Zacks Small-Cap Research

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TowerJazz (TSEM-NASDAQ)

TSEM: Q4 Earnings Beat, Panasonic venture to Start in April; OUTPERFORM

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	02/23/2012
Current Price (02/27/14)	$7.15
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 will spike the companies growth and should add to the business starting in April.

When the deal closes we will adjust numbers accordingly and revenues and earnings should ramp considerably while share count will increase.

SUMMARY DATA

52-Week High	**$8.55**
52-Week Low	**$3.86**
One-Year Return (%)	**-25.00**
Beta	**1.22**
Average Daily Volume (sh)	**344,320**
Dil. Shares Outstanding (mil)	**56.4**
Market Capitalization ($mil)	**$403**
Short Interest Ratio (days)	**2.32**
Institutional Ownership (%)	**1**
Insider Ownership (%)	**1**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**23.3**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**6.7**
P/E using 2014 Estimate	**4.6**
P/E using 2015 Estimate	**3.8**
Zacks Rank	**3**

Risk Level	**High**
Type of Stock	**Small-Value**
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	145 E	158 E	172 E	610 E
2015					730 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

Tower Jazz Beats Earnings for Q4 2013, Growth Accelerates From Here

On February 27 2014, Tower Jazz, the Israel-based specialty foundry, reported results for Q4 and the year ended December 31, 2013.

Although non-GAAP revenues for the quarter were down 9% from the year ago quarter, it was up slightly sequentially. The decline in revenues was entirely due to the decrease in sales to Micron and organically the company grew 20%. This growth was in spite of the fact that the industry as a whole saw sales decline 8-10% in the quarter. In the fourth quarter Tower Jazz saw 450 new design wins and mask-to-factory was up 25%.

Non-GAAP gross margin during the 2014 fourth quarter was 34.1%, an improvement over the 33.4% last year. Operating expense was up despite the decline in sales leading to a reduction in the operating profit for the company. Operating profit was $27.8 million versus $32.4 million a year ago.

Taxes came in at zero this year versus almost $2 million last year yielding an adjusted non-GAAP EPS of $0.34 versus $0.44 last year on a fully diluted basis. The fully diluted share count was up 14% and now stands at 56.4 million and a market value for the company of $403 million. The company's current enterprise value is $616 million or 1.2x enterprise value to trailing twelve months sales.

EBITDA for the quarter was a positive $27 million or using that as a run rate, $1.91 per fully diluted share, or 5.7x enterprise value to EBITDA. The current ratio was much improved to 2.1 times as company primarily paid down some short-term debt.

Full Year 2013 Results

Revenues for year ended December 31, 2014 were $505 million, down from $639 million for the 2013 year reflecting the loss of Micron sales.

Non-GAAP gross profit for the year was $163 million representing gross margin of 32.3%. This compares to non-GAAP gross profit of $233 million and gross margin of 36.5% in 2012.

Adjusted Non-GAAP net income for the year was $56.1 million or a fully diluted $1.06 per share, which compares to earnings of $132 million or $2.65 per share in 2012.

During 2013 over 13,000 new masks enter the factory up 25% from a year ago and indicating a strong 2014. On December 20, 2013, Tower Semiconductor Ltd. announced the signing a definitive agreement creating a joint venture with Panasonic Corporation where Tower Jazz will manufacture Panasonic products using Panasonic's three semiconductor manufacturing facilities in Japan, as well as possible expansion of the current operations in those fabs, by leveraging Tower Jazz's customers and businesses to capture out-of-group sales. By adding available capacity of approximately 800,000 wafers per year (8 inch equivalent) in the three manufacturing facilities in Japan, the joint venture is expected to improve Tower Jazz's profitability by increasing its revenue by approximately $400 million a year, thereby enabling a $900 million annual run rate, all following the closing of the transaction which is expected in April 2014.

This deal is expected to close in April and revenues will be added to Tower Jazz at the time the deal closes. For 51% of this joint venture Tower Jazz will be giving Panasonic 8 million shares of its stock leading to a dilution of 14% of the fully diluted share outstanding. When the deal closes, we will revise numbers to reflect the impact on Tower Jazz's income statement.

Forecast for Q1 Ending March 31, 2014

The company has given guidance that they expect revenues to range from $130-140 million in revenues, slightly higher sequentially than the fourth quarter's $132 million. Since the joint venture is not expected to conclude until April, we expect Q1 to look much the same as Q4 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

We are keeping our numbers that same until the joint venture is finalized and we get better guidance on how and when the joint venture business will effect Tower Jazz's income statement. Without the joint venture, sales could reach $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. Other than volume increases, the company has plans to rearrange capacity in the fabs to improve expenses some time in 2014. While there is great promise, investors must wait to see if the company can execute on its plan while still growing EPS for shareholders. This will take manufacturing, finance and sales to come together and ramp production.

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 growth internally as well as the new joint venture with Panasonic expected to close sometime in April.
- The stock is undervalued on a cash flow to sales basis compared to its peers.
- The company has gotten financing in place and once Panasonic is issued its 8 million shares in April, the equity dilution should slow making EPS growth easier.
- Q4 should be the last down quarter in terms of both sales and EPS, investors should show interest now that both sales and EPS will be up year over year going forward.

VALUATION

The firm appears undervalued when looking at several metrics, especially if earnings from the joint venture is accretive after the dilution from the stock used to invest in the Panasonic joint venture. Here is a table of comparable public foundry companies. Using and average enterprise value to sales, we can see that an average price for a profitable company with higher EBITDA than TowerJazz can command a ratio over 1 on average. If we take the mid range, we see that the company is worth $606 million, very close to the enterprise value of $616 it trades at today. Subtracting off the company's debt and net cash, we get a market value of $423 million or $7.50 a share for a current price. By year-end however, the stock could reach a price at a 20%-50% higher as sales grow throughout the year and the joint venture revenues and profits add to the company's growth.

Comparable Public Companies:

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Foundary Companies

Company	Ticker	Revenue 2014E	Revenue LTM	EBIDTA Margin	Enterprise Value / Sales 2014E	Enterprise Value / Sales LTM	Included in Average?
Advanced Semiconductor	ASX	$8,180	$7,520	21%	1.1x	1.2x	y
Magnachip	MX	$880	$836	18%	0.7x	0.7x	y
Semiconductor Manufacturing	SMI	$2,200	$2,060	34%	1.4x	1.5x	y
Taiwan Semiconductor	TSM	$22,600	$20,420	61%	4.1x	4.5x	n
United Microelectronics	UMC	$4,470	$4,230	34%	1.1x	1.1x	y
Average				**27%**	**1.1x**	**1.2x**	

	Revenue[1] 2014E	Revenue[1] LTM	EBITDA Margin	Enterprise Value / Sales 2014E	Enterprise Value / Sales LTM	Valuation Range Low	Valuation Range High
Tower Jazz	**$606**	**$505**	**14.80%**	**1.1x**	**1.2x**	**$606**	**$667**
YoY growth	**20%**						

Conclusion of Enterprise Value	**$636,000,000**
Market Value	**$423,000,000**
Fully Diluted Shares Outstanding	56,400,000
Price per Share	**$7.50**

Another potential headwind for the firm may be investors may be waiting for Tower to be GAAP profitable. Cash flow from operations has been quite strong over the past three years ($121M in 2010, $108M in 2011, $75M in 2012) this has not quite kept up with capital expenditures, which makes financing necessary. The enormous depreciation charges are on account of the build of FAB 2. As the depreciation charges wind down and the Micron plant gains strength the firm should see GAAP profitability.

PROJECTED INCOME STATEMENT

TOWERJAZZ
27-Feb-14

	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
REVENUE												
Net Revenue	147.6	112.647	125.236	$132.6	134.6	135	145	158	172	638.8	505.0	610.0
Yr-to-yr Gr.	6%	-24%	11.0%	6.0%	-9%	20%	16%	19%	28%	5%	-21%	21%
OPERATING EXPENSES												
Cost of goods sold	98.3	78.9	81.2	93.1	88.6	89.0	97.0	106.0	117.5	405.4	341.9	409.5
Gross Margin	49.3	33.7	44.0	39.5	45.9	46.0	48.0	52.0	54.5	233.4	163.2	200.5
% of Sales	33.4%	29.9%	35.2%	29.8%	34.1%	34.1%	33.1%	32.9%	31.7%	36.5%	32.3%	32.9%
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
M, G&A	9.7	9.4	10.9	10.2	10.4	10.6	10.9	11.0	12.0	39.2	40.5	44.5
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.	16.9	18.8	18.3	18.4	18.2	18.6	19.1	19.6	20.7	68.2	73.0	78.0
Operating Income	32.4	15.0	25.7	21.1	27.8	27.4	28.9	32.4	33.8	165.2	90.1	122.5
Yr-to-yr Gr.					-14%	83%						
Net Interest	(8.6)	(8.0)	(8.3)	(8.4)	(8.2)	(8.4)	(8.5)	(8.6)	(8.6)	(31.8)	(33.0)	(34.1)
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)
Pretax Income	23.9	6.7	9.4	12.2	19.2	18.6	20.0	23.4	24.8	132.3	56.3	88.4
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
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%
Net Income	21.9	6.5	10.8	12.2	19.2	18.6	20.0	23.4	24.8	131.5	56.1	88.4
Yr-to-yr Gr.					-13%	188%	85%	91%	29%			
Adj Non-GAAP EPS-Basic	$0.96	$0.28	$0.78	$0.26	$0.40	$0.39	$0.42	$0.49	$0.52	$5.94	$1.42	$1.84
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**
Yr-to-yr Gr.												
Share Out	22.8	23.0	39.1	47.0	47.9	47.9	47.9	47.9	47.9	22.2	39.6	47.9
Fully diluted shares	49.5	48.9	30.0	55.6	56.4	56.5	56.5	56.6	56.6	49.6	52.9	56.5
											6.7%	6.9%

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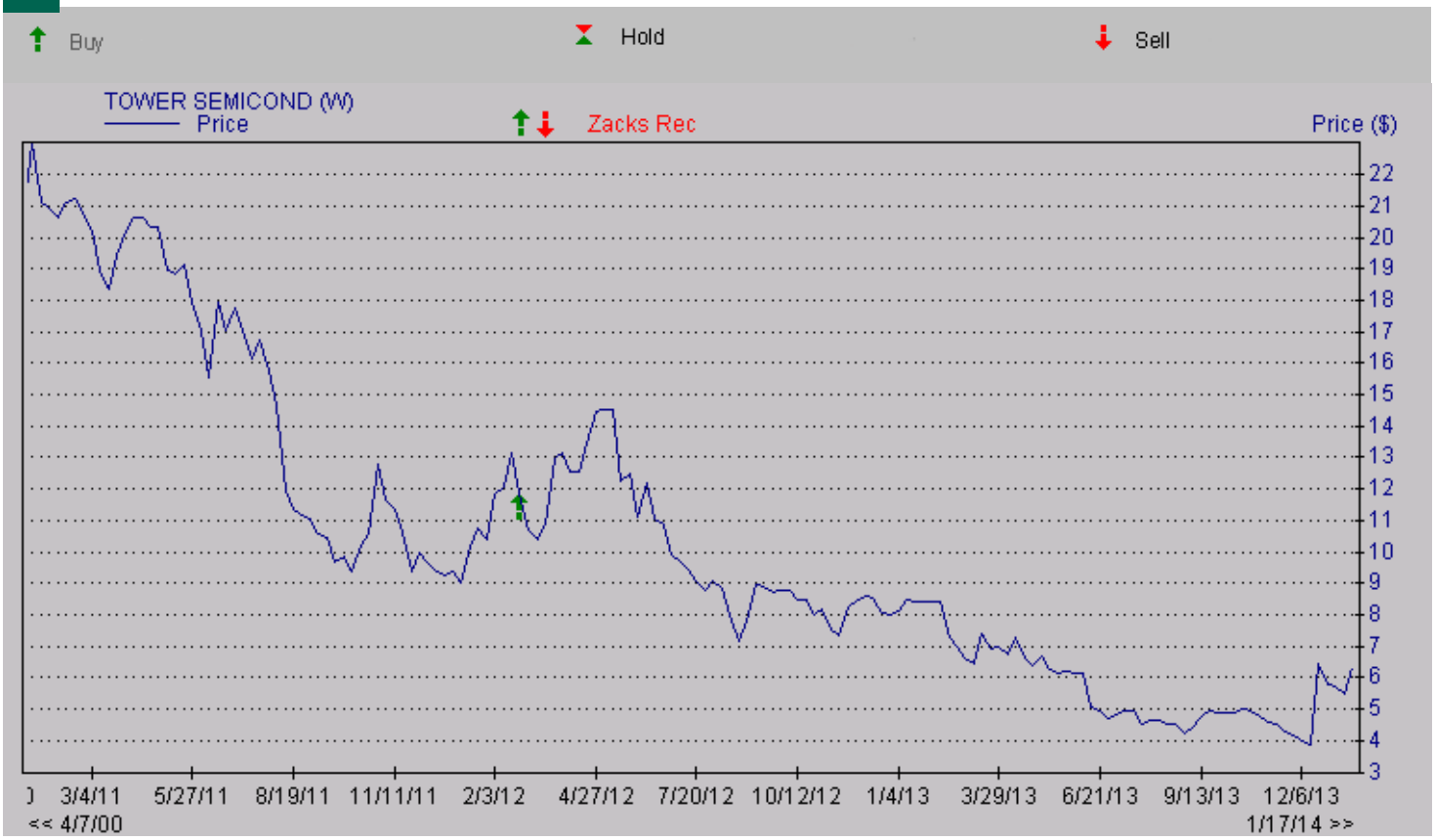

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