Zacks Small-Cap Research

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Lisa Thompson
lthompson@zacks.com
www.zacks.com
10 S. Riverside Plaza, Suite 1600, Chicago, IL 60606

TowerJazz

(TSEM-NASDAQ)

TSEM: Accelerating Growth and Improved Reporting Should Assure Investors

We believe that the stock is worth $22 based on using an industry average PE ratio of 14.7xs and a 2016 EPS estimate of $1.55.

Current Price (05/09/16)	$12.51
Valuation	**$22.00**

OUTLOOK

TowerJazz is a pure-play analog 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. It is expected to grow despite tepid world markets for semiconductors due to growth in the specific markets it addresses and via acquisitions.

SUMMARY DATA

52-Week High	**$17.00**
52-Week Low	**$11.23**
One-Year Return (%)	**-27.3**
Beta	**1.51**
Average Daily Volume (sh)	**357,820**
Shares Outstanding (mil)	**86**
Market Capitalization ($mil)	**$1,006**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**31**
Insider Ownership (%)	**1**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**11.2**
Earnings Per Share (%)	**4.6**
Dividend (%)	**N/A**
P/E using TTM EPS	**14.4**
P/E using 2016 Estimate	**8.1**
P/E using 2017 Estimate	**7.9**
Zacks Rank	**N/A**

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

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2014	133 A	234 A	226 A	235 A	828 A
2015	226 A	236 A	244 A	255 A	961 A
2016	278 A	300 E	315 E	328 E	1,220 E
2017					1,350 E

Earnings per Share
(Adjusted Non-GAAP Fully Diluted)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2014	NA	NA	NA	NA	NA
2015	-$0.03 R	$0.11 R	$0.18 R	$0.27 R	$0.65 R
2016	$0.31 A	$0.38 E	$0.41 E	$0.45 E	$1.55 E
2017					$1.59 E

R = restated

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WHATS NEW

Q1 Revenues Reaccelerate With the Maxim Acquisition

TowerJazz reported Q1 2015 revenues of $278 million versus last year's $226 million, up 23% and $254.6 million in Q4 2015. It also gave guidance of Q2 revenues with a mid-point of $300 million forecasting accelerating revenues in part due a full three months of Maxim revenues versus only two months in Q1. It was helped in the first quarter by a favorable yen to dollar rate, which inflated revenues by $5 million, as well as two months of the Maxim acquisition and strong demand.

In order to make it easier for investors to back out one-time expenses and the convertible and to report in-line with its peers, the company broke out the calculation for non-GAAP earnings for the first time. On a non-GAAP basis, ex-one time items and stock-based compensation, but including ongoing depreciation and amortization, it reported its non-GAAP net income of $35.6 million versus a loss of $7.6 million in Q1 2015. **Non-GAAP fully diluted EPS was $0.31 versus a loss last year of $0.03 and a positive $0.29 in Q4 2015.** This reporting now makes it easier to value the company versus other companies that report the same way, as well as well as being able to use PE ratios.

GAAP gross margins in the quarter were $61 million or 22% versus $33 million or 15%. Sequentially this was down from $64.5 million or 25.3% in Q4 2015 as the new Maxim revenue dragged down the overall company number. We expect overall gross margins to continue to improve as new incremental revenues should be at margins at 50% or higher and bring up the average over time.

Expenses were similar to last year showing the fixed cost leverage in the business.

The company-provided non-GAAP numbers have also caused us to revise our estimated non-GAAP historical numbers. For example, we had calculated that Q4 non-GAAP EPS including depreciation was $0.31 per share but the company has now indicated the accurate number was $0.27. Using these newly reported adjusted non-GAAP numbers, we now see that the stock price is at a rational PE ratio than the numbers that had been reported that took out depreciation and could not be used to compare to peers.

EBITDA for Q1 2016 was $78 million in the quarter (a margin of 28%), up from $51 million in 2016 or 51% year over year and on target with our estimate.

Maxim Transaction Adds a Minimum of $90 in Annual Revenues

TowerJazz closed the purchase of Maxim's 8-inch fab in San Antonio, Texas one month into Q1 2016, which they now call *TowerJazz Texas*. This fab increases its production capacity by 28,000 wafers per month and we expect it to generate a guaranteed minimum of $90 million in annual revenues from Maxim. The fab was acquired for 3.3 million shares of TSEM common stock. This acquisition gives the company an additional $200 million of capacity (including what is sells Maxim). The fab produces advanced analog platforms with geometries down to 130nm. It will also be able to use TSEM's specialty process technologies and the company plans to produce RF-ROI product there very quickly. We do not expect the transaction to be significantly dilutive or accretive in 2016. In the latter half of this year we do believe the company may be able to bring on some outside revenues to this fab by Q4. It already has two TOPS clients for this fab. The two together should generate $75 million in revenue. One is a one-year contract and the other over three years. One of these customers also put up $15 million to reserve space and allow equipment to be ordered to increase the capacity it needs.

2016 Forecast

We are upping our revenues numbers again due to the better than expected sales in Q1 and the company's Q2 guidance and belief that revenues will continue sequentially up this year based on it current book of business. Revenues are being increased to $1,194 million from $1,185 million. Gross margins and operating margins should continue to improve from Q1 as the fabs fill up and incremental revenues come in at gross margins over 50%.

Business continues strong across the board and the company is benefitting from a diverse customer base. The company has good visibility and capacity and should experience solid margin improvement. Growth in RF high precision analog should continue as the company's SiGe technology takes market share as it provides an advantage in performance and cost versus the competition. The company also expects to capture market share in RF SOI through qualifying additional capacity in San Antonio and improved processes. And of course CMOS image sensor remains strong as it targets high growth markets including high-end cinematography, machine vision, industrial sensors, extra-oral and medical x-rays, and gesture control sensors. Even the power management business is showing steep ramps.

New 2017 Estimate

In 2017 we are expecting 8% revenue growth with expanding margins due to capacity utilization. For the 2017 year, we are looking for revenues of $1.3 billion and non-GAAP EPS of $1.59 per share. Once of the significant differences between 2016 and 2017 is that TPSCo should be making meaningful profits that will be taxed at 40% in addition to some taxes paid in the US.

INVESTMENT THESIS

- The current fab capacity will allow the company to grow revenues and improve margins through capacity utilization.

	Q4 2015	Q1 2016
Fab1 Migdal Haemek, Israel 6"	65%	71%
Fab2 Migdal Haemek, Israel 8"	91%	91%
Fab3 Newport Beach, California 8"	91%	91%
Three TPSCo factories	41%	41%
San Antonio, 8"	NA	NA

- 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, comprising over 20% of revenues, sells into the smartphone market and will grow faster than that market as multiple chips are now being sold per device. Despite other company's woes, TowerJazz has an extremely diverse customer base and no one can cause great effect.
- 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.

- While its competitors are showing slowing or declining revenues, Tower is positioned to continue grow in 2016 and beyond.
- We believe the stock is undervalued versus its competition by almost ever valuation method possible.

VALUATION

TSEM's public foundry competitors have shown lackluster results of late. SMI grew 7.1% year-over-year in the fourth quarter. A bright spot for SMI is fingerprint sensors due to accelerating adoption in smartphones as well as diversification of its customer base to U.S. and Eurasia. Q1 2016 revenues at TSMC declined 8.3% and UMC saw an 8.6% decline. Given its product mix however, TowerJazz has done much better; TSEM grew 23% in Q1 2016, with approximately 70% of that coming from revenues from Maxim.

As shown on the chart below, the average company is trading at a valuation of 1.8 times 2016 estimated revenues. 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%. That reduces the 2016 revenue number to $1.0 billion. **Using these comparables, TSEM common stock is worth $17.26 today.**

Valuation Based on Enterprise Value to Sales

Foundry Companies

Company	Ticker	Revenue 2016E	Revenue LTM	EBIDTA Margin	Enterprise Value / Sales 2016E	Enterprise Value / Sales LTM	Included in Average?
Advanced Semiconductor	ASX	$8,580	$8,800	19%	1.1x	1.0x	y
Semiconductor Manufacturing	SMI	$2,690	$2,110	35%	1.3x	1.7x	y
Taiwan Semiconductor	TSM	$27,990	$26,190	64%	4.0x	4.2x	y
United Microelectronics	UMC	$4,560	$4,500	39%	1.0x	1.0x	y
Average				**39%**	**1.8x**	**2.0x**	

	Revenue* 2016E	Revenue* LTM	EBITDA* Margin	Enterprise Value / Sales 2016E	Enterprise Value / Sales LTM	Valuation Range Low	Valuation Range High
Tower Jazz	**$1,034**	**$826**	**33.3%**	**1.8x**	**2.0x**	**$1,643**	**$1,897**
YoY growth							

Conclusion of Enterprise Value	**$1,769,939,536**
Market Value	**$1,705,139,536**
Shares Outstanding	98,777,000
Price per Share	**$17.26**

Valuation Based on EBITDA

The same peer group as above trades at 5.0x enterprise value to EBITDA. TSEM generated $275.2 million in EBITDA in the last twelve months and we expect it to generate $353 million in 2016 year. Using the 5.0 multiple, the company should have an enterprise value of $1.38 billion now and $1.8 billion by next year. **This equates to $17.84 per share** with similar debt and cash and share count as today.

Foundry Companies	Ticker	Ent. Value	LTM 12-Mo EBITDA	EV/EBITDA
Company				
Advanced Semiconductor	ASX	9,020	$1,680	5.4
Semiconductor Manufacturing	SMI	3,527	$672	5.3
Taiwan Semiconductor	TSM	111,000	$16,850	6.6
United Microelectronics	UMC	4,590	$1,750	2.6
Average				**5.0x**

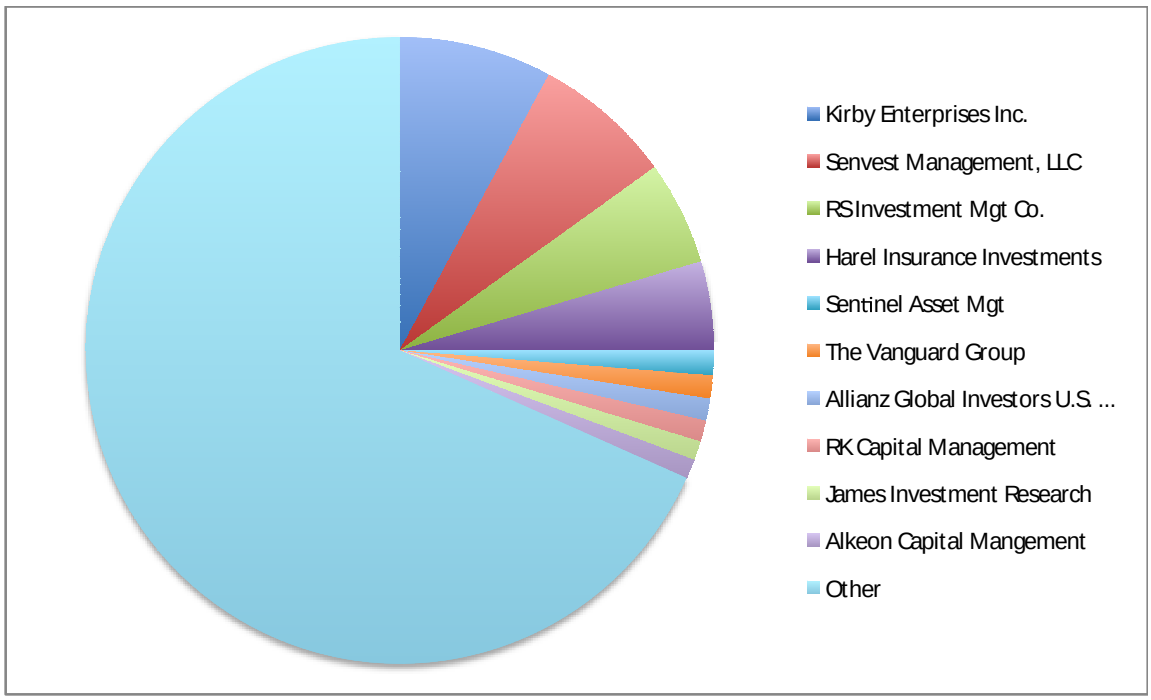
Valuing Based on PE

The PE ratio of the other foundry companies we see a range of 10.4 to 19.5 times 2016 estimated EPS. Our fully diluted non-GAAP EPS estimate for TSEM is $1.55. **Using the average PE of 14.7 times for the group that give us a stock price of $22.79 per share**.

Foundry Companies	Ticker	EPS 16E	EPS 17E	Price	PE 2016	PE 2017	Growth Rate
Company							
Advanced Semiconductor	ASX	$0.45	$0.53	$4.67	10.4	8.8	18%
Semiconductor Manufacturing	SMI	0.20	0.29	3.90	19.5	13.4	45%
Taiwan Semiconductor	TSM	1.84	1.98	23.38	12.7	11.8	8%
United Microelectronics	UMC	0.11	0.12	1.79	16.3	14.9	9%
Average					14.7	13.4	20.6%

OWNERSHIP

Chart 1: Largest Investors as of May 9, 2016



Source: E*TRADE and SEC filings

BALANCE SHEET

$ in thousands	Mar. 31, 2016	Dec. 31, 2015	
CURRENT ASSETS			
Cash and cash equivalents	**$244,577**	**$205,575**	19.0%
Trade accounts receivable	122,918	110,065	11.7%
Other receivables	9,363	7,376	26.9%
Inventories	128,031	105,681	21.1%
Other current assets	16,666	18,030	-7.6%
Total current assets	**521,555**	**446,727**	16.8%
LONG-TERM INVESTMENTS	11,816	11,737	0.7%
PROPERTY AND EQUIPMENT, NET	582,250	459,533	26.7%
INTANGIBLE ASSETS, NET	35,601	34,468	3.3%
GOODWILL	7,000	7,000	0.0%
OTHER ASSETS, NET	5,688	6,759	-15.8%
TOTAL ASSETS	1,163,910	966,224	20.5%
CURRENT LIABILITIES			
Current maturities of loans and debentures	**49,150**	**33,259**	47.8%
Trade accounts payable	104,617	91,773	14.0%
Deferred revenue	31,061	23,373	32.9%
Other current liabilities	73,929	62,714	17.9%
Total current liabilities	**258,757**	**211,119**	22.6%
LONG-TERM DEBT	**260,201**	**256,875**	1.3%
LONG-TERM CUSTOMERS' ADVANCES	28,444	21,102	34.8%
EMPLOYEE RELATED LIABILITIES	14,387	14,189	1.4%
DEFERRED TAX LIABILITY	95,638	69,744	37.1%
OTHER LONG-TERM LIABILITIES	2,116	7,609	-72.2%
Total liabilities	659,543	580,638	13.6%
SHAREHOLDERS' EQUITY	504,367	385,586	30.8%
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$1,163,910	$966,224	20.5%
Current Ratio	2.0	2.1	-4.7%
Quick Ratio	1.5	1.6	-5.9%
Debt Percent of Assets	27%	30%	-11.5%
Debt to Equity	0.6	0.8	-18.5%

INCOME STATEMENT

	March Q1 15R	June Q2 15	Sept Q3 15	Dec Q4 15R	March Q1 16	June Q2 16E	Sept Q3 16E	Dec Q4 16E	2014	2015	2016E	2017E
REVENUE												
Net Revenue	226.2	235.6	244.2	254.6	278.0	300.0	315.0	327.6	828.0	960.6	1,220.6	1,350.0
Yr-to-yr Gr.	71%	1%	8%	8%	23%	27%	29%	29%	64%	16%	27%	11%
OPERATING EXPENSES												
Cost of goods sold	193.2	183.1	188.8	190.1	216.7	233.0	240.0	250.0	764.2	755.2	939.7	994.0
Gross Margin	33.0	52.5	55.4	64.5	61.3	72.3	79.8	86.1	63.8	205.4	280.9	356.0
% of Sales	14.6%	22.3%	22.7%	25.3%	22.1%	24.1%	25.3%	26.3%	7.7%	21.4%	23.0%	26.4%
R&D	14.8	15.1	16.0	15.7	15.2	15.2	15.3	15.3	51.8	61.7	61.0	64.0
M, G&A	16.2	15.8	15.3	15.5	15.9	16.2	16.5	16.8	58.8	62.8	65.4	72.0
One-time charges	0.0	0.0	0.0	-1.0	(0.6)	0.0	0.0	0.0	56.7	56.7	0.0	0.0
Tot Operating Exp.	31.0	31.0	31.3	30.2	30.5	31.4	31.8	32.1	167.4	181.2	126.5	136.0
Operating Income	2.0	21.5	24.1	34.3	30.8	40.9	48.0	54.0	(103.6)	24.2	154.5	220.0
Operating Margin	1%	9%	10%	13%	11%	14%	15%	16%	-13%	3%	13%	16%
Yr-to-yr Gr.	-93%	-35%	-36%	-39%	1157%	49%	55%	22%	-13%	2.5%	12.7%	16.3%
Net Interest	(3.6)	(3.6)	(3.6)	(2.4)	(3.4)	(3.0)	(3.0)	(2.9)	(33.4)	(13.2)	(12.3)	(5.0)
Other non-cash financing expense	(84.6)	(7.3)	(5.3)	(12.8)	(4.0)	(3.0)	(3.0)	(3.0)	(55.4)	(109.9)	(13.0)	(8.0)
Other income	(0.0)	(0.0)	(0.2)	0.1	0.0	0.0	0.0	0.0	(0.1)	(0.2)	0.0	0.0
Gain from acqusiition	0.0	0.0	0.0	0.0	41.1	0.0	0.0	0.0	166.4	0.0	41.1	0.0
Profit before tax	(86.2)	10.6	14.9	19.3	64.6	34.9	42.0	48.1	(26.1)	(99.1)	170.4	207.0
	-38.1%	4.5%	6.1%	7.6%	23.2%	11.6%	13.3%	14.7%	-3.2%	-10.3%	14.0%	15.3%
Taxes	10.9	(2.5)	(0.9)	4.8	(0.1)	(2.1)	(2.4)	(4.0)	24.7	12.3	(8.6)	(30.0)
Tax Rate	-12.6%	-23.2%	-6.2%	24.8%	-0.1%	-6.0%	-5.7%	-8.3%	-94.7%	-12.4%	5.0%	14.5%
Profit before non-controlling	(75.4)	8.2	14.0	24.1	64.5	32.8	39.6	44.1	(1.4)	(86.8)	161.8	177.0
Minority Income	2.3	(0.4)	(0.5)	(2.0)	1.3	0.0	(3.0)	(4.0)	5.6	(0.5)	(5.7)	(23.8)
Net income	(73.1)	7.8	13.6	22.1	65.9	32.8	36.6	40.1	4.3	(87.4)	156.2	153.2
Yr-to-yr Gr.					-190%	322%	170%	82%	-92%	NM	NM	-2%
GAAP primary EPS	($1.15)	$0.10	$0.18	$0.28	$0.78	$0.38	$0.43	$0.47	$0.08	($1.18)	$1.83	$1.70
Fully diluted GAAP	($0.76)	$0.09	$0.16	$0.25	$0.69	$0.35	$0.39	$0.42	$0.07	-$0.96	$1.84	$1.50
Adj Non-GAAP EPS-Fully dil.	**($0.03)**	**$0.11**	**$0.18**	**$0.27**	**$0.31**	**$0.38**	**$0.41**	**$0.45**	**NA**	**$0.65**	**$1.55**	**$1.59**
										-1523%	-292%	-19%
Primary Share Out	63.6	76.7	77.4	79.6	84.5	85.6	85.6	85.6	51.8	74.3	85.3	90.0
Fully Diluted GAAP	96.2	87.6	86.8	89.0	98.8	100.0	100.0	100.0	63.2	97.0	99.7	102.0
Fully diluted treasury non-GAAP	96.2	87.0	87.0	91.1	92.9	99.0	99.0	99.0				
All in shares	104.5	103.5	103.5	103.5	106.9	106.9	106.9	106.9	91.8	103.7	106.9	108.0
EBITDA	**51.3**	**59.0**	**63.0**	**75.5**	**77.7**	**85.2**	**92.3**	**98.3**	**154.0**	**248.9**	**353.5**	**416.9**
EBITDA Margin	23%	25%	26%	30%	28%	28%	29%	30%	19%	26%	29%	31%

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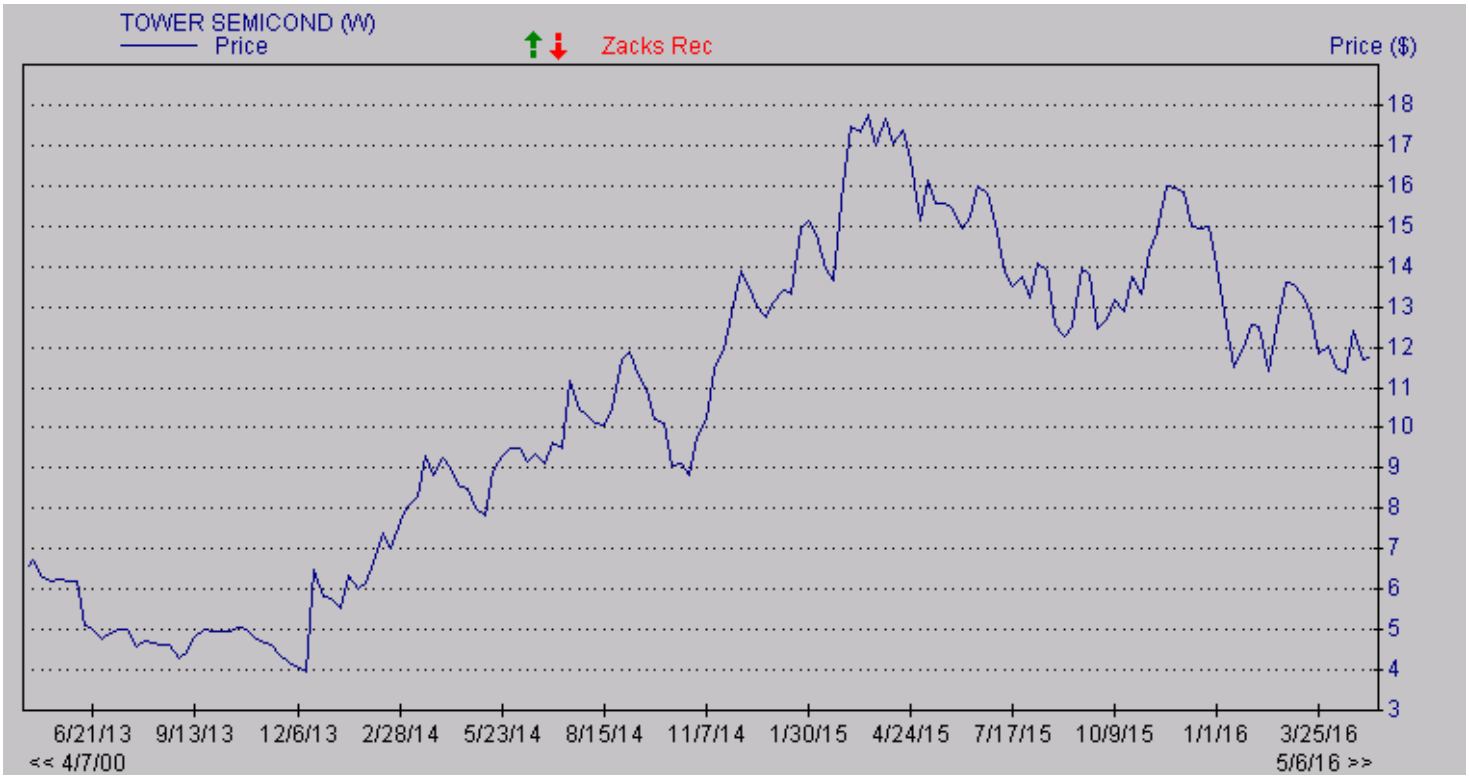
CASH FLOW

	3-months 31-Mar-15	3-months 30-Jun-15	3-months 30-Sep-15	3-months 31-Dec-15	3-months 31-Mar-16
CASH FLOWS - OPERATING ACTIVITIES					
Net profit (loss)	$ 24,071	$ 8,150	$ 14,002	$ 24,071	$ 64,548
Income and expense items not involving cash flows:					
Depreciation and amortization	43,663	$ 37,343	39,058	43,663	48,544
Financing expense associated with debentures series F	7,998	$ 1,945	2,696	7,998	38
Effect of fair value measurement on debt	3,804	$ 3,547	918	3,804	1,401
Financing costs relating to Jazz notes exchange	0	$ 0	0	0	0
Other expense (income), net	(70)	$ 4	247	(70)	0
Gain from acquisition	0	$ 0	0	0	(41,140)
Changes in assets and liabilities:					
Trade accounts receivable	11,795	$ (9,258)	(7,325)	11,795	(8,519)
Other receivables and other current assets	(4,463)	$ 2,188	(5,549)	(4,464)	822
Inventories	(1,302)	$ (6,098)	(12,151)	(1,302)	(9,224)
Trade accounts payable	(18,979)	$ (5,072)	(508)	(18,978)	10,145
Deferred revenue and customers' advances	8,613	$ 3,264	18,144	8,613	15,030
Other current liabilities	(16,413)	$ 15,248	1,597	(16,413)	(1,953)
Deferred tax liability, net	(4,612)	$ (245)	133	(4,612)	(2,173)
Other long-term liabilities	(925)	$ (82)	(440)	(925)	(77)
Net cash provided by operating activities	**53,180**	**50,934**	**50,822**	**53,180**	**77,442**
CASH FLOWS - INVESTING ACTIVITIES					
Investments in property and equipment, net	**(58,291)**	**$ (38,641)**	**(40,626)**	**(58,172)**	**(57,533)**
Investments in other assets	0	$ 0	0	(119)	0
Acquisition of subsidiary consolidated for the first time (a)	0	$ 0	0	0	0
Interest bearing deposits, including designated deposits	(30,000)	$ 0	0	(30,000)	10,000
Net cash provided by (used in) investing activities	(88,291)	$ 21,719	(40,626)	(88,291)	(47,533)
CASH FLOWS - FINANCING ACTIVITIES					
Proceeds on account of shareholders' equity	4,168	$ (817)	4,602	4,168	5,881
Proceeds from long-term loans	70,592	$ 0	0	70,592	17,000
Short-term loan repayment to Panasonic	0	$ 0	0	0	0
Debt repayment	(18,006)	$ (2,000)	(3,000)	33,483	(10,254)
Debenture repayment	0	$ 0	0	(51,489)	0
TPSCo dividend to Panasonic	(1,570)	$ 0	0	(1,570)	(2,563)
Net cash used in financing activities	10,064	$ (2,817)	1,602	55,184	10,064
Effect of foreign exchange rate change	154	$ (1,189)	1,047	154	9,029
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	49,002	$ 8,287	12,845	20,227	49,002
CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD	20,227	$ 156,348	142,503	155,348	175,575
CASH AND CASH EQUIVALENTS - END OF PERIOD	156,348	$ 142,503	155,348	175,575	224,577
Cash Flow	$ 79,466	$ 50,989	$ 56,921	$ 79,466	$ 73,391
Free cash flow	$ 21,175	$ 12,348	$ 16,295	$ 21,294	$ 15,858

HISTORICAL STOCK PRICE



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