a cumulative basis, more than 49% of Ormat Systems' capital stock (including by way of a public or private offering) without the prior written approval of the Investment Center. If Ormat Systems does not comply with these conditions, in whole or in part, it would be required to refund the amount of tax benefits (as adjusted by the Israeli consumer price index and for accrued interest) and would no longer benefit from the reduced Israeli tax rates, which could have an adverse effect on our financial condition, future results and cash flow. If Ormat Systems distributes dividends out of revenues derived during the tax exemption period from the approved investment program, it will be subject, in the year in which such dividend is paid, to Israeli income tax on the distributed dividend.

If our parent defaults on its lease agreement with the Israel Land Administration, or is involved in a bankruptcy or similar proceeding, our rights and remedies under certain agreements pursuant to which we acquired our products business and pursuant to which we sublease our land and manufacturing facilities from our parent may be adversely affected.

We acquired our business relating to the manufacture and sale of products for electricity generation and related services from our parent, Ormat Industries. In connection with that acquisition, we entered into a sublease with Ormat Industries for the lease of the land and facilities where our manufacturing and production operations are conducted and where our Israeli offices are located. Under the terms of our parent's lease agreement with the Israel Land Administration, any sublease for a period of more than five years may require the prior approval of the Israel Land Administration. As a result, the initial term of our sublease with Ormat Industries is for a period of four years and eleven months, extendable to twenty-five years (which includes the initial term) should our parent obtain the approval of the Israel Land Administration, to the extent necessary. If such an approval is required and our parent fails to obtain the Israel Land Administration's approval, our sublease will terminate on June 1, 2009, at which time we will have to renegotiate the terms of a new sublease. We may not be successful in reaching an agreement with our parent as to the terms of a new sublease or in obtaining such sublease on favorable terms, both of which would adversely affect our manufacturing activities and our financial position. Additionally, if our parent were to breach its obligations to the Israel Land Administration under its lease agreement, the Israel Land Administration could terminate the lease agreement and, consequently, our sublease would terminate as well.

As part of the acquisition described in the preceding paragraph, we also entered into a patent license agreement with Ormat Industries, pursuant to which we were granted an exclusive license for certain patents and trademarks relating to certain technologies that are used in our business. If a bankruptcy case were commenced by or against our parent, it is possible that performance of all or

part of the agreements entered into in connection with such acquisition (including the lease of land and facilities described above) could be stayed by the bankruptcy court in Israel or rejected by a liquidator appointed pursuant to the Bankruptcy Ordinance in Israel and thus not be enforceable. Any of these events could have a material and adverse effect on our business, financial condition, future results and cash flow.

We are a holding company and our revenues depend substantially on the performance of our subsidiaries and the projects they operate, most of which are subject to restrictions and taxation on dividends and distributions.

We are a holding company whose primary assets are our ownership of the equity interests in our subsidiaries. We conduct no other business and, as a result, we depend entirely upon our subsidiaries' earnings and cash flow.

The agreements pursuant to which most of our subsidiaries have incurred debt restrict the ability of these subsidiaries to pay dividends, make distributions or otherwise transfer funds to us prior to the satisfaction of other obligations, including the payment of operating expenses, debt service and replenishment or maintenance of cash reserves. In the case of some of our projects, such as the Mammoth project, there may be certain additional restrictions on dividend distributions pursuant to our agreements with our partners. Further, if we elect to receive distributions of earnings from our foreign operations, we may incur United States taxes on account of such distributions, net of any available foreign tax credits. In all of the foreign countries where our existing projects are located, dividend payments to us are also subject to withholding taxes. Each of the events described above may reduce or eliminate the aggregate amount of revenues we can receive from our subsidiaries.

Risks Relating to this Offering

Our controlling stockholders may take actions that conflict with your interests.

Immediately following this offering, 79.6% of our common stock will be held by Ormat Industries, Ltd. (77.2% if the underwriters exercise their over-allotment option in full), which is controlled by Bronicki Investments Ltd. Bronicki Investments Ltd. is a privately held Israeli company and is controlled by Lucien and Yehudit Bronicki. Because of these holdings, our parent company and its controlling stockholders will be able to exercise control over all matters requiring stockholder approval, including the election of directors, amendment of our certificate of incorporation and approval of significant corporate transactions, and they will have significant control over our management and policies. The directors elected by these stockholders will be able to significantly influence decisions affecting our capital structure. This control may have the effect of delaying or preventing changes in control or changes in management, or limiting the ability of our other stockholders to approve transactions that they may deem to be in their best interest. For example, our controlling stockholders will be able to control the sale or other disposition of our products business to another entity or the transfer of such business outside of the State of Israel, as such action requires the affirmative vote of at least 75% of our outstanding shares.

Some of our directors that also hold positions with our parent may have conflicts of interest with respect to matters involving both companies.

Two of our three directors are directors and/or officers of Ormat Industries. These directors will have fiduciary duties to both companies and may have conflicts of interest on matters affecting both us and our parent and in some circumstances may have interests adverse to our interests. Our Chairman, Director and Chief Technology Officer, Mr. Bronicki, will continue to be Chairman of our parent following the offering. In addition, our Chief Executive Officer and Director, Mrs. Bronicki, will continue to be the Chief Executive Officer of our parent following the offering.

There has been no prior market for our common stock and an active trading market may not develop.

Prior to this offering, there has been no public market for our common stock. An active trading market may not develop following the closing of this offering or, if developed, may not be sustained.

The lack of an active market may impair your ability to sell your shares of common stock at the time you wish to sell them or at a price that you consider reasonable. The lack of an active market may also reduce the fair market value and increase the volatility of your shares of common stock. An inactive market may also impair our ability to raise capital by selling shares of common stock and may impair our ability to acquire other companies or

technologies by using our shares of common stock as consideration.

The price of our common stock may fluctuate substantially and your investment may decline in value.

The initial public offering price for the shares of our common stock sold in this offering will be determined by negotiation between the representative of the underwriters and us. This price may not reflect the market price of our common stock following this offering. In addition, the market price of our common stock is likely to be highly volatile and may fluctuate substantially due to many factors, including:

- actual or anticipated fluctuations in our results of operations including as a result of seasonal variations in our electricity-based revenues;
- variance in our financial performance from the expectations of market analysts;
- conditions and trends in the end markets we serve and changes in the estimation of the size and growth rate of these markets;
- announcements of significant contracts by us or our competitors;
- changes in our pricing policies or the pricing policies of our competitors;
- loss of one or more of our significant customers;
- legislation;
- changes in market valuation or earnings of our competitors;
- the trading volume of our common stock; and
- general economic conditions.

In addition, the stock market in general, and the New York Stock Exchange and the market for energy companies in particular, have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of particular companies affected. These broad market and industry factors may materially harm the market price of our common stock, regardless of our operating performance. In the past, following periods of volatility in the market price of a company's securities, securities class-action litigation has often been instituted against that company. Such litigation, if instituted against us, could result in substantial costs and a diversion of management's attention and resources, which could materially harm our business, financial condition, future results and cash flow.

Our management team may invest or spend the proceeds of this offering in ways with which you may not agree or in ways that may not yield a positive return.

Presently, anticipated uses of the proceeds to us of this offering include funding business growth and expansion, providing additional working capital, and for other general corporate purposes. We cannot specify with certainty how we will use the net proceeds of this offering. Accordingly, our management will have considerable discretion in the application of these proceeds, and you will not have the opportunity to assess whether these proceeds are being used appropriately. These proceeds may be used for corporate purposes that do not increase our operating results or market value. Until the net proceeds are used, they may be placed in investments that do not produce income or that lose value.

Future sales of our common stock may depress our share price.

After this offering, we will have 30,624,996 shares of common stock outstanding. The 6,250,000 shares sold in this offering (or 7,187,500 shares if the underwriters' over-allotment option is exercised

in full) will be freely tradable without restriction or further registration under federal securities laws unless purchased by our affiliates. The remaining shares of common stock outstanding after this offering are subject to lock-up agreements, will be available for sale in the public market beginning 180 days after the date of this prospectus, and will be subject to certain volume limitations under Rule 144 of the Securities Act of 1933, as amended. Lehman Brothers Inc. may waive the lock-up provisions in its sole discretion.

Sales of substantial amounts of our common stock in the public market following this offering, or the perception that these sales may occur, could cause the market price of our common stock to decline. At or prior to the closing of this offering, we will enter into a registration rights agreement with Ormat Industries. See "Certain Relationships and Related Transactions" for more information.

This offering will cause substantial dilution in the net tangible book value of your shares of common stock.

The initial public offering price of our common stock is considerably more than the net tangible book value per share of our outstanding common stock. Accordingly, investors purchasing shares of common stock in this offering will contribute 78.8% of the total amount invested to fund our company, but will own only 20.4% of the shares of common stock outstanding after this offering. To the extent outstanding stock options are exercised, there will be further dilution to new investors. See "Dilution" for more information.

Provisions in our charter documents and Delaware law may delay or prevent acquisition of us, which could adversely affect the value of our common stock.

Our restated certificate of incorporation and our bylaws contain provisions that could make it harder for a third party to acquire us without the consent of our board of directors. These provisions do not permit actions by our stockholders by written consent. In addition, these provisions include procedural requirements relating to stockholder meetings and stockholder proposals that could make stockholder actions more difficult. Our board of directors will be classified into three classes of directors serving staggered, three-year terms and may be removed only for cause. Any vacancy on the board of directors may be filled only by the vote of the majority of directors then in office. Our board of directors has the right to issue preferred stock without stockholder approval, which could be used to institute a "poison pill" that would work to dilute the stock ownership of a potential hostile acquirer, effectively preventing acquisitions that have not been approved by our board of directors. Delaware law also imposes some restrictions on mergers and other business combinations between us and any holder of 15% or more of our outstanding common stock. Although we believe these provisions provide for an opportunity to receive a higher bid by requiring potential acquirers to negotiate with our board of directors, these provisions apply even if the offer may be considered beneficial by some stockholders.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Some of the statements made in this prospectus are forward-looking statements. These forward looking statements are based upon our current expectations and projections about future events. When used in this prospectus, the words "believe", "anticipate", "intend", "estimate", "expect", "should", "may" and similar expressions, or the negative of such words and expressions, are intended to identify forward-looking statements, although not all forward-looking statements contain such words or expressions. The forward-looking statements in this prospectus are primarily located in the material set forth under the headings "Prospectus Summary", "Risk Factors", "Capitalization", "Management's Discussion and Analysis of Financial Condition and Results of Operations", and "Business", but are found in other locations as well. These forward-looking statements generally relate to our plans, objectives and expectations for future operations and are based upon management's current estimates and projections of future results or trends. Although we believe that our plans and objectives reflected in or suggested by these forward-looking statements are reasonable, we may not achieve these plans or objectives. You should read this prospectus completely and with the understanding that actual future results may be materially different from what we expect. We will not update forward-looking statements even though our situation may change in the future.

Specific factors that might cause actual results to differ from our expectations or may affect the value of our

common stock include, but are not limited to:

- significant considerations and risks discussed in this prospectus;
- operating risks, including equipment failures and the amounts and timing of revenues and expenses;
- geothermal resource risk (such as the heat content of the reservoir, useful life and geological formation);
- environmental constraints on operations and environmental liabilities arising out of past or present operations;
- project delays or cancellations;
- financial market conditions and the results of financing efforts;
- political, legal, regulatory, governmental, administrative and economic conditions and developments in the United States and other countries in which we operate;
- the enforceability of the long-term power purchase agreements for our projects;
- contract counterparty risk;
- weather and other natural phenomena;
- the impact of recent and future federal and state regulatory proceedings and changes, including legislative and regulatory initiatives regarding deregulation and restructuring of the electric utility industry and incentives for the production of renewable energy, changes in environmental and other laws and regulations to which our company is subject, as well as changes in the application of existing laws and regulations;
- current and future litigation;
- our ability to successfully identify, integrate and complete acquisitions;
- competition from other similar geothermal energy projects, including any such new geothermal energy projects developed in the future, and from alternative electricity producing technologies;
- the effect of and changes in economic conditions in the areas in which we operate;
- market or business conditions and fluctuations in demand for energy or capacity in the markets in which we operate; and
- the direct or indirect impact on our company's business resulting from terrorist incidents or responses to such incidents, including the effect on the availability of and premiums on insurance.

USE OF PROCEEDS

We estimate that the net proceeds we will receive from this offering will be approximately \$89.9 million, or approximately \$103.8 million if the underwriters exercise their over-allotment option in full, in each case after deducting the underwriting discounts and commissions and estimated expenses of this offering payable by us. We expect to use all of the net proceeds from this offering for general corporate purposes, which may include making investments or acquisitions. We have no present understanding or agreement relating to any specific acquisition. Accordingly, management will have significant flexibility in applying the net proceeds of the offering. Pending the use of such proceeds as described above, we intend to invest such proceeds in interest-bearing investment-grade instruments or bank deposits.

DIVIDEND POLICY

We have adopted a dividend policy pursuant to which we currently expect, commencing with the first full fiscal quarter following the consummation of this offering, to distribute at least 20% of our annual profits available for distribution by way of quarterly dividends. In determining whether there are profits available for distribution, our board of directors will take into account our business plan and current and expected obligations, and no distribution will be made that in the judgment of our board of directors would prevent us from meeting such business plan or obligations.

Notwithstanding this policy, dividends will be paid only when, as and if approved by our board of directors out of funds legally available therefor. The actual amount and timing of dividend payments will depend upon our financial condition, results of operations, business prospects and such other matters as the board may deem relevant from time to time. Even if profits are available for the payment of dividends, the board of directors could determine that such profits should be retained for an extended period of time, used for working capital purposes, expansion or acquisition of businesses or any other appropriate purpose. As a holding company, we are dependent upon the earnings and cash flow of our subsidiaries in order to fund any dividend distributions, and, as a result, we may not be able to pay dividends in accordance with our policy. Our board of directors may, from time to time, examine our dividend policy and may, in its absolute discretion, change such policy. In accordance with this policy, conditional upon, and effective as of, the effectiveness of the registration statement of which this prospectus forms a part, we will pay an interim dividend for 2004 of \$2.5 million to our parent company, Ormat Industries.

CAPITALIZATION

The following table summarizes our capitalization as of June 30, 2004:

- on a historical basis; and
- (a) on a pro forma basis to give effect to (i) an interim dividend for 2004 of \$2.5 million to our parent company pursuant to our dividend policy that is conditional upon, and effective as of the effectiveness of this registration statement, and (ii) the \$4.8 million cash payment and the reclassification of the divisional deficit of \$10.3 million to retained earnings related to the purchase on July 1, 2004 of our parent's power generation business; and (b) as adjusted to give effect to the completion of this offering,

including the application of the estimated net proceeds to us from this offering as described under "Use of Proceeds."

You should read the following table in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations," "Description of Capital Stock" and our consolidated financial statements and related notes appearing elsewhere in this prospectus.

	<u>As of June 30, 2004</u>	
	<u>Actual</u>	<u>Pro Forma As Adjusted</u>
	(unaudited)	
	(in thousands)	
Cash and cash equivalents	\$ 21,170	\$ 103,742
Debt:		
Parent company loans	193,852	193,852
Long-term debt	442,300	442,300
Total debt	<u>636,152</u>	<u>636,152</u>
Shareholders' equity:		
Common stock, \$0.001 par value; 200,000,000 shares authorized and 24,374,996 shares issued and outstanding, historical; 200,000,000 shares authorized and 30,624,996 shares issued and outstanding, pro forma as adjusted	24	30
Additional paid-in capital	27,001	116,867
Divisional deficit	(10,293)	—
Unearned stock-based compensation	(51)	(51)
Retained Earnings	46,551	28,958
Total shareholders' equity	<u>63,232</u>	<u>145,804</u>
Total capitalization	<u>\$ 699,384</u>	<u>\$ 781,956</u>

The discussion and tables above exclude (i) 230,000 shares of our common stock issuable upon the exercise of stock options that will be outstanding as of the effective date of the registration statement, and (ii) 1,020,000 shares of our common stock reserved for future issuance under our 2004 Incentive Compensation Plan. See "Management—Stock Option Plan."

DILUTION

At June 30, 2004, the net tangible book value of our common stock was approximately \$13.5 million, or approximately \$0.56 per share of our common stock. After giving effect to the sale of shares of our common stock in this offering at an assumed initial public offering price of \$16.00 per share, and after deducting estimated underwriting discounts and commissions paid by us and the estimated expenses of this offering, the net tangible book value at June 30, 2004 attributable to common stockholders would have been approximately \$103.8 million, or approximately \$3.38 per share of our common stock. This represents an immediate increase in net tangible book value of \$2.82 per share, and an immediate dilution in net tangible book value of \$12.62 per share to new stockholders. The following table illustrates this per share dilution to new stockholders:

Assumed initial public offering price per share	\$ 16.00
Net tangible book value per share before the offering	\$ 0.56
Net increase in tangible book value per share attributable to new stockholders	<u>2.82</u>
Net tangible book value per share after the offering	<u>3.38</u>

The table below summarizes, as of June 30, 2004, the differences for our existing stockholders and new stockholders in this offering, with respect to the number of shares of common stock purchased from us, the total consideration paid and the average price per share paid before deducting fees and expenses.

	<u>Shares Issued</u>		<u>Total Consideration</u>		<u>Average Price Per Share</u>
	<u>Number</u>	<u>Percentage</u>	<u>Amount</u>	<u>Percentage</u>	
	(dollars in thousands, except per share data)				
Our existing stockholders	24,374,996	79.6%	\$ 26,862	21.2%	\$ 1.10
New stockholders in this offering	<u>6,250,000</u>	<u>20.4%</u>	<u>100,000</u>	<u>78.8%</u>	16.00
Total	<u>30,624,996</u>	<u>100.0%</u>	<u>\$ 126,862</u>	<u>100.0%</u>	

The discussion and tables above exclude (i) 230,000 shares of our common stock issuable upon the exercise of stock options that will be outstanding as of the effective date of the registration statement, and (ii) 1,020,000 shares of our common stock reserved for future issuance under our 2004 Incentive Compensation Plan. See "Management—Stock Option Plan."

SELECTED CONSOLIDATED FINANCIAL AND OTHER DATA

The following table sets forth our selected consolidated financial and other data for the periods ended and at the dates indicated. We have derived the selected consolidated financial and other data as of and for the periods ended December 31, 2001, 2002 and 2003 from our audited consolidated financial statements included elsewhere in this prospectus. We have derived the selected consolidated financial data as of and for the periods ended December 31, 1999 and 2000 from our unaudited consolidated financial statements not included in this prospectus. We have derived the selected consolidated financial and other data as of and for the six months ended June 30, 2003 and June 30, 2004 from our unaudited consolidated financial statements included elsewhere in this prospectus. In the opinion of our management, our unaudited consolidated financial statements contain all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of our financial position, results of operations and cash flows. The results of operations for the six months ended June 30, 2003 and June 30, 2004 are not necessarily indicative of the operating results to be expected for the full fiscal years encompassing such periods.

The information set forth below should be read in conjunction with the "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements included elsewhere in this prospectus.

	<u>Year Ended December 31,</u>					<u>Six Months Ended June 30,</u>	
	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2003</u>	<u>2004</u>
	(in thousands, except per share data)						
	(unaudited)					(unaudited)	

Statement of Operations Data:

Revenues:

Electricity Segment:

Energy and capacity	\$15,169	\$20,780	\$33,956	\$65,491	\$ 77,752	\$ 35,651	\$ 48,048
Lease	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>22,167</u>
Total Electricity Segment	15,169	20,780	33,956	65,491	77,752	35,651	70,215
Products Segment	<u>64,388</u>	<u>27,780</u>	<u>13,959</u>	<u>20,138</u>	<u>41,688</u>	<u>16,022</u>	<u>29,491</u>
	<u>79,557</u>	<u>48,560</u>	<u>47,915</u>	<u>85,629</u>	<u>119,440</u>	<u>51,673</u>	<u>99,706</u>

Cost of revenues:							
Electricity Segment:							
Energy and capacity	6,847	8,556	12,536	33,482	46,726	22,165	29,440
Lease	—	—	—	—	—	—	11,172
Total Electricity Segment	6,847	8,556	12,536	33,482	46,726	22,165	40,612
Products Segment	40,644	22,709	17,454	17,293	29,494	10,306	23,122
	47,491	31,265	29,990	50,775	76,220	32,471	63,734
Gross Margin	32,066	17,295	17,925	34,854	43,220	19,202	35,972
Operating Expenses:							
Research and development expenses	3,289	2,260	1,729	1,503	1,391	871	1,202
Selling and marketing expenses	6,593	3,624	6,535	6,051	7,087	2,666	3,946
General and administrative expenses	7,614	6,632	5,444	7,073	9,252	4,053	5,219
Operating income	14,570	4,779	4,217	20,227	25,490	11,612	25,605
Other income (expense):							
Interest income	961	1,499	1,323	609	607	299	431
Interest expense	(3,793)	(3,700)	(4,333)	(6,179)	(8,120)	(3,835)	(19,475)
Foreign currency translation and transaction gain (loss)	(9)	25	305	(323)	(316)	(151)	(397)
Other non-operating income	223	7,884	300	1,195	464	278	145
Income from continuing operations before income taxes, minority interest and equity in income of investees	11,952	10,487	1,812	15,529	18,125	8,203	6,309
Income tax provision	(3,226)	(494)	(3,065)	(6,135)	(2,506)	(2,173)	(1,957)
Minority interest in earnings of subsidiaries	(277)	(550)	(645)	(1,194)	(519)	(399)	(108)
Equity in income of investees	4	69	166	314	559	188	2,035
Income (loss) from continuing operations	8,453	9,512	(1,732)	8,514	15,659	5,819	6,279
Discontinued operations:							
Loss from operations of discontinued activities in Kazakhstan	(3,374)	(2,911)	(4,681)	(3,114)	—	—	—
Loss on sale of Kazakhstan operations	—	—	—	(6,444)	—	—	—

	Year Ended December 31,					Six Months Ended June 30,	
	1999	2000	2001	2002	2003	2003	2004
	(unaudited)					(unaudited)	
Income (loss) before cumulative effect of change in accounting principle	5,079	6,601	(6,413)	(1,044)	15,659	5,819	6,279
Cumulative effect of change in accounting principle (net of tax benefit of \$125)	—	—	—	—	(205)	(205)	—
Net income (loss)	\$ 5,079	\$ 6,601	\$ (6,413)	\$ (1,044)	\$ 15,454	\$ 5,614	\$ 6,279
Basic and diluted income (loss) per share:							
Income (loss) from continuing operations	\$ 0.36	\$ 0.41	\$ (0.07)	\$ 0.37	\$ 0.67	\$ 0.25	\$ 0.27
Loss from discontinued operations	(0.14)	(0.13)	(0.20)	(0.41)	—	—	—
Cumulative effect of change in accounting principle	—	—	—	—	(0.01)	(0.01)	—
Net income (loss)	\$ 0.22	\$ 0.28	\$ (0.27)	\$ (0.04)	\$ 0.66	\$ 0.24	\$ 0.27
Weighted average number of shares outstanding	23,214,281	23,214,281	23,214,281	23,214,281	23,214,281	23,214,281	23,227,036
Balance Sheet Data (at end of period):							
Cash and cash equivalents	\$ 7,803	\$ 10,071	\$ 13,202	\$ 36,684	\$ 8,873	\$ 17,719	\$ 21,170
Working capital (deficit)(1)	(6,037)	(23,392)	(50,459)	(79,853)	2,677	(76,975)	11,124
Property, plant and equipment, net	60,167	90,946	132,369	152,342	344,015	160,697	472,217

Total assets(1)	139,266	167,940	226,617	287,378	543,138	275,463	778,183
Long-term debt	51,118	61,358	91,321	95,807	260,488	101,041	442,300
Notes payable to Parent	—	—	—	—	177,004	—	193,852
Stockholder's equity(1)	21,335	29,001	22,966	27,837	36,975	35,096	63,232

(1) As described in Note 20 to the financial statements, the balance sheets as of December 31, 1999, 2000, 2001, 2002 and 2003 have been revised to reclassify certain amounts due to/from our parent, originally reported as an asset/liability, as a component of stockholder's equity. As a result of such revision, the (i) working capital increased (reduced) by \$(5,173), \$(4,716), \$(592), \$1,806, and \$(4,549); (ii) total assets increased (reduced) by \$0, \$0, \$7,227, \$0, and \$(4,398); and (iii) stockholder's equity increased (reduced) by \$(5,514), \$(4,449), \$(2,938), \$1,806, and \$(4,549), as of December 31, 1999, 2000, 2001, 2002, and 2003, respectively.

UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL DATA

The unaudited pro forma condensed combined statements of operations for the year ended December 31, 2003 and for the six months ended June 30, 2004 are based on our consolidated financial statements and the financial statements of the Puna, Heber 1, Heber 2 and Mammoth projects, which Heber 1 and Heber 2 projects and our 50% ownership interest in the Mammoth project were acquired on December 18, 2003, and the Puna project was acquired on June 3, 2004 and adjusted to give effect to the acquisitions thereof as if each had occurred on January 1, 2003.

The unaudited pro forma condensed combined financial data gives effect to the acquisitions of the Puna, Heber 1 and Heber 2 projects and our 50% ownership interest in the Mammoth project, which are accounted for using the purchase method of accounting. Pursuant to such method, the purchase price has been allocated to the principal categories of assets and liabilities based on independent valuations. It should be noted that because the acquisitions of the (i) Steamboat 1/1A project on June 30, 2003, (ii) Steamboat 2/3 project on February 11, 2004, and (iii) Steamboat Hills project on May 20, 2004 are not material under applicable Securities Act rules, such transactions have not been included in the accompanying pro forma balance sheet or results of operations. The historical unaudited combined revenues and combined net income of the Steamboat 1/1A, Steamboat 2/3 and Steamboat Hills projects for the twelve months ended December 31, 2003 amounted to revenues of \$19.7 million and combined net income of \$1.7 million.

The unaudited pro forma condensed combined financial data also give effect to (i) Ormat Funding's issuance of 8¼% senior secured notes in the amount of \$190 million, which offering was completed on February 13, 2004, and (ii) Orcal Geothermal's entering into a loan agreement with Beal Bank amounting to \$154.5 million in connection with the acquisition of the Heber 1, Heber 2 and Mammoth projects.

The unaudited pro forma condensed combined financial data presented herein does not necessarily reflect what our actual results of operations would have been had the transactions occurred at the dates indicated, or project our results of operations for any future date or period.

The unaudited pro forma condensed combined financial data should be read in conjunction with our historical consolidated financial statements and the historical financial statements of the Heber 1, Heber 2, Mammoth and Puna projects included elsewhere in this prospectus.

**Unaudited Pro Forma Condensed
Combined Statement of Operations
For the Six Months Ended June 30, 2004
(in thousands, except per share data)**

	Ormat Technologies Consolidated	for the period from January 1, 2004 to June 2, 2004	Pro Forma Adjustments	Pro Forma Combined
Revenues:				
Electricity Segment	\$ 70,215	\$ 9,759		\$ 79,974
Products Segment	29,491	—		29,491
	<u>99,706</u>	<u>9,759</u>		<u>109,465</u>
Cost of revenues:				
Electricity Segment	40,612	8,353	(1,337)(a) 313(b)	47,941
Products Segment	23,122	—		23,122
	<u>63,734</u>	<u>8,353</u>		<u>71,063</u>
Gross margin	35,972	1,406		38,402
Operating expenses:				
Selling, general and administrative	10,367	842		11,209
Operating income	25,605	564		27,193
Other income (expense):				
Interest income	431	—		431
Interest expense	(19,475)	(4,147)	4,147(c) (2,098)(d) (1,925)(f)	(23,498)
Foreign currency translation and transaction loss	(397)	—		(397)
Miscellaneous income	145	—		145
Income before income taxes, minority interest and equity in income of investees	6,309	(3,583)		3,874
Income tax provision	(1,957)	1,362	(459)(g)	(1,054)
Minority interest in earnings of subsidiaries	(108)	—		(108)
Equity in income of investees	2,035	—		2,035
Net income	<u>\$ 6,279</u>	<u>\$ (2,221)</u>		<u>\$ 4,747</u>
Pro forma net income per share — basic and diluted	<u>\$ 0.27</u>			<u>\$ 0.20</u>
Shares used in computing pro forma net income per share — basic and diluted	<u>23,227,036</u>			<u>23,227,036</u>

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**Unaudited Pro Forma Condensed
Combined Statement of Operations
For the Year Ended December 31, 2003
(in thousands, except per share data)**

	Ormat Technologies Consolidated	Heber Projects for the period from January 1, 2003 to December 17, 2003	Puna Project	Pro Forma Adjustments	Pro Forma Combined
Revenues:					
Electricity Segment	\$ 77,752	\$ 66,131	\$ 18,737		\$ 162,620
Products Segment	41,688	—	—		41,688
	<u>119,440</u>	<u>66,131</u>	<u>18,737</u>		<u>204,308</u>
Cost of revenues:					

Electricity Segment	46,726	37,483	14,735	(1,588)(a) 1,545(b)	98,901
Products Segment	<u>29,494</u>	<u>—</u>	<u>—</u>		<u>29,494</u>
	<u>76,220</u>	<u>37,483</u>	<u>14,735</u>		<u>128,395</u>
Gross margin	43,220	28,648	4,002		75,913
Operating expenses:					
Selling, general and administrative	<u>17,730</u>	<u>29</u>	<u>1,605</u>		<u>19,364</u>
Operating income	<u>25,490</u>	<u>28,619</u>	<u>2,397</u>		<u>56,549</u>
Other income (expense):					
Gain on discharge of liabilities subject to compromise	—	31,460	—		31,460
Reorganization costs	—	(4,029)	—		(4,029)
Interest income	607	99	—		706
Interest expense	(8,120)	(1,794)	(3,423)	5,217(c) (16,785)(d) (11,608)(e) (3,850)(f)	(40,363)
Foreign currency translation and transaction loss	(316)	—	—		(316)
Miscellaneous income	<u>464</u>	<u>—</u>	<u>—</u>		<u>464</u>
Income from continuing operations before income taxes, minority interest and equity in income of investees	18,125	54,355	(1,026)		44,471
Income tax provision	(2,506)	(20,655)	390	10,793(g)	(11,978)
Minority interest in earnings of subsidiaries	(519)	—	—		(519)
Equity in income of investees	<u>559</u>	<u>—</u>	<u>—</u>	967(h)	<u>1,526</u>
Income before cumulative effect of change in accounting principle	<u>\$ 15,659</u>	<u>\$ 33,700</u>	<u>\$ (636)</u>		<u>\$ 33,500</u>
Pro forma income per share — basic and diluted	<u>\$ 0.67</u>				<u>\$ 1.44</u>
Shares used in computing pro forma income per share — basic and diluted	<u>23,214,281</u>				<u>23,214,281</u>

Notes to Unaudited Pro Forma Condensed Combined Financial Data

The following adjustments were applied to our historical financial statements and those of the Puna, Heber 1, Heber 2 and Mammoth projects in order to prepare the pro forma condensed combined financial data.

Statements of Operations Footnotes:

The unaudited pro forma condensed combined statements of operations for the year ended December 31, 2003 and for the six months ended June 30, 2004 are based on our consolidated financial statements and the financial statements of the Puna, Heber 1, Heber 2 and Mammoth projects, and adjusted to give effect to the acquisitions as if they had occurred as of January 1, 2003 by: (1) combining our results of operations for the year ended December 31, 2003 and the six months ended June 30, 2004, with (i) the Puna project's operations for the year ended December 31, 2003 and for the period from January 1, 2004 to June 2, 2004, and (ii) the Heber 1 and Heber 2 projects' operations for the period from January 1, 2003 to December 17, 2003, and (2) recording our 50% equity in the income of the Mammoth project for the period from January 1, 2003 to December 17, 2003, with our results for the year ended December 31, 2003.

(a) Represents the recording of the change in depreciation resulting from the (step-down)/step-up in basis

of \$(80.3) million and \$110 million of property, plant and equipment to their respective fair values related to the acquisitions of the Puna, Heber 1, and Heber 2 projects, respectively. Property, plant and equipment are being depreciated using the straight-line method over the estimated service period of 15 to 23 years. The step-down of \$80.3 million related to the Puna project represents the difference between the net book value of the Puna project's long-lived assets prior to our purchase and the fair value allocated to the Puna project's power plant based on an independent valuation. Despite the step-down upon our purchase of the Puna project, no impairment charge was recorded as detailed impairment analysis during periods prior to our purchase concluded that the sum of the undiscounted expected future cash flows were more than the carrying amount of the Puna project's long-lived assets.

(b) Represents the recording of the change in amortization resulting from the step-up in basis of \$14.4 million and \$25.3 million of power purchase agreements to their respective fair values related to the acquisition of the Puna, Heber 1 and Heber 2 projects, respectively, using the straight-line method over the estimated contract periods of 15 to 23 years.

(c) Represents the elimination of interest expense related to (i) the Puna project of \$4.1 million (which includes \$2.8 million related to the termination of an interest rate swap agreement discussed below) for the six months ended June 30, 2004 and \$3.4 million for the year ended December 31, 2003 and (ii) the Heber 1 and Heber 2 projects of \$1.8 million for the period from January 1, 2003 to December 17, 2003. The Puna project included \$43.3 million of indebtedness which was repaid on June 3, 2004. The average interest rate on approximately 75% of such indebtedness was 8.17% and 3% on approximately 25% of such indebtedness. In addition, an interest rate swap agreement in connection with the Puna project indebtedness was terminated on June 3, 2004. Notes payable in connection with the Heber 1 and Heber 2 projects in the amount of \$12.5 million, which notes payable were terminated as part of the acquisition thereof, accrued interest at LIBOR plus 4.75% per annum from January 31, 2002 through July 31, 2003. Such indebtedness was extinguished as of December 17, 2003. Capital leases related to the Heber 1 and Heber 2 projects, which were also terminated as part of the acquisition thereof, in the amount of \$19.7 million, accrued interest at 5.34% per annum. Such indebtedness was extinguished as of January 30, 2004.

(d) Represents the recording of interest expense, prior to February 13, 2004, associated with the gross proceeds of \$190 million pursuant to the issuance by Ormat Funding of the senior secured notes with an interest rate of 8.25%, in the amount of \$1.9 million for the period from January 1, 2004 to February 13, 2004 and \$15.7 million for the fiscal year ended December 31, 2003, and the amortization of debt issue costs in the amount of \$0.2 million for the period from January 1, 2004 to February 13, 2004 and \$1.1 million for the fiscal year ended December 31, 2003.

(e) Represents the recording of interest expense associated with the gross proceeds of \$154.5 million from Beal Bank with an interest rate of 7.125% in the amount of \$11.0 million for the fiscal year ended December 31, 2003, and the amortization of debt issue costs in the amount of \$0.6 million for the fiscal year ended December 31, 2003. Such debt was incurred for the acquisition of the Heber 1 and Heber 2 projects.

(f) Represents the recording of interest expense in the amount of \$1.1 million for the six months ended June 30, 2004 and \$2.3 million for the fiscal year ended December 31, 2003 related to shareholder loans in the amount of \$32.8 million bearing an interest rate of 7.5% and interest expense of \$0.8 million for the six months ended June 30, 2004 and \$1.6 million for the fiscal year ended December 31, 2003, related to short-term loans of \$40 million bearing an interest rate of 4%. The shareholder loans and short-term loans were incurred in connection with the acquisition of the Puna project.

(g) Represents the recording of income tax expenses to reflect an effective tax rate of 40% on the pro forma adjustments, which is our expected effective tax rate.

(h) Represents the recording of our 50% equity in the income of the Mammoth project (net of taxes in the amount of \$645), increased by the amortization of the equity basis difference, and has been presented as "Equity in income of investee." As the purchase price is less than the underlying net equity of the Mammoth project by \$9.5 million, the equity basis will be amortized over the remaining useful life of the property, plant and equipment and the power purchase agreements, which is approximately 12 to 17 years.

Summarized statement of operations information of the Mammoth project for the period from January 1, 2003 to December 17, 2003 is as follows (in thousands):

Revenues	\$ 16,353
Gross margin	4,288
Net income	2,024
Company's equity in income of the Mammoth project:	
50% of the Mammoth project net income	\$ 1,012
Plus amortization of the equity basis difference	600
	<u>\$ 1,612</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion and analysis of our results of operations, financial condition and liquidity in conjunction with our consolidated financial statements and the related notes. Some of the information contained in this discussion and analysis or set forth elsewhere in this prospectus, including information with respect to our plans and strategies for our business, statements regarding the industry outlook, our expectations regarding the future performance of our business, and the other non-historical statements contained herein are forward-looking statements. See "Special Note Regarding Forward-Looking Statements." You should also review the "Risk Factors" section of this prospectus for a discussion of important factors that could cause actual results to differ materially from the results described herein or implied by such forward-looking statements. Unless specifically stated otherwise, references to balances and results of operations in this section are to our continuing operations and do not include our discontinued operations discussed below. For a discussion of the effect of our significant acquisitions, please see "Unaudited Pro Forma Condensed Combined Financial Data" included elsewhere in this prospectus, which does not include the acquisition of the Steamboat 2/3 project and Steamboat Hills project.

Overview

We are a leading vertically integrated company engaged in the geothermal and recovered energy power business. We design, develop, build, own and operate clean, environmentally friendly geothermal power plants, and we also design, develop and build, and plan to own and operate, recovered energy-based power plants, in each case, using equipment that we design and manufacture. In addition, we sell the equipment we design and manufacture for geothermal electricity generation, recovered energy-based electricity generation, and other equipment for electricity generation to third parties. Our operations consist of two principal business segments. The first consists of the sale of electricity from our power plants, which we refer to as the Electricity Segment, while the second consists of the design, manufacturing and sale of equipment for electricity generation, the installation thereof and the provision of services relating to the engineering, procurement, construction, operation and maintenance of geothermal and recovered energy power plants, which we refer to as the Products Segment.

Our Electricity Segment currently consists of our investment in power plants producing electricity from geothermal resources. It will also include our planned investment in power plants producing electricity from recovered energy resources. Our geothermal power plants include both power plants that we have built and power plants that we have acquired. Our Products Segment consists of the design, manufacture and sale of equipment that generates electricity, principally, from geothermal and recovered energy resources, but also using other fuel sources as well. Our Products Segment also includes, to the extent requested by our customers, the installation of our equipment and other related power plant installations and the provision of services relating to the engineering, procurement, construction, operation and maintenance of geothermal and recovered energy power plants. For the six months ended June 30, 2004, our Electricity Segment represented approximately 70.4% of our total revenues, while our Products Segment represented approximately 29.6% of our total revenues during such period.

Our Electricity Segment operations are conducted in the United States and throughout the world. We are the fastest growing geothermal power generation company in the United States, measured by growth in generating capacity. We have increased our net ownership interest in generating capacity by 164 MW between December

31, 2002 and June 30, 2004, of which 152 MW was attributable to our acquisition of geothermal power plants from third parties and 12 MW was attributable to increased generating capacity of our existing geothermal power plants resulting from plant technology upgrades and improvements to our geothermal reservoir operations, which include improving methods of heat source supply and delivery. Since January 1, 2001, we have completed various acquisitions of geothermal power plants in the United States with an aggregate acquisition cost, net of cash received, of \$502.3 million. We also own and operate or control and operate geothermal projects in Guatemala, Kenya, Nicaragua and the Philippines. In 2003, pro forma revenues from the sale of electricity by our

power plants were \$162.6 million. Our net ownership in our generating capacity has increased from 94 MW, as of December 31, 2001, to 305 MW, as of June 30, 2004. Such revenues do not include any revenues attributable to our Steamboat 2/3 project and Steamboat Hills project that were acquired in 2004, which we estimate (based on, in the case of the Steamboat 2/3 project, \$14.0 million of revenues generated by such project in 2003 and, in the case of the Steamboat Hills project, \$3.0 million based on the current revenue generation of such project, computed on an annualized basis) to be approximately \$17.0 million for the fiscal year ended December 31, 2003.

Our Products Segment operations are also conducted in the United States and throughout the world. For the fiscal year ended December 31, 2003, revenues attributable to our Products Segment were \$41.7 million. Such revenues included approximately \$5.0 million received from the construction of a recovered energy-based power plant in a gas processing plant in the United States. We expect that an important component of our Products Segment will be the design, manufacturing and sale of recovered energy products, which is a market opportunity we have identified that we expect will allow us (in our Electricity Segment) and potential customers (in our Products Segment) to utilize waste heat for the purpose of producing electricity.

Our Electricity Segment is characterized by relatively predictable revenues generated by our power plants pursuant to long-term power purchase agreements, with terms which are generally up to 20 years. By contrast, revenues attributable to our Products Segment, which are based on the sale of equipment and the provision of various services to our customers are far less predictable and may vary significantly from period to period. Our management assesses the performance of our two segments of operation differently. In the case of our Electricity Segment, when making decisions about potential acquisitions or the development of new projects, our management typically focuses on the internal rate of return of the relevant investment, relevant technical and geological matters and other relevant business considerations. Additionally, as part of our Electricity Segment, our management evaluates our operating projects based on the performance of such projects in terms of revenues and expenses in contrast to projects that are under development, which our management evaluates based on costs attributable to each such project. Our management evaluates the performance of our Products Segment based on the timely delivery of our products, performance quality of our products and costs actually incurred to complete customer orders as compared to the costs originally budgeted for such orders.

Recent Developments

In December 2003, we acquired our Heber 1 and Heber 2 projects and our 50% ownership interest in the Mammoth project for a total cost of approximately \$256.8 million. The acquisition of our Heber 1 and Heber 2 projects and our 50% ownership interest in the Mammoth project was financed with a combination of parent company loans, project finance debt provided by Beal Bank and short-term loans. We accounted for such acquisition pursuant to the purchase method of accounting in accordance with Statement of Financial Accounting Standards (which we refer to as SFAS) No. 141.

In February 2004, we acquired the Steamboat 2/3 project for a total cost of approximately \$82.8 million. The acquisition of the Steamboat 2/3 project was financed with a portion of the proceeds received from the issuance of the 8¼% senior secured notes by Ormat Funding. Such acquisition was accounted for pursuant to the purchase method of accounting in accordance with SFAS No. 141.

At the end of May 2004, we acquired the Steamboat Hills project for a total cost of approximately \$20.3 million and in early June 2004, we acquired the Puna project for a total cost of approximately \$71.2 million. The acquisition of the Steamboat Hills project was financed with internally generated cash while the acquisition of the Puna project was financed with parent company loans and short-term loans. We accounted for the acquisitions of both of the Puna and Steamboat Hills projects pursuant to the purchase method of accounting in accordance with SFAS No. 141.

As a result of our recent acquisitions, our results of operations for the various periods covered by our financial statements attached hereto may not be comparable with each other or indicative of future results.

Trends and Uncertainties

The geothermal industry in the United States has historically experienced significant growth followed by a consolidation of owners and operators of geothermal power plants. During the 1990s, growth and development in the geothermal industry occurred primarily in foreign markets and only minimal growth and development occurred in the United States. Since 2001, there has been increased demand for energy generated from geothermal resources in the United States as production costs for electricity generated from geothermal resources have become more competitive relative to fossil fuel generation due to increasing gas prices and as a result of newly enacted legislative and regulatory incentives, such as state renewable portfolio standards. We see the increasing demand for energy generated from geothermal and other renewable resources in the United States and the further introduction of renewable portfolio standards as the most significant trends affecting our industry today and in the immediate future. Our operations and the trends that from time to time impact our operations are subject to market cycles.

Although other trends, factors and uncertainties may impact our operations and financial condition, including many that we do not or cannot foresee, we believe that our results of operations and financial condition for the foreseeable future will be affected by the following trends, factors and uncertainties:

- We have experienced significant growth through the acquisition and enhancement of geothermal power plants. On a pro forma basis, the Heber 1 and Heber 2 projects and the Puna project accounted for 33.3% and 9.2% of our pro forma revenues, respectively, and 52.3% and 4.2% of our pro forma operating profits, respectively, for the fiscal year ended December 31, 2003. As a result of such acquisitions, we expect an increase in our revenues and operating profits for the current fiscal year, as compared to our consolidated revenues and operating profits for the fiscal year ended December 31, 2003. We also expect an increase in our revenues and operating profits for the current fiscal year as a result of the acquisition of the Steamboat 2/3 project and the Steamboat Hills project this year.
- In the United States, we expect to continue to benefit from the increasing demand for renewable energy as a result of favorable legislation adopted by 17 states, including California, Nevada and Hawaii (where we have been the most active in our geothermal development and in which all of our U.S. projects are located). In each of these states, relevant legislation currently requires that an increasing percentage of the electricity supplied by electric utility companies operating in such states be derived from renewable energy resources until certain pre-established goals are met. We expect that the additional demand for renewable energy from utilities in such states will create additional opportunities for us to expand existing projects and build new power plants.
- Outside of the United States, we expect that a variety of governmental initiatives, including the award of long-term contracts to independent power generators, the creation of competitive wholesale markets for selling and trading energy, capacity and related energy products and the adoption of programs designed to encourage "clean" renewable and sustainable energy sources, will create new opportunities for the development of new projects as well as create additional markets for our remote power units and other products.
- We have identified recovered energy-based power generation as a significant market opportunity for us in the United States and throughout the world. We are initially targeting the North American market and, thereafter, we intend to leverage our success in such market in order to expand such operations throughout the world. If our expectations regarding the growth in demand for our recovered energy units are not met, we may not be able to generate the revenues we expect from such operations.
- In the short term, we may experience a decline in our revenues attributable to our Products Segment as

we currently do not have any new orders to replace large existing contracts. In pursuing new orders, we participate in tenders for projects and proposals for installations and identify and monitor markets which utilize or plan to utilize geothermal energy and in which

geothermal resources are available. While a decline in the revenues attributable to our Products Segment may have an adverse impact on our results of operations for the relevant periods, we do not expect that any such decline would have a material adverse effect on our liquidity and capital resources for the relevant periods over the short-term. Over the long-term, we intend to continue to pursue growth in our recovered energy business, which may help to offset any potential adverse impact on our results of operations for the relevant periods.

- We expect to continue to generate the majority of our revenues from the sale of electricity from our power plants. All of our current revenues from the sale of electricity are derived from fully-contracted payments under long-term power purchase agreements.
- We expect that our financing expenses during the current fiscal year will increase, as compared to our financing expenses for the fiscal year ended December 31, 2003, as we financed the majority of our recent acquisitions with long-term non- and limited-recourse financing.
- The viability of the geothermal resources utilized by our power plants depends on various factors such as the heat content of the geothermal reservoir, useful life of the reservoir (the term during which such geothermal reservoir has sufficient extractable fluids for our operations) and operational factors relating to the extraction of the geothermal fluids. Our geothermal power plants may experience an unexpected decline in the capacity of their respective geothermal wells. Such factors, together with the possibility that we may fail to find commercially viable geothermal resources in the future, represent significant uncertainties we face in connection with our operations.
- Our foreign operations are subject to significant political, economic and financial risks, which vary by country. Such risks include the ongoing privatization of the electricity industry in the Philippines, the partial privatization of the electricity sector in Guatemala, labor unrest and strengthening of unions in Nicaragua and the political uncertainty currently prevailing in Kenya. Although we maintain political risk insurance as an attempt to mitigate such risks, such insurance does not provide complete coverage with respect to all such risks.
- We do not expect the current low interest rate environment to continue in the foreseeable future. Any increases in interest rates that impact our existing financings or future financings could increase the aggregate amount of our interest expenses and thus could have an adverse effect on our results of operations.
- We have experienced recent increases in the cost of raw materials required for our equipment manufacturing activities, which we believe have resulted primarily from increased demand in the Chinese market for such raw materials and increases in the cost of transportation of our products. An increase in such costs may have an adverse effect on our financial condition and results of operations.

Revenues

We generate our revenues primarily from the sale of electricity from our geothermal power plants, the design, manufacturing and sale of equipment for electricity generation and the construction, installation and engineering of power plant equipment.

Revenues attributable to our Electricity Segment are relatively predictable as they are derived from the sale

of electricity from our power plants pursuant to long-term power purchase agreements, however, such revenues are subject to seasonal variations, as more fully described below in the section entitled "Seasonality". Our power purchase agreements generally provide for the payment of capacity payments, energy payments, or both. Generally, capacity payments are payments calculated based on the amount of time that our power plants are available to generate electricity. Some of our power purchase agreements provide for bonus payments in the event that we are able to exceed certain target levels and the potential forfeiture of payments if we fail to meet minimum target levels. Energy payments, on the other hand, are payments calculated based on the amount of electrical energy delivered to the relevant power purchaser at a designated delivery point. The rates applicable to such

payments are either fixed (subject, in certain cases, to certain adjustments) or are based on the relevant power purchaser's short run avoided costs (the incremental costs that the power purchaser avoids by not having to generate such electrical energy itself or purchase it from others). As required by Emerging Issues Task Force No. 01-8, *Determining Whether an Arrangement Contains a Lease*, we assessed all of our power purchase agreements acquired since July 1, 2003, and concluded that all such agreements related to our Heber 1 and 2, Steamboat 2/3, Steamboat Hills, and Puna projects contained a lease element requiring lease accounting. Accordingly, revenues related to the lease element of the agreements are presented as "lease" revenue, with the remaining revenue related to the production and delivery of the energy presented as "energy and capacity" revenue in our financial statements. As the lease revenue and the energy and capacity revenues are derived from the same arrangement and both fall within our electricity segment, we analyze such revenues, and related costs, on a combined basis for management purposes.

Revenues attributable to our Products Segment are generally unpredictable because larger customer orders for our products are typically a result of our participating in, and winning, tenders issued by potential customers in connection with projects they are developing. Such projects often take a long time to design and develop and are often subject to various contingencies such as the customer's ability to raise the necessary financing for such project. As a result, we are generally unable to predict the timing of such orders for our products and may not be able to replace existing orders that we have completed with new ones. As a result, our revenues from our Products Segment fluctuate (and at times, extensively) from period to period.

The following table sets forth a breakdown of our revenues for the periods indicated:

	<u>Revenues</u>					<u>% of revenues for period indicated</u>				
	<u>(in thousands)</u>									
	<u>Year ended December 31,</u>			<u>Six months ended June 30,</u>		<u>Year ended December 31,</u>			<u>Six months ended June 30,</u>	
	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2003</u>	<u>2004</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2003</u>	<u>2004</u>
					<u>(unaudited)</u>					
Revenues										
Electricity Segment	\$ 33,956	\$ 65,491	\$ 77,752	\$ 35,651	\$ 70,215	70.9%	76.5%	65.1%	69.0%	70.4%
Products Segment	<u>13,959</u>	<u>20,138</u>	<u>41,688</u>	<u>16,022</u>	<u>29,491</u>	<u>29.1</u>	<u>23.5</u>	<u>34.9</u>	<u>31.0</u>	<u>29.6</u>
Total	\$ 47,915	\$ 85,629	\$ 119,440	\$ 51,673	\$ 99,706	100%	100%	100%	100%	100%

Geographical breakdown

11.7%, 48.0% and 56.4% of the revenues attributable to our Electricity Segment were generated in the United States in 2001, 2002, and 2003, respectively. For the six months ended June 30, 2004, 80.7% of our revenues attributable to our Electricity Segment were generated in the United States, as compared to 52.2% for the same period in 2003. During the past three fiscal years, the percentage of our total revenues attributable to the sale of electricity in the United States has increased significantly, as compared to the percentage of our total revenues that is attributable to the sale of electricity by our foreign projects that has declined commensurately. Such increase is largely attributable to our recent acquisition of various projects in the United States. The following table sets forth the geographic breakdown of the revenues attributable to our Electricity Segment for

the periods indicated:

	Year ended December 31,			Six Months ended June 30,	
	2001	2002	2003	2003	2004
United States	11.7%	48.0%	56.4%	52.2%	80.7%
Foreign	88.3%	52.0%	43.6%	47.8%	19.3%

Historically, revenues attributable to our Products Segment, after giving effect to the elimination of intercompany balances, have been derived primarily from outside of the United States, which is reflective of the historical demand in the United States described elsewhere in this prospectus. Since 2003, we have begun to generate revenues attributable to our Products Segment in the United States

as well. However, as a result of the volatility and unpredictability of the revenues attributable to our Products Segment and the impact that a few sales or EPC contracts can have on the geographic distribution of such revenues, the geographical distribution of such revenues may not be indicative of any developing trends or of our future results.

Seasonality

The demand for the electricity generated by our domestic projects and the prices paid for such electricity pursuant to our power purchase agreements are subject to seasonal variations. The demand for electricity from the Heber 1 project and Heber 2 project, the Mammoth project and the Ormesa project is the highest in the summer months of June through September, because the power purchaser for those projects, Southern California Edison Company, delivers more electricity to its California markets during such period in order to meet demand for air conditioning and other energy-intensive cooling systems utilized during such summer months. The demand for electricity from the Steamboat complex and the Brady project is more balanced, consisting of both summer and winter peaks that reflect the greater temperature variation in Nevada. Similarly, the demand for electricity from the Puna project is balanced due to the equatorial temperature in Hawaii (with less pronounced temperature variations during the year). In California, the capacity rates payable pursuant to the applicable power purchase agreement are higher in the summer months and as a result we receive higher revenues during such months. In contrast, there are no significant changes in prices during the year payable pursuant to our power purchase agreement for the Puna project and the Nevada projects. In the winter, due principally to the lower ambient temperature, our power plants produce more energy and as a result we receive higher energy revenues. However, the higher capacity payments payable by the power purchaser in California in the summer months as a result of the increase in demand and in prices has a more significant impact on our revenues than that of the higher energy revenues generally generated in winter due to increased efficiency, and as a result our revenues are generally higher in the summer than in the winter.

Expenses

Electricity Segment

The principal expenses attributable to our operating projects include operation and maintenance expenses such as salaries, equipment expenses, cost of parts and chemicals, costs related to third-party services, lease expenses, royalties, startup and auxiliary electricity purchases, property taxes and insurance and, for the California projects, transmission charges, scheduling charges and purchases of sweet water for use in our plant cooling towers. Some of these expenses, such as parts and third-party services, are not incurred on a regular basis, which results in fluctuations in our expenses and our results of operations for individual projects from quarter to quarter.

Our partner in the Mammoth project reimburses us for 50% of the actual costs associated with the operation and maintenance of the project, plus certain general and administrative expenses.

Lease expenses are included as a component of operating expenses and principally consist of payments made to government agencies and private entities as compensation for the use of the relevant geothermal

resources and site leases where plants are located.

Royalty payments are payments made as compensation for the right to use certain geothermal resources and are included as a component of operating expenses and are paid as a percentage of the revenues derived from the associated geothermal resources.

Products Segment

The principal expenses attributable to our Products Segment include materials, salaries and related employee benefits, expenses related to subcontracting activities, transportation expenses, sales commissions to sales representatives and royalties pertaining to government participation in our research and development programs at a rate of 3.5% of the proceeds recovered from the sale of products which were developed pursuant to such research and development programs.

Some of the principal expenses attributable to our Products Segment, such as a portion of the costs related to labor, utilities and other support services, are fixed and, in order to maintain our current production and construction capability, must be incurred, notwithstanding the revenues attributable to our Products Segment. As a result, the cost of revenues attributable to our Products Segment, expressed as a percentage of total revenues, is often very volatile. To date, our management has made the strategic decision to maintain our production and construction capacity and, therefore, maintain the fixed cost component of the total costs attributable to our Products Segment at the current level. Another reason for such volatility is that in responding to bids for our products, we price our products and services in relation to existing competition and other prevailing market conditions, which may vary substantially from order to order.

Critical Accounting Policies

Our critical accounting policies are more fully described in Note 1 to our audited consolidated financial statements. However, certain of our accounting policies are particularly important to the portrayal of our financial position and results of operations. In applying these critical accounting policies, our management uses its judgment to determine the appropriate assumptions to be used in making certain estimates. Such estimates are based on management's historical experience, the terms of existing contracts, management's observance of trends in the geothermal industry, information provided by our customers and information available to management from other outside sources, as appropriate. Such estimates are subject to an inherent degree of uncertainty. Our critical accounting policies include:

- *Revenues* . Revenues related to the sale of electricity from our geothermal power plants and capacity payments paid in connection with such sale are recorded based upon output delivered and capacity provided by such power plants at rates specified pursuant to the relevant power purchase agreements. Revenues generated from engineering and operating services and sales of products and parts are recorded once the service is provided or product delivery is made, as applicable. Revenues generated from the construction of geothermal power plant equipment, on behalf of third parties, is recognized on the percentage completion method, which is the relationship between costs actually incurred and total estimated costs to completion. Such cost estimate is made by management in part based on prior operations and in part based on specific project characteristics and designs. If management's estimates utilized with respect to our Products Segment of total estimated costs to completion are inaccurate, then the percentage of completion will also be inaccurate and thus lead management to over- or underestimate the gross margins for our Products Segment. Selling, general and administrative costs are charged as and when incurred. Provisions for estimated losses relating to contracts are made in the period in which such losses are determined. Changes in job performance, job conditions, and estimated profitability, including those arising from the application of penalty provisions in relevant contracts and final contract settlements, may result in revisions to costs and income and are recognized in the period in which the revisions are determined.
- *Impairment of Long-lived Assets and Long-lived Assets to Be Disposed of* . Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated future net undiscounted cash flows

expected to be generated by the relevant asset. The significant assumptions that we use in estimating our undiscounted future cash flows include (i) projected generating capacity of the project and rates to be received under the respective power purchase agreements, and (ii) projected operating expenses of the relevant project. If assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value, less costs to sell. Our assessment regarding the existence of impairment factors is based on market conditions, operational performance and legal factors relating to our business. Our review of existing

factors and the resulting appropriate carrying value of our long-lived assets are subject to judgement and estimates that management is required to make. We believe that no impairment exists for our long-lived assets, however future estimates as to the recoverability of such assets may change based on revised circumstances.

- *Obligations Associated with the Retirement of Long-Lived Assets* . Effective January 1, 2003, we adopted SFAS No. 143, *Accounting for Obligations Associated with the Retirement of Long-Lived Assets* . Pursuant to SFAS No. 143, entities are required to record the fair market value of any legal liability related to the retirement of any of its assets in the period in which such liability is incurred. Our liabilities related to the retirement of our assets include our obligation to capping wells upon termination of our operating activities, the dismantling of our geothermal power plants upon cessation of our operations and the performance of certain remedial measures related to the land on which such operations were conducted. When a new liability for an asset retirement obligation is recorded, we capitalize the costs of such liability by increasing the carrying amount of the related long-lived asset. Such liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. At retirement, an entity either settles the obligation for its recorded amount or incurs a gain or a loss with respect thereto, as applicable. We estimate the costs related to such liabilities and if such estimates are incorrect, then the capitalized costs and carrying amount of the related long-lived asset will change and as a result may affect our financial condition.
- *Derivative Instruments*. SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended and interpreted by other related accounting literature, establishes accounting and reporting standards for derivative instruments (including certain derivative instruments embedded in other contracts). SFAS No. 133 requires companies to record derivatives on their balance sheets as either assets or liabilities measured at their fair value unless such instruments are exempted from derivative treatment as a normal purchase and normal sale. All changes in the fair value of derivatives are recognized currently in earnings unless specific hedge criteria are met, which requires a company to formally document, designate and assess the effectiveness of transactions that receive hedge accounting.

We maintain a risk management strategy that incorporates the use of interest rate swaps and interest rate caps to minimize significant fluctuation in cash flows and/or earnings that is caused by interest rate volatility. Gain or loss on contracts that initially qualify for cash flow hedge accounting is included as a component of other comprehensive income and are subsequently reclassified into earnings when interest on the related debt is paid. Gain or loss on contracts that are not designated to qualify as a cash flow hedge is included as a component of interest expense.

We were required to adopt and have become subject to the provisions of SFAS No. 133 Derivative Implementation Group ("DIG") Issue No. C15 (DIG Issue No. C15), *Normal Purchases and Normal Sales Exception for Certain Option-Type Contracts and Forward Contracts in Electricity* , which expands the requirements for the normal purchase and normal sales exception to include electricity contracts entered into by a utility company when certain criteria are met. Also, pursuant to DIG Issue No. C15, contracts that have a price adjustment clause based on an index that is not directly related to the electricity generated, as defined in SFAS No. 133, do not meet the requirements for the normal purchases and normal sales exception. We have power sales agreements that qualify as derivative

instruments under DIG Issue No. C15 and do not meet the exception as they have a price adjustment clause based on an index that does not directly relate to the sources of the power used to generate the electricity. Our adoption of the provisions of DIG Issue No. C15 in 2002 did not have a material impact on our consolidated financial position and results of operations.

In June 2003, the FASB issued DIG Issue No. C20, *Scope Exceptions: Interpretation of the Meaning of Not Clearly and Closely Related in Paragraph 10(b) regarding Contracts with a Price Adjustment Feature*. DIG Issue No. C20 specified additional circumstances in which a

price adjustment feature in a derivative contract would not be an impediment to qualifying for the normal purchases and normal sales scope exception under SFAS No. 133. DIG Issue No. C20 was effective as of the first day of the fiscal quarter beginning after July 10, 2003, or October 1, 2003 for us. DIG Issue No. C20 requires contracts that did not previously qualify for the normal purchases and normal sales scope exception, and do qualify for the exception under DIG Issue No. C20, to freeze the fair value of the contract as of the date of the initial application, and amortize such fair value over the remaining contract period. Upon our adoption of DIG Issue No. C20, we elected the normal purchase and normal sales scope exception under FAS No. 133 related to our power purchase agreements. Such adoption did not have a material impact on our consolidated financial position and results of operations.

- *Accounting for Income Taxes*. As part of the process of preparing our consolidated financial statements, we are required to estimate our income tax in each of the jurisdictions in which we operate. This process requires us to estimate our actual current tax exposure and make an assessment of temporary differences resulting from differing treatment of items for tax and accounting purposes. Such differences result in deferred tax assets and liabilities which are included on our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and, to the extent we believe that such recovery is not likely, we must establish a valuation allowance. To the extent we establish a valuation allowance or increase such allowance in a period, we must include an expense within the tax provision in our statement of operations. Management uses significant judgment in determining our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. In the event that we generate taxable income in a particular jurisdiction in which we operate and in which we have net operating loss carry-forwards for which a deferred tax valuation allowance has been established, we may be required to adjust our valuation allowance.
- *Stock-Based Compensation*. We account for stock-based compensation based on the provisions of Accounting Board Opinion No. 25, *Accounting for Stock Issued to Employees*, which we refer to as APB 25, which states that no compensation expense is required to be recorded for stock options or other stock-based awards to employees that are granted with an exercise price equal to or above the estimated fair value per share of common stock on the relevant grant date. In the event that stock options are granted at a price that is lower than the fair market value on the relevant date, the difference between the fair market value of the common stock and the exercise price of the stock options is recorded as unearned compensation. Unearned compensation is amortized to compensation expense over the vesting period applicable to the stock option. We have adopted the disclosure requirements of SFAS No. 123, *Accounting for Stock-Based Compensation*, as it relates to stock options granted to employees, which requires pro forma net income to be disclosed based on the fair value of the options granted at the date of the relevant grant.
- *New Accounting Pronouncements*

Consolidation of Variable Interest Entities

In January 2003, the Financial Accounting Standards Board, which we refer to as FASB, issued Interpretation No. 46, *Consolidation of Variable Interest Entities, an interpretation of ARB 51*, which we refer to as FIN No. 46, as amended by FIN No. 46R in December 2003. Among other things, FIN

No. 46R generally deferred the effective date of FIN No. 46 to the quarter ended March 31, 2004. The objectives of FIN No. 46R are to provide guidance on the identification of Variable Interest Entities, which we refer to as VIEs, for which control is achieved through means other than ownership of a majority of the voting interest of an entity, and how to determine which company (if any), as the primary beneficiary, should consolidate such VIE. A variable interest in a VIE, by definition, is an asset, liability, equity, contractual arrangement or other economic interest that absorbs the entity's economic variability.

Effective as of March 31, 2004, we adopted FIN No. 46R. In connection with the adoption of FIN No. 46R, we concluded that Ormat-Leyte Co. Ltd., in which we have an 80% ownership

interest, should be deconsolidated. Ormat-Leyte Co. Ltd.'s operating results were accounted for using the consolidated method of accounting for the three-month period ended March 31, 2004 and, effective April 1, 2004, our ownership interest in Ormat-Leyte Co. Ltd. is accounted for using the equity method of accounting.

Derivative Instruments and Hedging Activities

In April 2003, the FASB issued SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*. SFAS No. 149 amends and clarifies the accounting and reporting treatment for derivative instruments, including certain derivatives embedded in other contracts, and hedging activities under SFAS No. 133. The amendments set forth in SFAS No. 149 require that contracts with comparable characteristics be accounted for as derivative instruments. SFAS No. 149 clarifies the circumstances under which a contract meets the characteristics of a derivative instrument according to SFAS No. 133 and clarifies when a derivative instrument contains a financing component that warrants special reporting in the statement of cash flows. The requirements of SFAS No. 149 are effective for contracts entered into or modified after June 30, 2003, and for hedging arrangements designated after June 30, 2003. We adopted the provisions of SFAS No. 149 effective July 1, 2003, which did not have a material impact on our consolidated results of operations and financial position as of December 31, 2003.

Accounting for Certain Financial Instruments with Characteristics of both Liability and Equity

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. SFAS No. 150 establishes standards for how a company classifies and measures in its statement of financial position certain financial instruments with characteristics of both liabilities and equity. It requires that a company classify a financial instrument that is within its scope as a liability because that financial instrument embodies an obligation of the company. The requirements of SFAS No. 150 are effective for financial instruments entered into or modified after May 31, 2003, effective the first interim period beginning after June 15, 2003. For financial instruments created prior to the issuance date of SFAS No. 150, a transition is achieved by reporting the cumulative effect of a change in accounting principle. We adopted the provisions of SFAS No. 150 effective July 1, 2003, which did not have a material impact on our consolidated results of operations and financial position as of December 31, 2003.

Determining Whether an Arrangement Contains a Lease

In May 2003, the Emerging Issues Task Force ("EITF") reached consensus in EITF Issue No. 01-8, *Determining Whether an Arrangement Contains a Lease*, to clarify the requirements of identifying whether an arrangement contains a lease at its inception. The guidance in the consensus is designed to broaden the scope of arrangements, such as power purchase agreements, accounted for as leases. EITF No. 01-8 requires both parties to an arrangement to determine whether a service contract or similar arrangement is, or includes, a lease within the scope of SFAS No. 13, *Accounting for Leases*. The consensus is being applied prospectively to arrangements agreed to, modified, or acquired in business combinations on or after July 1, 2003. The adoption of EITF No. 01-8 effective July 1, 2003 did not have a material effect on our financial position or results of operations. Power purchase agreements acquired as part of the projects purchased since July 1, 2003 (Heber 1 and 2, Steamboat 2/3, Steamboat Hills, and Puna projects), contain lease elements within the scope of SFAS 13. Accordingly, for the six months ended June 30, 2004, revenues and costs associated with the lease element of the power

purchase agreements that were acquired since July 1, 2003 have been presented as "lease" revenue, with the remaining revenue related to the production and delivery of the energy being presented as "energy and capacity" revenue in our financial statements. Lease revenue related to the Heber 1 and 2 projects from the date we acquired it (December 18, 2003) to December 31, 2003 was not material.

Obligations Associated with the Retirement of Long-Lived Assets.

For a discussion of SFAS No. 143, please see the discussion set forth above.

Results of Operations

Our historical operating results as a percentage of total revenues are presented below. A comparison of the different periods described below may be of limited value, as a result of the effects that (i) our recent acquisitions and enhancements of acquired projects, (ii) the sale of our investment in Karaganda Holding Company, which we refer to as KHC, in the third quarter of 2002, which owned and operated two coal fired power plants in Kazakhstan, and (iii) volatility in revenues of our Products Segment, in each case, have had on our historical operating results.

	Year ended December 31,			Six Months ended June 30,	
	2001	2002 (in thousands)	2003	2003 (in thousands) (unaudited)	2004 (unaudited)
Statements of Operations Data:					
Revenues:					
Electricity Segment	70.9	76.5	65.1	69.0	70.4
Products Segment	<u>29.1</u>	<u>23.5</u>	<u>34.9</u>	<u>31.0</u>	<u>29.6</u>
	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>
Cost of revenues:					
Electricity Segment	36.9	51.1	60.1	62.2	57.8
Products Segment	<u>125.0</u>	<u>85.9</u>	<u>70.7</u>	<u>64.3</u>	<u>78.4</u>
	<u>62.6</u>	<u>59.3</u>	<u>63.8</u>	<u>62.8</u>	<u>63.9</u>
Gross margin:					
Electricity Segment	63.1	48.9	39.9	37.8	42.2
Products Segment	<u>(25.0)</u>	<u>14.1</u>	<u>29.3</u>	<u>35.7</u>	<u>21.6</u>
	37.4	40.7	36.2	37.2	36.1
Operating expenses:					
Research and development	3.6	1.8	1.2	1.7	1.2
Selling and marketing	13.6	7.1	5.9	5.2	4.0
General and administrative	<u>11.4</u>	<u>8.3</u>	<u>7.7</u>	<u>7.8</u>	<u>5.2</u>
Operating income	8.8	23.5	21.4	22.5	25.7
Other income (expense):					
Interest income	2.8	0.7	0.5	0.6	0.4
Interest expense	(9.1)	(7.2)	(6.8)	(7.4)	(19.5)
Foreign currency translation and transaction gain (loss)	0.6	(0.4)	(0.3)	(0.3)	(0.4)
Miscellaneous income	<u>0.6</u>	<u>1.5</u>	<u>0.4</u>	<u>0.5</u>	<u>0.1</u>
Income (loss) from continuing operations before income taxes, minority interest and equity in income of investees	3.7	18.1	15.2	15.9	6.3
Income tax provision	(6.4)	(7.2)	(2.1)	(4.2)	(2.4)
Minority interest in earnings of subsidiaries	(1.2)	(1.4)	(0.5)	(0.8)	(0.1)
Equity of income of investees	<u>0.3</u>	<u>0.4</u>	<u>0.5</u>	<u>0.4</u>	<u>2.5</u>

Income (loss) from continuing operations	(3.6)	9.9	13.1	11.3	6.3
Discontinued operations:					
Loss from operations of discontinued activities in Kazakhstan	(9.8)	(3.6)	—	—	—
Loss of sale of Kazakhstan operations	—	(7.5)	—	—	—
Income (loss) before cumulative effect of change in accounting principle	(13.4)	(1.2)	13.1	11.3	6.3
Cumulative effect of change in accounting principle net of tax benefit	—	—	(0.2)	(0.4)	—
Net income (loss)	<u>(13.4)</u>	<u>(1.2)</u>	<u>12.9</u>	<u>10.9</u>	<u>6.3</u>

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Comparison of the Six Months Ended June 30, 2004 and the Six Months Ended June 30, 2003

Total Revenues

Total revenues for the six months ended June 30, 2004 were \$99.7 million, as compared with \$51.7 million for the six months ended June 30, 2003, which represented a 92.8% increase in total revenues. Such increase was attributable to additional revenues being generated from the Heber 1 project and the Heber 2 project that were acquired in December of 2003 and the Steamboat 2/3 project that was acquired on February 13, 2004. Such increase in revenues was also due to an additional \$13.5 million received from the sale of products during such period.

Electricity Segment

	<u>Six Months ended June 30,</u>	
	<u>2003</u>	<u>2004</u>
	(in millions)	
Heber 1 and Heber 2 Project	\$ —	\$ 27.4
Steamboat Project	—	6.9
Puna Project	—	1.8
Steamboat Hills Project	—	0.5
Other Projects	<u>35.7</u>	<u>33.6</u>
Total	<u>\$ 35.7</u>	<u>\$ 70.2</u>

Revenues attributable to our Electricity Segment for the six months ended June 30, 2004 were \$70.2 million, as compared with \$35.7 million for the six months ended June 30, 2003, which represented a 96.6% increase in such revenues. Such period included \$27.4 million of revenues generated by the Heber 1 project and Heber 2 project, \$6.9 million of revenues generated by the Steamboat 1/1A and Steamboat 2/3 projects, \$1.8 million of revenues generated by the Puna project and \$0.5 million of revenues generated by Steamboat Hills project, as compared to the same period in 2003, during which we did not record any revenues from such projects. Revenues from other projects decreased due to the deconsolidation of the Leyte project as of April 1, 2004.

Products Segment

Revenues attributable to our Products Segment for the six months ended June 30, 2004 were \$29.5 million, as compared with \$16.0 million for the six months ended June 30, 2003, which represented an 84.4% increase in such revenues. This increase resulted from added revenues of \$13.5 million, principally attributable to two large projects (Mokai and Wairakei) during the six-month period ended June 30, 2004. Such increase reflects the volatility of the revenues generated from our Products Segment.

Total Cost of Revenues

Total cost of revenues for the six months ended June 30, 2004 was \$63.7 million, as compared with \$32.5

million for the six months ended June 30, 2003, which represented an 96.0% increase in total cost of revenues. As a percentage of total revenues, our total cost of revenues for the six months ended June 30, 2004 and the six months ended June 30, 2003 were 63.9% and 62.8%, respectively.

Electricity Segment

Total cost of revenues attributable to our Electricity Segment for the six months ended June 30, 2004 was \$40.6 million, as compared with \$22.2 million for the six months ended June 30, 2003, which represented a 82.9% increase in cost of revenues for such segment. The six months ended June 30, 2004 included \$17.3 million, \$3.7 million \$1.1 million and \$0.3 million, respectively, of cost of revenues attributable to the Heber 1 project and the Heber 2 project and the Steamboat 1/1A and Steamboat 2/3 projects, as compared to the six months ended June 30, 2003, during which such projects were not

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included in our results of operations. As a percentage of total electricity revenues, total cost of revenues attributable to our Electricity Segment for the six months ended June 30, 2004 (57.8%) was slightly lower than the percentage for the six months ended June 30, 2003 (62.2%) because as a percentage of revenues, total cost of revenues for our newly acquired projects were slightly lower than the projects in our portfolio prior to such acquisitions.

Products Segment

Total cost of revenues attributable to our Products Segment for the six months ended June 30, 2004 was \$23.1 million, as compared with \$10.3 million for the six months ended June 30, 2003, which represented a 124.3% increase in cost of revenues related to such segment. Such \$12.8 million increase in cost of revenues was attributable to an increase in revenues recognized during the relevant period in 2004 as a result of an increase in the volume of sales, as compared to the relevant period in 2003. As a percentage of total products revenues, our total cost of revenues attributable to our Products Segment for the six months ended June 30, 2004 was 78.4% and for the six months ended June 30, 2003 was 64.3%. The lower percentage of cost of revenues in 2003 resulted from the cancellation of a provision recorded in 2002 for the construction of a project following negotiations with a customer.

Research and Development Expenses

Research and development expenses for the six months ended June 30, 2004 were \$1.2 million, as compared with \$0.9 million for the six months ended June 30, 2003, which represented a 33.3% increase in research and development expenses. Such increase was in the ordinary course of our operations and does not represent any significant change in our research and development program or our ability to maintain and continue to develop our technologies and operations and reflects fluctuations in the period in which actual expenses were incurred.

Selling and Marketing Expenses

Selling and marketing expenses for the six months ended June 30, 2004 were \$3.9 million, as compared with \$2.7 million for the six months ended June 30, 2003, which represented a 44.4% increase in selling and marketing expenses. Selling and marketing expenses for the six months ended June 30, 2004 constituted 4.0% of total revenues for such period, as compared with 5.2% for the six months ended June 30, 2003. Such 1.2% decrease is attributable to the fixed cost nature of certain of our selling and marketing expenses as compared to a larger revenue base. The larger revenue base was principally attributable to an increase in the revenues generated by our Electricity Segment. Once a project is in operation and generates electricity, selling and marketing expenses attributable to such project are relatively insignificant.

General and Administrative Expenses

General and administrative expenses for the six months ended June 30, 2004 were \$5.2 million, as compared with \$4.1 million for the six months ended June 30, 2003, which represented a 26.8% increase in general and administrative expenses. Such increase was principally attributable to an increase in professional services fees related to our business development activities in the United States. General and administrative expenses for the six months ended June 30, 2004 constituted 5.2% of total revenues for such period, as compared with 7.8% for the six months ended June 30, 2003. Such 2.6% decrease is attributable to the fixed cost nature of certain of our general and administrative expenses as compared to a larger revenue base.

Interest Expense

Interest expense for the six months ended June 30, 2004 was \$19.5 million, as compared with \$3.8 million for the six months ended June 30, 2003, which represented a 413.2% increase in such interest expense. Approximately \$5.9 million of such increase was attributable to the interest expenses incurred by certain of our subsidiaries in connection with the Beal Bank financing and approximately

\$6.3 million of such increase was attributable to the interest expenses incurred in connection with the issuance by Ormat Funding, on February 13, 2004, of \$190.0 million of senior secured notes. The remaining \$3.5 million increase was attributable to an increase in parent company loans.

Income Taxes

Income taxes for the six months ended June 30, 2004 were \$2.0 million, as compared with \$2.2 million for the six months ended June 30, 2003, which represented a 9.1% decrease in such income taxes. The effective tax rate for six months ended June 30, 2004 and June 30, 2003 was 31.0% and 26.5%, respectively. The lower effective rate for the six months ended June 30, 2003 was primarily due to the tax holiday in the Philippines that was applicable in 2003, but not in 2004.

Equity in Income of Investees

Our participation in the income generated from our investees for the six months ended June 30, 2004 was \$2.0 million (net of tax expense in the amount of \$0.5 million), as compared with \$0.2 million for the six months ended June 30, 2003, which represented a 900.0% increase. Such increase was principally attributable to the income generated in connection with our 50.0% equity interest in the Mammoth project, which was acquired in December, 2003 and which accounted for \$0.7 million of such income for the six months ended June 30, 2004, and from income generated in connection with our 80% equity interest in the Ormat Leyte project which was deconsolidated as of April 1, 2004 (as a result of the application of FIN No. 46) and which accounted for \$1.0 million.

Net Income

Net income for the six months ended June 30, 2004 was \$6.3 million, as compared with \$5.6 million for the six months ended June 30, 2003, which represented an increase of 12.5% in our net income. Net income as a percentage of our total revenues for the six months ended June 30, 2004 was 6.3%, as compared with 10.9% for the six months ended June 30, 2003. Such decrease in percentage was principally attributable to an increase in our financing expenses relating to the financing of the acquisition of the Heber 1 project, Heber 2 project and Steamboat 2/3 project.

Comparison of the Year Ended December 31, 2003 and the Year Ended December 31, 2002

Total Revenues

Total revenues for the year ended December 31, 2003 were \$119.4 million, as compared with \$85.6 million for the year ended December 31, 2002, which represented a 39.5% increase in our total revenues. Such increase was principally attributable to the receipt of additional revenues generated by the Ormesa project that was acquired on April 15, 2002 and the increase in revenues generated from the sale and installation of equipment to power plants worldwide.

Electricity Segment

	<u>Year ended December 31,</u>	
	<u>2002</u>	<u>2003</u>
	<u>(in millions)</u>	
Ormesa Project	\$ 21.8	\$ 30.5
Heber 1 and Heber 2 Projects	—	2.0
Steamboat 1/1A Project	—	1.0

Leyte Project	15.6	12.6
Momotombo Project	9.2	11.6
Other Projects	18.9	20.1
Total	<u>\$ 65.5</u>	<u>\$ 77.8</u>

Revenues from the sale of electricity for the year ended December 31, 2003 were \$77.8 million, as compared with \$65.5 million for the year ended December 31, 2002, which represented a 18.8%

increase in such revenues. Such increase was a result of: (i) the acquisition of the Ormesa project in April of 2002, which for the full fiscal year ended December 31, 2003 generated \$30.5 million of revenues, as compared to \$21.8 million for the eight months of operation in 2002 following its acquisition; (ii) \$2.0 million of revenues generated by the Heber 1 project and the Heber 2 project for the 13-day period ended December 31, 2003, as compared with no revenues attributable to such projects in 2002; and (iii) \$1.0 million of revenues generated by the Steamboat 1/1A project as compared with no revenues attributable to such project in 2002. The increase in our revenues for the fiscal year ended December 31, 2003, as compared to the fiscal year ended December 31, 2002, would have been higher but for the one-time addition to the revenues received in 2002 in the amount of \$2.7 million, as a result of a disputed performance bonus that was resolved and recognized in 2002.

Products Segment

Revenues from our Products Segment for the year ended December 31, 2003 were \$41.7 million, as compared with \$20.1 million for the year ended December 31, 2002, which represented a 107.5% increase in such revenues. Such increase resulted primarily from \$14.0 million of revenues primarily attributable to two large projects (Mokai and Miravalles) and the sale of products, services and parts for the year ended December 31, 2003. Such increase reflects the volatility of the revenues generated from our Products Segment.

Total Cost of Revenues

Total cost of revenues for the year ended December 31, 2003 was \$76.2 million, as compared with \$50.8 million for the year ended December 31, 2002, which represented a 50.0% increase. As a percentage of total revenues, our total cost of revenues for the year ended December 31, 2003 was 63.8%, as compared to 59.3% for the year ended December 31, 2002. This increase is explained below.

Electricity Segment

Cost of revenues attributable to our Electricity Segment for the year ended December 31, 2003 was \$46.7 million, as compared with \$33.5 million for the year ended December 31, 2002, which represented a 39.4% increase for such cost of revenues. Such increase was principally attributable to the acquisition of the Ormesa project, as cost of revenues for the year ended December 31, 2003 included expenses of the Ormesa project in the amount of \$23.3 million, as compared to \$15.7 million for the year ended December 31, 2002. The Ormesa project had higher operating expenses than the other projects we operated at such time due to additional transmission costs relating to the transmission of electricity over the Imperial Irrigation District transmission system and the type of equipment used in the Ormesa project, which is more costly to operate and maintain than the equipment used in our other projects that existed at the time of such acquisition. As a percentage of total electricity revenues, the total cost of revenues attributable to our Electricity Segment was 60.1% for the year ended December 31, 2003 as compared to 51.1% for the year ended December 31, 2002. Such increase, on a percentage basis, was partially attributable to \$2.7 million of revenues received as a result of a one-time disputed performance bonus that was resolved and recognized in 2002.

Products Segment

Cost of revenues attributable to our Products Segment for the year ended December 31, 2003 was \$29.5 million, as compared with \$17.3 million for the year ended December 31, 2002, which represented a 70.5% increase in such cost of revenues. Such \$12.2 million increase in cost of revenues was attributable to the generation of additional revenues from the sale of our equipment during the year ended December 31, 2003. As a percentage of our total Products Segment revenues, our cost of revenues attributable to our Products Segment for the year ended December 31, 2003 was 70.7% as compared to 85.9% for the year ended December 31, 2002. Such 15.2% decrease was primarily attributable to a 107.5% increase in our Products Segment revenues as

compared to the fixed nature of much of our cost of revenues, such as salaries, depreciation, expenses related to maintaining operations, utilities and property expenses.

Research and Development Expenses

Research and development expenses for the year ended December 31, 2003 were \$1.4 million, as compared with \$1.5 million for the year ended December 31, 2002, which represented a 6.7% decrease in such research and development expenses. Such decrease reflects a fluctuation in the ordinary course of our business and does not represent a significant change in our research and development program or our ability to maintain and continue to develop our technologies and operations.

Selling and Marketing Expenses

Selling and marketing expenses for the year ended December 31, 2003 were \$7.1 million, as compared with \$6.1 million for the year ended December 31, 2002, which represented a 16.4% increase in such selling and marketing expenses. Selling and marketing expenses for the year ended December 31, 2003 represented 5.9% of our total revenues, as compared to 7.1% for the year ended December 31, 2002. Such 1.2% decrease is a result of the effect of the fixed cost component of our selling and marketing expenses over a larger revenue base. The larger revenue base was principally attributable to an increase in the revenues generated by our Electricity Segment. Once a project is in operation and generates electricity, selling and marketing expenses are relatively insignificant.

General and Administrative Expenses

General and administrative expenses for the year ended December 31, 2003 were \$9.3 million, as compared with \$7.1 million for the year ended December 31, 2002, which represented a 31.0% increase in general and administrative expenses. Such increase was attributable to costs related to an increase in our personnel, wages and professional services and other costs related to our business development activities in the United States which were primarily related to the pursuit and consummation of the acquisition of the Heber 1 and Heber 2 projects and our 50% ownership interest in the Mammoth project. As a percentage of our total revenues, general and administrative expenses were 7.7% of such revenues for the year ended December 31, 2003 and 8.3% of such revenues for the year ended December 31, 2002.

Interest Expense

Interest expense for the year ended December 31, 2003 was \$8.1 million, as compared with \$6.2 million for the year ended December 31, 2002, which represented an increase of 30.6% in our total interest expense. Such increase resulted from \$1.9 million of interest expense incurred in connection with the United Capital project finance loan incurred on December 31, 2002 by our project subsidiary to refinance the Ormesa acquisition, \$0.8 million of interest expense incurred in connection with outstanding parent company loans, and \$0.4 million of interest expense incurred in connection with the Beal Bank loan incurred on December 18, 2003, in order to finance the acquisition of the Heber 1 project, the Heber 2 project and the Mammoth project. Interest expenses related to certain other bank loans decreased by \$1.2 million for the fiscal year ended December 31, 2003 due to a decrease in outstanding corresponding balances.

Income Taxes

Income taxes for the year ended December 31, 2003 were \$2.5 million, as compared with \$6.1 million for the year ended December 31, 2002, which represented a decrease of 59.0% in such income taxes. The effective tax rate for the years ended December 31, 2003 and 2002 was 13.8% and 39.5%, respectively. For the year ended December 31, 2003, our effective tax rate was reduced by approximately 8.4% as a result of the application of investment tax credits. In addition, our foreign tax rates were substantially lower than our U.S. tax rates due primarily to the tax holiday in the Philippines that applied to us and the reversal of a deferred tax valuation allowance related to the realization of net operating losses in Ormat Systems which decreased our effective tax rate by approximately 5.6%. For the year ended December 31, 2002, our effective tax rate was reduced by approximately 2.5% as a result of the application of investment tax credits and increased by approximately 8.0% related to a deferred tax valuation allowance applied to the net operating losses in Ormat Systems.

Equity in Income of Investees

Our participation in the income generated from our investees for the year ended December 31, 2003 was \$0.6 million, as compared with \$0.3 million for the year ended December 31, 2002, which represented an increase of 100%. Such increase was principally attributable to an increase in our income derived from our 21.0% ownership of the Zunil project, which had lower debt service and therefore higher net income.

Discontinued Operations

Losses from operations of discontinued activities in Kazakhstan and losses from the sale of our Kazakhstan operations were \$3.1 million and \$6.4 million, respectively for the year ended December 31, 2002. The sale of our Kazakhstan operations (consisting of coal fired power plants and related assets), occurred on September 16, 2002. Such losses were recorded and reflected in our financial statements for the fiscal year ended December 31, 2002.

Net Income

Our income from continuing operations was \$15.7 million in the fiscal year ended December 31, 2003, as compared to \$8.5 million in fiscal year ended December 31, 2002, representing 13.1% of revenues in 2003 as compared to 9.9% of revenues in 2002. Such increase was attributable to increased revenues in both segments. Net income in 2002 was equal to a loss of \$1.0 million as a result of the loss from discontinued operations in Kazakhstan and the loss from the sale of our Kazakhstan assets. Net income in 2003 was \$15.5 million.

Comparison of the Year Ended December 31, 2002 and the Year Ended December 31, 2001

Total Revenues

Total revenues for the year ended December 31, 2002 were \$85.6 million, as compared with \$47.9 million for the year ended December 31, 2001, which represented a 78.7% increase in such total revenues. Such increase in total revenues was principally attributable to the revenues generated by the acquired Ormesa project and Brady project and is also due to an increase in the revenues generated by our Products Segment.

Electricity Segment

	<u>Year ended December 31,</u>	
	<u>2001</u>	<u>2002</u>
	(in millions)	
Brady Project	\$ 4.0	\$ 9.6
Ormesa Project	—	21.8
Leyte Project	12.5	15.6
Other Projects	17.5	18.5
Total	<u>\$ 34.0</u>	<u>\$ 65.5</u>

Revenues attributable to our Electricity Segment for the year ended December 31, 2002 were \$65.5 million, as compared with \$34.0 million for the year ended December 31, 2001, which represented a 92.6% increase in such revenues. Such increase in revenues was principally attributable to the acquisition of the Ormesa project, as total revenues for the year ended December 31, 2002 included \$21.8 million of revenues generated from the Ormesa project, as compared with the year ended December 31, 2001, during which no revenues from the Ormesa project were recorded. Additionally, the acquisition of the Brady project on June 29, 2001 also contributed additional revenues, as total revenues for the year ended December 31, 2002 included Brady project revenues in the amount of \$9.6 million, while the period from June 29, 2001 to December 31, 2001 only included \$4.0 million of Brady project revenues. Lastly, our increased revenues were partially attributable to \$2.7 million of revenues received as a result of a one-time disputed performance bonus that was resolved and recognized in 2002.

Products Segment

Revenues from our Products Segment for the year ended December 31, 2002 were \$20.1 million, as compared with \$14.0 million for the year ended December 31, 2001, which represented a 43.6% increase in such revenues. Such increase resulted from revenues of \$7.0 million attributable to the Miravalles power plant during the year ended December 31, 2002, as compared with no revenues from any large project during 2001. Such difference reflects the volatility of the revenues generated from our Products Segment.

Total Cost of Revenues

Total cost of revenues for the year ended December 31, 2002 was \$50.8 million, as compared with \$30.0 million for the year ended December 31, 2001, which represented a 69.3% increase in total cost of revenues. As a percentage of our total revenues, our total cost of revenues for the year ended December 31, 2002 was 59.3%, as compared with 62.6% for the year ended December 31, 2001.

Electricity Segment

Cost of revenues attributable to our Electricity Segment for the year ended December 31, 2002 was \$33.5 million, as compared with cost of revenues of \$12.5 million for the year ended December 31, 2001, which represented a 168.0% increase in such cost of revenues. Such increase was principally attributable to the acquisition of the Ormesa project, as cost of revenues for the year ended December 31, 2002 included expenses of the Ormesa project equal to \$15.7 million, as compared to operating expenses relating to the Ormesa project during the year ended December 31, 2001. In addition to the acquisition of the Ormesa project, as a result of the acquisition of Brady project, operating expenses for the year ended December 31, 2002 included expenses for the Brady project equal to \$5.3 million, as compared to the fiscal year ended December 31, 2001, which included \$2.6 million of such expenses. As a percentage of our total Electricity Segment revenues, our cost of revenues attributable to our Electricity Segment was 51.1% for the fiscal year ended December 31, 2002, as compared with 36.9% for the fiscal year ended December 31, 2001. Such increase was primarily attributable to the cost of revenues for the Ormesa project which were substantially higher than the cost of revenues of our other existing projects at the time of such acquisition which are due to additional transmission costs relating to the transmission of electricity over the Imperial Irrigation District transmission system and the type of equipment used in the Ormesa project, which is more costly to operate and maintain than the equipment used in our other projects that existed at the time of such acquisition.

Products Segment

Cost of revenues attributable to our Products Segment for the year ended December 31, 2002 was \$17.3 million, as compared with \$17.5 million for the year ended December 31, 2001, which represented a 1.1% decrease in such cost of revenues. As a percentage of our total Products Segment revenues, our cost of revenues attributable to our Products Segment for the fiscal year ended December 31, 2002 was 85.9%, as compared with 125.0% for the fiscal year ended December 31, 2001. Such reduction was primarily attributable to a higher volume of product sales which was sufficient to decrease the related fixed costs, such as salaries, depreciation, expenses related to maintaining operations, utilities and property expenses, whereas in 2001, cost of revenues attributable to our Products Segment exceeded revenues generated from our Products Segment.

Research and Development Expenses

Research and development expenses for the year ended December 31, 2002 were \$1.5 million, as compared with \$1.7 million for the year ended December 31, 2001, which represented a 11.8% decrease in research and development expenses. Such decrease was in ordinary course of our operations and does not represent a significant change in our research and development program or our ability to maintain and continue to develop our technologies and operations.

Selling and marketing expenses for the year ended December 31, 2002 were \$6.1 million, as compared with \$6.5 million for the year ended December 31, 2001, which represented a 6.2% decrease in such selling and marketing expenses. Selling and marketing expenses for the year ended December 31, 2002 represented 7.1% of our total revenues, as compared with 13.6% for the year ended December 31, 2001. Such 6.5% decrease is attributable to the fixed cost nature of certain of our selling and marketing expenses as compared to a larger revenue base. The larger revenue base was principally attributable to an increase in the revenues generated by our Electricity Segment. Once a project is in operation and generates electricity, selling and marketing expenses attributable to such project are relatively insignificant.

General and Administrative Expenses

General and administrative expenses for the year ended December 31, 2002 were \$7.1 million, as compared with \$5.4 million for the year ended December 31, 2001, which represented a 31.5% increase in general and administrative expenses. Such increase was principally attributable to an increase in our business development activities in the United States, an increase in personnel and the retainer of professional consultants in connection with the acquisition of the Ormesa project. General and administrative expenses for the year ended December 31, 2002 constituted 8.3% of our total revenues, as compared to 11.3% for the year ended December 31, 2001.

Interest Expense

Interest expense for the year ended December 31, 2002 was \$6.2 million, as compared with \$4.3 million for the year ended December 31, 2001, which represented a 44.2% increase in our total interest expense. Such increase was primarily attributable to an increase in interest expense and related guarantee fees of \$1.9 million relating to short term bank loans.

Income Taxes

Income taxes for the year ended December 31, 2002 were \$6.1 million, as compared with \$3.1 million for the year ended December 31, 2001, which represented an increase of 96.8% in such income taxes. The effective tax rate for the years ended December 31, 2002 and 2001 was 39.5% and 169.2%. For the year ended December 31, 2002, our effective tax rate was reduced by approximately 2.5% as a result of the application of investment tax credits and increased by approximately 8.0% related to a deferred tax valuation allowance applied to the net operating losses of Ormat Systems. For the year ended December 31, 2001, our effective tax rate was increased by a deferred tax valuation allowance applied to the net operating losses in Ormat Systems.

Equity in Income of Investees

Our participation in the income generated from our investees for the year ended December 31, 2002 was \$0.3 million, as compared with \$0.2 million for the year ended December 31, 2001, which represented an increase of 50.0%. Such increase was principally attributable to an increase in our income derived from our 21.0% ownership interest of the Zunil project, which had lower debt service and therefore higher net income.

Discontinued Operations

Losses from operations of discontinued activities in Kazakhstan and losses from the sale of our operations in Kazakhstan were \$3.1 million and \$6.4 million, respectively, for the year ended December 31, 2002. Losses from operations of discontinued activities in Kazakhstan for the year ended December 31, 2001 were \$4.7 million.

Net Income (Loss)

Our income from continuing operations was \$8.5 million in the fiscal year ended December 31, 2002, as compared to a loss of \$1.7 million for the fiscal year ended December 31, 2001. Such increase

was attributable to increased revenues generated by both segments. Loss from discontinued operations amounted to \$3.1 million compared with \$4.7 million in 2001. In 2002, we also recorded a loss on the sale of our Kazakhstan assets of \$6.4 million. The net income was a loss of \$1 million in 2002, compared to a loss of \$6.4 million in 2001.

Quarterly Results of Operations