Zacks Equity Research

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# Towerjazz (TSEM-NASDAQ)

**TSEM: Operational and Financial moves make Towerjazz a force- Outperform.**

| | |
|---|---|
| **Current Recommendation** | **Outperform** |
| Prior Recommendation | N/A |
| Date of Last Change | 01/31/2010 |
| Current Price (07/09/10) | $1.38 |
| **Six- Month Target Price** | **$3.50** |

## OUTLOOK

Towerjazz is a pure-play semiconductor wafer foundry with two IC plants in Israel and one in California, that manufacture SiGe, MEMS, RF, embedded flash-based memory, analog/mixed-signal, and CMOS image-sensor devices. Q1 revenue reached an all time high and June guidance is for 8-12.5% sequential growth on the top-line. For the first time since 2000 the firm had an operating profit on a GAAP basis. TSEM has had a flurry of operational and financial moves that will strengthen the balance sheet and improve capacity expansion. We reiterate our outperform rating on TSEM.

## SUMMARY DATA

| | |
|---|---|
| **52-Week High** | **$1.84** |
| **52-Week Low** | **$0.35** |
| **One-Year Return (%)** | **294.29** |
| **Beta** | **1.92** |
| **Average Daily Volume (sh)** | **628,572** |
| **Shares Outstanding (mil)** | **234** |
| **Market Capitalization ($mil)** | **$323** |
| **Short Interest Ratio (days)** | **1.93** |
| **Institutional Ownership (%)** | **6** |
| **Insider Ownership (%)** | **1** |
| **Annual Cash Dividend** | **$0.00** |
| **Dividend Yield (%)** | **0.00** |
| **5-Yr. Historical Growth Rates** | |
| **Sales (%)** | **26.6** |
| **Earnings Per Share (%)** | **N/A** |
| **Dividend (%)** | **N/A** |
| **P/E using TTM EPS** | **3.9** |
| **P/E using 2010 Estimate** | **2.1** |
| **P/E using 2011 Estimate** | **1.7** |
| **Zacks Rank** | **3** |

| | |
|---|---|
| **Risk Level** | **Above Avg.,** |
| **Type of Stock** | **Small-Blend** |
| **Industry** | **Elec Comp-Semic** |
| **Zacks Rank in Industry** | **N/A** |

## ZACKS ESTIMATES

**Revenue**
(in millions of $)

| | Q1 (Mar) | Q2 (Jun) | Q3 (Sep) | Q4 (Dec) | Year (Dec) |
|---|---|---|---|---|---|
| 2008 | 58 A | 58 A | 59 A | 77 A | 252 A |
| 2009 | 58 A | 61 A | 80 A | 101 A | 297 A |
| 2010 | 114 A | 125 E | 130 E | 135 E | 504 E |
| 2011 | 138 E | 140 E | 145 E | 150 E | 573 E |

**Earnings per Share**
(Non-GAAP)

| | Q1 (Mar) | Q2 (Jun) | Q3 (Sep) | Q4 (Dec) | Year (Dec) |
|---|---|---|---|---|---|
| 2008 | -$0.04 A | $0.08 A | $0.04 A | $0.04 A | $0.12 A |
| 2009 | -$0.02 A | $0.03 A | $0.07 A | $0.11 A | $0.19 A |
| 2010 | $0.14 A | $0.16 E | $0.17 E | $0.18 E | $0.65 E |
| 2011 | $0.19 E | $0.20 E | $0.21 E | $0.22 E | $0.82 E |

Zacks Projected EPS Growth Rate - Next 5 Years % **15**

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## RECENT NEWS

The firm continues to make both operational and financial improvements to the business model. On July 11th the firm continued on the financial front by announcing it agreed to exchange approximately $80 million in principal of its $123 million 8% convertible senior bonds due 2011 for new non-convertible senior bonds due 2015. The new non-convertible bonds will rank equally with the outstanding bonds and will have an 8% annual coupon.

In order for the institutional bondholder to agree the firm issued warrants with an approximate 20% premium. (over the average of the volume weighted average prices for the ordinary shares for the 15 trading days preceding execution of the Exchange Agreement)

Exchanging bondholders will receive warrants for the purchase of approximately $25 million Tower ordinary shares at an exercise price of $1.70 per share. The outstanding 8% convertible senior bonds being exchanged, which are convertible into approximately 20 million Tower ordinary shares, will be cancelled and retired upon consummation of this exchange transaction.

Another deal which will settle on or around the 12th of July is the issue approximately 5.4 million shares to YA Global Master SPV Ltd., for a purchase price of $7 million. Use of proceeds are listed as general corporate purposes, but we suspect the proceeds will be used to boost capacity expansion possibly at Fab 2.

On June 30th, 2010 TSEM announced it has signed an agreement with its lender, Wells Fargo Capital Finance to extend its credit lines from September 2011 to September 2014. Under the agreement, the four-year lines totaling $45 million will bear an interest rate equal to, at the Company's option, the USD LIBOR rate plus a margin ranging from 2.25% to 2.75% per annum, or the lender's prime rate plus a margin ranging from 0.50% to 1.00%.

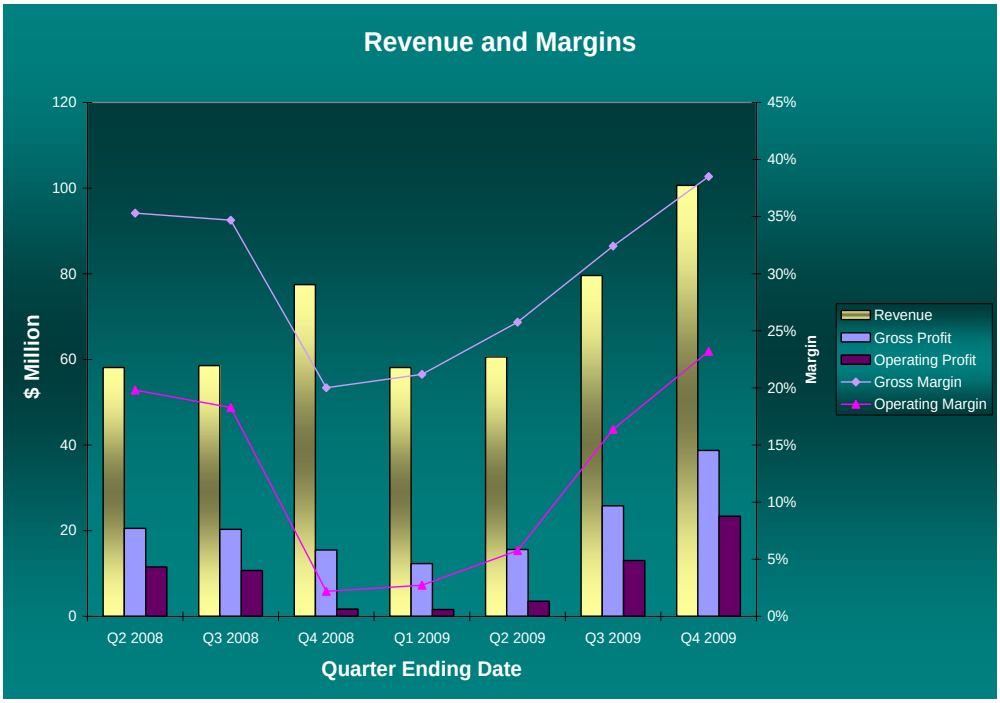
On June 29th, 2010 TowerJazz and Vishay Intertechnology, (the Siliconix division of which is the world leader in low-voltage power MOSFETs), announced that they are expanding their business relationship to include planar MOSFETs and Super Junction MOSFETs. Production of these products under the terms of the expanded relationship between TowerJazz and Vishay is expected to result in tens of millions of dollars in additional yearly revenue.

TSEM's cash balance, as of March 31, 2010 was $83.4 million, as compared to $81.8 million as of December 2009 and $40 million as of March 2009.

Management forecasts revenue in the second quarter of 2010 to range between $123 and $128 million, representing a sequential revenue growth of 8.1-12.5% and 107% year-over-year growth in revenues.

On February 16, 2010 TowerJazz announced it has accelerated plans for additional capacity expansion to meet customer demand. At Fab2 (located in Israel), capacity will increase by approximately 30,000 wafers per year in order to meet the expanding needs of customers for its wide range of specialty process technologies. At the Newport Beach, CA manufacturing facility, capacity will be increased by 36,000 wafers per year. The total payments to purchase the equipment by TowerJazz are expected to be approximately $15 million, resulting in an increase of approximately 66,000 wafers per year. Based on customer forecasts, management projects this cost-effective investment has a rate of return of two quarters.

On April 1, 2010 the firm announced that VectraWave has designed its first 40G high speed coder circuit using a Silicon Germanium (SiGe) BiCMOS process. VectraWave chose TowerJazz's SBC18HX process over Indium Phosphide (InP), the traditional semiconductor material for choice for 40G circuits, due to its advantage of integrating digital circuits on the same die enabling lower cost, lower power consumption, better temperature compensation and smaller total board area.




On April 14, 2010 TowerJazz, and Tego, a leading provider of high-memory RFID tagging solutions, announced a silicon partnership to manufacture the TegoChipÔ, a high-memory passive Gen2 RFID chip. Tego is utilizing the 180nm process (TS18) from TowerJazz for its TegoChip to tag over 1500 pressurized and non-pressurized parts and components on the Airbus A350 XWB aircraft fleet to improve processes such as maintenance and warehouse logistics.

## VALUATION

TSEM is currently trading at 2.1x FY 2010 EPS estimates, while the cash per share stands at approximately $0.31 per share. The firm has seen its current ratio climb to 1.85.

We feel Towerjazz should outpace its foundry competitors as well as the overall semiconductor industry in 2010. Specialty foundry, enjoys higher margins and is less susceptible to industry downturns. In addition the firm is out in front on several industry leading technologies such as HPA, Power, and optical. The Tower and Jazz merger was completed at a time when the rest of the industry was struggling to survive. The balance sheet is a source of strength which likely sets up the firm for further growth activity in the future.

The recent capacity expansion is a clear sign that solid demand from customers has returned. We value the firm based on a price to earnings multiple of 6.3x FY 2010 EPS estimates or an enterprise value/sales ratio of 1.3x. This analysis leads to a price target of $3.50.

## Industry Comparables

| | Pr Chg YTD | P/E CurrFY | EPS Gr 5Yr Est | Price/ Book | Price/ Sales | Price/ CF |
|---|---|---|---|---|---|---|
| **TOWER SEMICOND** | 42.3 | 2.1 | | 4.7 | 0.9 | 4.7 |
| Industry Mean | 21.5 | 33.8 | 17.1 | 2.5 | 5.1 | 28.5 |
| Industry Median | 8.2 | 15.8 | 18.4 | 1.8 | 1.7 | 21.4 |
| S&P 500 | -3.3 | 13.6 | | 3.2 | 2.1 | 12.4 |
| CABOT MICROELEC | 7.4 | 16.8 | 13.0 | 1.7 | 2.2 | 22.5 |
| CHIPMOS TEC LTD | 109.9 | | | 0.4 | 0.3 | 1.9 |
| STANDARD MICROS | 12.2 | 23.1 | 15.0 | 1.4 | 1.5 | 19.6 |

## PROJECTED INCOME STATEMENT

| INCOME STATEMENT ($ Millions) | Mar-09 Q109 | Jun-09 Q209 | Sep-09 Q309 | Dec-09 Q409 | Mar-10 Q1 10 | Mar-10 Q2 10E | FY 2006 | FY 2007 | FY 2008 | FY 2009 | FY 2010 E | FY 2011 E |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **REVENUE** | | | | | | | | | | | | |
| **Net Revenue** | **58.1** | **60.6** | **79.6** | **100.6** | **113.8** | **125.0** | **187.4** | **230.9** | **251.7** | **354.5** | **504.0** | **573.0** |
| *Sequential Growth* | | *4%* | *31%* | *26%* | *13%* | *10%* | | | | | | |
| **OPERATING EXPENSES** | | | | | | | | | | | | |
| Cost of Revenues | 45.75 | 44.88 | 53.71 | 61.87 | 64.49 | 70.00 | 128.3 | 147.4 | 174.2 | 224.9 | 285.0 | 315.0 |
| *% of Revenue* | *78.8%* | *74.1%* | *67.5%* | *61.5%* | *56.7%* | *56.0%* | | | | | | |
| **Gross Profit -** | **12.3** | **15.7** | **25.9** | **38.7** | **49.3** | **55.0** | **59.1** | **83.5** | **77.5** | **129.6** | **219.0** | **258.0** |
| *Proforma Gross Margin* | *21.2%* | *25.9%* | *32.5%* | *38.5%* | *43.3%* | *44.0%* | *31.5%* | *36.2%* | *30.8%* | *36.6%* | *43.5%* | *45.0%* |
| R&D + Engg | 3.79 | 5.93 | 5.76 | 6.69 | 5.52 | 7.00 | 10.6 | 10.4 | 13.2 | 23.9 | 37.0 | 42.0 |
| *% of Revenue* | *6.5%* | *9.8%* | *7.2%* | *6.7%* | *4.9%* | *5.6%* | *5.7%* | *4.5%* | *5.3%* | *6.7%* | *7.3%* | *7.3%* |
| SG&A | 6.93 | 6.25 | 7.06 | 8.71 | 8.59 | 9.00 | 21.9 | 24.2 | 28.1 | 30.6 | 30 | 33 |
| *% of Revenue* | *11.9%* | *10.3%* | *8.9%* | *8.7%* | *7.5%* | *7.2%* | *11.7%* | *10.5%* | *11.2%* | *8.6%* | *6.0%* | *5.8%* |
| GW Amort, Restructuring, other | - | - | - | | | | | - | - | - | | |
| *% of Revenue* | | | | | | | | | | | | |
| Total Operating Expenses | 10.73 | 12.18 | 12.82 | 15.41 | 14.11 | 16.00 | 32.5 | 34.6 | 41.4 | 54.5 | 67 | 75 |
| *% of Revenue* | *18.5%* | *20.1%* | *16.1%* | *15.3%* | *12.4%* | *12.8%* | *17.3%* | *15.0%* | *16.4%* | *15.4%* | *13%* | *13%* |
| **Operating Income -** | **1.58** | **3.50** | **13.04** | **23.34** | **35.2** | **39.0** | **26.6** | **48.9** | **36.1** | **75.1** | **152** | **183** |
| *Operating Margin* | *2.7%* | *5.8%* | *16.4%* | *23.2%* | *30.9%* | *31.2%* | *14%* | *21%* | *14%* | *21%* | *30%* | *32%* |
| **NON-OPERATING ITEMS** | | | | | | | | | | | | |
| Non operating Income/Expense | -5.8 | 0.2 | -6.0 | 0.0 | -4 | -3 | -34.4 | -28.8 | -19.4 | -9.4 | -5 | -14 |
| *% of Revenue* | *-9.97%* | *0.39%* | *-7.54%* | *0.00%* | *-3.15%* | *-2.69%* | *-18.35%* | *-12.48%* | *-7.72%* | *-2.64%* | *-0.99%* | *-2.44%* |
| Tax Provision | -1.3 | -1.6 | -4.2 | 2.1 | 2.7 | 2.2 | 0.00 | 0.00 | 0.58 | -1.1 | 12 | 12 |
| *Effective Tax Rate* | | | | | | | | | | | | |
| **Net Income -** | **-2.93** | **5.37** | **11.24** | **21.22** | **28.97** | **33.44** | **-7.77** | **20.08** | **16.08** | **66.79** | **135.0** | **157.0** |
| *Net Income Margin* | *-5.0%* | *8.9%* | *14.1%* | *21.1%* | *25.5%* | *26.8%* | *-4.1%* | *8.7%* | *6.4%* | *18.8%* | *27%* | *27%* |
| **EARNINGS PER SHARE** | | | | | | | | | | | | |
| **EPS - Basic** | -$0.02 | $0.03 | $0.07 | $0.11 | $0.14 | $0.16 | -$0.09 | $0.17 | $0.12 | $0.35 | $0.65 | $0.82 |
| EPS - Diluted | -$0.02 | $0.03 | $0.07 | $0.11 | $0.14 | $0.16 | -$0.09 | $0.17 | $0.12 | $0.35 | $0.65 | $0.82 |

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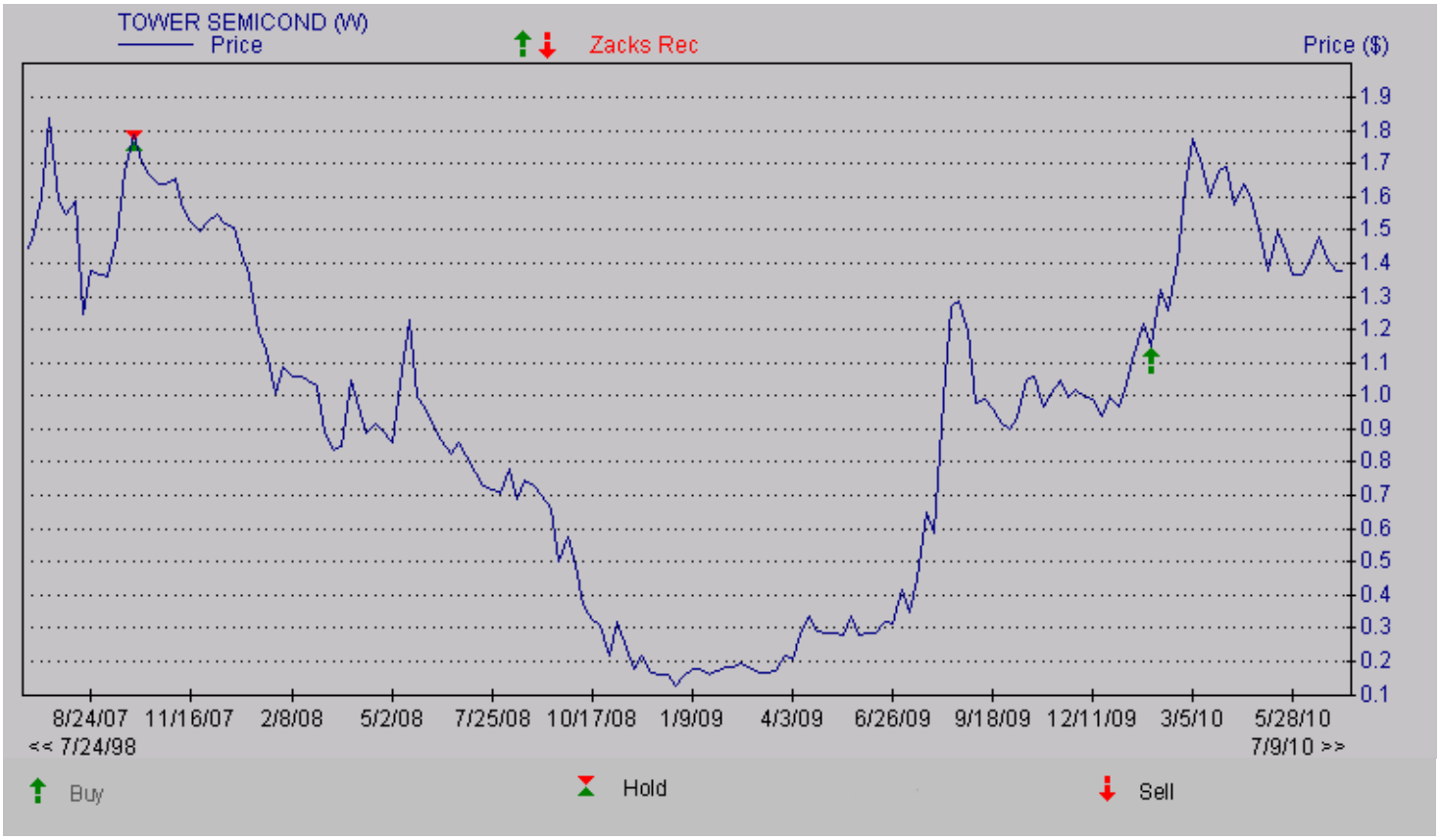
## HISTORICAL ZACKS RECOMMENDATIONS

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