Zacks Small-Cap Research

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TowerJazz (TSEM-NASDAQ)

TSEM: Debt Restructuring Improves Liquidity; OUTPERFORM

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	02/23/2012
Current Price (03/19/14)	$8.73
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 company's growth and should add to 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	**$8.99**
52-Week Low	**$3.85**
One-Year Return (%)	**24.71**
Beta	**1.79**
Average Daily Volume (sh)	**258.904**
Dil. Shares Outstanding (mil)	**61.9**
Market Capitalization ($mil)	**$540.0**
Short Interest Ratio (days)	**0.38**
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	**7.6**
P/E using 2014 Estimate	**5.7**
P/E using 2015 Estimate	**4.7**
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 Debt Restructuring Improves Liquidity

On March 20, 2014, Tower Jazz, the analog semiconductor specialty foundry, announced a the issuance of $55 million of new 8% convertible bonds in exchange for $45 million of its 8% bonds due June 2015 and $10 million in cash. This reduces the total amount of the 8% bonds due June 2015 from $94 million to $49 million. This remaining $49 million is expected to be paid in full next June, reducing total long-term debt to $278 million from the current $317 million as of December 31, 2014. This will reduce interest payments by $3.1 million per year as well as keeping $45 million in long-term debt rather than becoming reclassified as short term as of June 2014. The reclassification would have caused the company's current ratio to decline to 1.6 times from 2.1 times where it was as of December 31, 2013.

The new issue is however convertible, as opposed to a straight bond, and at the conversion price of $10.07, increases fully diluted shares by 5.46 million shares, or 9.7%. When the joint venture with Panasonic closes in April, we expect approximately another 950,000 shares to be added to the fully diluted count. Thus fully diluted shares should increase from 56.5 million as of December 31, 2013 to approximately 63 million in April, an increase of 11.5%.

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 the same until the joint venture closes which is expected to happen on April 1, 2014. Despite owning only 51% of the joint venture, the company will be reporting 100% of the revenues as is normal accounting and then the profit (or loss) of the minority interest owned by Panasonic will be subtracted on a line item above pretax income. 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. Alternatively, Tower Jazz has suggested it is considering closing it Nishwaki fab, and moving its production to the Panasonic fabs. Were this to happen, the company could save as much as $100 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. This fab closing could occur as soon as the June quarter of 2014.

We expect the joint venture to add as much as $85 million to the June quarter, albeit at no additional profit. At the price of $8.40 per share the deal will add another 950,000 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. Perhaps by then there will be the fab closing and expenses will be affected.

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.

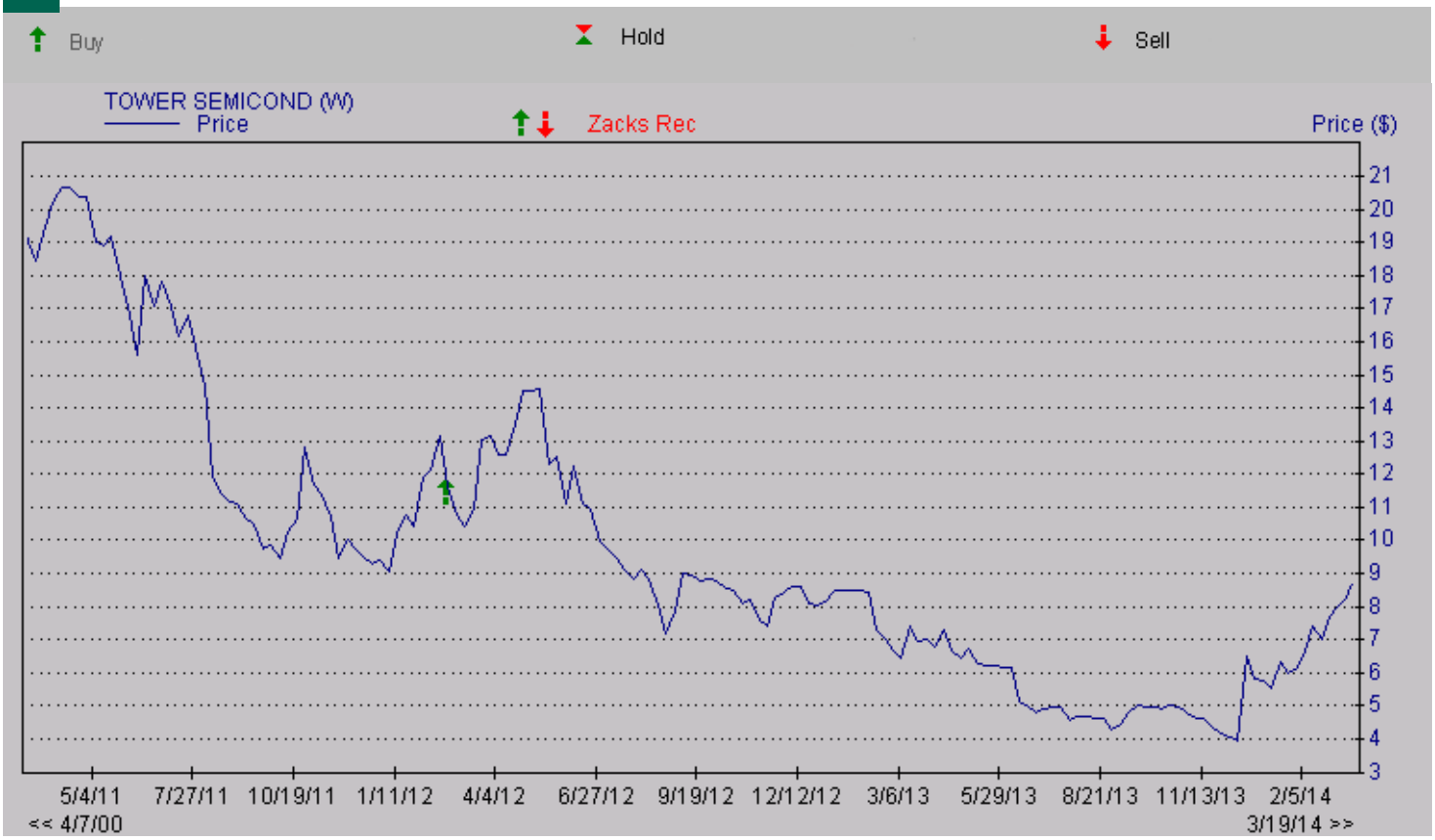
INVESTMENT THESIS

- 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 the new joint venture with Panasonic expected to close in April.
- The stock is undervalued on a cash flow to sales basis as well as sales to enterprise value compared to its peers.
- The company restructuring has improved liquidity and will reduce long term debt upon conversion.
- The potential closing of the Nishiwaki fab would greatly improve profitability and boost EPS considerably in late 2014 and beyond.
- 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. Using and average enterprise value to sales, an average price for a profitable company with higher EBITDA than TowerJazz can command a ratio over 1 on average. If the company can achieve sales in the range of $1 billion in 2015, the company could approach at $1 billion enterprise value by the end of 2014. Subtracting the net cash gives a market value of $800 million. Using 63 million shares outstanding leads us to $12.70 share price. Upon closing of the Panasonic joint venture agreement we will be revising our earnings numbers and our current price target to reflect new revenues, expenses and share count.

HISTORICAL ZACKS RECOMMENDATIONS



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