

TOWER SEMICONDUCTOR LTD  
Form 20-F/A  
February 03, 2014

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

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FORM 20-F/A  
Amendment No.1

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ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2012

Commission File number: 0-24790

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TOWER SEMICONDUCTOR LTD.  
(Exact name of registrant as specified in its charter and translation of registrant's name into English)

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Israel  
(Jurisdiction of incorporation or organization)  
Ramat Gavriel Industrial Park  
P.O. Box 619, Migdal Haemek 23105, Israel

(Address of principal executive offices)

Nati Somekh, +972-4-6506109, natiso@towersemi.com;  
Ramat Gavriel Industrial Park P.O. Box 619, Migdal Haemek 23105, Israel

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Securities registered or to be registered pursuant to Section 12(b) of the Act:

| Title of Each Class  | Name of Each Exchange on Which Registered |
|--|---|
| Ordinary Shares, par value New Israeli Shekels 15.00 per share | NASDAQ Global Select Market               |

Securities registered or to be registered pursuant to Section 12(g) of the Act: None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report: 22,311,513 Ordinary Shares.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

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If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (section 229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

US GAAP  International Financial Reporting Standards as issued by the International Accounting Standards Board  Other

If “Other” has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

Item 17  Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

(iii)

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## EXPLANATORY NOTE

This Amendment No. 1 to Form 20-F amends our Annual Report on Form 20-F for the fiscal year ended December 31, 2012, filed with the Securities and Exchange Commission on April 30, 2013, to include a revised report of Brightman Almagor Zohar & Co., the Company's public registered independent accounting firm, which contains a reference to the consolidated statements of comprehensive loss included in this Annual Report. No other change has been made to the consolidated financial statements. We have included additional disclosure at the end of Item 5 B.

Since the rules of the Securities and Exchange Commission require that any Item of Form 20-F which is being amended must be filed in its entirety, this Amendment also includes Items 5, 8, 18 and 19 of our 20-F in their entirety. Except as described above, no change has been made to such Items or to any other portion of the Annual Report on Form 20-F as filed on April 30, 2013. The filing of this Amendment does not, and does not purport to, otherwise amend, update or restate the information in the Annual Report on Form 20-F as filed on April 30, 2013 or reflect any events that have occurred after such date.

### ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

#### A. OPERATING RESULTS

##### Management's Discussion and Analysis of Financial Condition and Results of Operations

The information contained in this section should be read in conjunction with our consolidated financial statements for the year ended December 31, 2012 and related notes and the information contained elsewhere in this annual report. Our financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("US GAAP").

##### Critical Accounting Policies

##### Revenue Recognition.

Our net revenues are generated principally from sales of semiconductor wafers. We also derive revenues from engineering and design support and other technical and support services. The majority of our revenue is achieved through the efforts of our direct sales force.

In accordance with ASC Topic 605 "Revenue Recognition", we recognize revenues from sale of products when the following fundamental criteria are met: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred or services have been rendered, (iii) the price to the customer is fixed or determinable; and (iv) collection of the resulting receivable is reasonably assured. These criteria are usually met at the time of product shipment. Revenues are recognized when the acceptance criteria are satisfied, based on performing electronic, functional and quality tests on the products prior to shipment. Such company testing reliably demonstrates that the products meet all of the specified acceptance criteria.

Revenues for engineering, design and other support services are recognized ratably over the contract term or as services are performed.

Advances received from customers towards future engineering services, and/or product purchases are deferred until services are rendered or products are shipped to the customer.

Revenue relating to a turn-key agreement with an Asian entity are recognized based on ASC 605-35 (formerly SOP 81-1 “Accounting for Performance of Construction Type and Certain Production Type Contracts”) using the percentage of completion method. Measurement of the percentage toward completion is determined, based on the ratio of actual labor hours completed to total labor hours estimated to be completed over the duration of the contract. Such measurement involves management's estimates and judgment and is based on a detailed project plan, our substantial experience in building a fab, transferring and implementing new technologies and engaging sub-contractors' experts.

Our revenue recognition policy is significant because our revenues are a key component of our results of operations. We follow very specific and detailed guidelines in measuring revenue; however, an accrual for estimated sales returns and allowances relating to specific yield or quality commitments, which is computed primarily on the basis of historical experience and specific identification, is recorded. Any changes in assumptions for determining the accrual for returns and other factors affecting revenue recognition may affect mainly the timing of our revenue recognition, which may affect our financial position and results of operations.

#### Depreciation and Amortization.

We are heavily capital oriented and the amount of depreciation is a significant amount of our yearly expenses. Changes to the useful lives assumption and hence the depreciation may have a material impact on our results of operations. Depreciation and amortization expenses in 2012 amounted to \$174 million. Currently, we estimate that the expected economic life of our assets is as follows: (i) buildings (including facility infrastructure) –10 to 25 years; (ii) machinery and equipment, software and hardware – 3 to 7 years; and (iii) technology and other intangible assets –1 to 19 years. Costs in relation to Fab 2 technologies were amortized over the expected estimated economic life of the technologies commonly used in the industry commencing on the date on which each technology was ready for its intended use. The amounts attributed to intangible assets as part of the purchase price allocations for the acquisitions of Jazz and TJP are amortized over the expected estimated economic lives of the intangible assets commonly used in the industry. Changes in our estimates regarding the expected economic life of our assets might affect our depreciation and amortization expenses.

#### Impairment of Fixed Assets and Intangible Assets.

Management reviews long-lived tangible assets and intangible assets on a periodic basis, as well as when such a review is required based upon relevant circumstances to determine whether events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. For those assets that have definite useful lives, recoverability tests are performed based on undiscounted expected cash flows. When the asset is not recoverable, an impairment loss should be computed based on the difference between the carrying amount of the assets (or asset group) and the fair value. The fair value in most instances will be determined using present value techniques applied to expected cash flows. Changes in the assumptions used in forecasting future cash flows and the fair value of the assets may have a significant effect on determining whether an impairment charge is required and hence may affect our results of operations.

#### Impairment of Goodwill.

Goodwill is subject to an impairment test on an annual basis or upon the occurrence of certain events or circumstances. Goodwill impairment is assessed based on a comparison of the fair value of the unit to which the goodwill is ascribed and the underlying carrying value of its net assets, including goodwill. If the carrying amount of the unit exceeds its fair value, the implied fair value of the goodwill is compared with its carrying amount to measure the amount of impairment loss, if any. Changes in the assumptions used in calculation of the fair value of the unit may have a significant effect on determining whether an impairment charge is required and hence may affect our results of operations.

#### Convertible Debentures.

In accordance with ASC 470-20 "Debt with Conversion and Other Options", the proceeds from the sale of debt securities with a conversion feature and other options are allocated to each of the securities issued based on their relative fair value.

We are required, according to ASC Topic 815 "Derivatives and Hedging"; to determine whether the conversion option embedded in the convertible debt should be bifurcated and accounted for separately. Such determination is based on whether on a standalone basis such conversion option would be classified as equity. If the option can be classified as equity, no bifurcation is required. The analysis required under ASC Topic 815 involves the consideration of many factors and assumptions. Any changes in those factors or assumptions may have a significant effect on determining whether embedded derivatives are required to be bifurcated and hence may affect our results of operations.

#### Income Taxes.

We account for income taxes in accordance with ASC Topic 740, "Income Taxes". This Topic prescribes the use of the liability method whereby deferred tax asset and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities. Deferred taxes are computed based on the tax rates anticipated (under applicable law as of the balance sheet date) to be in effect when the deferred taxes are expected to be paid or realized.

We evaluate how realizable our deferred tax assets are for each jurisdiction in which we operate at each reporting date, and establish valuation allowances when it is more likely than not that all or a portion of our deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income of the same character and in the same jurisdiction. We consider all available positive and negative evidence in making this assessment, including, but not limited to, the scheduled reversal of deferred tax liabilities and projected future taxable income. In circumstances where there is sufficient negative evidence indicating that our deferred tax assets are not more-likely-than-not realizable, we establish a valuation allowance.

We use a two-step approach to recognizing and measuring uncertain tax positions. The first step is to evaluate tax positions taken or expected to be taken in a tax return by assessing whether they are more-likely-than-not sustainable, based solely on their technical merits, upon examination and including resolution of any related appeals or litigation process. The second step is to measure the associated tax benefit of each position as the largest amount that we believe is more-likely-than-not realizable. Differences between the amount of tax benefits taken or expected to be taken in our income tax returns and the amount of tax benefits recognized in our financial statements represent our unrecognized income tax benefits, which are recorded as a liability. Our policy is to include interest and penalties related to unrecognized income tax benefits as a component of income tax expense.



### Initial Adoption of New Standards

In the first quarter of 2012, the Company adopted amended standards that increase the prominence of items reported in other comprehensive income. These amended standards eliminate the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity and require that all changes in stockholders' equity - except investments by, and distributions to, owners - be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The adoption of these amended standards did impact the presentation of other comprehensive income, as we elected to present two separate but consecutive statements, but did not have an impact on our financial position or results of operations.

In May 2011, the FASB issued ASU No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs ("ASU 2011-04"). ASU 2011-04 was issued to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between GAAP and International Financial Reporting Standards. ASU 2011-04 clarifies the FASB's intent about the application of existing fair value measurement and disclosure requirements, changes certain fair value measurement principles and enhances fair value disclosure requirements. Effective January 1, 2012, the Company adopted the disclosure provisions included in ASU 2011-04. The adoption of ASU 2011-04 had no impact on our financial position or results of operations.

### Results of Operations

You should read the following discussion and analysis of our financial condition and results of operations in conjunction with the financial statements and the related notes thereto included in this annual report. The following table sets forth certain statement of operations data as a percentage of total revenues for the years indicated.

|  | Year Ended December 31, |       |      |    |      |    |
|--|-------------------------|-------|------|----|------|----|
|  | 2012                    |       | 2011 |    | 2010 |    |
| <b>Statement of Operations Data:</b>           |                         |       |      |    |      |    |
| Revenues                                       | 100                     | %     | 100  | %  | 100  | %  |
| Cost of revenues                               | 87.7                    |       | 86.1 |    | 79.0 |    |
| Gross profit                                   | 12.3                    |       | 13.9 |    | 21.0 |    |
| Research and development expenses, net         | 4.9                     |       | 4.1  |    | 4.7  |    |
| Marketing, general and administrative expenses | 7.0                     |       | 7.9  |    | 7.8  |    |
| Acquisition related costs                      | 0.9                     |       | 0.2  |    | --   |    |
| Operating profit (loss)                        |                         | (0.4) | 1.7  |    | 8.5  |    |
| Interest expenses, net                         | (5.0                    | )     | (4.5 | )  | (5.2 | )  |
| Other financing expense, net                   | (4.3                    | )     | (2.0 | )  | (9.1 | )  |
| Gain on acquisition                            | --                      |       | 3.2  |    | --   |    |
| Other income (expense), net                    | (0.2                    | )     | 2.2  |    | --   |    |
| Income tax expense                             | (1.1                    | )     | (3.5 | )  | (2.5 | )  |
| Loss   | (11.0                   | )%    | (3.0 | )% | (8.3 | )% |

Our consolidated financial statements include TJP results from June 3, 2011, as detailed in Note 3 to the consolidated financial statements for the year ended December 31, 2012.



Year Ended December 31, 2012 compared to Year Ended December 31, 2011

**Revenues.** Revenue for the year ended December 31, 2012 amounted to \$638.8 million compared to \$611.0 million for the year ended December 31, 2011. This increase in revenues was mainly due to higher average selling prices of approximately 10%, offset by (i) 3% lower volume of wafers manufactured by us and shipped to our customers; and by (ii) a reduction of \$28 million in revenues relating to the agreement with the Asian entity, as detailed in Notes 2K and 16D(2) to the annual consolidated financial statements for the year ended December 31, 2012.

**Cost of Revenues.** Cost of revenues for the year ended December 31, 2012 amounted to \$560.0 million, as compared to \$526.2 million for the year ended December 31, 2011. The \$34 million increase in cost of revenues was mainly due to the inclusion of TJP's cost of revenue for the full year ended December 31, 2012 compared to only seven months in the corresponding period in 2011. Cost of revenues for the year ended December 31, 2011 included a one-time reduction of depreciation expenses resulting from the grants approval by the Investment Centre (see Note 7B to the consolidated financial statements for the year ended December 31, 2012).

**Gross Profit.** Gross profit for the year ended December 31, 2012 was \$78.8 million, as compared to \$84.8 million for the year ended December 31, 2011, a decrease of \$6 million, resulting from the above described \$34 million increase in cost of revenues offset by the above described \$28 million revenue increase. Gross profit for the year ended December 31, 2012 decreased following weakening customer demand in the semiconductor industry which was offset by the inclusion of TJP gross profit for the full year ended December 31, 2012 compared to only seven months in the corresponding period in 2011.

**Research and Development Expenses.** Research and development expenses for the year ended December 31, 2012 amounted to \$31.1 million, as compared to \$24.9 million for the year ended December 31, 2011. The increase in research and development expenses was mainly due to including TJP's research and development expenses for the full year ended December 31, 2012 compared to only seven months in the corresponding period in 2011.

**Marketing, General and Administrative Expenses.** Marketing, general and administrative expenses for the year ended December 31, 2012 amounted to \$44.4 million as compared to \$48.2 million for the year ended December 31, 2011. The decrease, despite the inclusion of TJP's marketing, general and administrative expenses for the full year ended December 31, 2012 compared to only seven months in the corresponding period in 2011 is due to cost savings actions in 2012 and due to reduced stock based compensation expenses recorded in 2012. The compensation attributed to options granted in 2009 was amortized through the vesting period of three years with higher effect in 2011 than in 2012.

**Acquisition Related and Reorganization Costs.** In 2012, the Company executed a plan of reorganization to increase the efficiency of its Japanese facility, including a reduction in the number of employees, resulting in \$5.8 million of reorganization costs in the year ended December 31 2012. Acquisition related costs in the year ended December 31, 2011 amounted to \$1.5 million.

**Operating Profit (Loss).** Operating loss for the year ended December 31, 2012 was \$2.5 million, as compared to \$10.2 million operating profit for the year ended December 31, 2011, resulting from the above described decrease of \$6.0 in gross profit and the higher operating expenses, as described above.

**Interest Expenses, Net.** Interest expenses, net for the year ended December 31, 2012 were \$31.8 million compared to interest expenses, net of \$27.8 million for the year ended December 31, 2011. The increase was mainly due to the debentures Series F issued in 2012.

Other Financing Expenses, Net. Other financing expenses, net for the year ended December 31, 2012 were \$27.6 million compared to other financing expenses, net of \$12.5 million for the year ended December 31, 2011. The increase in financing expenses, net is described in details in Note 19 to the consolidated financial statements as of December 31, 2012.

Gain from Acquisition. In 2011, gain from the acquisition of TJP was \$19.5 million gross, as detailed in Note 3 to the consolidated financial statements attached to this annual report.

The loss for the year ended December 31, 2011 included approximately \$10 million net positive effect from TJP acquisition, comprised of (i) approximately \$19.5 million gross gain from the acquisition, as the fair market value of the assets, net acquired exceeded the purchase price; and (ii) approximately \$9.5 million of related tax provisions and other expenses directly associated with this acquisition.

Other Income, Net. Other income, net for the year ended December 31, 2011 included approximately \$14 million gross gain from the sale of the 10% holdings in HHNEC.

Income Tax Expenses. Income tax expenses resulting from the subsidiaries' income before taxes, amounted to \$7.3 million in the year ended December 31, 2012 as compared to \$21.4 million for the year ended December 31, 2011. Income tax expense for the year ended December 31, 2011 results from our subsidiaries' operating income and the approximately \$13 million income tax expenses relating to the gain from the acquisition of TJP and to the gain from the sale of the holdings in HHNEC.

Loss. Loss for the year ended December 31, 2012 was \$70.3 million as compared to \$18.5 million for the year ended December 31, 2011. The increased loss was mainly due to the \$19.5 million gross gain from the acquisition of TJP in year ended December 31, 2011 and \$14.1 million gross gain from the sale of our 10% holdings in HHNEC in year ended December 31, 2011, as well as an increase in 2012 of \$15.1 million in the financing expense, net detailed in Note 19 to the consolidated financial statements attached to this annual report and lower operating profit in 2012 of \$12.7 million, all of which were partially offset by \$14.0 million lower tax expenses.

Year Ended December 31, 2011 compared to Year Ended December 31, 2010

Revenue. Revenues for the year ended December 31, 2011 were \$611.0 million compared to \$509.3 million for the year ended December 31, 2010. Such increase in revenues was primarily a result of higher wafers shipped of 32% (mainly resulting from the inclusion during 2011 of shipments from TJP, partially offset by lower shipments due to the weakening customer demand in the semiconductor industry), while the average selling price decreased by 4%.

Revenues for the year ended December 31, 2010 included \$27 million higher revenues, as compared to the year ended December 31, 2011, relating to the agreement with the Asian entity, as detailed in Notes 2K and 16D(2) to the annual consolidated financial statements for the year ended December 31, 2011 included in this report. The project with the Asian entity is expected to be finalized in the coming year and we expect 2012 revenues from this project to be approximately \$25 million lower than in 2011.

Cost of Total Revenues. Cost of revenues for the year ended December 31, 2011 amounted to \$526.2 million, as compared to \$402.1 million for the year ended December 31, 2010. The increase in cost of revenues is mainly due to including 2011 TJP's cost of revenue. Cost of revenues for the year ended December 31, 2011 included one-time depreciation expenses reduction resulting from the grants approval by the Investment Centre, see Note 7B to the consolidated financial statements for the year ended December 31, 2011 included in this report, as well as a reduction of \$17 million from the Asian project referred to above.

Gross Profit . Gross profit for the year ended December 31, 2011 was \$84.8 million, as compared to \$107.2 million for the year ended December 31, 2010, a decrease of \$22.4 million, resulting from the above described \$124.1 million increase in cost of revenues offset by the above described \$101.7 million revenue increase. Gross profit for the year ended December 31, 2011 decreased following the weakening customer demand in the semiconductor industry which was offset by the inclusion of 2011 TJP's gross profit.



Research and Development. Research and development expenses for the year ended December 31, 2011 amounted to \$24.9 million, substantially the same as the \$23.9 million for the year ended December 31, 2010.

Marketing, General and Administrative Expenses. Marketing, general and administrative expenses for the year ended December 31, 2011 amounted to \$48.2 million as compared to \$40.0 million for the year ended December 31, 2010. The increase is mainly due to including 2011 TJP's Marketing, general and administrative expenses. As a percentage of revenues, marketing, general and administrative expenses remained at approximately 8% of revenues.

Operating Profit. Operating profit for the year ended December 31, 2011 was \$10.2 million, as compared to \$43.3 million for the year ended December 31, 2010, a decrease of \$33.1 million, resulting mainly from the above described decrease of \$22.4 in gross profit, the above described \$1.0 million research & development expenses increase and the above described \$8.2 million marketing, general and administrative expenses increase.

Financing Expenses, Net. Financing expenses, net for the year ended December 31, 2011 were \$40.3 million compared to financing expenses, net of \$72.9 million for the year ended December 31, 2010. The decrease in financing expenses, net is described in details in Note 19 to the consolidated financial statements as of December 31, 2012 included in this report.

Gain from acquisition. Gain from acquisition of TJP was \$19.5 million gross, as detailed in Note 3 to the consolidated financial statements as of December 31, 2011 included in this report. Loss for the year ended December 31, 2011 included approximately \$10 million net positive effect from Nishiwaki Fab acquisition, comprised of (i) approximately \$19.5 million gross gain from the acquisition, as the fair market value of the assets, net acquired exceeded the purchase price and (ii) approximately \$9.5 million of related tax provisions and other expenses directly associated with this acquisition.

Other income, Net. Other income, net for the year ended December 31, 2011 includes approximately \$15 million gross gain from the sale of our 10% holdings in HHNEC.

Income Tax expense. Income tax expense resulting from the subsidiaries' income before taxes, amounted to \$21.4 million in the year ended December 31, 2011 as compared to \$12.8 million for the year ended December 31, 2010. Income tax expense in the year ended December 31, 2011 resulted from our subsidiaries' operating income and approximately \$8 million income tax expenses relating to the gain from the acquisition of TJP.

Loss. Loss for the year ended December 31, 2011 was \$18.5 million as compared to \$42.4 million for the year ended December 31, 2010. Such \$23.9 million improvement is due to the \$32.6 million lower financing expenses, \$19.5 million gross gain from the acquisition of TJP and \$13.4 million other income which were partially offset by the lower operating profit of \$33.1 million and \$8.5 million higher tax expenses.

#### Impact of Inflation and Currency Fluctuations

The US Dollar costs of our operations in Israel are influenced by changes in the rate of inflation in Israel and the extent to which such changes are not offset by the change in valuation of the NIS in relation to the US Dollar. During the year ended December 31, 2012, the exchange rate of the US Dollar in relation to the NIS decreased by 2.3% and the Israeli Consumer Price Index ("CPI") increased by 1.6% (during the year ended December 31, 2011, there was an increase of 7.7% in the exchange rate of the US Dollar in relation to the NIS and an increase of 2.2% in the CPI).

We believe that the rate of inflation in Israel has not had a material effect on our business to date. However, our US Dollar costs will increase if inflation in Israel exceeds the devaluation of the NIS against the US Dollar.

The US Dollar costs of our operations in Japan are influenced by the changes in valuation of the Japanese Yen (JPY) in relation to the US Dollar. During the year ended December 31, 2012, the exchange rate of the US Dollar in relation to the JPY increased by 11.2% (during 2011, from the acquisition of TJP until December 31, 2011, the exchange rate of the US Dollar in relation to the JPY decreased by 4.2%).

Nearly the entire cash generated from our operations and from our financing and investing activities is denominated in US Dollar, JPY and NIS. Our expenses and costs are denominated in NIS, US Dollar, JPY and Euros. We are, therefore, exposed to the risk of currency exchange rate fluctuations.

Tower and Jazz's bank loans mainly provide for interest based on a floating LIBOR rate and TJP's bank loans interest is based on the higher of TIBOR rate or LIBOR rate, therefore we are exposed to interest rate fluctuations. From time to time, we engage in various hedging strategies to reduce our exposure to some, but not all, of these risks. However, despite any such hedging activity, we are likely to remain exposed to interest rate fluctuations, which may increase the cost of our business activities, particularly our financing expenses.

Part of Tower's debentures are denominated in NIS and linked to the Israeli CPI and therefore we are exposed to fluctuation of the NIS/US Dollar exchange rate. The US Dollar amount of our financing costs (interest and currency adjustments) related to these debentures will increase if the rate of inflation in Israel is not offset by the devaluation of the NIS in relation to the US Dollar. In addition, the US Dollar amount of any repayment on account of the principal of these debentures will also increase.

The quantitative and qualitative disclosures about market risk are in Item 11 of this annual report.

## B. LIQUIDITY AND CAPITAL RESOURCES

As of December 31, 2012, we had an aggregate amount of \$133.4 million in cash, cash equivalents and interest bearing deposits, including \$10 million of designated deposits as compared to \$101.1 million of cash and cash equivalents as of December 31, 2011.

The main cash activities during the year ended December 31, 2012 consisted of the following: we generated an amount of \$95.3 million from operating activities, excluding \$20.1 million of TJP re-organization payments, we raised \$104.7 million, net from convertible notes issuances (for further details see also Note 13 to the consolidated financial statements attached to this annual report) and received \$14.4 million loan from GE Japan Corporation under our credit line agreement. These liquidity resources mainly financed the capital investments we made during the year ended December 31, 2012, which aggregated to approximately \$105.7 million, net and the repayment of debt principle payments in the amount of \$55.9 million.

Following the recent economic slowdown worldwide and specifically in the semiconductor industry, the Company has experienced weakening customer demand and reduced rate of growth.

Market analysts are currently cautious as to the forecasted industry demand and conditions. The effects of a downturn in the semiconductor industry and/or in the global economy include global decreased demand, downward price pressure, excess inventory and unutilized capacity worldwide, which negatively impact consumer and customer demand for the Company's products and the end products of the Company's customers. A downturn in the semiconductor industry and/or in the global economy may adversely affect the Company's commercial relationships with its customers, suppliers, and creditors, including its lenders, its ability to cover its manufacturing facilities' fixed

costs, its plans to continue its capacity growth, and the Company's future financial results and position, including its ability to raise funds in the capital markets and to fulfill its debt obligations and other liabilities, comprised mainly of banks' loans and debentures.

The Company is exploring various ways to fund its capacity and growth plans, the ramp-up of its business, technology capabilities and to fulfill its debt obligations and other liabilities. However, there is no assurance as to the extent of such funding or when, if at all, such funding will be available to the Company. Such funding may include, among others, debt restructuring and/or refinancing, possible financing transactions, sale of assets, intellectual property licensing, possible sale and lease-back of real estate assets and improving cash flow from operations through operating efficiencies.

For implications on our operations if we do not generate increased levels of cash from operations and/or do not raise additional funding and if we will not be in compliance with the repayment schedule under the amended facility agreement and are unsuccessful in negotiating a revised repayment schedule, see “Risk Factors - Risks Affecting Our Business”.

#### Tower's Credit Facility

As of December 31, 2012, Tower's outstanding debt under its credit facility with Bank Leumi and Bank Hapoalim (the: “Israeli Banks”) was approximately \$131 million.

#### Agreements and Amendments under the Credit Facility of Tower

For detailed information see Notes 12B and 16 to the 2012 annual consolidated financial statements for the year ended December 31, 2012.

In March 2013, Tower entered into a letter agreement with the Israeli Banks pursuant to which it was agreed, among other things, that: (i) The outstanding loan of \$131 million will carry annual interest of LIBOR + 3.5% per annum and will be payable in 10 quarterly installments, starting in March 2014 and ending in June 2016, with such repayment being made in the following amounts: two installments of \$5 million in March and June 2014, two installments of \$10 million in September and December 2014, two installments of \$15 million in March and June 2015, three installments of \$20 million in September 2015, December 2015 and March 2016, and a final installment of \$11 million due June 2016; (ii) the financial covenants were revised, and Tower and the Israeli Banks agreed to further revise the financial covenants by July 31, 2013; (iii) Tower would be allowed to raise funds by issuing subordinated debt instruments; (iv) in certain circumstances stipulated in said agreements, following receipt by Tower of significant amounts of proceeds from certain sources, Tower agreed to early repayment of a certain amount of the outstanding loans; and (v) warrants granted to the Israeli Banks were set to expire in December 2016.

We have registered liens in favor of the State of Israel and the banks on substantially all of our present and future assets.

According to the Facility Agreement, satisfying the financial ratios and covenants is a material provision. The amended Facility Agreement provides that if, as a result of any default, the Israeli Banks were to accelerate Tower's obligations, Tower would be obligated, among other matters, to immediately repay all loans made by the Israeli Banks (which as of December 31, 2012 amounted to approximately \$131 million) plus penalties, and the Israeli Banks would be entitled to exercise the remedies available to them under the amended Facility Agreement, including enforcement of their liens against all of Tower's assets.



Under the terms of the amended Facility Agreement, (i) there are limitations on changes of ownership which generally require that, TIC hold a minimum of approximately 3.2 million of our ordinary shares (including shares issuable upon conversion of our equity equivalent capital notes), and (ii) TIC nominate a majority of our board of directors (subject to exceptions including the exclusion for the purpose of this calculation of the external directors and 1 independent director under Nasdaq Marketplace rules); and (iii) additional conditions and covenants, including restrictions on incurring debt and a prohibition on the distribution of dividends.

#### Investment Center Grants

In February 2011, we received an official approval certificate (“ktav ishur”) from the Israeli Investment Center, a governmental agency, for our expansion program according to which we received approximately \$36 million as of December 31, 2012, for eligible investments made by the Company from January 1, 2006, of which approximately NIS 10 million (\$2 million) were received in 2012.

Under our previous approved program approved in December 2000, we received \$165 million of grants for capital expenditure investments made through 2005.

Entitlement to the above grants is subject to various conditions stipulated by the criteria set forth in the certificate of approval issued by the Israeli Investment Center, as well as by the Israeli Law for the Encouragement of Capital Investments - 1959 (“Investment