Zacks Small-Cap Research

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TowerJazz

(TSEM-NASDAQ)

TSEM: Raising Numbers--- End User Markets Are Hot and Should Accelerate Growth

OUTLOOK

TowerJazz is a pure-play semiconductor wafer foundry that manufactures SiGe, MEMS, RF, embedded flash-based memory, analog/mixed-signal, and CMOS image-sensor devices in the US, Israel and Japan. It has ample capacity and is serving high growth markets such as RF High Position analog, CMOS image sensors, and power management that should accelerate both revenue and margin growth as these products grow to be a larger percentage of the revenue mix.

Current Recommendation	**Buy**
Prior Recommendation	Hold
Date of Last Change	02/23/2012
Current Price (05/13/15)	$13.93
Target Price	**$22**

SUMMARY DATA

52-Week High	**$17.95**
52-Week Low	**$8.84**
One-Year Return (%)	**33.7**
Beta	**1.54**
Average Daily Volume (sh)	**819,791**
Shares Outstanding (mil)	**77**
Market Capitalization ($mil)	**$1,073**
Short Interest Ratio (days)	**4.5**
Institutional Ownership (%)	**38**
Insider Ownership (%)	**1**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**9.0**
Earnings Per Share (%)	**-5.9**
Dividend (%)	**N/A**
P/E using TTM EPS	**6.9**
P/E using 2015 Estimate	**6.0**
P/E using 2016 Estimate	**5.0**
Zacks Rank	**3**

Risk Level	**Above Average**
Type of Stock	**Mid-Growth**
Industry	**Elect. Comp-Semi.**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2013	113 A	125 A	133 A	135 R	505 A
2014	133 A	234 A	226 A	235 A	828 A
2015	226 A	236 A	244 E	250 E	956 E
2016					1,100 E

Earnings per Share
(Non-GAAP Fully Diluted)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2013	$0.15 A	$0.21 A	$0.25 A	$0.30 A	$0.97 A
2014	$0.30 A	$0.41 A	$0.40 A	$0.54 A	$1.65 A
2015	$0.52 A	$0.54 A	$0.54 E	$0.62 E	$2.32 E
2016					$3.18 E

Income Statement uses fully diluted shares outstanding

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WHATS NEW

Raising Estimates: Q2 Shows Better than Expected Margins As Business Accelerates

TowerJazz is on a roll and revenues and earnings continue to exceed expectations. Its key markets are exhibiting high growth and demand seems to be accelerating as markets such as front end RF for smartphones are growing faster than units. In the area of power management the company is growing revenues about 30% in 2015 over 2014, and expects to grow that product line 60% in 2016. Business is so strong in some areas that the company is now accepting “reservations” for capacity in return for a prepaid deposit. This novel mechanism allows customers to be first in line for capacity above and beyond their normal usage while contributing financing toward TowerJazz’s capital expenditures for expanding that capacity.

Revenues came in for Q2 just slightly ahead of plan, but the company guided higher for next quarter indicating revenue expectations of $244 million, plus or minus 5%. It is also on track to reach a goal $250 million in revenues in Q2 and GAAP margin of 40%.

Non-GAAP EPS using primary shares came in at came in at $0.70, while non-GAAP fully diluted EPS was $0.54 versus our estimate of $0.52 and $0.41 a year ago. For Q2 gross margin was a little higher than expected and expenses a little lower.

Carrying this gross margin expansion through, along with the slightly higher revenues, is causing us to raise our Q3, Q4, and annual numbers.

While currency has caused problems for many companies of late, TowerJazz is naturally hedged with revenues and expenses mostly within countries and currency changes did not affect the quarter materially, nor is it expected to going forward.

Forecasts

Revenues for the year should be $8 million higher than originally thought, and we are raising 2015 revenues to $956 million, up 15%. This assumes Panasonic revenues are flat and the rest of the business grows 25%.

We are raising our annual earnings estimates for 2015 once again, this time from $2.20, to $2.32, due to higher margin assumptions and slightly higher revenue expectations. This would be EPS growth of 45% on a fully diluted non-GAAP basis.

For 2016, we are also keeping revenues the same and raising non-GAAP fully diluted EPS to $3.18 from $3.03. We are optimistic that revenues could accelerate as the company’s products are going into high growth markets. As the company said on the earnings call the “RF High Position analog business unit, CMOS image sensor business unit, TOPS business unit and power management business unit are all experiencing nice double digit year-over-year growth with 2016 forecast that only gets stronger.” Specifically the power management business unit is experiencing very strong growth, the company expects 30% in revenue growth 2015 over 2014, and forecasted an additional 60% increase for 2016 over 2015.

Its biggest dollar segment is its RF business, which sells to smartphone and telecom infrastructure. This market grows even faster than the smartphone market as more of these chips are being used per handset. The company is having good success penetrating the Chinese market, as there is some product shortage. Also being sold to handset manufactures are its offerings in high megapixel smartphone camera chips. Additionally, the company is well positioned to serve the Internet of Things (IoT) market as sensors are needed to control these devices once they are connected to the Internet. Gesture control is another market that should exhibit high growth. TSEM has already signed Intel as a customer for this and another unnamed company. Since these markets are nascent, we are optimistic that volume production will follow in coming years.

INVESTMENT THESIS

- The current fab capacity will allow the company to double revenues and improve margins through capacity utilization. Capacity should be sufficient until 2017, giving the company breathing room to reap profits.
- Having Panasonic as a partner gives the company increased stature in the industry and has attracted new customers who have a favorable disposition to working with a trusted and known company with high quality product and leading edge expertise in imaging.
- Its largest market segment, RF, sells into the smartphone market and will grow faster than that market as multiple chips are now being sold per device.
- The company has a strong market position in high quality imaging and 3D, which is increasing being used for gesturing controls as well as smartphones with high megapixel cameras. In this area its primary competition is Sony, which makes it a preferable source for many companies that compete with Sony.
- The company should have accelerating revenue growth over 15% and non-GAAP EPS growth for next year over 37%.
- We believe that the stock could move to $22 based on blend of enterprise value to sales and multiple of EBITDA ratios versus peer values by next year and rate the stock a buy.

VALUATION

Over the summer the valuation of other foundry companies, using a multiple of enterprise value to sales, has come down somewhat explaining perhaps why TSEM shares have also suffered. The industry has shown some slowing in handsets and other products as the global economy and in particular, the Chinese market has slowed. Given its product mix however, TowerJazz has not seen the same slowdown. As shown on the chart below, the average company is trading at a valuation of 1.9 times 2015 estimated revenues compared with 2.1 to 2.2 times just three months ago. In using these companies as comparables, we have taken out the 49% of revenues we estimate are afforded to the Panasonic joint venture, as TowerJazz only owns 51%. If we estimate that approximately $350 million of 2016 revenues will be in the JV that reduces the 2016 revenue number to $827 million.

Foundary Companies

Company	Ticker	Revenue 2015E	Revenue LTM	EBIDTA Margin	Enterprise Value / Sales 2015E	Enterprise Value / Sales LTM	Included in Average?
Advanced Semiconductor	ASX	$9,160	$8,470	13%	1.1x	1.1x	y
Semiconductor Manufacturing	SMI	$2,150	$2,030	7%	0.3x	0.3x	n
Taiwan Semiconductor	TSM	$26,940	$27,310	39%	3.8x	3.8x	Y
United Microelectronics	UMC	$4,680	$4,640	38%	0.9x	0.9x	y
Average				**30%**	**1.9x**	**1.9x**	

	Revenue* 2016E	Revenue* LTM	EBITDA Margin	Enterprise Value / Sales 2016E	Enterprise Value / Sales LTM	Valuation Range Low	Valuation Range High
Tower Jazz	**$827**	**$748**	**25%**	**1.9x**	**1.9x**	**$1,448**	**$1,58**
YoY growth	**23%**						

Conclusion of Enterprise Value	**$1,518,121,100**
Market Value	**$1,405,709,100**
Shares Outstanding	77,000,000
Price per Share	**$18.26**

* Adjusted for minority revenues

Using a comparable valuation of 1.9 times sales, and looking at 2016 adjusted sales; we come up with a value of $18.26 per share by 2016 that is 31% higher than today's price.

Valuing Based on EBITDA

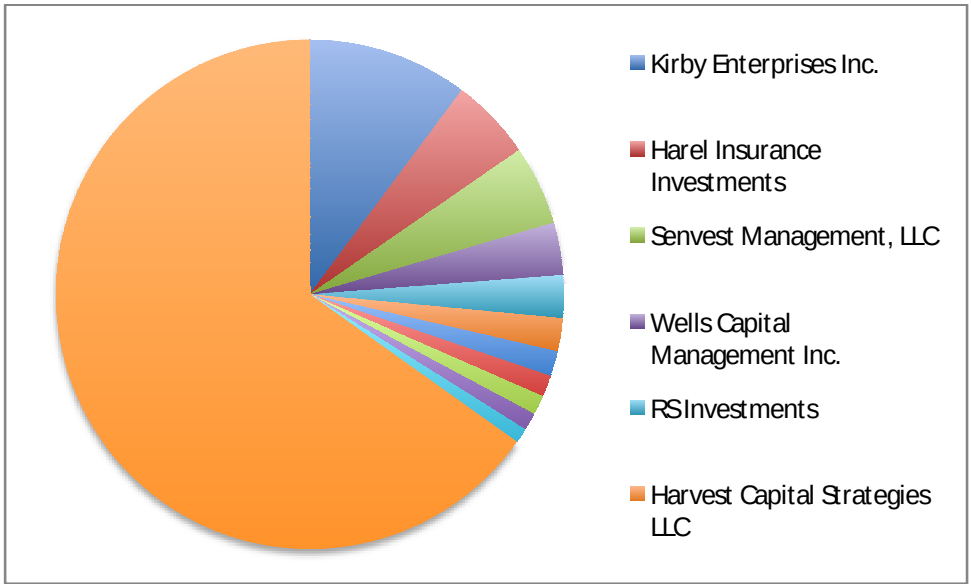
The same peer group as above trades at 3.6x enterprise value to EBITDA. TSEM should generate about $240 million in EBITDA this year and $350 million next year. Using the 3.6 multiple, the company should have an enterprise value of $1.3 billion.

Foundry Companies Company	**Ticker**	**Ent. Value**	**LTM 12-Mo EBITDA**	**EV/EBITDA**
Advanced Semiconductor	ASX	9,690	$1,850	5.2
Semiconductor Manufacturing	SMI	648	$669	1.0
Taiwan Semiconductor	TSM	103,000	$17,780	5.8
United Microelectronics	UMC	4,130	$1,760	2.3
Average				**3.6x**

OWNERSHIP

Since the distribution of Kenon's holdings in TSEM, it is no longer the largest shareholder. We believe much of the selling since the distribution has been the shareholder's of Kenon, who are taking a profit or selling equity instrument not suitable for their portfolios. This exceptional liquidity event has created a buying opportunity in TSEM stock.

Chart 1: Largest Investors



Source: E*TRADE and SEC filings

INCOME STATEMENT

	March Q1 14A	June Q2 14A	Sept Q3 14A	Dec Q4 14A	March Q1 15	June Q2 15	Sept Q3 15E	Dec Q4 15E	Non-GAAP 2013	Non-GAAP 2014A	Non-GAAP 2015E	Non-GAAP 2016E
REVENUE												
Net Revenue	132.7	234.1	226.0	235.3	226.2	235.6	244.0	250.0	505.0	828.0	955.8	1,100.1
Yr-to-yr Gr.	18%	87%	70%	75%	71%	1%	8%	6%	-21%	64%	15%	15%
OPERATING EXPENSES												
Cost of goods sold	88.2	171.7	158.2	151.1	145.5	148.2	153.0	150.0	341.9	569.1	600.0	638.0
Gross Margin	44.5	62.4	67.8	84.2	80.7	87.4	91.0	100.0	163.2	258.9	355.8	462.1
% of Sales	33.5%	26.7%	30.0%	35.8%	35.7%	37.1%	37.3%	40.0%	32.3%	31.3%	37.2%	42.0%
R&D	7.2	13.7	15.4	13.7	14.4	14.4	14.5	14.7	32.5	50.0	58.0	60.0
M, G&A	9.9	15.6	15.0	14.6	14.9	14.4	14.5	15.2	40.5	55.1	59.0	60.8
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
Tot Operating Exp.	17.0	29.3	30.4	28.3	29.4	28.8	29.0	29.9	73.0	105.0	117.0	120.8
Operating Income	27.5	33.1	37.4	55.9	51.3	58.6	62.0	70.1	90.1	153.9	238.8	341.3
Operating Margin	21%	14%	17%	24%	23%	25%	25%	28%	18%	19%	25%	31%
Yr-to-yr Gr.	84%	29%	77%	101%	87%	77%	66%	25%		19%	25.0%	31.0%
Net Interest	(8.1)	(8.8)	(8.7)	(7.8)	(3.6)	(3.6)	(3.6)	(2.0)	(33.0)	(33.4)	(12.8)	(8.0)
Other income	0.1	0.1	(0.4)	0.0	(0.0)	(0.0)	0.0	0.0	(0.9)	(0.1)	(0.0)	(0.0)
Minority Income	0.0	6.7	2.5	(3.6)	2.3	(0.4)	(0.8)	(1.0)	0.0	5.6	(3.0)	(10.0)
Pretax Income	19.5	31.1	30.9	44.5	50.0	54.6	57.6	67.1	56.3	126.0	222.9	323.3
	14.7%	13.3%	13.7%	18.9%	22.1%	23.2%	23.6%	26.8%	11.1%	15.2%	23.3%	29.4%
Taxes	0.0	0.0	0.0	(1.4)	0.5	0.7	0.3	0.4	0.2	(1.6)	1.8	3.5
Tax Rate	0.0%	0.0%	0.0%	-3.2%	0.9%	1.3%	0.5%	0.5%	0.3%	-1.2%	0.8%	1.1%
Net Income	19.5	31.1	30.9	45.9	49.5	53.9	57.3	66.8	56.1	127.5	221.1	319.8
Yr-to-yr Gr.	201%	188%	153%	140%	154%	74%	86%	45%	-57%	127%	73%	45%
Adj Non-GAAP EPS-Basic	$0.41	$0.62	$0.58	$0.83	$0.78	$0.70	$0.74	$0.87	$1.42	$2.46	$3.00	$4.15
Adj Non-GAAP EPS-Fully dil.	**$0.30**	**$0.41**	**$0.40**	**$0.50**	**$0.52**	**$0.54**	**$0.59**	**$0.67**	**$0.97**	**$1.61**	**$2.32**	**$3.18**
Yr-to-yr Gr.	95%	68%	87%	69%	75%	32%	49%	33%	-63%	65%	45%	37%
Share Out	48.1	50.1	53.2	55.6	63.6	77.0	77.0	77.0	39.6	51.8	73.6	77.0
Fully diluted shares (w/ converts)	81.2	89.1	92.2	101.6	102.0	103.0	103.0	103.0	76.1	91.8	102.8	103.0
	13%	43%	17%	28%	26%	16%	12%	1%	53.4%	20.6%	11.9%	0.2%

BALANCE SHEET

$ in thousands	June 30, 2015	March 31, 2015	
CURRENT ASSETS			
Cash and cash equivalents	**$142,503**	**$134,216**	6%
Trade accounts receivable	112,624	105,491	7%
Other receivables	6,333	7,408	-15%
Inventories	91,855	86,153	7%
Other current assets	18,796	20,314	-7%
Total current assets	**372,111**	**353,582**	5%
LONG-TERM INVESTMENTS	12,437	11,785	6%
PROPERTY AND EQUIPMENT, NET	415,092	408,513	2%
INTANGIBLE ASSETS, NET	39,283	41,225	-5%
GOODWILL	7,000	7,000	0%
OTHER ASSETS, NET	7,410	6,391	16%
TOTAL ASSETS	853,333	828,496	3%
CURRENT LIABILITIES			
Current maturities of loans and debentures	**40,558**	**26,721**	52%
Trade accounts payable	106,677	108,616	-2%
Deferred revenue	11,540	8,112	42%
Other current liabilities	72,715	59,102	23%
Total current liabilities	**231,490**	**202,551**	14%
LONG-TERM DEBT	**214,357**	**225,841**	-5%
LONG-TERM CUSTOMERS' ADVANCES	6,178	6,181	0%
EMPLOYEE RELATED LIABILITIES	16,571	15,973	4%
DEFERRED TAX LIABILITY	74,551	75,854	-2%
OTHER LONG-TERM LIABILITIES	9,897	10,057	-2%
Non-controlling Interest	-9,418	-9,418	0%
Total liabilities	553,044	536,457	3%
SHAREHOLDERS' EQUITY	300,289	292,039	3%
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$828,496	$828,496	0%
Current Ratio	1.6	1.7	-8%
Quick Ratio	1.2	1.3	-8%
Debt Percent of Assets	30.8%	30.5%	1%
Debt to Equity	0.8	0.9	-2%

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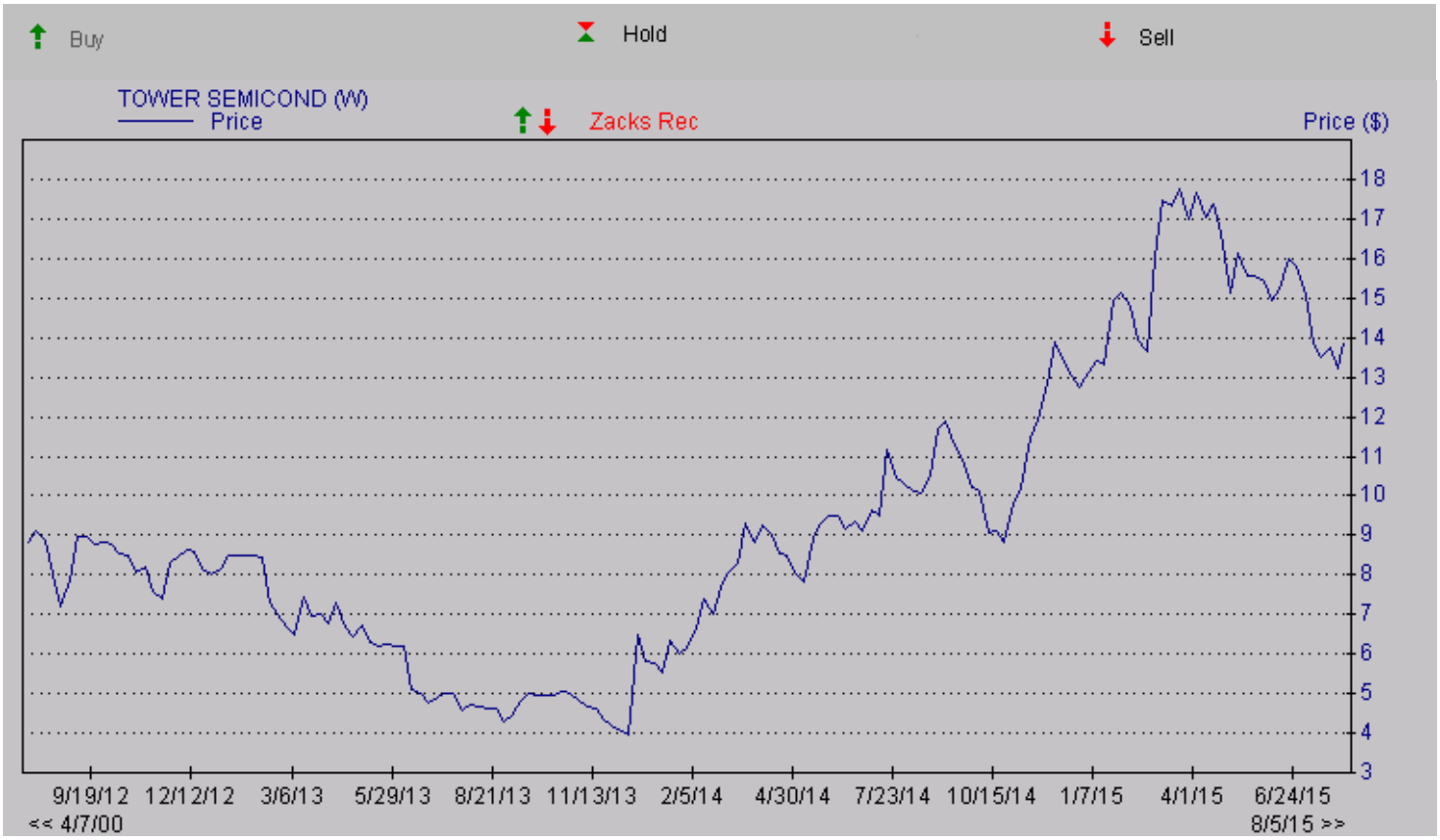

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