Zacks Small-Cap Research

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TowerJazz (TSEM-NASDAQ)

TSEM: Joint Venture Closes, Raising Revenue Numbers; OUTPERFORM

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	02/23/2012
Current Price (03/31/14)	$9.14
Target Price	**$10.00**

OUTLOOK

TowerJazz (formerly know as Tower Semiconductor) is a pure-play semiconductor wafer foundry that manufactures SiGe, MEMS, RF, embedded flash-based memory, analog/mixed-signal, and CMOS image-sensor devices. Its recent joint venture agreement with Panasonic has closed and should add $400 m/yr. in new consolidated revenues.

We are raising 2013 revenues to $810m and 2014 revenues to $1.1B.

SUMMARY DATA

52-Week High	**$9.50**
52-Week Low	**$3.86**
One-Year Return (%)	**30.20**
Beta	**1.77**
Average Daily Volume (sh)	**351,608**
Dil. Shares Outstanding (mil)	**104**
Market Capitalization ($mil)	**$950.6**
Short Interest Ratio (days)	**0.32**
Institutional Ownership (%)	**3**
Insider Ownership (%)	**1**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**19.5**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**8.6**
P/E using 2014 Estimate	**5.9**
P/E using 2015 Estimate	**4.9**
Zacks Rank	**3**

Risk Level	**High**
Type of Stock	**Small-Blend**
Industry	**Elec Comp-Semic**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2012	168 A	140 A	176 A	148 R	639 R
2013	113 A	125 A	133 A	135 A	505 A
2014	135 E	225 E	220 E	230 E	810 E
2015					1068 E

Earnings per Share
(Non-GAAP Diluted)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2012	$0.68 A	$0.90 A	$0.90 A	$0.44 R	$2.65 A
2013	$0.13 A	$0.36 A	$0.22 A	$0.34 A	$1.06 A
2014	$0.33 E	$0.35 E	$0.41 E	$0.44 E	$1.56 E
2015					$1.87 E

Income Statement and Valuation use fully diluted shares outstanding

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WHATS NEW

Panasonic Joint Venture Agreement Closes, Raising Revenues

Today TowerJazz closed its joint venture agreement by issuing 870,454 shares ($7.5 million in value) in exchange for 51% of a joint venture with Panasonic that is expected to add $400 million in annual revenues. The agreement has Panasonic contributing enough in revenues for manufacturing its products to have the joint venture breakeven. So by itself, the agreement will not add to earnings. However, the company also announced that due to the capacity afforded by this agreement, TowerJazz would now be able to close its Nishiwaki fab and transfer production to the fabs owned by the joint venture. As a result TowerJazz will be able to save as much as $130 million a year in expenses. The closing will cause expenses for employee layoffs and we expect the company to take a one-time charge in the June quarter.

Forecast for Q1 Ending March 31, 2014

The company has given guidance to expect revenues in the March quarter to range from $130-140 million in revenues, slightly higher sequentially than the fourth quarter's $132 million. Since the joint venture did not conclude until April 1, we expect Q1 to look much the same as Q4 except for an increase in share count due to the debt restructuring on March 20, 2014. As a result we are expecting revenues of $135 million versus $113 million, up 20%. Adjusted non-GAAP EPS could come in at $0.33 versus $0.13 last year driven almost entirely by a 4-percentage point improvement in gross margin.

Forecast for 2014

Starting in the June quarter, TowerJazz will be adding 100% of the joint venture revenues and expenses despite owning only 51% of the joint venture and then the profit (or loss) of the minority interest owned by Panasonic will be subtracted on a line item. The deal is structured so that Panasonic will provide enough in revenues for its products to cover the cost of the fabs. Thus we expect that the operation will show breakeven until the company can attract new business from third parties to these fabs. To add to capacity utilization, TowerJazz will be moving production from its Nishiwaki fab to the Panasonic fabs. This should improve margins at the joint venture, but more importantly will save Tower Jazz as much as $130 million per year in expenses, which could boost profitability to operating margins over 20% up from the 11.1% reported for the year ending 2013 and return it to 2011 margins.

We expect the joint venture to add as much as $85 million to the June quarter, albeit at no additional profit. The deal will add another 870,454 shares to the outstanding. In the September quarter, the deal could add $100 million in revenues, but Micron revenues will fall to zero reducing the quarter by $30 million. By September, we are expecting the company to save approximately $25 million from the fab closing and that much again in December. As a result of the joint venture closing **we are raising our 2014 to $810 million in revenues (up 60% versus 2013).**

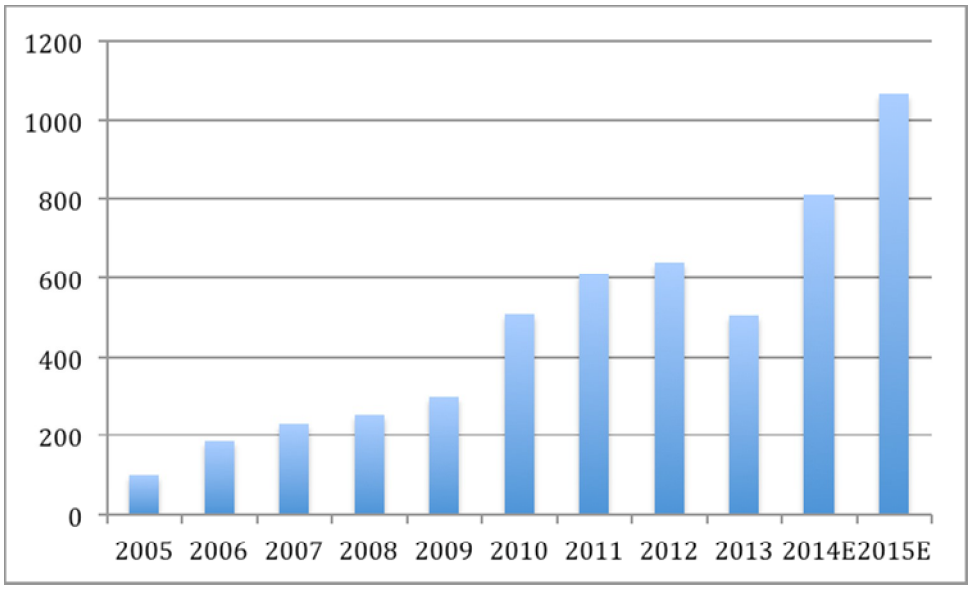
Without the joint venture, sales could have reached $610 million by internal growth alone. With the joint venture, the company believes it could be at a $900 million run rate by Q2 and exit Q4 at a $1B run rate. The plan is to let the profits from sales to Panasonic cover the fixed costs of the fabs and all other capacity would be sold to other customers and provide the profit. Much of the new business expected is from higher margin products. Because of these dynamics the company expects to reach GAAP profitability by perhaps year-end. This would be a reversal of a GAAP loss in 2013 of $108 million dollars.

While the expense reduction from the fab closing is a net plus, the fully diluted share count has now risen to 104 million due primarily to the debt restructuring of March 20th plus the 850,545 shares issued in consideration for the joint venture. This share count is up from the fully diluted number of 56.4 million as of December 31, 2014. As a result we are unable to raise earnings estimates until we see how the company's business model falls out as a result of the joint venture and fab closing.

Forecast for 2015

Although it is early to tell how revenues and expenses will fall in 2015 given the new joint venture and expense structure we are tentatively forecasting **revenues to reach $1.1 B in 2015** due to improved margins from capacity utilization and higher margin product mix as well as an improved fixed cost structure due to the fab closing. It remains to be seen what the cash needs of the company may be and what dilution may occur to satisfy future plans. As 2014 proceeds will tune our estimates for 2015.

Chart 1. Tower Jazz Revenues



INVESTMENT THESIS

- The company is coming off a year of declining sales and has fallen out of view of investors due to the loss of a major customer and will again gain favor as it proves high growth internally as well as through the new joint venture with Panasonic.
- The stock is undervalued on a PE basis compared to its peers.
- The company restructuring has improved liquidity and will reduce long-term debt upon conversion.
- The closing of the Nishiwaki fab should greatly improve profitability and boost margins considerably in late 2014 and beyond.

VALUATION

While fully valued looking at an enterprise value to sales basis, the firm appears undervalued when looking at its PE ratio. With an non-GAAP estimate of $1.56 for this year and $1.87 for next, the company is showing approximately 20% growth and a 2014 PE multiple of 5.9X reflecting no doubt that is has not yet reached cash flow breakeven and the uncertainly of its newly restructured business model and capital requirements going forward. Should the company successfully execute its plans we believe the share price could increase to $10 by year-end.

Tower Jazz Income Statement

	Dec Q4 12R	March Q1 13	June Q2 13	Sept Q3 13	Dec Q4 13	March Q1 14E	June Q2 14E	Sept Q3 14E	Dec Q4 14E	Non-GAAP 2012	Non-GAAP 2013	Non-GAAP 2014E	Non-GAAP 2015E
REVENUE													
Net Revenue	147.6	112.647	125.236	$132.6	134.6	135	225	220	230	638.8	505.0	810.0	1,068.0
Yr-to-yr Gr.	6%	-24%	11.0%	6.0%	-9%	20%	80%	66%	71%	5%	-21%	60%	32%
OPERATING EXPENSES													
Cost of goods sold	98.3	78.9	81.2	93.1	88.6	89.0	155.0	155.0	161.0	405.4	341.9	560.0	733.0
Gross Margin	49.3	33.7	44.0	39.5	45.9	46.0	70.0	65.0	69.0	233.4	163.2	250.0	335.0
% of Sales	33.4%	29.9%	35.2%	29.8%	34.1%	34.1%	31.1%	29.5%	30.0%	36.5%	32.3%	30.9%	31.4%
R&D	7.1	9.3	7.4	8.1	7.8	8.0	8.2	8.6	8.7	29.1	32.5	33.5	40.0
M, G&A	9.7	9.4	10.9	10.2	10.4	10.6	17.0	8.0	8.6	39.2	40.5	44.2	62.0
One-time charges	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Tot Operating Exp.	16.9	18.8	18.3	18.4	18.2	18.6	25.2	16.6	17.3	68.2	73.0	77.7	102.0
Operating Income	32.4	15.0	25.7	21.1	27.8	27.4	44.8	48.4	51.7	165.2	90.1	172.3	233.0
Yr-to-yr Gr.					-14%	83%						21%	21.8%
Net Interest	(8.6)	(8.0)	(8.3)	(8.4)	(8.2)	(8.4)	(8.5)	(5.0)	(5.2)	(31.8)	(33.0)	(27.1)	(27.1)
Other income	0.1	(0.3)	(8.0)	(0.5)	(0.4)	(0.4)	(0.4)	(0.4)	(0.4)	(1.0)	(0.9)	(1.6)	(1.6)
Minority Income						0.0	0.0	0.0	0.0	0.0	0.0	0.0	(5.0)
Pretax Income	23.9	6.7	9.4	12.2	19.2	18.6	35.9	43.0	46.1	132.3	56.3	143.6	199.3
						13.8%	16.0%	19.5%	20.0%	20.7%	11.1%	17.7%	18.7%
Taxes	1.9	0.2	(1.4)	0.0	0.0	0.0	0.0	0.0	0.0	0.9	0.2	0.0	0.7
Tax Rate	8.1%	2.9%	-15.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.6%	0.3%	0.0%	0.4%
Net Income	21.9	6.5	10.8	12.2	19.2	18.6	35.9	43.0	46.1	131.5	56.1	143.6	198.6
Yr-to-yr Gr.					-13%	188%	233%	252%	140%				
Adj Non-GAAP EPS-Basic	$0.96	$0.28	$0.78	$0.26	$0.40	$0.39	$0.74	$0.88	$0.92	$5.94	$1.42	$2.93	$3.89
Adj Non-GAAP EPS-Fully dil.	**$0.44**	**$0.13**	**$0.36**	**$0.22**	**$0.34**	**$0.33**	**$0.35**	**$0.41**	**$0.44**	**$2.65**	**$1.06**	**$1.56**	**$1.87**
Yr-to-yr Gr.													
Share Out	22.8	23.0	39.1	47.0	47.9	48.0	48.9	49.0	50.0	22.2	39.6	49.0	51.0
Fully diluted shares	49.5	48.9	30.0	55.6	56.4	56.5	104.0	104.0	104.0	49.6	52.9	92.1	106.1
											6.7%	74.1%	15.1%

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