Zacks Small-Cap Research

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Tower Semiconductor (NASDAQ: TSEM)

TSEM: Tower's Revenue Decline Projected to Continue For the Next Four Quarters

Using the 2.1 times EV to Sales for 2023, we believe TSEM stock is worth at least $35.85 per share despite declining revenues. The company is flush with $1.2 billion in cash with which to expand capacity

Current Price (11/10/2023)	$24.53
Valuation	**$35.85**

OUTLOOK

Tower and Intel have struck a deal for Tower to invest up to $300 million to expand Intel's New Mexico fab to produce 300mm chips for Tower's customers. Tower received a $353 million break-up fee from the failed Intel acquisition and now has $1.2 billion in net cash. Tower is a pure-play analog semi-conductor 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 is serving markets in mobile such as RF High Position analog, as well as in CMOS image sensors, and power management. It also added a new fab in Italy in partnership with STMicro.

SUMMARY DATA

52-Week High	**46.38**
52-Week Low	**21.91**
One-Year Return (%)	**-40.3**
Beta	**0.8**
Average Daily Volume (sh)	**931,924**
Shares Outstanding (mil)	**110.3**
Market Capitalization ($mil)	**$2,706**
Short Interest Ratio (days)	**0.7**
Institutional Ownership (%)	**60**
Insider Ownership (%)	**1**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**6.7**
Earnings Per Share (%)	**13.4**
Dividend (%)	**N/A**
P/E using TTM EPS	**10.5**
P/E using 2023 Estimate	**11.6**
P/E using 2024 Estimate	**13.6**

Risk Level	**Below Average**
Type of Stock	**Mid Value**
Industry	**Elec Comp-Semis**

ZACKS ESTIMATES

Revenue
(In millions of US$)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2021	$347 A	$362 A	$387 A	$393 A	$1,508 A
2022	$421 A	$426 A	$427 A	$403 A	$1,668 A
2023	$356 A	$357 A	$358 A	$350 E	$1,421 E
2024					$1,400 E

Earnings per Share
(non-GAAP)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2021	$0.31 A	$0.34 A	$0.41 A	$0.55 A	$1.61 A
2022	$0.55 A	$0.58 A	$0.72 A	$0.69 A	$2.52 A
2023	$0.60 A	$0.52 A	$0.54 A	$0.49 E	$2.11 E
2024					$1.80 E

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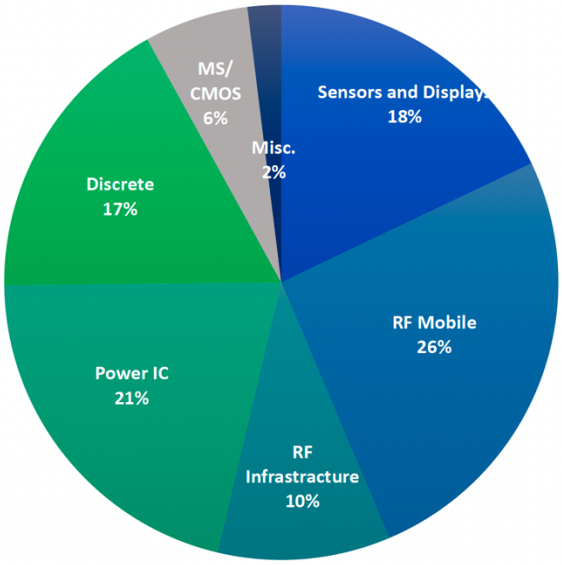
WHAT'S NEW

Tower Projects Another Revenue Decline in Q4 as the Global Demand Remains Weaken

Tower reported another quarterly revenue decline in Q3 2023 as demand remains weak across the board. While orders have not picked up, the company believes that customers' inventories are at or below the previous steady-state levels and conditions could improve. It has not missed filling any customer orders due to the war in Israel and has multiple locations qualified for its lines should production need to be shifted. There are a few bright spots going forward, particularly in satellite internet where the company had a design win with a major player. Also, management expects a pick-up in data centers as the industry moves to 800G more quickly than expected.

As shown in the chart below, the biggest contributor to revenues remains RF mobile used in cellular handsets. We believe the market is stable and may even be showing signs of picking up.

Q3 2023 Revenue Breakdown by Market End Applications



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Source: Tower Semiconductor

Fab utilization is still weak and below 2019 and 2020 levels. There is a gap in our table as the company did not report numbers right before and during the acquisition attempt.

Table. 1 Fab Capacity Utilization

	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2023	Q3 2023
Fab1 Migdal Haemek, Israel 6"	84%	76%	60%	70%	60%	60%	50%	64%	70%	70%	55%
Fab2 Migdal Haemek, Israel 8"	70%	80%	80%	70%	70%	70%	60%	76%	80%	75%	75%
Fab3 Newport Beach, CA 8"	80%	70%	50%	50%	55%	70%	70%	75%	75%	40%	40%
Three TPSCo factories	50%	50%	NA	NA	NA	NA	NA	NA	NA	NA	NA
8 inch	NA	NA	50%	55%	55%	60%	60%	65%	70%	70%	60%
12 inch	NA	NA	60%	70%	80%	85%	70%	90%	90%	75%	60%
San Antonio, 8"	50%	50%	50%	55%	65%	70%	60%	67%	70%	65%	65%
	Q1 2019	**Q2 2019**	**Q3 2019**	**Q4 2019**	**Q1 2020**	**Q2 2020**	**Q3 2020**	**Q4 2020**	**Q1 2020**	**Q2 2023**	**Q3 2023**
Quarterly Average Utilization	67%	65%	58%	62%	64%	69%	62%	73%	76%	66%	59%

We are taking forecasts down for Q4 and 2024 as demand remains weak and the company exhibits sequential quarterly revenue decline, at least for the next two quarters. In addition, the company's new model points to incremental revenues contributing less gross margin than previously expected. The stock however may have hit a low as investors realize the company's enterprise value after stripping away the cash. TSEM trades at an enterprise value of $1.5 billion-, or 1.1 times EV to estimated sales for 2023. With new estimates, its PE is only 11.2 times 2023 EPS.

Q3 2023 Results

Revenues in Q3 2023 were $358 versus $427 million in Q3 2022 and were again down 16% year over year the same as in Q2 2023. Revenues declined sequentially as expected due to the softness in demand from customers across the board, but we believe demand is holding somewhat steady despite the company guide to a sequentially down Q4 2023.

Q3 2023 gross margin decreased to 24.3% from 29.2% a year ago. Gross margin dollars decreased by $38 million, or 30%. Not including the one-time gain from Intel, operating expenses decreased by $3.1 million. Without gains, the operating margin declined to 13.6% from 19.5% last year. Other income was $10 million compared to none a year ago from net interest on cash and marketable securities.

With the one-time gain, pretax profit was $58.6 million versus $69.9 million a year ago. Taxes were $34.4 million in the quarter compared to $3.2 million last year.

GAAP net income was $342 million versus $69.1 million last year, while non-GAAP net income was an estimated $57.9 million versus $80.2 million a year ago.

Diluted GAAP EPS was $3.07 per share versus $0.62 last year. Adjusted non-GAAP diluted EPS decreased to $0.52 versus $0.72 a year ago. Average diluted shares for the quarter were 111.2 million, up from 110.8 million last year. EBITDA for the third quarter of 2023 was $147.4 million compared to $157.6 million a year ago and down sequentially from $119.2 million in Q2 2023.

Balance Sheet

On September 30th, the company had cash, short-term deposits, and marketable securities of $1.23 billion compared to $914 million last quarter aided by the breakup fee payment by Intel. Debt increased by $7.4 million to $228 million from last quarter. Its quick ratio increased to 5.5xs and it has $1.5 billion in working capital. Operating cash flow spiked sequentially as well as year over year to $408 million. Free cash flow was $307 million after spending a net $101 million on cap ex in the quarter. Cap ex expenditures will increase dramatically as the company builds out Agrate and New Mexico. While it typically spends $180-$200 million per year, it will spend another $350 million on Agrate, and $300 million for New Mexico.

During the Quarter

On Sept. 5th, soon after the acquisition by Intel was terminated, Intel Foundry Services (IFS) and Tower Semiconductor announced an agreement where Intel would provide foundry services and 300mm manufacturing capacity to help Tower serve its customers globally. Tower agreed to use Intel's advanced fab, Fab 11X in Rio Rancho, New Mexico, and invest up to $300 million to acquire and own equipment and other fixed assets to be installed in this fab, providing a new capacity of over 600,000 photo layers per month for Tower. This capacity will support forecasted demand for 300mm advanced analog processing. There Intel will manufacture Tower's 65-nanometer power management BCD (bipolar-CMOS-DMOS) flows, among other flows there. This collaboration will have a particular focus on advanced power management and radio frequency silicon on insulator (RF-SOI) solutions, with full process flow qualification planned in 2024. Tower's 65nm

BCD technology offers customers improved power efficiency, die size, and die cost through its best-in-class Rdson figure of merit. Similarly, Tower's 65nm RF SOI technology helps customers reduce handset battery consumption while improving wireless connections through its best-in-class RonCoff figure of merit.

During the conference call management showed a new business model reflecting investments in new capacity. In the past incremental revenues were coming in at above 50% gross margin, increased investment and current prices should result in incremental margins at 32% as shown in the following chart. Through operating leverage, this incremental gross margin should translate into 24% net margins. So as shown at 85% capacity utilization, revenues would increase 86% and net income 140%.

Financial Model ($M)

	Q3 2023 Annualized Run Rate		Built-out capacity@85% utilization*	Incremental $M	Incremental % of Incremental Revenue
Revenue	1,432	1.9X	2,660	1,228	
Gross Profit	347	2.1X	740	393	32%
Operating Profit	195	2.9X	560	365	30%
Net Profit	208 **	2.4X	500	292	24%

** Including New Mexico capacity corridor and Agrate capacity based on previously announced Cap-Ex investments*
*** Excluding Intel merger contract termination fees received in Q3'2023, net of associated cost and taxes*

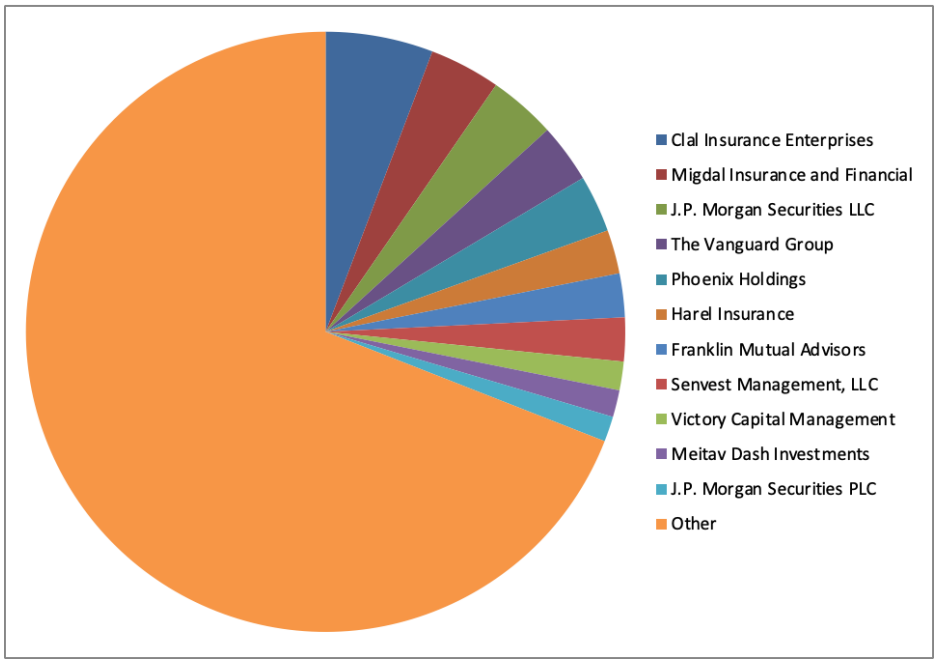
Source: Tower Semiconductor

VALUATION

TSEM trades at an enterprise value of $1.5 billion-, or 1.1 times EV to estimated sales for 2023 versus its peers who trade at 4.7 times. Even at the low end at 2.1 times sales, Tower's market cap would be $4.0 billion or $35.85 per share.

	Ticker	EPS 23E	EPS 24E	Price	PE 2023E	PE 2024E	Growth Rate	Sales 2023E	EV/Sales	EV
Company										
Taiwan Semiconductor	TSM	5.12	6.05	95.99	18.7	15.9	18.2%	66.71	7.19	479.4
United Microelectronics	UMC	0.72	0.68	6.80	9.4	10.0	-5.6%	6.98	2.12	14.8
Average					14.1	12.9			4.7	

OWNERSHIP



INCOME STATEMENT

	March Q1 22	June Q2 22	Sept Q3 22	Dec Q4 22	March Q1 23	June Q2 23	Sept Q3 23	Dec Q4 23E	2021	2022	2023E	2024E
REVENUE	421.1	426.2	427.1	403.2	355.6	357.2	358.2	350.0	1,508.2	1,677.6	1,421.0	1,400.0
Yr-to-yr Gr.	21%	18%	10%	-2%	-16%	-16%	-16%	-13%		11%	-15%	-1%
OPERATING EXPENSES												
Cost of goods sold	316.5	313.7	302.6	278.5	259.9	270.7	271.3	266.7	1,179.0	1,211.3	1,068.6	1,054.3
Gross Margin	104.6	112.4	124.5	124.7	95.7	86.5	86.9	83.3	329.1	466.3	352.4	345.7
% of Sales	24.8%	26.4%	29.2%	30.9%	26.9%	24.2%	24.3%	23.8%	21.8%	27.8%	24.8%	24.7%
R&D	20.3	20.5	22.4	20.7	19.3	19.5	20.2	20.1	85.4	83.9	79.1	82.0
M, G&A	21.3	21.3	18.9	18.9	18.6	17.4	18.0	18.5	77.2	80.3	72.6	74.0
One-time charges	0.0	0.0	4.0	(13.6)	(31.7)	(0.9)	(313.5)	0.0	0.0	(9.6)	(346.0)	0.0
Tot Operating Exp.	41.6	41.8	45.3	26.0	6.3	36.0	(275.3)	38.6	162.6	154.6	(194.4)	156.0
Operating Income	63.1	70.7	79.2	98.7	89.4	50.5	362.2	44.7	166.5	311.7	546.8	189.7
Operating Margin	15.0%	16.6%	18.5%	24.5%	25.1%	14.1%	101.1%	12.8%	11%	19%	38%	14%
Yr-to-yr Gr.	94%	108%	79%	77%	42%	-29%	357%	-55%		68%	107%	-65%
Interest & other non-cash financing	(2.1)	(8.2)	(9.4)	(0.1)	7.0	3.9	10.0	8.0	(11.4)	(19.7)	28.9	24.0
Gain from acqusiition	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Profit before tax	60.9	62.5	69.9	98.7	96.4	54.5	372.1	52.7	155.1	292.0	575.7	213.7
Profit margin	14.5%	14.7%	16.4%	24.5%	27.1%	15.2%	103.9%	15.1%	10.3%	17.4%	40.5%	15.3%
Taxes	(5.2)	(4.3)	(3.2)	(12.8)	(15.0)	(5.7)	(34.4)	(7.4)	(1.0)	(25.5)	(62.6)	(29.9)
Tax Rate	8.5%	6.9%	4.5%	13.0%	15.6%	10.6%	9.2%	14.0%	0.7%	8.7%	10.9%	14.0%
Profit before non-controlling	55.8	58.2	66.7	85.8	81.4	48.7	337.7	45.3	154.1	266.5	513.1	183.8
Minority Income	(1.7)	(0.1)	2.5	(2.5)	(10.0)	2.5	4.3	2.0	(4.1)	(1.9)	(1.2)	(8.0)
GAAP Net income	54.0	58.1	69.1	83.3	71.4	51.2	342.1	47.3	150.0	264.6	512.0	175.8
Yr-to-yr Gr.	91%	88%	77%	61%	32%	-12%	395%	-43%		76%	94%	-66%
Non-GAAP Net Income	60.3	64.1	80.2	76.7	62.0	57.9	60.5	54.8	177.1	279.2	235.1	199.8
Yr-to-yr Gr.	79%	72%	78%	26%	3%	-10%	-25%	-29%		58%	-16%	-15%
GAAP primary EPS	$0.50	$0.53	$0.63	$0.76	$0.65	$0.47	$3.10	$0.43	$1.39	$2.42	$4.65	$1.59
Fully diluted GAAP EPS	$0.49	$0.53	$0.62	$0.75	$0.64	$0.46	$3.07	$0.43	$1.37	$2.39	$4.60	$1.58
Adj Non-GAAP EPS-Fully dil.	**$0.55**	**$0.58**	**$0.72**	**$0.69**	**$0.60**	**$0.52**	**$0.54**	**$0.49**	**$1.61**	**$2.52**	**$2.11**	**$1.80**
Yr-to-yr Gr.	78%	70%	76%	25%	10%	-10%	-25%	-29%		56%	-16%	-15%

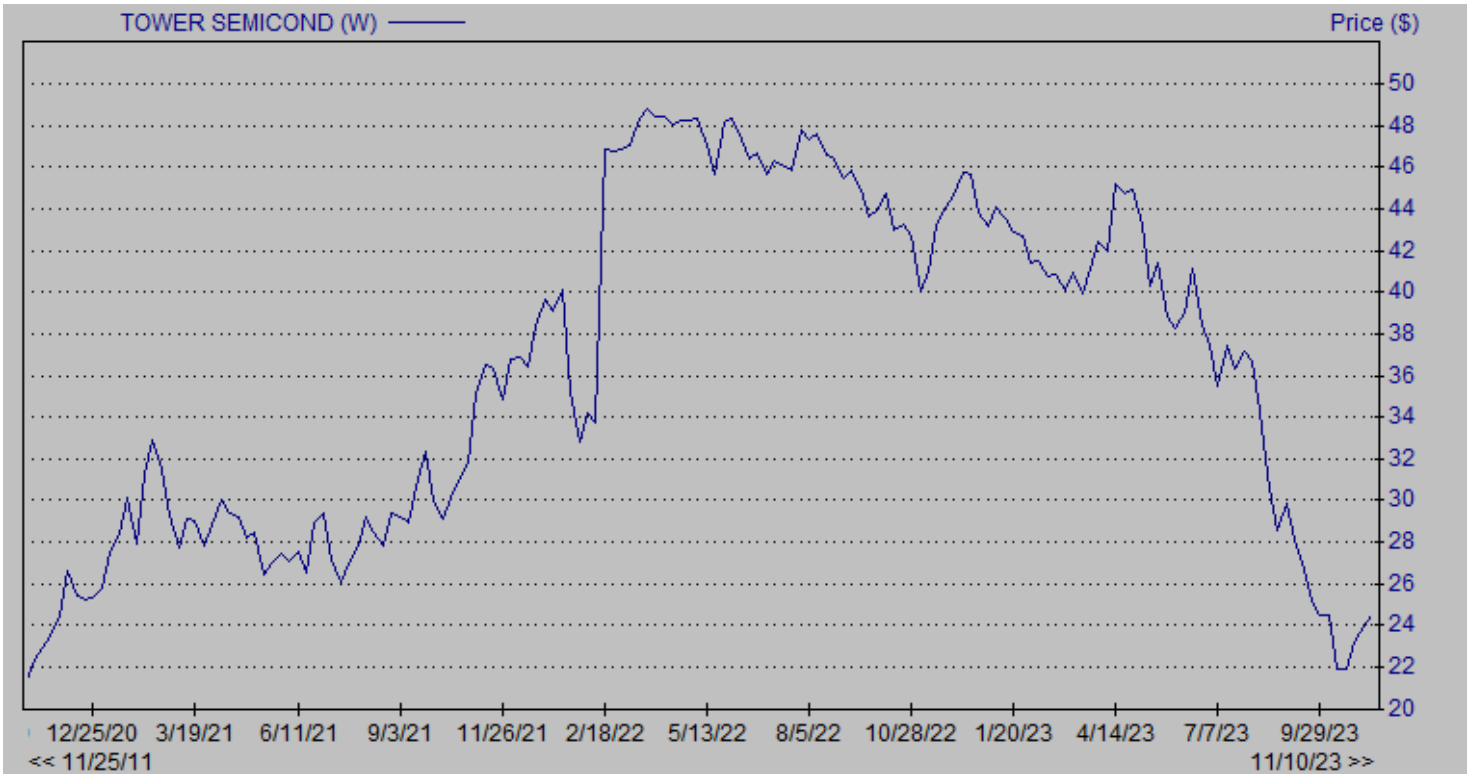
BALANCE SHEET

$ in thousands	Sept 30, 2023	June 30, 2023	Qtr-Qtr % Change	Sept 30, 2022	Yr-Yr % Change
CURRENT ASSETS					
Cash and cash equivalents	**$314,816**	**$318,195**	-1.1%	**$360,369**	-12.6%
Short term deposits	**735,382**	**419,520**	75.3%	**338,811**	117.0%
Marketable securities	**179,381**	**175,872**	2.0%	**171,951**	4.3%
Trade accounts receivable	150,162	163,293	-8.0%	165,086	-9.0%
Inventories	304,245	330,819	-8.0%	269,405	12.9%
Other current assets	33,453	32,396	3.3%	41,710	-19.8%
Total current assets	1,717,439	1,440,095	19.3%	1,347,332	27.5%
PROPERTY AND EQUIPMENT, NET	1,062,456	1,018,636	4.3%	902,440	17.7%
GOODWILL & INTANGIBLE ASSETS, NET	12,557	13,049	-3.8%	15,774	-20.4%
DEFERRED TAX & OTHER ASSETS, NET	43,342	62,288	-30.4%	88,864	-51.2%
TOTAL ASSETS	2,835,794	2,534,068	11.9%	2,354,410	20.4%
CURRENT LIABILITIES					
Short term debt	**47,671**	**41,300**	15.4%	**61,186**	-22.1%
Trade accounts payable	106,362	154,507	-31.2%	143,992	-26.1%
Deferred revenue	23,745	22,402	6.0%	37,907	-37.4%
Other current liabilities	80,392	83,631	-3.9%	121,487	-33.8%
Total current liabilities	258,170	301,840	-14.5%	364,572	-29.2%
LONG-TERM DEBT	**179,901**	**178,865**	0.6%	**202,142**	-11.0%
LONG-TERM CUSTOMERS' ADVANCES	30,285	31,209	-3.0%	44,414	-31.8%
DEFERRED TAX LIABILITY	18,626	11,057	68.5%	20,356	-8.5%
Total liabilities	486,982	522,971	-6.9%	631,484	-22.9%
SHAREHOLDERS' EQUITY	2,348,812	2,011,105	16.8%	1,752,926	34.0%
TOTAL LIABILITIES AND EQUITY	$2,835,794	$2,534,076	11.9%	$2,384,410	18.9%
Current Ratio	6.7	4.8	39.4%	3.7	80.0%
Quick Ratio	5.5	3.7	48.9%	3.0	85.1%
Working Capital	1,459,269	1,138,255	28.2%	982,760	48.5%
Debt Percent of Assets	8.0%	8.7%	-7.6%	11%	-28.2%
Debt to Equity	0.1	0.1	-11.5%	0.2	-35.5%
Cash and equivalents	1,229,579	913,587	34.6%	871,131	41.1%
Cash and equivalents per share	$11.15	$8.31	34.2%	$8.00	39.4%
Debt	227,572	220,165	3.4%	263,328	-13.6%
Change in cash	315,992	(32,378)	-45.9%	358,448	-11.8%
Change in debt	7,407	(23,504)	-18.0%	(35,756)	-120.7%

CASH FLOW

	Year 2020	Year 2021	3-Mo 3/31/22	3-Mo 6/30/22	3-Mo 9/30/22	3-Mo 12/31/22	Year 2022	3-Mo 3/31/23	3-Mo 6/30/23	3-Mo 9/30/23
CASH FLOWS - OPERATING ACTIVITIES										
Net profit (loss)	$ 83,289	$ 154,075	$ 55,774	$ 58,173	$ 66,682	$ 85,842	$ 266,471	$ 81,368	$ 48,706	$ 337,737
Income and non-cash expense items:										
Depreciation and amortization	240,531	270,710	70,780	67,007	74,958	79,893	292,638	62,387	63,579	66,877
Effect of fair value measurement on debt	6,645	1,138	(1,330)	2,276	104	9,312	10,362	(926)	3,102	3,044
Other expense (income), net	5,215	(1,461)	1,347	560	7,950	(2,923)	6,934	815	(149)	(21)
Changes in assets and liabilities:										
Trade accounts receivable	(33,087)	14,335	(35,181)	3,578	3,991	12,380	(15,232)	7,413	(21,241)	12,529
Other assets	(7,999)	(26,731)	13,874	(3,355)	527	9,381	20,427	(1,138)	2,114	(4,099)
Inventories	(2,891)	(44,192)	(18,328)	(10,630)	(25,510)	(23,423)	(77,891)	(57,420)	16,315	22,477
Trade accounts payable	(18,576)	(25,004)	30,595	22,415	(15,951)	(57,952)	(20,893)	44,542	(24,712)	(58,107)
Deferred revenue and customers' advances	(3,072)	74,524	3,385	(14,031)	(16,906)	(2,517)	(30,069)	(15,470)	(10,723)	419
Other current liabilities	347	16,850	15,103	10,974	20,725	14,231	61,033	(45,053)	(5,479)	(3,885)
Employee related liabilities	3,936	(2,681)	331	26	(220)	2,819	2,956	371	267	191
Deferred tax liability, net	2,223	(10,270)	221	1,104	6,052	5,707	13,084	(4,162)	3,715	25,080
Net cash provided by operating activities	**276,561**	**421,293**	**136,571**	**138,097**	**122,402**	**132,750**	**529,820**	**72,727**	**75,494**	**402,242**
CASH FLOWS - INVESTING ACTIVITIES										
Investments in property and equipment, net	**(256,539)**	**(279,260)**	**(80,840)**	**(49,377)**	**(45,134)**	**(38,186)**	**(213,537)**	**(105,245)**	**(89,433)**	**(101,080)**
Interest bearing deposits, including designated deposits	(107,070)	(59,684)	(29,611)	(65,134)	129,257	(150,423)	(115,911)	24,194	42,615	(318,497)
Net cash provided by (used in) investing activities	(363,609)	(338,944)	(110,451)	(114,511)	84,123	(188,609)	(329,448)	(81,051)	(46,818)	(419,577)
CASH FLOWS - FINANCING ACTIVITIES										
Exercise of warrants and options	2,512	458	44	0	5,469	(5,469)	44	0	0	0
Debt repayment	(63,699)	(77,315)	(30,539)	(8,211)	(28,164)	(11,465)	(78,379)	(28,796)	(10,093)	15,493
Proceeds from investment in subsidiary	0	0	0	0	0	11,685	11,685	1,932	0	0
Net cash used in financing activities	(61,187)	(76,857)	(30,495)	(8,211)	(22,695)	(5,249)	(66,650)	(26,864)	(10,093)	15,493
Effect of foreign exchange rate change	4,357	(6,245)	(3,071)	(7,682)	(4,638)	11,498	(3,893)	(637)	(5,322)	(1,537)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(143,878)	(753)	(7,446)	7,693	179,192	(49,610)	129,829	(35,825)	13,261	(3,379)
CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD	355,561	211,683	210,930	203,484	211,177	390,369	210,930	340,759	304,934	318,195
CASH AND CASH EQUIVALENTS - END OF PERIOD	211,683	210,930	203,484	211,177	390,369	340,759	340,759	304,934	318,195	314,816
Operating Cash Flow	$ 335,680	$ 424,462	$ 126,571	$ 128,016	$ 149,694	$ 172,124	$ 576,405	$ 143,644	$ 115,238	$ 407,637
Free cash flow	$ 79,141	$ 145,202	$ 45,731	$ 78,639	$ 104,560	$ 133,938	$ 362,868	$ 38,399	$ 25,805	$ 306,557

HISTORICAL STOCK PRICE



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