

TOWER SEMICONDUCTOR LTD  
Form 20-F  
May 14, 2015

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

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FORM 20-F

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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, 2014

0-24790

Commission File number:

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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  
(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

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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<br>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: 58,033,049 Ordinary Shares.

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

Yes ☒ No ☐

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 ☐

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 <input checked="" type="checkbox"/> | International Financial Reporting Standards as issued by the International Accounting Standards Board <input type="checkbox"/> | Other <input type="checkbox"/> |
|---------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------|--------------------------------|

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 ☒

## FORWARD LOOKING STATEMENTS

This annual report on Form 20-F includes certain “forward-looking” statements within the meaning of Section 21E of the Securities Exchange Act of 1934. The use of the words “projects,” “expects,” “may,” “plans” or “intends,” or words of similar import, identifies a statement as “forward-looking”. There can be no assurance, however, that actual results will not differ materially from our expectations or projections. Factors that could cause actual results to differ from our expectations or projections include the risks and uncertainties relating to our business described in this annual report in “Item 3. Key Information-Risk Factors”.

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## EXPLANATORY INFORMATION

All references herein to “dollars”, “US dollars”, “USD” or “\$” are to United States dollars, and all references to “Shekels” or “NIS” are to New Israeli Shekels.

On September 19, 2008, we completed a merger with Jazz Technologies, Inc. (“Jazz Technologies”) and its wholly-owned subsidiary Jazz Semiconductor, Inc. (“Jazz Semiconductor”), an independent semiconductor foundry focused on specialty process technologies for the manufacture of analog intensive mixed-signal semiconductor devices. As a result of this transaction, Jazz Technologies became a wholly-owned subsidiary of Tower Semiconductor Ltd. (“Tower”). Jazz Technologies, Jazz Semiconductor and its wholly-owned subsidiaries are collectively referred to as “Jazz” in this report.

On June 3, 2011, we acquired a fabrication facility in Nishiwaki City, Hyogo, Japan from Micron Technology, Inc. (“Micron”) which we hold through our wholly-owned Japanese subsidiary, TowerJazz Japan, Ltd. (“TJP”). In 2014, the operations of the facility in Nishiwaki ceased in the course of a restructuring of our activities and business in Japan.

In March 2014, we acquired a 51% equity stake in TowerJazz Panasonic Semiconductor Co., Ltd., (“TPSCo”), a company formed by Panasonic Corporation (“Panasonic” or “Panasonic Corporation”).

The consolidated financial statements included in this annual report include the results and balances of Tower and the following companies from the applicable merger and acquisition dates: (i) its wholly-owned subsidiaries (1) Jazz, and (2) TJP and (ii) since March 31 2014, its majority-owned subsidiary, TPSCo.

As used in this annual report, “Fab 1” means the semiconductor fabrication facility located in Migdal Haemek, Israel that Tower acquired from National Semiconductor Inc. (“National Semiconductor”) in 1993. “Fab 2” means the semiconductor fabrication facility located in Migdal Haemek, Israel that Tower established in 2003. “Fab 3” means the semiconductor fabrication facility Jazz operates in Newport Beach, California. “Fab 4” means the semiconductor fabrication facility TJP operated in Nishiwaki City, Hyogo, Japan. “Arai E” means the semiconductor fabrication facility TPSCo operates in Kurihara 4-5-1, Myoko-shi, Niigata, Japan. “Uozu E” means the semiconductor fabrication facility TPSCo operates in Higashiyama 800, Uozu-shi, Toyama, Japan. “Tonami CD” means the semiconductor fabrication facilities TPSCo operates in Higashi-Kaihatsu 271, Tonami-shi, Toyama, Japan.

As used in this annual report, as of any particular date, “we,” “us,” “our,” and “the Company” and words of similar import refer collectively to Tower and its then owned and/or consolidated subsidiaries.

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Manufacturing or production capacity refers to installed equipment capacity in our facilities and is a function of the process technology and product mix being manufactured because certain processes require more processing steps than others. All information herein with respect to the wafer capacity of our manufacturing facilities is based upon our estimate of the effectiveness of the manufacturing equipment and processes in use or expected to be in use during a period and the estimated or expected process technology and product mix for such period. Unless otherwise specifically stated, all references herein to “wafers” with respect to Fab 1 capacity are to 150-mm wafers, with respect to Fab 2, Fab 3, Fab 4, Arai E and Tonami CD capacity are to 200-mm wafers and with respect to Uozu E are to 300-mm wafers.

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JAZZ SEMICONDUCTOR® is a registered trademark of Jazz Semiconductor, Inc. in the U.S.

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PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

Selected Consolidated Financial Data

Our historical consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States (“US GAAP”) and are presented in U.S. dollars. The selected historical consolidated financial information as of December 31, 2014 and 2013 and for each of the three years ended December 31, 2014, 2013 and 2012 has been derived from, and should be read in conjunction with, our consolidated financial statements, and notes thereto appearing elsewhere in this annual report. The selected financial data as of December 31, 2012, 2011 and 2010 and for each of the years ended December 31, 2011 and 2010 has been derived from our audited financial statements for those years not included in this annual report.

Our consolidated financial statements include TJP’s results commencing June 3, 2011 and TPSCo’s results commencing April 1, 2014, and our consolidated balance sheets include TJP’s balances for December 31, 2011 and on and TPSCo’s balances for December 31, 2014. As mentioned above, in 2014, the operations of TJP in the Nishiwaki facility ceased in the course of a restructuring of our activities and business in Japan.

Due to the acquisition of TPSCo and the cessation of operations of TJP, it may be difficult to compare the results of operations for the period subsequent to these transactions with prior periods. The selected historical consolidated financial data set forth below should be read in conjunction with our consolidated financial statements and related notes appearing in this annual report and the “Management’s Discussion and Analysis of Financial Condition and Results of Operations” appearing elsewhere in this report. Our historical financial information may not be indicative of future performance.

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Year Ended December 31,  
2014      2013      2012      2011      2010  
(in thousands, except per share data)

**Statement of Operations Data:**

|                                                             |            |              |             |             |             |
|-------------------------------------------------------------|------------|--------------|-------------|-------------|-------------|
| Revenues                                                    | \$828,008  | \$505,009    | \$638,831   | \$611,023   | \$509,262   |
| Cost of revenues                                            | 764,220    | 476,900      | 560,046     | 526,198     | 402,077     |
| Gross profit                                                | 63,788     | 28,109       | 78,785      | 84,825      | 107,185     |
| Research and development                                    | 51,841     | 33,064       | 31,093      | 24,886      | 23,876      |
| Marketing, general and administrative                       | 58,783     | 42,916       | 44,413      | 48,239      | 39,986      |
| Nishiwaki Fab impairment                                    | 47,472     | --           | --          | --          | --          |
| Nishiwaki Fab restructuring costs                           | 8,028      | --           | --          | --          | --          |
| Acquisition related and reorganization costs                | 1,229      | --           | 5,789       | 1,493       | --          |
| Amortization related to a lease agreement early termination | --         | 7,464        | --          | --          | --          |
| Operating profit (loss)                                     | (103,565 ) | (55,335 )    | (2,510 )    | 10,207      | 43,323      |
| Interest expenses, net                                      | (33,409 )  | (32,971 )    | (31,808 )   | (27,797 )   | (26,406 )   |
| Other non-cash financing expenses, net                      | (55,404 )  | (27,838 )    | (27,583 )   | (12,505 )   | (46,519 )   |
| Gain from acquisition                                       | 166,404    | --           | --          | 19,467      | --          |
| Other income (expense), net                                 | (140 )     | (904 )       | (1,042 )    | 13,460      | 65          |
| Income (loss) before income tax expenses                    | (26,114 )  | (117,048 )   | (62,943 )   | 2,832       | (29,537 )   |
| Income tax benefit (expense)                                | 24,742     | 9,388        | (7,326 )    | (21,362 )   | (12,830 )   |
| Loss                                                        | (1,372 )   | (107,660 )   | (70,269 )   | (18,530 )   | (42,367 )   |
| Net loss attributable to non controlling interest           | 5,635      | --           | --          | --          | --          |
| Net Income (Loss) attributable to the Company               | \$4,263    | \$(107,660 ) | \$(70,269 ) | \$(18,530 ) | \$(42,367 ) |
| Basic earnings (loss) per ordinary share                    | \$0.08     | \$(2.72 )    | \$(3.17 )   | \$(0.90 )   | \$(2.63 )   |
| Diluted earnings per ordinary share                         | \$0.07     |              |             |             |             |

**Other Financial Data:**

Depreciation and amortization, including amortization of financing expenses and accretion

As of December 31,  
2014      2013      2012      2011      2010  
(in thousands of US dollars, except share data which is in thousands)

**Selected Balance Sheet Data:**

Cash and cash equivalents, short-term interest-bearing deposits and designated deposits

|                                                                          |           |           |           |           |           |
|--------------------------------------------------------------------------|-----------|-----------|-----------|-----------|-----------|
| Working capital                                                          | \$187,167 | \$122,871 | \$133,398 | \$101,149 | \$198,382 |
| Total assets                                                             | 93,759    | 150,498   | 128,787   | 35,830    | 72,053    |
| Short-term bank debt and current maturities of debentures and bank loans | 884,146   | 705,887   | 814,241   | 857,221   | 801,728   |
| Loan from banks, net of current maturities                               | 119,999   | 36,441    | 49,923    | 48,255    | 122,179   |
| Debentures, net of current maturities                                    | 159,776   | 108,739   | 94,922    | 103,845   | 111,882   |
| Shareholders' equity                                                     | 107,311   | 208,146   | 193,962   | 197,765   | 247,598   |
|                                                                          | 195,561   | 141,248   | 220,025   | 174,703   | 117,782   |

|                                                                           |        |        |        |        |        |
|---------------------------------------------------------------------------|--------|--------|--------|--------|--------|
| Weighted average number of ordinary shares<br>outstanding during any year | 51,798 | 39,633 | 22,173 | 20,649 | 16,086 |
| Number of shares outstanding as of December<br>31 of any year             | 58,034 | 47,870 | 22,312 | 21,219 | 17,703 |

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## Risk Factors

Our business faces many risks. Any of the risks discussed below may have an adverse impact on our business, financial condition and operating results.

### Risks Affecting Our Business

Demand for our foundry services is dependent on the demand in our customers' end markets. A decrease in demand for products that contain semiconductors may decrease the demand for our services and products and a decrease in the selling prices of our customers' products may reduce our margins.

Our customers generally use the semiconductors produced in our fabs in a wide variety of applications. We derive a significant percentage of our operating revenues from customers who use our manufacturing services to make semiconductors for communication devices, consumer electronics, PCs and other electronic devices. Any significant decrease in the demand for these devices or products may decrease the demand for our services and products. In addition, if the average selling prices of communication devices, consumer electronics, PCs or other electronic devices decline significantly, we may be pressured to reduce our selling prices, which may reduce our revenues and margins significantly. As demonstrated by downturns in demand for high technology products in the past, market conditions can change rapidly, without apparent warning or advance notice. In such instances, our customers may experience inventory buildup and/or difficulties in selling their products and, in turn, may reduce or cancel orders for wafers from us which may harm our business and profitability. The timing, severity and recovery of these downturns cannot be predicted accurately or at all.

In order for demand for our wafer fabrication services to increase, we try to attract new customers or the markets for the end products utilizing the integrated circuits that we manufacture must develop and expand. For example, the success of our imaging process technologies will depend, in part, on the growth of markets for certain image sensor product applications. Because our services may be used in many new applications, it is difficult to forecast demand. If demand is lower than expected, we may have excess capacity, which may adversely affect our financial results. If demand is higher than expected, we may be unable to fill all of the orders we receive, which may result in the loss of customers and revenue.

If we do not maintain our current customers and attract additional customers, our business may be adversely affected.

Loss or cancellation of business from, or decreases in the sales volume or sales prices to, our significant customers, or our failure to replace lost business with new customers, could seriously harm our financial results, revenue and business.

We have relationships with several customers that represent a material portion of our revenues. During the year ended December 31, 2014, we had four customers that each contributed between 7% to 38% of our revenue. During the year ended December 31, 2013, we had three customers that each contributed between 7% to 27% of our revenue. During the year ended December 31, 2012, we had two customers that contributed 6% and 43% of our revenue. The loss of any one of these customers, whether due to their insolvency or their unwillingness or inability to perform their obligations under their respective relationships with us, or if we are unable to renew our engagements with them on commercially reasonable terms, or attract additional customers to replace such lost business, may materially negatively impact our overall business and our consolidated financial position and financial results.

Panasonic Semiconductor Solutions Co., Ltd. ("PSCS"), a wholly-owned subsidiary of Panasonic Corporation, is expected to be a significant customer of TPSCo at least during its initial five years of operation and is expected to comprise a major portion of TPSCo's revenue for such duration. For said period, our ability to successfully operate TPSCo is essentially dependent on PSCS ordering a sufficient number of wafers and manufacturing services from TPSCo. While we have commenced discussions with potential third party foundry customers to initiate manufacturing at TPSCo and certain foundry customers have begun process transfers and ramp up for production, implementation of new customer processes may take more than two years to reach the mass production stage, as customary in our industry. Failure to generate sufficient revenue from PSCS or new customers to replace lost business may adversely affect TPSCo's business, including potential cessation of operations of certain of its fabs, and may impact our consolidated financial results.

The production lines of our manufacturing fabrications may stop for short or long periods of time due to high utilization in certain areas, bottlenecks, power outages, water leaks, chemical leaks and other causes, which may adversely affect our cycle time, yield, and on schedule delivery, thereby potentially causing an immediate loss of a material amount of revenue for the current and coming quarter or quarters, which would adversely affect our revenue, profitability and short term financial forecasts as compared to our original estimations, and also cause customers that did not receive their order on time to contemplate transferring their product orders to other fabs. In addition, current high utilization we face may cause bottlenecks in the production lines, which may adversely affect our cycle time, yield, on schedule delivery, and customers' satisfaction and future purchase orders from us which would adversely affect our revenue, profitability and financial position.

There are many events that may occur which will adversely affect the manufacturing process running in a facility. From time to time, there are events such as high utilization we currently experience in certain areas, bottlenecks machines, power outages, water leaks and chemical leaks that may adversely affect our cycle time, yield and on schedule delivery. In such events, we try to mitigate any potential damage caused by such events and have insurance coverage which we believe to be sufficient. However, we cannot ensure that such events will have no negative effect on the Company. Such events may potentially cause an immediate loss of a material amount of revenue for the current and coming quarter or quarters, which would adversely affect our revenue, profitability and short term financial forecasts as compared to our original estimations. In addition, it may cause customers that did not receive their order on time to contemplate transferring their product orders to other fabs. In addition, the current high utilization we face may cause bottlenecks in the production lines, which may adversely affect our cycle time, yield, on-schedule delivery, and customers' satisfaction and future purchase orders from us which would adversely affect our revenue, profitability and financial position.



Our operating results fluctuate from quarter to quarter which makes it difficult to predict our future performance and such fluctuations may ultimately negatively affect our financial condition and ability to maintain our operations.

Our revenues, expenses and operating results have varied significantly in the past and may fluctuate significantly from quarter to quarter in the future due to a number of factors, many of which are beyond our control. These factors include, among others:

- The cyclical nature of the semiconductor industry and the volatility of the markets served by our customers;
- Changes in the economic conditions of geographical regions where our customers and their markets are located;
- Inventory and supply chain management of our customers;
- The loss of a key customer, postponement of an order from a key customer or the rescheduling or cancellation of large orders;
- The occurrence of accounts receivable write-offs, failure of a key customer to pay accounts receivable in a timely manner or the financial condition of our customers;
- The rescheduling or cancellation of planned capital expenditures;
- The occurrence of an unexpected event, such as environmental events or industrial accidents such as fire or explosions, electricity outage or misprocess, affecting the manufacturing process and our ability to recover the lost or damaged products and provide quality and timely production to our customers with no significant additional costs;
- Completing capacity expansions and recruitment of personnel in a timely manner to address product demands by our customers;
  - Our ability to satisfy our customers' demand for quality and timely production;
  - The timing and volume of orders relative to our available production capacity;
  - Our ability to obtain raw materials and equipment on a timely and cost-effective basis;
  - Price erosion in the industry;
  - Our susceptibility to intellectual property rights disputes;
- Our dependency on export licenses and other permits required for our operations and the sale of our products;
- Our ability to maintain existing partners and to enter into new partnerships and technology and supply alliances on mutually beneficial terms;

- Interest, price index and currency rate fluctuations that were not hedged;
  - Technological changes and short product life cycles;
  - Timing for the design and qualification of new products;
- Increase in the fair value of our banks' loans, certain of our warrants and debentures; and
  - Changes in accounting rules affecting our results.

Furthermore, integrated device manufacturers continue to design and manufacture integrated circuits in their own fabrication facilities. There is a possibility that in certain periods or under certain circumstances such as low demand, they will choose to manufacture their products in their facilities instead of manufacturing products at external foundries. If our customers will choose to manufacture internally rather than manufacture at our facilities, our business may be negatively impacted.

Due to the factors noted above and other risks discussed in this section, many of which are beyond our control, investors should not rely on quarter-to-quarter comparisons to predict our future performance. Unfavorable changes in any of the above factors may seriously harm our Company, including our operating results, financial condition and ability to maintain our operations.

Our financial statements, financial position and operations may be affected as a result of our debt and other liabilities.

As of March 31, 2015, we had approximately \$296 million of consolidated debt outstanding, comprised as follows: Tower had (i) approximately \$99 million of outstanding secured bank loans, maturing through October 2018 in installments amounting to \$8 million during 2015, \$14 million during 2016, \$56 million during 2017 and approximately \$21 million during 2018, (ii) approximately \$12 million of unsecured outstanding non-convertible debentures, 50% of which are payable in December 2015 and the remainder in December 2016, and (iii) approximately \$35 million of unsecured outstanding debentures Series F, convertible into our ordinary shares, 50% of which are payable in December 2015 and the remainder in December 2016, unless earlier converted into our ordinary shares. As of March 31, 2015, Jazz had (i) approximately \$19 million of outstanding borrowings under its up to \$70 million Wells Fargo credit line due December 2018, and (ii) approximately \$58 million of outstanding debentures, convertible into our ordinary shares, payable in December 2018, unless converted earlier. As of March 31, 2015, TPSCo has loans amounting to 8.8 billion Japanese Yen (approximately \$73 million) provided by JA Mitsui Leasing, Ltd. and Bank of Tokyo Lease Co., Ltd. (BOT), to be repaid in seven semi-annual equal installments starting June 2016 and ending June 2019. Carrying such amount of debt and other liabilities may have significant negative consequences on our business, including:

- limiting our ability to fulfill our debt obligations and other liabilities;
- requiring the use of a substantial portion of our cash flow from operating activities to service our indebtedness rather than investing our cash flows to fund our growth plans, working capital and capital expenditures;
- increasing our vulnerability to adverse economic and industry conditions;
- limiting our ability to obtain additional financing;
- limiting our flexibility in planning for, or reacting to, changes in our business and the industry in which we compete;





- placing us at a competitive disadvantage with respect to less leveraged competitors and competitors that have better access to capital resources;
- volatility in our non-cash financing expenses due to increases in the fair value of our debt obligations, which may increase our net loss or reduce our net profits;
- increasing the payable amounts in USD of the TPSCo loan and our financing expenses in case the exchange rate USD to JPY decreases;
- the effect of financial instruments' accounting treatment under US GAAP on non-cash other financing expenses, net to be included in our statement of operations in 2015, primarily the impact of amortization, accretion and acceleration thereof as a result of debentures Series F conversion to shares which may increase our non-cash other financing expenses in 2015 by up to an additional \$80 million, primarily in the statements of operations for the first quarter of 2015, and reduce net profits (while reducing such expenses and improving profitability in the future periods thereafter), however, such impact would improve shareholders' equity and reduce liabilities, all in accordance with US GAAP (ASC 470 formerly EITF 98-5 and EITF 27-00), and such accelerated accretion and amortization of the Beneficial Conversion Feature created in 2012; and/or
- enforcement by the banks and other financing entities of their liens against Tower or Jazz's respective assets, as applicable at the occurrence of an event of default.

In order to finance our debt and other liabilities and obligations, in addition to cash on hand and expected cash flow from operating activities, we continue to explore measures to obtain funds from additional sources including sales of assets, debt and/or equity restructuring and/or re-financing, sale of new securities, opportunities for the sale and lease-back of a portion of Tower's real estate assets, sale of intellectual property and/or intellectual property licensing, as well as additional financing alternatives. However, there is no assurance that we will be able to obtain sufficient funding, if at all, from the financing sources detailed above or other sources in a timely manner (or on commercially reasonable terms) in order to allow us to cover all our future costs, comprised mainly of fixed costs, capital expenditure costs and other debt, liabilities and obligations in a timely manner and/or fund our growth plans.

Our success as a leading specialty foundry depends on our ability to continue to expand our business, customer base and market presence, including through acquisitions which involves various risks. There is no assurance that we will be successful in executing our acquisitions and integrating them into our business, utilizing our expanded capacity and finding new business, including successfully operating TPSCo and integrating our foundry business opportunities into TPSCo fabs.

Our Company's growth as a leading specialty foundry depends, to a significant degree, upon our ability to increase our presence in the specialty foundry field and gain more market share across the various specialty segments. In order to do so and thereby improve our financial position and operations, we need to expand our business, including through acquisitions, attract new customers who will utilize our expanded capacity.

Our success at such expansion is dependent, in part, on finding suitable targets for acquisitions, successfully financing and consummating such acquisitions, loading the acquired facilities and integrating them into our business.

We cannot assure you that we will be successful in expanding our business, attracting new customers and increasing our market presence. Further, we cannot assure that we will find and successfully execute such acquisitions or that they will achieve the expected synergies. With respect to our acquisition of the 51% equity stake in TPSCo in March 2014, we cannot assure that we will successfully transfer and ramp up new foundry business and new customers into TPSCo fabs. Achieving the anticipated benefits of acquisitions depend in part on successfully consolidating functions

and integrating operations, procedures and personnel in a timely and efficient manner, as well as on our ability to realize the anticipated growth opportunities and synergies from integrating that business into our existing business. Integration also requires the dedication of substantial management effort, time and resources which may divert our management's focus and our resources from other strategic opportunities and from operational matters during this process. The integration process may result in the loss of key employees, the disruption of ongoing business, supplier, customer, employee, labor union, and/or governmental relationships, and difficulties in sustaining current insurance policies that may adversely affect our ability to achieve the anticipated benefits of acquisition.

Our reliance on acquisitions as a means of growth involves risks that may adversely affect our future revenues and operating results. For example:

- We may fail to identify acquisitions that would enable us to execute our business strategy.
- Other foundries may bid against us to acquire potential targets. This competition may result in decreased availability of, or increased prices for, suitable acquisition candidates.
- We may not be able to obtain the necessary regulatory approvals, or we may not be able to obtain the necessary approvals from our lender banks, and as a result, or for other reasons, we may fail to consummate certain acquisitions.
- Potential acquisitions may divert management's attention away from our existing business operations, which may have a negative adverse effect on our business.
- We may fail to integrate acquisitions successfully in accordance with our business strategy, achieve expected synergies or attract sufficient business to newly acquired facilities in a timely manner.
- We may not be able to retain experienced management and skilled employees from the businesses we acquire and, if we cannot retain such personnel, we may not be able to attract new skilled employees and experienced management to replace them.
- We may purchase a company with excessive unknown contingent liabilities, including, among others, patent infringement or product liability.
- We may not be able to obtain sufficient financing which could limit our ability to engage in certain acquisitions.
- The amount or terms of financing actually required before and after acquisition may vary from our expectations.

If we are unable to manage fluctuations in cash flow, our business and financial condition may be adversely affected.

Our working capital requirements and cash flows are subject to quarterly and yearly fluctuations, depending on a number of factors. If we are unable to manage fluctuations in cash flow, our business, operating results and financial condition may be materially adversely affected. Factors which could lead us to suffer cash flow fluctuations include:

- fluctuations in the level of revenues from our operating activities;
- fluctuations in the collection of receivables;
- timing and size of payables;
- the timing and size of capital expenditures;

- The net impact of JPY/ USD fluctuations on our JPY income and JPY expenses.
- the repayment schedules of our debt service obligations;
- our ability to fulfill our obligations and meet performance milestones under our facility agreement and foundry agreements;
- fluctuations in the LIBOR or TIBOR (Tokyo Interbank Offered Rate) rates which apply to our banks' loans; and
- fluctuations in the USD to NIS exchange rate.

If Tower fails to comply with the repayment schedule or any other terms of its amended facility agreement, or if Tower fails to meet any of the covenants and financial ratios stipulated in its amended facility agreement and Tower's banks do not waive its noncompliance, Tower's business and financial position may be adversely affected.

Under Tower's amended facility agreement with Bank Hapoalim B.M. and Bank Leumi Le-Israel B.M., in the event that Tower fails to comply with the repayment schedule or any other covenants and terms of its amended facility agreement, including certain limitations on changes of ownership as defined therein and is unsuccessful in negotiating a revised repayment schedule or revised terms, or fails to meet any of the covenants and financial ratios stipulated in the amended facility agreement, or if there is an event of default, and Tower's banks do not waive its noncompliance, Tower's banks may require Tower to immediately repay all loans due to them by Tower totaling approximately \$99 million, plus penalties, and the banks would be entitled to exercise the remedies available to them under the amended facility agreement, including enforcement of their lien against Tower's assets.

Kenon Holdings, Ltd., one of our major shareholders ("Kenon"), recently announced that it has decided to pursue a change of holding that will affect its shareholdings in Tower (whether by distribution of shares to Kenon's shareholders and/or otherwise), which change of holding may conflict with the change of ownership covenants under our facility agreement (see also "Item 5B – Liquidity and Capital Resources - Tower's Credit Facility - Agreements and Amendments under the Credit Facility of Tower" ). If Kenon proceeds with such change of holdings in a manner which conflicts with our facility agreement, a consent or a waiver will be required from the banks in order to avoid an event of default under the facility agreement. There is no assurance that such a consent or a waiver will be granted.

In addition, there is no assurance that Tower will be able to generate and/or have the cash necessary to fund the scheduled approximately \$99 million bank principal payments due from 2015 to 2018 from its operations or other sources. If Tower is not able to generate and/or have cash from operations or otherwise raise sufficient funds in a timely manner, Tower would likely be unable to comply with the repayment schedule and/or may fail to meet covenants and financial ratios under the facility agreement, which may have a material adverse effect on Tower.

Israeli banking regulations may impose restrictions on the total debt that Tower may borrow from Israeli banks.

Pursuant to a directive published by the Israel Supervisor of Banks, effective March 31, 2004, Tower may be deemed part of a group of borrowers comprised of the Ofer Brothers Group, the Israel Corporation Ltd. (the "Israel Corporation"), Kenon and other companies which are also included in such group of borrowers pursuant to the directive, including companies under the control or deemed control of these entities. The directive imposes limitations on amounts that Israeli banks may lend to borrowers or groups of borrowers, hence restricting the ability of Tower to receive loans from certain Israeli banks, considering all Israeli bank's outstanding loans to the group. Should Tower's existing lender banks exceed these limitations, their ability to lend additional money to Tower in the future, if Tower would be interested in receiving such loan, would be limited and they may ask Tower to repay some or all of its \$99 million outstanding borrowings as of March 31, 2015, which may have a material adverse effect on Tower's business

and financial condition.

Our acquisition of a majority stake in TPSCo involves risks that may adversely affect our future financial performance and position.

Our acquisition of a majority stake in TPSCo involves known and unknown risks that may adversely affect our future financial performance and position, including:

- Failure to successfully integrate TPSCo in accordance with our business strategy;
- Historically, TPSCo's fabs solely manufactured Panasonic Corporation's and its customers' products. TPSCo intends to bring various process technologies to its fabs to enable the manufacture of a wide range of products at these facilities for a broad range of customers. This requires significant capital expenditures and on-site qualification of technologies. There is no assurance that TPSCo will be successful in expanding its customer base in a timely manner in order to cover its manufacturing, operating and technology ramp costs. In the event that TPSCo is unable to generate sufficient additional revenues from third party customers, we may not meet our future revenue expectations and may fail to achieve certain level of utilization in certain TPSCo fabs which may lead to cessation of operations of certain TPSCo fabs, which could negatively affect our future revenue growth and financial performance.
- The establishment of TPSCo involves a major change of control event in the fabrication facilities that were transferred by Panasonic Corporation to TPSCo, including the transfer of employees to a new employer (TPSCo) controlled by Tower and operation as an independent legal entity. There is no assurance that the employees will successfully integrate and adjust to the new business and working requirements, which are relevant to an independent manufacturing company, including, transfer and ramp up of new technologies, engagement with new customers, compliance with TPSCo's manufacturing and service commitments to a diversified customer base, compliance with reporting requirements to government offices and banks and compliance with Sarbanes Oxley Act requirements. If TPSCo's employees fail to successfully integrate and if TPSCo fails to execute its business plan, it could negatively affect our future revenue growth and financial performance.

The cessation of Fab 4 operations in the course of restructuring our activities and business in Japan involves risks that may negatively impact our financial results.

The cessation in 2014 of the Nishiwaki fab operations in the course of restructuring our activities and business in Japan, also included the sale of TowerJazz Japan ('TJP') manufacturing equipment and tools in order to fund TJP's liabilities, (including termination and other payments to TJP employees, vendors and others). If TJP will be required to pay more in the future to settle claims and/or any potential claims from vendors or other third parties, it will result in lack of funds available in TJP, unless TJP is able to sell its land and buildings for a sufficient amount and in a timely manner. If this does not provide sufficient funds, TJP will need to file for a voluntary closure process under Japan laws (unless any creditors do so beforehand).

Failure to comply with the terms of the Israeli Investment Center regulations and the criteria set forth in the certificates of approval may subject us to significant penalties by the Investment Center.

In 2011, we received an official approval certificate (“ktav ishur”) from the Israeli investment center (“Investment Center”), a governmental agency, for our expansion program pursuant to which we have received approximately \$36 million to date for investments made commencing 2006 and through 2012. The final investments report detailing all investments made in accordance with the approval has been filed with the Investment Center. Under our previous program approved in December 2000, we received \$165 million of grants for capital expenditure investments made during the years 2001 through 2005. This plan was completed and approved by the Investment Center.

Eligibility for the above grants is subject to various conditions stipulated by the Israeli Law for the Encouragement of Capital Investments - 1959 (“Investments Law”) and the regulations promulgated thereunder, as well as the criteria set forth in the certificates of approval. In the event we breach the various conditions and terms related thereto, we may be exposed to significant penalties by the Investment Center. In order to secure fulfillment of the conditions related to the receipt of investment grants, floating liens were registered in favor of the State of Israel on substantially all of Tower’s assets. These liens secure the Investment Center against a breach by us of the terms of the investments grant program.

If we do not receive orders from our customers with whom we have signed long-term contracts, we may have excess capacity.

We have committed a portion of our capacity for future orders from some customers with whom we have signed long-term contracts. If these customers do not place orders with us in accordance with their contractual loading and purchase commitments, and if we are unable to fill such unutilized capacity in a timely manner, our financial results may be adversely affected.

We may be required to incur additional indebtedness.

Although we are limited by the covenants in our loan facilities, we could find ourselves in a position in which we may be required to take on additional indebtedness in order to fund our operations and repay our debt, which would increase the amount of our outstanding indebtedness. Any additional indebtedness may increase the risks associated with servicing our indebtedness as described above.

A global recession, unfavorable economic conditions and/or credit crisis may adversely affect our results and our ability to fulfill our debt obligations and other liabilities.

The effects of a downturn or a weakness in the semiconductor industry and/or in the global economy may include global decreased demand, downward price pressure, excess inventory and unutilized capacity worldwide, which may negatively impact consumer and customer demand for the Company’s products and the end products of the Company’s customers. Such a downturn or a weakness may adversely affect the Company’s customer base and/or customers’ products base by adversely affecting the Company’s ability to maintain its customers’ existing demand for products and attract new customers and new business to its fabs. Such a downturn or weakness may also adversely affect the Company’s ability to increase the utilization rates in its manufacturing facilities and maintain them at a high level that would suffice to cover its substantial fixed costs, maintain commercial relationships with its customers, suppliers, and creditors, including its lenders, and continue its capacity growth. In addition, such a downturn or weakness may negatively impact the Company’s ability to improve its future financial results and position, including its ability to raise funds in the capital markets and fulfill its debt obligations and other liabilities, including refinancing its debt and other liabilities and/or pay them in a timely manner, comprised mainly of bank’ loans and debentures. There is no assurance that such downturn will not occur.





The lack of a significant backlog resulting from our customers not placing purchase orders far in advance makes it difficult for us to forecast our revenues in future periods.

Our customers generally do not place purchase orders far in advance, partly due to the cyclical nature of the semiconductor industry. As a result, we do not typically operate with any significant backlog. The lack of a significant backlog makes it difficult for us to forecast our revenues in future periods. Moreover, since our expense levels are based in part on our expectations of future revenues, we may be unable to adjust costs in a timely manner to compensate for revenue shortfalls. We expect that, in the future, our revenues in any quarter will continue to be substantially dependent upon purchase orders received in that quarter and in the immediately preceding quarter. We cannot assure you that any of our customers will continue to place orders with us in the future at the same levels as in prior periods. If orders received from our customers differ adversely from the number of wafers forecasted to be ordered, our operating results, financial condition and ability to maintain our operations may be adversely affected.

We may manufacture wafers based on forecasted demand, rather than actual orders from customers. If our forecasted demand exceeds actual demand, we may have obsolete inventory, which could have a negative impact on our results of operations.

We target manufacturing wafers in an amount matching each customer's specific purchase order. On occasion, we may produce wafers in excess of a customer's orders based on forecasted customer demand, because we may forecast future excess demand or because of future capacity constraints. If we manufacture more wafers than are actually ordered by customers, we may be left with excess inventory that may ultimately become obsolete and must be scrapped or sold at a significant discount. Significant amounts of obsolete inventory could have a negative impact on our results of operations.

Our business may be adversely affected if we are unable to operate our facilities at utilization rates that are high enough to reach revenue levels that would cover our fixed costs, reduce our losses and allow us to be profitable.

As is common in our industry, a large portion of our total costs is comprised of fixed costs, associated mainly with our manufacturing facilities, while our variable costs are relatively small. Therefore, during periods when our facilities manufacture at high utilization rates, we are able to cover our costs. However, at times when the utilization rate is low, the reduced revenues may not cover all of the costs since a large portion of them are fixed costs and remain constant, irrespective of the fact that fewer wafers were manufactured. In addition, depreciation costs in our industry are high, which may result in losses under GAAP. If customer demand for our products is not sufficient, we may not be able to operate our facilities consistently at high utilization rates, which may not enable us to fully cover all of our costs, debt and others liabilities and/or achieve and maintain operating profits or net profits.

Our sales cycles are typically long, and orders received may not meet our expectations, which may adversely affect our operating results.

Our sales cycles, which we measure from first contact with a customer to first shipment of a product ordered by the customer, vary substantially and may last as long as two years or more, particularly for new technologies. In addition, even after we make initial shipments of prototype products, it may take several more months to reach full production of the product. As a result of these long sales cycles, we may be required to invest substantial time and incur significant expenses in advance of the receipt of any product order and related revenue. If orders ultimately received are significantly lower than our expectations, we will have excess capacity that we may not be able to fill within a short period of time, resulting in lower utilization of our facilities. We may have to reduce prices in order to try to sell more wafers in order to utilize the excess capacity which may adversely affect our operating results, financial condition and ability to maintain our operations. In addition to the revenue loss, we may be unable to adjust our costs in a timely manner to align with the lower revenue, since a large portion of our cost is fixed costs which remain

constant irrespective of the number of wafers actually manufactured, as common in our industry, thereby potentially harming our financial results.

The cyclical nature of the semiconductor industry and any resulting periodic overcapacity may lead to erosion of sale prices, may make our business and operating results particularly vulnerable to economic downturns, and may reduce our revenues, earnings and margins.

The semiconductor industry has historically been highly cyclical and subject to significant and often rapid increases and decreases in product demand. Traditionally, companies in the semiconductor industry have expanded aggressively during periods of decreased demand in order to have the capacity needed to meet expected demand in future upturns. If actual demand does not increase or declines, or if companies in the industry expand too aggressively, the industry may experience a period in which industry-wide capacity exceeds demand. This could result in overcapacity and excess inventories, potentially leading to rapid erosion of average sales prices. The prices that we can charge our customers for our services are significantly related to the overall worldwide supply of integrated circuits and semiconductor products. The overall supply of semiconductor products is based in part on the capacity of other companies, which is outside of our control. In periods of overcapacity, despite the fact that we utilize niche technologies and manufacture specialty products, we may have to lower the prices we charge our customers for our services which may reduce our margins and weaken our financial condition and results of operations. We cannot give assurance that an increase in the demand for foundry services in the future will not lead to under-capacity, which could result in the loss of customers and materially adversely affect our revenues, earnings and margins. Analysts believe that such patterns may repeat in the future. The overcapacity, under-utilization and downward price pressure characteristic of a downturn in the semiconductor market and/or in the global economy, as experienced several times in the past, may negatively impact consumer and customer demand for the Company's products, the end products of the Company's customers and the financial markets, which may adversely affect our business, our ability to raise funds, restructure and/or re-finance our debt and service our other liabilities.

If Tower fails to comply with the terms of an agreement under which Tower provided a turn-key solution for the upgrade of a fabrication facility in Asia, Tower's financial results may be affected.

In 2009, Tower entered into a definitive agreement with an Asian entity for the provision by Tower on a turn-key basis of various services and equipment required for the capacity ramp-up and upgrade of the entity's currently installed and commissioned eight inch refurbished wafer fabrication facility. Under said agreement, Tower provides technical consultation, know-how, training and turn-key manufacturing solutions, including arranging for the required manufacturing and the transfer of certain equipment required for the fab ramp-up and upgrade. The total turnkey project consideration was approximately \$130 million and was fully received as of December 31, 2014. Upon completion of the project, the warranty period began for the support services. If we fail to meet our remaining obligations under this agreement for the warranty period, we may face claims for liability or indemnification which may impact our financial results.

If we do not maintain and develop our technology processes and services, we may lose customers and may be unable to attract new ones.

The semiconductor market is characterized by rapid change, including the following:

- rapid technological developments;

- evolving industry standards;
- changes in customer and product end user requirements;
- frequent new product introductions and enhancements; and
- short product life cycles with declining prices as products mature.

Our ability to maintain our current customer base and attract new customers is dependent in part on our ability to continuously develop and introduce to production advanced specialized manufacturing process technologies and purchase the appropriate equipment. If we are unable to successfully develop and introduce these processes to production in a timely manner or at all, or if we are unable to purchase the appropriate equipment required for such processes, we may be unable to maintain our current customer base and may be unable to attract new customers.

The semiconductor foundry business is highly competitive; our competitors may have competitive advantages over us and our results of operations may be adversely affected if we do not successfully compete in the industry.

The semiconductor foundry industry is highly competitive. We compete with more than ten independent dedicated foundries, the majority of which are located in Asia-Pacific, including foundries based in Taiwan, China, Korea and Malaysia, and with over 20 integrated semiconductor and end-product manufacturers that allocate a portion of their manufacturing capacity to foundry operations. The foundries with which we compete benefit from their close geographic proximity to companies involved in the design, manufacture and sale of semiconductor products.

As our competitors continue to expand their manufacturing capacity, there could be an increase in specialty semiconductor capacity. As specialty capacity increases, there may be more competition and pricing pressure on our services, which may result in underutilization of our capacity, decrease of our profit margins, reduced earnings or increased losses.

In addition, some semiconductor companies have advanced their CMOS designs to smaller geometries than 45 nanometer. These smaller geometries may provide customers with performance and integration features that may be comparable to, or exceed, features offered by our specialty process technologies. The smaller geometries may also be more cost-effective at higher production volumes for certain applications, such as when a large amount of digital content is required in a mixed-signal semiconductor and less analog content is then required. Our specialty processes will therefore compete with these more advanced CMOS processes and some of our potential and existing customers could elect to design these advanced CMOS processes into their next generation products. We are not currently capable, and do not currently plan to become capable, of providing CMOS processes at these smaller geometries. If our potential or existing customers choose to design their products using these advanced CMOS processes, our business may be negatively impacted.

In addition, many of our competitors may have one or more of the following competitive advantages over us:

- greater manufacturing capacity;
- more advanced technological capabilities;

- a more diverse and established customer base;
- greater financial, marketing, distribution and other resources;
- a better cost structure; and/or
- better operational performance in cycle time and yields.

If we do not compete successfully, our business and results of operations may be adversely affected.

If we experience difficulty in achieving acceptable device yields, product performance and delivery times as a result of manufacturing problems, our business may be seriously harmed.

The process technology for the manufacture of semiconductor wafers is highly complex, requires advanced and costly equipment and is constantly being modified in an effort to improve device yields, product performance and delivery times. Microscopic impurities such as dust and other contaminants, difficulties in the production process, defects in the key materials and tools used to manufacture wafers and other factors can cause wafers to be rejected or individual semiconductors on specific wafers to be non-functional. We may experience difficulty achieving acceptable device yields, product performance and product delivery times in the future as a result of manufacturing problems. Although we continuously enhance our manufacturing capabilities and efficiency, from time to time we have experienced production difficulties that have caused delivery delays and quality control problems, as is common in the semiconductor industry. In the past, we have encountered the following problems:

- difficulties in upgrading or expanding existing facilities;
- unexpected breakdowns in our manufacturing equipment and/or related facility systems;
- unexpected events, such as an electricity outage or misprocess, affecting the manufacturing process;
- difficulties in changing or upgrading our process technologies;
- raw material shortages or impurities;
- delays in delivery or shortages of spare parts; and
- difficulties in maintenance and upgrade of our equipment.

Should these problems repeat, we may suffer delays in delivery, loss of reputation, business and revenues and adverse impact on our operating results, financial condition and our ability to maintain our operations.

If we are unable to purchase equipment and raw materials, we may not be able to manufacture our products in a timely fashion, which may result in a loss of existing and potential new customers.

To increase the production capability and maintain the quality of production in our facilities, we must procure additional equipment. In periods of high market demand, the lead times from order to delivery of manufacturing equipment could be as long as 12 to 18 months. We also procure used equipment which can take longer to qualify into the manufacturing process, hence we may not be able to manufacture our products in a timely manner. In addition, our manufacturing processes use many raw materials, including silicon wafers, chemicals, gases and various metals, and require large amounts of fresh water and electricity. Manufacturing equipment and raw materials generally are

available from several suppliers. In several instances, however, we purchase equipment and raw materials from a single source. Shortages in supplies of manufacturing equipment and raw materials could occur due to an interruption of supply or increased industry demand. Any such shortages could result in production delays that may result in a loss of existing and potential new customers which may have a material adverse effect on our business and financial condition.

Our exposure to currency exchange and interest rate fluctuations may increase our cost of operations.

Of our revenues for the year ended December 31, 2014, approximately 40% was in Japanese Yen (JPY) and most of our remaining revenues were in U.S. dollars (USD). Of our revenues for the year ended December 31, 2013, approximately 27% was in Japanese Yen (JPY) and the rest of our revenues were in U.S. dollars (USD). Our financing and investing activities and our expenses and costs are denominated mainly in USD, with a smaller portion in New Israeli Shekels (NIS) (mainly payroll and utilities costs for the Israeli site) and JPY (solely in the TPSCo entity). Therefore, we are exposed to the risk of currency exchange rate fluctuations to this extent.

The dollar amount of our operations, which is denominated in NIS, is influenced by the timing of any change in the rate of inflation in Israel and the extent to which such change is not offset by the change in valuation of the NIS in relation to the US dollar. The dollar amount of our operations, which is denominated in JPY, is influenced by the timing of any change in the USD to JPY exchange rate. Such dollar amount of operations will increase if the US dollar devalues against the NIS or the JPY. Outstanding principal and interest on some of Tower's debentures is linked to the Israeli consumer price index (CPI) and therefore, Tower's US dollar costs will increase if inflation in Israel exceeds the devaluation of the NIS against the US dollar.

The US dollar amounts of revenues and costs of our operations in Japan are influenced by the changes in valuation of the Japanese Yen (JPY) in relation to the US dollar, however, on a net basis, currency exchange rate fluctuations had essentially no impact on our consolidated statements of operations and financial results, since such fluctuations were naturally hedged by the revenue denominated in JPY against the costs denominated in JPY. With regards to the balance sheet, since our assets and liabilities in TPSCo are linked to the JPY, increases in the USD to JPY exchange rate cause a decrease in our net assets amount in TPSCo. Tower, Jazz and TPSCo's borrowings under their respective credit facilities provide for interest based on a floating LIBOR rate or TIBOR rate, thereby exposing us to interest rate fluctuations. Furthermore, if any of the respective banks incurs increased costs in financing the applicable credit facility due to changes in law or the unavailability of foreign currency, such bank may exercise its right to increase the interest rate on the credit facility or require us to bear such increased cost as provided for in the respective credit facility agreement.

Tower regularly engages in various hedging strategies to reduce its exposure to some, but not all, of these risks and intends to continue to do so in the future. However, despite any such hedging activity, Tower is likely to remain exposed to interest rate and exchange rate fluctuations and inflation, which may increase the cost of its operating and financing activities.

We depend on intellectual property rights of third parties and failure to maintain or acquire licenses could harm our business.

We depend on third party intellectual property in order for us to provide certain foundry services and design support to our customers. If problems or delays arise with respect to the timely development, quality and provision of such intellectual property to us, the design and production of our customers' products could be delayed, resulting in underutilization of our capacity. If any of our intellectual property vendors goes out of business, liquidates, merges with, or is acquired by, another company that discontinues the vendor's previous line of business, or if we fail to maintain or acquire licenses to such intellectual property for any other reason, our business may be adversely affected. In addition, license fees and royalties payable under these agreements may impact our margins and operating results.

Failure to comply with the intellectual property rights of third parties or to defend our intellectual property rights could harm our business.

Our ability to compete successfully depends in part on our ability to operate without infringing on the proprietary rights of others and defending our intellectual property rights. Because of the complexity of the technologies used and the multitude of patents, copyrights and other overlapping intellectual property rights, it is often difficult for semiconductor companies to determine infringement. Therefore, the semiconductor industry is characterized by frequent litigation regarding patent, trade secret and other intellectual property rights. We have been subject to intellectual property claims from time to time, some of which have been resolved through license agreements, the terms of which have not had a material effect on our business.

From time to time, we are a party to litigation matters incidental to the conduct of our business. Because of the nature of the industry, we may be a party to infringement claims in the future. In the event any third party were to assert infringement claims against us or our customers, we may have to consider alternatives including, but not limited to:

- negotiating cross-license agreements;
- acquiring licenses to the allegedly infringed patents, which may not be available on commercially reasonable terms, if at all;
- discontinuing use of certain process technologies, architectures, or designs, which could cause us to stop manufacturing certain integrated circuits if we are unable to design around the allegedly infringed patents;
- litigating the matter in court and paying substantial monetary damages in the event we lose; or
- developing non-infringing technologies, which may not be feasible.

Any one or several of these alternatives could place substantial financial and other burdens on us and hinder our business. Litigation, which could result in substantial costs to us and diversion of our resources, may be necessary to enforce our patents or other intellectual property rights or to defend us or our customers against claimed infringement of the rights of others. If we fail to obtain certain licenses or if we will be involved in litigation relating to alleged patent infringement or other intellectual property matters, it may prevent us from manufacturing particular products or using particular technologies, which may reduce our opportunities to generate revenues.

As of December 31, 2014, we held 205 patents in force. We intend to continue to file patent applications when appropriate. The process of applying for patents to obtain patent protection may take a long time and be expensive. We cannot assure you that patents will be issued from pending or future applications or that, if patents are issued, they will not be challenged, invalidated or circumvented or that the rights granted under the patents will provide us with meaningful protection or any commercial advantage. In addition, we cannot assure you that other countries in which we market our services and products will respect our intellectual property rights to the same extent as the United States. Effective intellectual property enforcement may be unavailable or limited in some countries. We cannot assure you that we will, at all times, enforce our patents or other intellectual property rights and it may be difficult for us to protect our intellectual property from misuse or infringement by other companies in certain countries. Further, we cannot assure you that courts will uphold our intellectual property rights or enforce the contractual arrangements that we have entered into to protect our proprietary technology, which may reduce our opportunities to generate revenues. Our inability to enforce our intellectual property rights in some countries may harm our business and results of operations.





We could be seriously harmed by failure to comply with environmental regulations.

Our business is subject to a variety of laws and governmental regulations in Israel, the U.S. and Japan relating to the use, discharge and disposal of toxic or otherwise hazardous materials used in Tower's production processes in Israel, in Jazz's production processes in California and in TPSCo's facilities in Japan. If we fail to use, discharge or dispose of hazardous materials appropriately, or if applicable environmental laws or regulations change in the future, we may be subject to substantial liability or may be required to suspend or significantly modify our manufacturing operations. In addition, there may be risk of environmental liability if the activities in relation to Fab 4's cessation of operations and the sale and removal of its assets is not done in compliance with applicable environmental regulations.

We are subject to risk of loss due to fire because the materials we use in our manufacturing processes are highly flammable.

We use highly flammable materials such as silane and hydrogen in our manufacturing processes and are therefore subject to risk of loss arising from fire. The risk of fire associated with these materials cannot be completely eliminated. Although we maintain insurance policies to reduce potential losses that may be caused by fire, including business interruption insurance, our insurance coverage may not be sufficient to cover all of our potential losses due to a fire. If any of our fabs were to be damaged or cease operations as a result of a fire, and if our insurance proves to be inadequate, it may reduce our manufacturing capacity and revenues. In addition, a power outage, even of very limited duration, caused by a fire may result in a loss of wafers in production, deterioration in our fab yield and substantial downtime to reset equipment before resuming production.

Possible product returns could harm our business.

Products manufactured by us may be returned within specified periods if they are defective or otherwise fail to meet customers' prior agreed upon specifications. Although product returns have historically been less than 1% of revenues, future product returns, if any, significantly exceeding our established provisions, may have an adverse effect on our business and financial condition.

We are subject to risks related to our international operations.

We have generated substantial revenue from customers located in Asia-Pacific. Because of our international operations, we are vulnerable to the following risks:

- JPY and NIS fluctuations against the USD, see above "Our exposure to currency exchange and interest rate fluctuations may increase our cost of operations".
- the burden and cost of compliance with foreign government regulation, as well as compliance with a variety of foreign laws;
- general geopolitical risks, such as political and economic instability, international terrorism, potential hostilities and changes in diplomatic and trade relationships;

- natural disasters affecting the countries in which we conduct our business;
- imposition of regulatory requirements, tariffs, import and export restrictions and other trade barriers and restrictions, including the timing and availability of export licenses and permits;
- adverse foreign and international tax rules and regulations, such as withholding taxes deducted from amounts due to us may not be refunded to us by the tax authorities since we are not entitled to foreign tax credit in Israel;
  - weak protection of our intellectual property rights;
  - delays in product shipments due to local customs restrictions;
  - laws and business practices favoring local companies;
  - difficulties in collecting accounts receivable; and
- difficulties and costs of staffing and managing foreign operations.

In addition, Israel, the United States, Japan and other foreign countries may implement quotas, duties, taxes or other charges or restrictions upon the importation or exportation of our products, leading to a reduction in sales and profitability in that country. The geographical distance between Israel, the United States, Japan and the rest of Asia and Europe also creates a number of logistical and communication challenges. We cannot assure you that we will be able to sufficiently mitigate the risks related to our international operations.

Our business could suffer if we are unable to retain and recruit qualified personnel.

We depend on the continued services of our senior executive officers, senior managers and skilled technical and other personnel. Our business could suffer if we lose the services of some of these personnel due to resignation, medical absence, illness or other reasons, and cannot find and integrate adequate replacement personnel into our senior management, business or operations in a timely manner. In particular with respect to our acquired TPSCo fabs, there is no assurance that the employees will successfully integrate and adjust to the new business and working requirements, which are relevant to an independent manufacturing company, including transfer and ramp up of new technologies, engagement with new customers, compliance with TPSCo's manufacturing and service commitments to a diversified customer base, compliance with reporting requirements to government offices and banks and compliance with the requirements of the Sarbanes-Oxley Act of 2002. We seek to recruit highly qualified personnel and there is intense competition for the services of these personnel in the semiconductor industry. Competition for personnel may increase significantly in the future as new fabless semiconductor companies as well as new semiconductor manufacturing facilities are established. Our ability to retain existing personnel and attract new personnel is in part dependent on the compensation packages we offer. As demand for qualified personnel increases, we may be forced to increase the compensation levels and to adjust the cash, equity and other components of compensation we offer our personnel.

Our business forecasts are premised on the increasing use of outsourced foundry services by both fabless semiconductor companies and integrated device manufacturers. Our business may not be successful if this trend does not continue to develop in the manner we expect.

We operate as an independent semiconductor foundry focused primarily on specialty process technologies. Our business model assumes that demand for these processes within the semiconductor industry will grow and follow the

broader trend towards outsourcing foundry operations. If the broader trend to outsourced foundry services does not prove applicable to the specialty process technologies that we are focused on, our business, results of operations and cash flow may be harmed.

If we are unable to collaborate successfully with electronic design automation vendors and third-party design service companies to meet our customers' design needs, our business may be harmed.

We have established relationships with electronic design automation vendors and third-party design service companies. We work together with these vendors to develop complete design kits that our customers can use to meet their design needs using our process technologies. Our ability to meet our customers' design needs successfully, including their schedule and budget requirements, depends on the availability and quality of the relevant services, tools and intellectual property provided by electronic design automation vendors and design service providers. Difficulties or delays in these areas may adversely affect our ability to meet our customers' needs, and thereby harm our business.

Failure to comply with existing or future governmental regulations could reduce our sales or increase our manufacturing costs.

The semiconductors we produce and the export of technologies used in our manufacturing processes may be subject to U.S., Israeli and/or Japanese export control and other regulations established by other countries. Failure to comply with existing or evolving U.S., Israeli, Japanese or other applicable governmental regulation or to obtain timely domestic or foreign regulatory approvals or certificates could materially harm our business by reducing our sales, requiring extensive modifications to processes that we use in our product manufacturing, or requiring extensive modifications to our customers' products. We may not export products using or incorporating controlled technology without obtaining an export license. These restrictions may make foreign competitors facing less stringent controls on their processes and their customers' products more competitive in the global market. The relevant government may not approve any pending or future export license requests. In addition, the list of products and countries for which export approval is required, and the regulatory policies with respect thereto, could be modified from time to time.

If the integrated circuits we manufacture are integrated into defective products, we may be subject to product liability or other claims which could damage our reputation and harm our business.

Our customers integrate our custom integrated circuits into their products which they then sell to end users. If these products are defective or malfunction, we may be subject to product liability claims, as well as possible recalls, safety alerts or advisory notices relating to the product. We cannot assure you that our insurance policies will be adequate to satisfy claims that may be made against us. Also, we may be unable to obtain insurance in the future at satisfactory rates, with adequate coverage, or at all. Product liability claims or product recalls in the future, regardless of their ultimate outcome, may have a material adverse effect on our business, reputation, financial condition and our ability to attract and retain customers.

A significant portion of Fab 3's and TPSCO's workforce is unionized, and its operations may be adversely affected by work stoppages, strikes or other collective actions which may disrupt its production and adversely affect the yield of its fab.

A significant portion of Fab 3's employees at the Newport Beach, California fab are represented by a union and covered by a collective bargaining agreement that is scheduled to expire in May 2015 and is currently being negotiated for renewal. Similarly, a significant portion of TPSCO's employees at its fabs in Japan are represented by a union and covered by a collective bargaining agreement. We cannot predict the effect that continued union representation or future organizational activities will have on these fabs' business. Specifically under TPSCO's collective bargaining agreement, the union and the company are required to first negotiate any points of dispute before taking any action such as work stoppages, strikes or other collective actions. We cannot assure you that Fab 3's and TPSCO's fabs will not experience a material work stoppage, strike or other collective action in the future, which may disrupt their production and adversely affect our customer relations and operational results.



Our production yields and business could be significantly harmed by natural disasters, particularly earthquakes.

Fab 1 and Fab 2 are located in an area near the Syrian-African rift valley, which is known to have seismic activity. Fab 3 is located in southern California, a region known for seismic activity. TPSCo fabs are located in Japan, which is generally susceptible to seismic activity. Due to the complex and delicate nature of our manufacturing processes, our facilities are particularly sensitive to the effects of vibrations associated with even minor earthquakes. Our business operations depend on our ability to maintain and protect our facilities, computer systems and personnel. We cannot be certain that precautions that any of our fabs have taken to seismically upgrade the fabs will be adequate to protect our facilities in the event of an earthquake. Earthquakes may lead to fire in the fabs or other material damage, and any resulting damage could seriously disrupt production and result in reduced revenues. Although we maintain insurance policies to reduce potential losses that may be caused by earthquakes and other natural disasters, including business interruption insurance, our insurance coverage may not be sufficient to cover all of our potential losses. If any of our fabs were to be damaged or cease operations as a result thereof, and if our insurance proves to be inadequate, it may reduce our manufacturing capacity and revenues and may expose us to liability for third party claims. A power outage, even of very limited duration, caused by an earthquake or other natural disaster may result in a loss of wafers in production, deterioration in our fab yield and substantial downtime to reset equipment before resuming production, and any such losses or damages incurred by us may have a material adverse effect on our business.

Climate change may negatively affect our business.

There is increasing concern that climate change is occurring and may have dramatic effects on human activity if no aggressive remediation steps are taken. Public expectations with respect to reductions in greenhouse gas emissions may result in increased energy, transportation and raw material costs.

Scientific examination of, political attention to, and rules and regulations on, issues surrounding the existence and extent of climate change may result in increased production costs due to increase in the prices of energy and introduction of energy or carbon tax. A variety of regulatory developments have been introduced that focus on restricting or managing emissions of carbon dioxide, methane and other greenhouse gases. Enterprises may need to purchase new equipment at higher costs or raw materials with lower carbon footprints. These developments and further legislation that is likely to be enacted may adversely affect our operations. Changes in environmental regulations, such as those on the use of per fluorinated compounds, may increase our production costs, which may adversely affect our results of operation and financial condition.

In addition, more frequent droughts and floods, extreme weather conditions and rising sea levels may occur due to climate change. For example, transportation suspension caused by extreme weather conditions, including snow storms, may harm the distribution of our products. We cannot predict the economic impact, if any, of disasters resulting from climate change.

Compliance with the US Conflict Minerals Law may affect our ability or the ability of our suppliers to purchase raw materials at an effective cost.

Many industries rely on materials which are subject to regulation concerning certain minerals sourced from the Democratic Republic of Congo ("DRC") or adjoining countries, which include Sudan, Uganda, Rwanda, Burundi, United Republic of Tanzania, Zambia, Angola, Congo, and Central African Republic. These minerals are commonly referred to as conflict minerals. Conflict minerals which may be used in our industry or by our suppliers include Columbite-tantalite (derivative of tantalum [Ta]), Cassiterite (derivative of tin [Sn]), gold [Au], Wolframite (derivative of tungsten [W]), and Cobalt [Co]. We comply with the annual disclosure and reporting requirements adopted by the SEC with respect to use of conflict minerals mined from the DRC and adjoining countries. There are costs associated with complying with these disclosure requirements, including for diligence to determine the sources of conflict minerals used in our products and other potential changes to products, processes or sources of supply as a consequence of such verification activities. Although we expect that we and our vendors will be able to comply with said requirements, there can be no guarantee that we will be able to gather all the information required from our vendors. In addition, there is increasing public sentiment that companies should avoid using conflict minerals from the DRC and adjoining countries. Although we believe our suppliers do not rely on such conflict minerals, there can be no guarantee that we will continue to be able to obtain adequate supplies of materials needed for our production from supply chains outside the DRC and adjoining countries. A failure to obtain necessary information or to maintain adequate supplies of materials from supply chains outside the DRC and adjoining countries may delay our production, increasing the risk of losing customers and business.

Risks relating to construction activities adjacent to Fab 3 and its fabrication facility lease.

Jazz leases its fabrication facilities and headquarters under lease contracts that Jazz can extend until 2027, through the exercise of options at Jazz's sole discretion to extend the lease periods from 2017 to 2022 and from 2022 to 2027. A few years ago, the landlord began a construction project adjacent to the fabrication facility. Although Jazz does not anticipate an adverse impact to its operations, it is possible that construction activities adjacent to Jazz's fabrication facility could result in temporary reductions or interruptions in the supply of utilities to the property and that a portion or all of the fabrication facility may need to be idled temporarily during development. If construction activities limit or interrupt the supply of water, gas or electricity to Fab 3 or cause significant vibrations or other disruptions, it could limit or delay Fab 3's production, which could adversely affect our business and operating results. In addition, an unplanned power outage caused by construction activities, even of very limited duration, could result in a loss of wafers in production, deterioration in Fab 3's yield on schedule delivery and substantial downtime to reset equipment before resuming production, which may cause customers' dissatisfaction and cause customers to contemplate transferring their product order to other fabs, which would adversely affect our revenue and financial results. In addition, the recent lease amendment set forth certain obligations of Jazz and the landlord, including certain noise abatement actions at the fabrication facility.

#### Risks Related to Our Securities

Tower's outstanding debentures are subordinated to Tower's indebtedness to its banks and obligations to secured creditors and Jazz's notes are subordinated to Jazz's secured indebtedness to its bank.

Tower's outstanding debentures (Series D and F totaling \$47 million as of March 31, 2015) are subordinated to (i) approximately \$99 million in the aggregate payable to the banks as of March 31, 2015 under Tower's facility agreement; and (ii) any obligations to the Investment Center of the Israeli Ministry of Economy under the Investment Center's "Approved Enterprise" program in relation to Fab 2. Tower has not guaranteed any of TPSCo or Jazz's debt, including Jazz's debt under its bank loan and Jazz's debt to its note holders. Jazz's notes (totaling \$58 million as of March 31, 2015) are subordinated to approximately \$19 million outstanding as of March 31, 2015 under Jazz's bank



credit line of up to \$70 million.

Fluctuations in the market price of our traded securities, including our share and debenture price, may significantly affect our reported GAAP non-cash financing expenses and our ability to issue new securities.

The stock market and the Israeli convertible debentures' and straight bonds' markets, in general, have experienced volatility that often has been unrelated to the operating performance of the related companies. The share price for many companies in the semiconductor industry has experienced wide fluctuations, which has often been unrelated to the operating performance of such companies. These broad market and industry fluctuations may adversely affect the market price of Tower's equity and debt securities, regardless of Tower's actual operating performance.

In addition, it is possible that Tower's operating results may be below the expectations of public market analysts and investors, which may adversely affect the price of Tower's securities.

Fluctuations in price of Tower's equity and debt securities may impact our financial results as such factors serve as inputs in our fair value measurement of financial instruments which are presented at fair value under prevailing accounting standards.

The recent increase in our share market price and the extensive Series F conversion to shares had an effect on the financial instruments' accounting treatment under US GAAP on non-cash other financing expenses, net to be included in our statement of operations in 2015, primarily the impact of amortization, accretion and acceleration thereof, which can increase our non-cash other financing expenses, net in 2015 by up to approximately \$80 million and reduce net profits (while reducing such expenses and improving profitability in the future periods thereafter). However, this will improve shareholders' equity and reduce liabilities, all in accordance with US GAAP (ASC 470 formerly EITF 98-5 and EITF 27-00), and such accelerated accretion and amortization of the Beneficial Conversion Feature created in 2012.

In addition, fluctuation in the market price of our securities may cause a significant fluctuation in our reported GAAP non-cash financing expenses, which may harm our ability to accurately forecast our reported GAAP non-cash financing expenses, our reported net profit or loss and our reported earnings or losses per share, and may cause our gross and operating profits to result in a net loss, increase our net loss or reduce our net profits. This non-cash appreciation in our obligations and financing expenses will either eventually be reversed or be converted into shareholders' equity, or a combination thereof.

Such adverse fluctuations in the market price of our equity and debt securities may also negatively impact our ability to issue new securities to finance our growth plans, obligations and liabilities.

Market sales of Tower's shares or conversion or exercise of a material portion of securities into shares or issuance of new ordinary shares, or even the perception that such may occur, may depress the market price of Tower's shares, impair our ability to raise future capital through the financial markets and limit our ability to fund our growth plans, our debt and other liabilities, which may have adverse effects on our business and financial position.

Market sales of Tower's shares, or a conversion or exercise of a material portion of our convertible securities (including notes, warrants and options), or issuance of new ordinary shares, or sales of Tower's shares by its major shareholders on or off-market, or even the perception that such sales, conversions, exercises or issuances may occur, could depress the market price of Tower's ordinary shares, may impair our ability to raise capital through the sale of Tower's securities, may limit our ability to fund our growth plans, to service our debt and other liabilities and may require Tower to request certain consents or waivers in order to avoid a possible event of default which may result from the sales of Tower's shares by our major shareholder (see Item 5B - Liquidity and Capital Resources), which may have an adverse effect on our business and financial position.

Any inability to comply with Section 404 of the Sarbanes-Oxley Act of 2002 regarding internal control attestation or any SEC filing requirement may adversely affect our financial position.

We are subject to the reporting and filing requirements of the United States Securities and Exchange Commission ("SEC"). The SEC, as directed by Section 404(a) of the United States Sarbanes-Oxley Act of 2002, adopted rules requiring public companies to include a management report assessing the company's effectiveness of internal control over financial reporting and an attestation thereof by its auditors in its annual report. Our management and/or our auditors may conclude that our internal controls over financial reporting are not effective. Such a conclusion could result in a loss of investor confidence in the reliability of our financial statements, which could negatively impact the market price of our shares and our ability to access the capital markets. In addition, we are required to file reports and other information with the SEC under the Securities Exchange Act of 1934 and the regulations thereunder applicable to foreign private issuers the company, see also item 10-Additional Information -- Documents on Display. Failure by us to file reports and other information with the SEC under the Securities Exchange Act of 1934 and the regulations thereunder may result in a deficiency and may negatively impact the market price of our shares and our ability to access the capital markets, thereby adversely affecting our financial position.

#### Risks Related to Our Operations in Israel

Instability in Israel may harm our business.

Fab 1 and Fab 2 manufacturing facilities, Tower's design center and certain of Tower's corporate and sales offices are located in Israel. Accordingly, political, economic and military conditions in Israel may directly affect our business.

Since the establishment of the State of Israel in 1948, Israel has been and is subject to armed conflict with neighboring states and terrorist activity, with varying levels of severity. Parties with whom we do business have sometimes declined to travel to Israel during periods of heightened unrest or tension, forcing us to make alternative arrangements where necessary. In addition, the political and security situation in Israel may result in parties with whom we have agreements claiming that they are not obligated to perform their commitments under those agreements pursuant to force majeure provisions. We can give no assurance that security and political conditions will not adversely impact our business in the future. Any hostilities involving Israel or the interruption or curtailment of trade between Israel and its present trading partners could adversely affect our operations and make it more difficult for us to do business and raise capital. Furthermore, we could experience serious disruption to our manufacturing in Israel if acts associated with said conflict result in any serious damage to said manufacturing facilities. In addition, our business interruption insurance may not adequately compensate us for losses that may be incurred, and any losses or damages incurred by us may have a material adverse effect on our business.



In the event of severe unrest or other conflict, Israeli personnel could be required to serve in the military for extended periods of time. In response to increases in terrorist activity, there have been periods of significant call-ups of Israeli military reservists, and it is possible that there will be additional call-ups in the future. Many male Israeli citizens, including most of Tower's male employees under the age of 40, are subject to compulsory military reserve service and may be called to active duty under emergency circumstances. Our operations in Israel could be disrupted by the absence, for a significant period of time, of one or more of our key employees or a significant number of our other employees due to military service. Such disruption may harm our operations.

If the exemption allowing us to operate our Israeli manufacturing facilities seven days a week is not renewed, our business will be adversely affected.

We operate our Israeli manufacturing facilities seven days a week pursuant to an exemption from the law that requires businesses in Israel to be closed from sundown on Friday through sundown on Saturday. This exemption expires by its terms on December 31, 2016. If the exemption is not renewed in the future and we are forced to close either or both of the Israeli facilities for this period each week, our financial results and business will be harmed.

It may be difficult to enforce a US judgment against us, our officers, directors and advisors or to assert US securities law claims in Israel.

Tower is incorporated in Israel. Most of Tower's executive officers and directors and our Israeli accountants and attorneys are nonresidents of the United States, and a majority of Tower's assets (excluding its U.S. subsidiaries and their assets) and the assets of these persons are located outside the United States. Therefore, it may be difficult to enforce a judgment obtained in the United States, against Tower or any of these persons, in US or Israeli courts based on the civil liability provisions of the U.S. federal securities laws, except to the extent that such judgment could be enforced in the U.S. against Tower's U.S. subsidiaries. Additionally, it may be difficult to enforce civil liabilities under U.S. federal securities laws claimed in original actions instituted in Israel.

Provisions of Israeli law may delay, prevent or otherwise impede a merger with, or an acquisition of, our company, which could prevent a change of control, even when the terms of such a transaction are favorable to us and our shareholders.

Israeli corporate law regulates mergers, requires tender offers for acquisitions of shares above specified thresholds, requires special approvals for transactions involving directors, officers or significant shareholders and regulates other matters that may be relevant to such types of transactions. For example, a merger may not be consummated unless at least 50 days have passed from the date on which a merger proposal is filed by each merging company with the Israel Registrar of Companies and at least 30 days have passed from the date on which the shareholders of both merging companies have approved the merger. In addition, a majority of each class of securities of the target company must approve a merger. Moreover, a tender offer for all of a company's issued and outstanding shares can only be completed if the acquirer receives positive responses from the holders of at least 95% of the issued share capital. Completion of the tender offer also requires approval of a majority of the offerees that do not have a personal interest in the tender offer, unless, following consummation of the tender offer, the acquirer would hold at least 98% of Tower's outstanding shares. Furthermore, the shareholders, including those who indicated their acceptance of the tender offer, may, at any time within six months following the completion of the tender offer, claim that the consideration for the acquisition of the shares does not reflect their fair market value, and petition an Israeli court to alter the consideration for the acquisition accordingly, unless the acquirer stipulated in its tender offer that a shareholder that accepts the offer may not seek such appraisal rights, and the acquirer or the company published all required information with respect to the tender offer prior to the tender offer's response date. Furthermore, Israeli tax considerations may make potential transactions unappealing to Tower or to its shareholders whose country of residence does not have a tax treaty with Israel exempting such shareholders from Israeli tax. These and other similar provisions could delay, prevent or

impede a merger with or an acquisition of our company, even if such a merger or acquisition would be beneficial to Tower or its shareholders.

The rights and responsibilities of Tower's shareholders will be governed by Israeli law which differs in some material respects from the rights and responsibilities of shareholders of U.S. companies.

The rights and responsibilities of the holders of Tower's ordinary shares are governed by its articles of association and by Israeli law. These rights and responsibilities differ in some material respects from the rights and responsibilities of shareholders in typical U.S.-registered corporations. In particular, a shareholder of an Israeli company has certain duties to act in good faith and fairness towards the company and other shareholders, and to refrain from abusing its power in the company. There is limited case law available to assist Tower shareholders in understanding the nature of this duty or the implications of these provisions. These provisions may be interpreted to impose additional obligations and liabilities on holders of Tower's ordinary shares that are not typically imposed on shareholders of U.S. corporations.

ITEM 4.

INFORMATION ON THE COMPANY

A.

HISTORY AND DEVELOPMENT OF THE COMPANY

We are a pure-play independent specialty foundry dedicated to the manufacture of semiconductors. Typically, pure-play foundries do not offer products of their own, but focus on producing integrated circuits, or ICs, based on the design specifications of their customers. We manufacture semiconductors for our customers primarily based on third party designs. We currently offer the process manufacture geometries of 0.35, 0.50, 0.55, 0.60, 0.80-micron and above on 150-mm wafers and 0.35, 0.18, 0.16, 0.13 and 0.11-micron on 200-mm wafers and 65 nanometer and 45 nanometer on 300-mm wafers. We also provide design support and complementary technical services. ICs manufactured by us are incorporated into a wide range of products in diverse markets, including consumer electronics, personal computers, communications, automotive, industrial and medical device products.

We are focused on establishing leading market share in high-growth specialized markets by providing our customers with high-value wafer foundry services. Our historical focus has been standard digital complementary metal oxide semiconductor ("CMOS") process technology, which is the most widely used method of producing ICs. We are currently focused on the emerging opportunities in specialized technologies including CMOS image sensors, mixed-signal, radio frequency CMOS (RFCMOS), bipolar CMOS (BiCMOS), and silicon-germanium BiCMOS (SiGe BiCMOS or SiGe), high voltage CMOS, radio frequency identification (RFID) technologies and power management. To better serve our customers, we have developed and are continuously expanding our technology offerings in these fields. Through our experience and expertise gained over more than twenty years of operation, we differentiate ourselves by creating a high level of value for our clients through innovative technological processes, design and engineering support, competitive manufacturing indices, and dedicated customer service.

Tower was founded in 1993, with the acquisition of National Semiconductor's 150-mm wafer fabrication facility located in Migdal Haemek, Israel, and commenced operations as an independent foundry. Since then, we have significantly upgraded our Fab 1 facility, equipment, capacity and technological capabilities with process geometries ranging from 1.0-micron to 0.35-micron and enhanced our process technologies to include CMOS image sensors, embedded flash, advanced analog, RF (radio frequency) and mixed-signal technologies.

In 2003, we commenced production in Fab 2, a wafer fabrication facility we established in Migdal Haemek, Israel. Fab 2 supports geometries ranging from 0.35 to 0.13-micron, using advanced CMOS technology, including CMOS image sensors, embedded flash, advanced analog, RF (radio frequency), power platforms and mixed-signal technologies.

In September 2008, we merged with Jazz Technologies, Inc ("Jazz"). Jazz focuses on specialty process technologies for the manufacture of analog and mixed-signal semiconductor devices, and supports geometries ranging from 0.50 to 0.13-micron. Jazz's specialty process technologies include advanced analog, radio frequency, high voltage, bipolar and silicon germanium bipolar complementary metal oxide ("SiGe") semiconductor processes. ICs manufactured by Jazz are incorporated into a wide range of products, including cellular phones, wireless local area networking devices, digital TVs, set-top boxes, gaming devices, switches, routers and broadband modems. Jazz operates one semiconductor fabrication facility in Newport Beach, California ("Fab 3").

In June 2011, we acquired a fabrication facility in Nishiwaki City, Hyogo, Japan ("Fab 4") from Micron. The assets and related business that we acquired from Micron were held and conducted through a wholly owned Japanese subsidiary, TowerJazz Japan Ltd. ("TJP"). Fab 4 supported geometries ranging from 0.13 to 0.095-micron to manufacture DRAM as well as CMOS and CMOS image sensor products. In 2014, the operations of Fab 4 ceased in the course of restructuring our activities and business in Japan.

In March 2014, we acquired from Panasonic 51% of a newly established company, TowerJazz Panasonic Semiconductor Co., Ltd., ("TPSCo"), that manufactures products for Panasonic and potentially other third parties, using Panasonic's three semiconductor manufacturing facilities located in Hokuriku Japan (Uozu E, Tonami CD and Arai E). Pursuant to the transaction, Panasonic transferred its semiconductor wafer manufacturing process and capacity tools (8 inch and 12 inch) at said three fabs to TPSCo, and entered into a five-year manufacturing agreement for the manufacture of products for Panasonic by TPSCo.

Our executive offices and Israeli manufacturing facilities are located in the Ramat Gavriel Industrial Park, Shaul Amor Street, Post Office Box 619, Migdal Haemek, 23105 Israel, and our telephone number is 972-4-650-6611. Our agent for service of process in the United States is Tower Semiconductor USA, Inc. located at 2570 North First Street, Suite 480 San Jose, CA 95131.

For more information about us, go to [www.towerjazz.com](http://www.towerjazz.com). Information on our web site is not incorporated by reference in this annual report.

## B.

## BUSINESS OVERVIEW

### INDUSTRY OVERVIEW

#### PROLIFERATION OF ANALOG AND MIXED-SIGNAL SEMICONDUCTORS AND THE GROWING NEED FOR SPECIALTY PROCESS TECHNOLOGIES

Semiconductor devices are responsible for the rapid growth of the electronics industry over the past fifty years. They are critical components in a variety of applications, from computers, consumer electronics and communications, to industrial, military, medical and automotive applications. Rapid changes in the semiconductor industry frequently make recently introduced devices and applications obsolete within a very short period of time. With the increase in their performance and decrease in their size and cost, the use of semiconductors and the number of their applications have increased significantly.





Historically, the semiconductor industry was composed primarily of companies that designed and manufactured ICs in their own fabrication facilities. These companies, such as Intel and IBM, are known as integrated device manufacturers, or IDMs. In the mid-1980s, fabless IC companies, which focused on IC design and used external manufacturing capacity, began to emerge. Fabless companies initially outsourced production to IDMs, which filled this need through their excess capacity. As the semiconductor industry continued to grow, increasing competition forced fabless companies and IDMs to seek reliable and dedicated sources of IC manufacturing services. Use of external manufacturing capacity allowed IDMs to reduce their investment in their existing and next-generation manufacturing facilities and process technologies. This need for external manufacturing capacity led to the development of independent companies, known as foundries, which focus primarily on providing IC manufacturing services to semiconductor suppliers. Foundry services are used by nearly all major semiconductor companies in the world, including IDMs, as part of a dual-source, risk-diversification and cost effectiveness strategy.

Semiconductor suppliers face increasing demands for new products that provide higher performance, greater functionality and smaller form factors at lower prices - all features that require increasingly complex ICs. The industry has experienced a dramatic increase in the number of applications that incorporate semiconductors. Further, in order to compete successfully, semiconductor suppliers must minimize the time it takes to bring a product to market. As a result, fabless companies and IDMs have focused more on their core competencies, design and intellectual property, and tend to outsource manufacturing to foundries.

The two basic functional technologies for semiconductor products are digital and analog. Digital semiconductors provide critical processing power and have helped enable many of the computing and communication advances of recent years. Analog semiconductors monitor and manipulate real world signals such as sound, light, pressure, motion, temperature, electrical current and radio waves, for use in a wide variety of electronic products such as digital still cameras, x-ray medical applications, flat panel displays, personal computers, cellular handsets, telecommunications equipment, consumer electronics, automotive electronics and industrial electronics. Analog-digital, or mixed-signal, semiconductors combine analog and digital devices on a single chip which can process both analog and digital signals.

Integrating analog and digital components on a single, mixed-signal semiconductor enables the development of smaller, more highly integrated, power-efficient, feature-rich and cost-effective semiconductor devices but presents significant design and manufacturing challenges. For example, combining high-speed digital circuits with sensitive analog circuits on a single, mixed-signal semiconductor can increase electromagnetic interference and power consumption, both of which cause a higher amount of heat to be dissipated and decrease the overall performance of the semiconductor. Challenges associated with the design and manufacture of mixed-signal semiconductors increase as the industry moves toward more advanced process geometries. As a result, analog and mixed-signal semiconductors can be complex to manufacture and typically require sophisticated design expertise and strong application specific experience and intellectual property. In addition, today's analog market is driven strongly by growing sensitivity to environmental requirements such as the conservation of energy, and human well being. This is seen in applications designed for diagnostics, medical devices, entertainment, infotainment and safety, all developed using analog technology.

Mixed-signal ICs are an essential part of any front-end electronic system. Our advanced analog CMOS process technologies have more features than standard analog CMOS process technologies and are well suited for higher performance or more highly integrated analog and mixed-signal semiconductors, such as high-speed analog-to-digital or digital-to-analog converters and mixed-signal semiconductors with integrated data converters. These process technologies generally incorporate higher density passive components, such as capacitors and resistors, as well as improved active components, such as native or low voltage devices, and improved isolation techniques, into standard analog CMOS process technologies.



The enormous costs associated with modern fabs, combined with the increasing demand for complex ICs, has created an expanding market for outsourced foundry manufacturing. Foundries can cost-effectively supply advanced ICs to even the smallest fabless companies by creating economies of scale through pooling the demand of numerous customers. In addition, customers whose IC designs require process technologies other than standard digital CMOS have created a market for independent foundries that focus on providing specialized process technologies. Specialty process technologies enable greater analog content and can reduce the die size of an analog or mixed-signal semiconductor, thereby increasing the number of dies that can be manufactured on a wafer and reducing final die cost. In addition, specialty process technologies can enable increased performance, superior noise reduction and improved power efficiency of analog and mixed-signal semiconductors compared to traditional standard CMOS processes. These specialty process technologies include advanced analog CMOS, radio frequency CMOS (RF CMOS), CMOS image sensors (CIS), high voltage CMOS, bipolar CMOS (BiCMOS), silicon germanium BiCMOS (SiGe BiCMOS), and bipolar CMOS double-diffused metal oxide semiconductor (BCD). We have mastered the skills required to work in this technology intensive environment which is rapidly changing. We work closely with our customers to provide them with unique and specialized solutions needed for their business success.

Foundries also offer competitive customer service through design, testing, and other technical services.

#### MANUFACTURING PROCESSES AND SPECIALIZED TECHNOLOGIES

We manufacture ICs on silicon wafers, generally using the customer's proprietary circuit designs. In some cases, we use third-party or our own proprietary design elements. The end product of our manufacturing process is a silicon wafer containing multiple identical ICs. In most cases, our customer assumes responsibility for dicing, assembly, packaging and testing.

We provide wafer fabrication services to fabless IC companies and IDMs, as sole source or second source, and enable smooth integration of the semiconductor design and manufacturing processes. By doing so, we enable our customers to bring high-performance, highly integrated ICs to market rapidly and cost effectively. We believe that our technological strengths and emphasis on customer service have allowed us to develop a unique position in large, high-growth specialized markets for CMOS image sensors, RF, power management and high performance mixed signal ICs.

We manufacture using specialty process technologies, mostly based on CMOS process platforms with added features to enable special and unique functionality, improved size, performance and cost characteristics for analog and mixed-signal semiconductors. Products made with our specialty process technologies are typically more complex to manufacture than products made using standard process technologies employing similar line widths. Generally, customers that use our specialty process technologies cannot easily transfer designs to another foundry because the analog characteristics of the design are dependent upon the specific process technology used for manufacturing. The specialty process design infrastructure is complex and includes design kits and device models that are specific to the foundry in which the process is implemented and to the process technology itself. In addition, the relatively small engineering community with specialty process expertise and the significant investment required for development or transfer and maintenance of specialty process technologies has limited the number of foundries capable of offering specialty process technologies. We believe that our specialized process technologies combined with design enablement capabilities distinguish our IC manufacturing services and attract industry-leading customers.

We also offer process transfer services to integrated device manufacturers (IDMs) who wish to manufacture products using their own process and do not have sufficient capacity in their own fabs. Existing or new fabs may engage us for such services in order to expand their technology offerings. Our process transfer services are also used by fabless companies that have proprietary process flows that they wish to manufacture at additional manufacturing sites for purposes of geographic diversity or require a new technology node which is very costly to build independent of other business commitments. Our process services include development, transfer, and extensive optimization as defined by customer needs.

With our world-class engineering team, well established transfer methodologies, and vast manufacturing experience, we offer state of the art production lines for core CMOS and specialized technologies such as back-end-of-line (BEOL) magnetoresistive random access memory (MRAM) and MEMS, among others. With a combination of well known intellectual property protection and capacity flexibility commitment, we ensure customer confidence and satisfaction for low-risk services and fast time-to-market.

We are a trusted, customer-oriented service provider that has built a solid reputation in the foundry industry over the last twenty years. We have built strong relationships with customers, who continue to use our services, even as their demands evolve to smaller form factors and new applications. Our consistent focus on providing high-quality, value added services, including engineering and design support, has allowed us to attract customers that seek to work with a proven provider of foundry solutions. Our emphasis on working closely with customers and accelerating the time-to-market of our customers' next-generation products has enabled us to maintain a high customer retention rate and increase the number of new customers and new products for production.

We derived a very significant amount of our revenues for the year ended December 31, 2014 from our target specialized markets: CMOS image sensors, wireless communication, RF, high performance analog and power ICs. We are highly experienced in these markets, having been an early entrant and having developed unique proprietary technologies, including through licensing and joint development efforts with our customers and other technology companies.

The specific process technologies that we currently focus on include: CMOS image sensors (CIS), advanced analog CMOS, radio frequency CMOS (RF CMOS), radio frequency identification (RFID), bipolar CMOS (BiCMOS), silicon germanium (SiGe BiCMOS), high voltage CMOS, silicon-on-insulator (SOI) and power LDMOS.

#### CMOS Image Sensors

CMOS image sensors are ICs used to capture an image in a wide variety of consumer, communications, medical, automotive and industrial market applications, including camera-equipped cell phones, digital still and video cameras, security and surveillance cameras and video game consoles. Our dedicated manufacturing and testing processes assure consistently high electro-optical performance of the integrated sensor through wafer-level characterization. Our CMOS image sensor processes have demonstrated superior optical characteristics, excellent spectral response and high resolution and sensitivity. The ultra-low dark current, high efficiency and accurate spectral response of our photodiode enable faithful color reproduction and acute detail definition.

We are currently actively involved in the high-end sensor and applications specific markets, which include applications such as high end video, industrial machine vision, dental x-ray, medical x-ray automotive sensors and three dimensional sensors for entertainment and industrial applications.

We recognized the market potential of using CMOS process technology for a digital camera-on-a-chip, which would integrate a CMOS image sensor, filters and digital circuitry. Upon entering the CMOS image sensor foundry business, we utilized research and development work that had been ongoing since 1993. Our services include a broad range of turnkey solutions and services, including silicon proven pixels services, optical characterization of a CMOS process, innovative patented stitching manufacturing technique and optical testing and packaging. The CMOS image sensors that we manufacture deliver outstanding image quality for a broad spectrum of digital imaging applications. Following the acquisition of TPSCo we are now offering even more advanced CMOS Image Sensor technology with technologies of 110nm on 200mm wafers and 65nm on 300mm wafers with pixel sizes down to 1.12 micron utilizing dual light pipe technology.

Having this new technology, we are now offering our customers state of the art pixels for a variety of new markets such as the high end smart phone camera or the rapidly growing security camera markets.

Specifically, our CIS portfolio includes pixels ranging from 1.12 micron up to 150 micron, all developed by us. We provide both rolling shutter and global shutter pixels. The latter are used mainly in the industrial sensor and in the three dimensional sensors markets. Our advanced photo diode (APD) technology used in CMOS image sensors enables improved optical and electrical performance such as low dark current, low noise, high well capacity, high quantum efficiency and high uniformity of pixels utilizing deep sub-micron process technologies, thus enabling the manufacturing of very sophisticated and high performance camera module solutions.

For the X-ray market, we offer our innovative patented “stitching” technology on 0.18-micron process and a variety of 15 to 150-micron pixels that are optimized for X-ray applications. In addition, we offer this technology in TPSCo’s 300mm 65nm fab to create 1 die per wafer products. These pixels are used by our customers in dental and other medical X-ray products. Our stitching technology enables semiconductor exposure tools to manufacture single ultra high-resolution CMOS image sensors containing millions of pixels at sizes far larger than their existing field. This technology is also used by us in the manufacturing of large sensors (up to one die per wafer) on 8” and 12” wafers and high end large format sensors with special pixels that we have developed specifically for this market.

## RF CMOS

In recent years, more and more designers opt to develop high frequency products based on RF CMOS technologies. The superior cost structure of CMOS technologies enables high volume, low cost production of high frequency products. We used our mixed signal expertise to leverage and develop processes and provide services for customers that utilize CMOS technologies and require high frequency performance.

Our RF CMOS process technologies have more features than advanced analog CMOS process technologies and are well suited for wireless semiconductors, such as highly integrated wireless transceivers, power amplifiers, and television tuners. These process technologies generally incorporate integrated inductors, high performance variable capacitors, or varactors, and RF laterally diffused metal oxide semiconductors into an advanced analog CMOS process technology. In addition to the process features, our RF offering includes design kits with RF models, device simulation and physical layouts tailored specifically for RF performance. We currently have RF CMOS process technologies in 0.25 micron, 0.18 micron and 0.13 micron.



Further, we have versions of our RF CMOS process built on silicon-on-insulator (SOI) substrates (RF SOI). These RF SOI process technologies include devices optimized to deliver higher performance and improved isolation relative to devices in our RF CMOS process. We currently have RF SOI process technologies in 0.18 micron and 0.13 micron lithography nodes.

#### BiCMOS for RF and High Performance Analog

Our BiCMOS process technologies have more features than RF CMOS process technologies and are well suited for RF semiconductors, such as wireless transceivers and television tuners. These process technologies generally incorporate high-speed bipolar transistors into an RF CMOS process. The equipment requirements for BiCMOS manufacturing are specialized, and require enhanced tool capabilities to achieve high yield manufacturing. We currently have 0.35 micron BiCMOS process technology.

Our SiGe BiCMOS process technologies have more features than BiCMOS processes and are well suited for more advanced RF and high performance analog semiconductors such as high-speed, low noise, highly integrated multi-band wireless transceivers, optical networking components, television tuners and power amplifiers. These integrated circuits generally incorporate a silicon germanium bipolar transistor, which is formed by the deposition of a thin layer of silicon germanium within a bipolar transistor, to achieve higher speed, lower noise, and more efficient power performance than a BiCMOS process technology. It is also possible to achieve higher speed using SiGe BiCMOS process technologies equivalent to those demonstrated in standard CMOS processes that are two process generations smaller in line-width. For example, a 0.18 micron SiGe BiCMOS process is able to achieve speeds comparable to a 90 nanometer RF CMOS process. As a result, SiGe BiCMOS makes it possible to create analog products using a larger geometry process technology at a lower cost while achieving similar or superior performance to that achieved using a smaller geometry standard CMOS process technology. The equipment requirements for SiGe BiCMOS manufacturing are similar to the specialized equipment requirements for BiCMOS. We developed enhanced tool capabilities in conjunction with large semiconductor tool suppliers to achieve high yield SiGe manufacturing. We believe this equipment and related process expertise makes us one of the few integrated circuit manufacturers with demonstrated ability to deliver SiGe BiCMOS products. We currently have 0.35 micron, 0.18 micron and 0.13 SiGe BiCMOS micron technologies available.

#### Power and Power Management ICs

Our power technologies are generally divided into a low-voltage BCD offering and a 700V ultra-high voltage offering. Our low-voltage BCD process technologies have more features than advanced analog CMOS processes and are well suited for power and driver semiconductors, such as voltage regulators, battery chargers, power management products and audio amplifiers. These process technologies generally incorporate higher voltage CMOS devices such as 5V, 8V, 12V, 40V and 60V LDMOS devices, and, in the case of BCD, bipolar devices, into an advanced analog CMOS process. We currently have high voltage and low Rdson BCD offerings in 0.5 micron, 0.35 micron, 0.25 micron and 0.18 micron. We offer a cost effective and digital intensive power management platform, based on our 0.18um technology node with advanced isolation options that allow our customers to design high performance products as well as products with high levels of integration.

Our 700V ultra-high voltage platform supports the fast growing LED lighting market as well as serving the more established AC adaptor and motor driver markets.



In addition, we have developed a unique, zero mask adder NVM solution (Y-Flash) specifically for power and power management devices on our 0.18 micron platform. We have released several Y-flash based modules to our customers which have been integrated into their products.

We continue to invest in technology that improves performance and integration level and reduces the cost of analog and mixed-signal products. This includes improving the density of passive elements such as capacitors and inductors, improving the analog performance and voltage handling capability of active devices, and integrating additional advanced features in our specialty CMOS processes. Examples of such features currently under development include technologies aimed at integrating micro-electro-mechanical-system (MEMS) devices with CMOS and scaling the features we offer today to the 0.13 micron process technology, including the integration of advanced SiGe transistors with 0.13 micron CMOS and copper metallization.

#### CUSTOMERS, MARKETING AND SALES

Our marketing and sales strategy seeks to aggressively expand our global customer base. We have marketing and sales support personnel in the United States, Korea, Taiwan, Japan, China and Israel. We appointed country managers in Korea and China. Our marketing and sales staff is supported by independent sales representatives, located in Europe, United States and Japan, who have been selected based on their experience in and understanding of the semiconductor marketplace.

Our sales cycle is generally 8 to 26 months or longer for new customers and can be as short as 8 to 12 months for existing customers. The typical stages in the sales cycle process from initial contact until production are:

- technical evaluation;
- product design to our specifications, including integration of third party intellectual property;
  - photomask - design and third party photomask manufacturing;
  - silicon prototyping;
  - assembly and test;
  - validation and qualification; and
  - production.

The primary customers of our foundry services are fabless semiconductor companies and independent device manufacturers (IDMs). A portion of our product sales are made pursuant to long-term contracts with our customers, under which we have agreed to reserve manufacturing capacity at our production facilities for such customers. Our customers include many industry leaders. During the year ended December 31, 2014, we had four significant customers that each contributed between 7% to 38% of our revenues. During the year ended December 31, 2013, we had three significant customers that each contributed between 7% to 27% of our revenues. In 2012, we had two significant customers that contributed 6% and 43% of our revenues.

The percentage of our revenues from customers located outside the United States was 55%, 23% and 19% in the years ended December 31, 2014, 2013 and 2012, respectively. The following table sets forth the geographical distribution, by percentage, of our net revenues for the periods indicated:

|                           | Year ended December 31, |   |      |   |      |   |
|---------------------------|-------------------------|---|------|---|------|---|
|                           | 2014                    |   | 2013 |   | 2012 |   |
| United States             | 45                      | % | 77   | % | 81   | % |
| Japan                     | 40                      | % | 2    | % | 1    | % |
| Asia, excluding Japan (*) | 11                      | % | 14   | % | 13   | % |
| Europe                    | 4                       | % | 7    | % | 5    | % |
| Total                     | 100                     | % | 100  | % | 100  | % |

\* Represents revenues from individual countries of less than 10% each.

We price our products on a per wafer basis, taking into account the complexity of the technology, the prevailing market conditions, volume forecasts, the strength and history of our relationships with the customer and our current capacity utilization. Most of our customers usually place their purchase orders only two to four months before shipment; however a few of our major customers are obligated to provide us with longer forecasts of their wafer needs.

We publish press releases, articles, technology journals, white papers, perform presentations, participate in panel sessions at industry conferences, hold a variety of regional and international technology seminars, and attend and exhibit at various industry trade shows to promote our products, technology offering and services. We discuss advances in our process technology portfolio and progress on specific relevant programs with our prospective and major customers as well as industry analysts and research analysts on a regular basis and publicly release any such information that we deem material or important to disclose and as required by law.

Our customers use our processes to design and market a broad range of analog and mixed-signal semiconductors for diverse end markets, including wire and wireless high-speed communications, consumer electronics, automotive and industrial. We manufacture products for a wide range of electronic products, including but not limited to, high-performance applications, such as transceivers and power management for cellular phones; transceivers and power amplifiers for wireless local area networking products; power management, audio amplifiers and driver integrated circuits for consumer electronics; tuners for digital televisions and set-top boxes; modem chipsets for broadband access devices and gaming devices; serializer/deserializers, or SerDes, for fiber optic transceivers; high end video cameras, dental and medical x-ray vision, industrial cameras, focal plan arrays for imaging applications; controllers for power amplifier and switching chips in cellular phones and wireline interfaces for switches and routers.

#### Competition

The global semiconductor foundry industry is highly competitive. We broadly compete with the pure-play advanced technology node-driven foundry service providers such as Taiwan Semiconductor Manufacturing Corporation (“TSMC”), United Microelectronics Corporation (“UMC”), Global Foundries Inc. and Semiconductor Manufacturing International Corp. (“SMIC”). These four foundries primarily compete against one another and focus on 12 inch deep-submicron CMOS processing. They each also have some capacity for specialty process technologies. The rest of the foundry industry generally targets either industry standard 8 inch CMOS processing or specialty process technologies. It includes existing Chinese, Korean and Malaysian foundries. We compete most directly in the specialty segment with foundries such as Vanguard Semiconductor, DongBu, X-Fab, and HH Semi. We also compete with integrated device manufacturers that have internal semiconductor manufacturing capacity or foundry operations, such as IBM, ST and Samsung, that produce ICs for their own use and may allocate a portion of their manufacturing capacity to external customers. Most of the foundries with which we compete are located in Asia-Pacific and benefit from their close proximity to companies involved in the design of ICs and to the Asian customer base. The principal elements of competition in the wafer foundry market are:

- technical competency;

- production speed and cycle time;
- time-to-market
- research and development capabilities;
- technology offering, available geometries and wafer size;
- available capacity;
- quality of manufacturing process and products manufactured;
- access to intellectual property ;
- manufacturing yields;
- design and customer support services;
- price;
- management expertise;
- strategic relationships; and
- stability and reliability of supply in order to be a dependable supplier.

Many of our competitors have greater manufacturing capacity, geographically diverse manufacturing facilities, longer or more established relationships with their customers, a more diverse customer base, superior research and development capability, better cost structure and greater financial, marketing and other resources. As a result, these companies may be able to compete more aggressively over a longer period of time than us.

We seek to compete primarily on the basis of advanced specialty technology, R&D, breadth of process offering, production quality, technical support and our design, engineering and manufacturing services. We have a differentiated service offering and proven track record in specialized markets, which enables us to effectively compete with larger foundry service providers.

Some semiconductor companies have advanced their CMOS designs to 90 and 35 nanometer or smaller geometries. These smaller geometries may provide customers with performance and integration features that may be comparable to, or exceed, features offered by our specialty process technologies, and may be more cost-effective at higher production volumes for certain applications, such as when a large amount of digital content is required in a mixed-signal semiconductor and less analog content is required. Our specialty process technologies will therefore compete with these advanced CMOS processes for customers and some of our potential and existing customers could elect to design these advanced CMOS processes into their next generation products. We are not currently capable, and do not currently plan to become capable, of providing CMOS processes at these smaller geometries.

## WAFER FABRICATION SERVICES

Wafer fabrication is an intricate process that consists of constructing layers of conducting and insulating materials on raw wafers in intricate patterns that give the IC its function. IC manufacturing requires hundreds of interrelated steps

performed on different types of equipment, and each step must be completed with extreme accuracy for finished ICs to work properly. The process can be summarized as follows:

Circuit Design. IC production begins when a fabless IC company or IDM designs (or engages a third party or us) the layout of a device's components and designates the interconnections between each component. The result is a pattern of components and connections that defines the function of the IC. In highly complex circuits, there may be more than 43 layers of electronic patterns. After the IC design is complete, we provide these companies with IC manufacturing services.

**Mask Making.** The design for each layer of a semiconductor wafer is imprinted on a photographic negative, called a reticle or mask. The mask is the blueprint for each specific layer of the semiconductor wafer.

**IC Manufacturing.** Transistors and other circuit elements comprising an IC are formed by repeating a series of processes in which photosensitive material is deposited on the wafer and exposed to light through a mask. Advanced IC manufacturing processes consist of hundreds of steps, including photolithography, oxidation, etching and stripping of different layers and materials, ion implantation, deposition of thin film layers, chemical mechanical polishing and thermal processing. The final step in the IC manufacturing process is wafer probe, which involves electronically inspecting each individual IC in order to identify those that are operable for assembly.

**Assembly and Test.** After IC manufacture, the wafers are transferred to assembly and test facilities. In the assembly process, each wafer is cut into dies, or individual semiconductors, and tested. Defective dies are discarded, while good dies are packaged and assembled. Assembly protects the IC, facilitates its integration into electronic systems and enables the dissipation of heat or cold. Following assembly, the functionality, voltage, current and timing of each IC is tested. After testing, the completed IC is shipped to the customer.

## PROCUREMENT AND SOURCING

Our manufacturing processes use many materials, including silicon wafers, chemicals, gases, photomasks and various metals. These raw materials generally are available from several suppliers. In many instances, we purchase raw materials from a single source to obtain preferred pricing. In those cases, we generally also seek to identify, and in some cases qualify, alternative sources of supply.

In addition, we have agreements with several key material suppliers under which they hold certain levels of inventory for our use. We are not obliged under these agreements to purchase and pay for the raw material inventory that is held by our vendors at our sites until we actually use it, unless we hold the inventory beyond specified time limits.

## RESEARCH AND DEVELOPMENT

Our future success depends, to a large degree, on our ability to continue to successfully develop and introduce to production advanced process technologies that meet our customers' needs. Our process development strategy relies on CMOS process platforms that we license and transfer from third parties or develop ourselves.

From time to time, at a customer's request, we develop a specialty process module, which in accordance with the applicable agreement may be used for such customer on an exclusive basis or added to our process offering. Such developments are very common in all of our special process technologies noted above.

Our research and development activities have related primarily to our process, device and design development efforts in all specialty areas that were mentioned above, and have been sponsored and funded by us and in certain cases with some participation of the Israeli Office of the Chief Scientist ("OCS"). Accordingly, Tower is subject to restrictions set forth in Israeli law which limit the ability of a company to transfer technologies outside of Israel, if such technologies were developed with OCS funding. In addition, we may be required to obtain export licenses before exporting certain technology or products to any third party and may be required to comply with Israeli, U.S. and other foreign export regulations as may be applicable.

Our research and development activities seek to upgrade and improve our manufacturing technologies and processes. We maintain a central research and development team primarily responsible for developing cost-effective technologies that can serve the manufacturing needs of our customers. A substantial portion of our research and development activities are undertaken in cooperation with our customers and equipment vendors. Due to the rapid changes in technology that characterize the semiconductor industry, effective research and development is essential to our success. We plan to continue to invest significantly in research and development activities in order to develop advanced process technologies for new applications.

Research and development expenses for the years ended December 31, 2014, 2013 and 2012 were \$57.8 million, \$33.1 million and \$31.1 million, respectively, net of government participation of \$1.8 million, \$0.4 million and \$0.6 million, respectively. As of December 31, 2014, we employed 393 professionals in our research and development departments, 44 of whom have PhDs. In addition to our research and development departments located at our facilities in Migdal Haemek, Israel, in Newport Beach, California and in Hokuriku Japan, we maintain a design center in Netanya, Israel.

## PROPRIETARY RIGHTS

### Intellectual Property and Licensing Agreements

Our success depends in part on our ability to obtain patents, licenses and other intellectual property rights covering our production processes. To that end, we have obtained certain patents, acquired patent licenses and intend to continue to seek patents on our intellectual property.

As of December 31, 2014, we held 205 patents in force. We have entered into various patent and other technology license agreements with technology companies, including Synopsys, ARM, Cadence, and others, under which we have obtained rights to additional technologies and intellectual property.

We constantly seek to strengthen our technological expertise through relationships with technology companies. We seek to expand our core strengths in CMOS image sensors, embedded flash, power management, RF, SiGe, MEMS and mixed-signal technologies by continuous development in these areas. A main component of our process development strategy is to acquire licenses for standard CMOS technologies and cell libraries from leading providers, such as ARM and Kilopass, and further develop specialized processes through our internal design teams. The licensing of these technologies has significantly reduced our internal development costs.

In connection with the separation of Jazz Semiconductor's business from Conexant in 2002, Conexant contributed to Jazz Semiconductor a substantial portion of its intellectual property, including software licenses, patents and intellectual property rights in know-how related to its business. Jazz agreed to license intellectual property rights relating to the intellectual property contributed to Jazz by Conexant back to Conexant and its affiliates. Conexant may use this license to have Conexant products produced by third-party manufacturers and to sell such products, subject to obtaining Jazz's prior consent.

Panasonic granted a license to certain process technologies to TPSCo for the manufacture of products for Panasonic and third party foundry customers. TPSCo may, in certain circumstances, sub-license such technology to Tower or other third parties for payment of royalties. The term of the agreement is five years ending in March 2019 after which the parties will discuss extending or renewing the agreement.

Our ability to compete depends on our ability to operate without infringing upon the proprietary rights of others. The semiconductor industry is generally characterized by frequent litigation over patent and other intellectual property rights. As is the case with many companies in the semiconductor industry, we have from time to time received

communications from third parties asserting that their patents cover certain of our technologies or alleging infringement of intellectual property rights. We expect that we will receive similar communications in the future. Irrespective of the validity or the successful assertion of such claims, we could incur significant costs and devote significant management resources in defending these claims.



## DESIGN SERVICES

To better serve our customers' design needs using advanced CMOS and mixed-signal processes, we have entered into a series of agreements with leading providers of physical design libraries, mixed-signal and non volatile memory design components. These components are basic design building blocks, such as standard cells, interface input-output (I/O) cells, software compilers for the generation of on-chip embedded memories arrays, mixed-signal and non-volatile memory design blocks. To achieve optimal performance, all of these components must be customized to work with our manufacturing process. These components are used in most of our customers' chip designs.

We interact closely with customers throughout the design development and prototyping process to assist them in the development of high performance and low power consumption semiconductor designs and to lower their final die, or individual semiconductor, costs through die size reductions and integration. We provide engineering support and services as well as manufacturing support in an effort to accelerate our customers' design and qualification process so that our customers can achieve faster time to market. We have entered into alliances with Cadence Design Systems, Inc., Synopsys, Inc., Mentor Graphics Corp., and other suppliers of electronic design automation tools, and also licensed standard cells, I/O and memory technologies from ARM, Synopsys, Inc., and other leading providers of physical intellectual property components for the design and manufacture of ICs. Through these relationships, we provide our customers with the ability to simulate the behavior of their design in our processes using standard electronic design automation, or EDA tools.

The applications for which our specialty process technologies are targeted present challenges that require an in-depth set of simulation models. We provide these models as an integral part of our design support. At the initial design stage, our customers' internal design teams use the proprietary design kits that we have developed to design semiconductors that can be successfully and cost-effectively manufactured using our specialty process technologies. These design kits, which collectively comprise our design library and design platform, allow our customers to quickly simulate the performance of a semiconductor design with our processes, enabling them to refine their product design to ensure alignment to our manufacturing process before actually manufacturing the semiconductor. Our engineers, who have significant experience with analog and mixed-signal semiconductor design and production, work closely with our customers' design teams to provide design advice and help them optimize their designs for our processes and their performance requirements. After the initial design phase, we provide our customers with a multi-project wafer service to facilitate the early and rapid use of our specialty process technologies, which allows them to gain early access to actual samples of their designs. Under this multi-project wafer service, we schedule a bimonthly multi-project wafer run in which we manufacture several customers' designs in a single mask set, providing our customers with an opportunity to reduce the cost and time required to test their designs. Our design center helps customers accelerate the design-to-silicon process and enhances first-time silicon success by providing them with the required design resources and capabilities. Our design support can assist in all or part of the design flow. Our in-depth knowledge of the fab and processes provide a substantive advantage when implementing designs that reach the boundaries of technology. In addition, our IP and engineering services can assist and relieve some of our customers' issues, providing the specific skills and expertise critical for successful implementation of our customers' design on our manufacturing process.

We believe that our circuit design expertise and our ability to accelerate our customers' design cycle while reducing their design costs represent one of our competitive strengths.

## SPECIAL SECURITY AGREEMENT WITH DSS

In connection with Jazz's aerospace and defense business, its facility security clearance and trusted foundry status, Tower and Jazz have worked with the Defense Security Service of the United States Department of Defense ("DSS") to mitigate concern of foreign ownership, control or influence over the operations of Jazz specifically relating to protection of classified information and prevention of potential unauthorized access thereto by creating Jazz Semiconductor Trusted foundry ("JSTF") as a subsidiary of Jazz and limiting possession of all classified information solely to JSTF. Tower and Jazz have further agreed to operate JSTF under a special security agreement signed with DSS. JSTF has been certified by the Defense Microelectronics Activity ("DMEA") for participation in the Department of Defense's accredited supplier program and has obtained a facility security clearance from DSS and accreditation by DMEA as a Category 1A and 1B accredited supplier.

## C. ORGANIZATIONAL STRUCTURE

The legal name of our company is Tower Semiconductor Ltd. Tower was incorporated under the laws of the State of Israel in 1993. Tower directly operates our Fab 1 and Fab 2 facilities in Israel. Tower's wholly-owned subsidiary, Jazz Technologies, Inc. owns all of the shares of Jazz Semiconductor, Inc. (both of which are incorporated under the laws of the State of Delaware) which operates our Fab 3 facility. Tower's wholly-owned subsidiary, TowerJazz Japan, Ltd. (incorporated in Japan) operated our Fab 4 facility in Japan, which operation ceased in 2014 in the course of restructuring our activities and business in Japan. Tower holds a 51% equity stake in TPSCo (and PSCS holds the remaining equity of TPSCo). TPSCo is incorporated under the laws of Japan and operates three fabs Arai E, Uozo E and Tonami CD located in Japan.

## D. PROPERTY, PLANTS AND EQUIPMENT

### Manufacturing Facilities

During 2014, we operated seven manufacturing facilities—our Fab 1 and Fab 2 facilities in Israel, our Fab 3 Jazz facility in Newport Beach, California, our Fab 4 facility in Japan and TPSCo's three fabs Arai E, Uozo E and Tonami CD in Japan. The capacity in each of our facilities at any particular time is variable and depends on the combination of the processes being used and the product mix being manufactured. Hence, it may be significantly lower at certain times as a result of certain combinations that may require more processing steps than others. We have the ability to rapidly change the mix of production processes in use in order to respond to changing customer needs and maximize utilization of the fab. In general, our ability to increase our manufacturing capacity has been achieved through the addition of equipment, improvement in equipment utilization, the reconfiguration and expansion of the existing clean room area and the construction of an additional clean room area.

Capital expenditures in 2014 and 2013 were approximately \$50 million and \$77 million, respectively, net of proceeds from sale of equipment and fixed assets of approximately \$45 million and \$5 million, respectively.

### Fab 1

We acquired our Fab 1 facility from National Semiconductor in 1993, which had operated the facility since 1986. The facility is located in Migdal Haemek, Israel. We occupy the facility under a long-term lease from the Israel Lands Authority which expires in 2032.

Due to the sensitivity and complexity of the semiconductor manufacturing process, a semiconductor manufacturing facility requires a special "clean room" in which most of the manufacturing functions are performed. Our Fab 1 facility includes an approximately 51,900 square foot clean room.



Since we commenced manufacturing at Fab 1, we increased its manufacturing capacity and expanded the technologies qualified in the fab, including specialized processes. Fab 1 supports geometries ranging from 1.0 micron to 0.35-micron.

#### Fab 2

In 2003, we commenced production in our Fab 2, also located in Migdal Haemek, Israel. Fab 2 supports geometries ranging from 0.35 to 0.11-micron, using advanced CMOS technology, including CMOS image sensors, embedded flash, advanced analog, RF SOI, power platforms and mixed-signal technologies. Since 2000, we have invested significantly in the purchase of fixed assets, primarily in connection with the construction of Fab 2, technology advancement and capacity expansion.

The land on which Fab 2 is located is subject to a long-term lease from the Israel Lands Authority that expires in 2049. The overall clean room area in Fab 2 is approximately 100,000 square feet.

#### Fab 3

Jazz's manufacturing facilities and headquarters, which we refer to as Fab 3, are located in Newport Beach, California. Fab 3 supports geometries ranging from 0.80 to 0.13-micron. The manufacturing facility comprises 320,000 square feet, including 120,000 square feet of overall clean room area.

Jazz leases its fabrication facilities and headquarters under lease contracts that Jazz can extend until 2027, through the exercise of options at Jazz's sole discretion to extend the lease periods from 2017 to 2022 and from 2022 to 2027. In December 2010, Jazz's fabrication facilities, land and headquarters were sold. In connection with the sale, Jazz negotiated amendments to its operating leases that confirm Jazz's ability to remain in the fabrication facilities through 2027, including the Jazz's option to extend the lease terms at its sole discretion from 2017 to 2022 and from 2022 to 2027. Under Jazz amended leases with the new owner, the Jazz's rental payments consist of fixed base rent and fixed management fees and Jazz's pro rata share of certain expenses incurred by the landlord in the ownership of these buildings, including property taxes, building insurance and common area maintenance. Jazz's landlord exercised its right to terminate the previous office building lease, effective January 1, 2014. Jazz moved its offices to the fabrication building and to a nearby new leased office space. Jazz and the landlord signed an additional amendment to the amended lease to reflect termination of the office building lease and certain obligations of Jazz and the landlord, including certain noise abatement actions at the fabrication facility. This office building lease termination has no impact whatsoever on the Jazz's fabrication buildings, facilities and operations and Jazz's ability to remain in the fabrication facilities through 2027 (including by exercising its two consecutive five-year extension periods which it can exercise in its sole discretion).

#### Fab 4

In June 2011, we acquired a fabrication facility in Nishiwaki City, Hyogo, Japan from Micron, which we refer to as Fab 4. The assets and related business that we acquired from Micron are held and conducted through a wholly owned Japanese subsidiary, TowerJazz Japan Ltd. In 2014, the operations of Fab 4 ceased in the course of the restructuring of our activities and business in Japan.

#### Uozu E, Tonami CD and Arai E

In March 2014, we acquired a 51% equity stake in TPSCo, a company formed by Panasonic Corporation, to manufacture products for Panasonic and potentially other third parties, using Panasonic's three semiconductor manufacturing facilities located in Hokuriku, Japan. Pursuant to the transaction, Panasonic transferred its

semiconductor wafer manufacturing process and capacity tools (8 inch and 12 inch) at its three fabs located in Hokuriku (Uozu E, Tonami CD and Arai E) to TPSCo. The fabs support geometrics ranging down to 45 nanometer.

## ENVIRONMENTAL, SAFETY AND QUALITY MATTERS AND CERTIFICATIONS

We have placed significant emphasis on achieving and maintaining a high standard of manufacturing quality. All our facilities are ISO 9001 certified, an international quality standard that provides guidance to achieve an effective quality management system. In addition, all our facilities are TS16949 certified, a more stringent automotive quality standard.

For environmental, our operations are subject to a variety of laws and governmental regulations relating to the use, discharge and disposal of toxic or otherwise hazardous materials used in our production processes. Failure to comply with these laws and regulations could subject us to material costs and liabilities, including costs to clean up contamination caused by our operations. All of our facilities are ISO 14000 certified, an international standard that provides management guidance on how to achieve an effective environmental management system. Risks have been evaluated and mitigation plans are in place to prevent and control accidental spills and discharges. Procedures have also been established at all our locations to ensure all accidental spills and discharges are properly addressed. The environmental management system assists in evaluating compliance status with all applicable environmental laws and regulations as well as establishing loss prevention and control measures. In addition, our facilities are subject to strict regulations and periodic monitoring by government agencies. With these systems, we believe we are currently in compliance in all material respects with applicable environmental laws and regulations.

For safety, all of our facilities are OHSAS 18000 certified, an international occupational health and safety standard that provides guidance on how to achieve an effective health and safety management system. The health and safety standard management system assists in evaluating compliance status with all applicable health and safety laws and regulations as well as establishing preventative and control measures. We believe we are currently in compliance with all applicable health and safety laws and regulations.

Our goal in implementing OHSAS 18001, ISO 14001, ISO 9001 and TS16949 systems is to continually improve our environmental, health, safety and quality management systems.

ITEM 4A.

### UNRESOLVED STAFF COMMENTS

Not Applicable.

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 years ended December 31, 2013 and 2014 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 revenue are generated principally from sales of semiconductor wafers. We also derive revenue 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. Revenue 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 prior to formal customer acceptance.

Revenue 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. Our revenue recognition policy is significant because our revenue are a key component of our results of operations. We follow very specific and detailed guidelines in measuring revenue. An accrual for estimated sales returns and allowances relating to specific yield or quality commitments as a reduction of revenues at the time of shipment, which is computed primarily on the basis of historical experience and specific identification of events necessitating an allowance, 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 2014 amounted to \$243 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 – 4 to 19 years. The amounts attributed to intangible assets as part of the purchase price allocations for the acquisitions of Jazz and TPSCo 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. The goodwill impairment test is performed according to the following principles: an initial qualitative assessment of the likelihood of impairment may be performed. If this step does not result in a more likely than not indication of impairment, no further impairment testing is required. If it does result in a more likely than not indication of impairment, the impairment test is performed. 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. The Company uses the income approach methodology of valuation that includes discounted cash flows to determine the fair value of the unit. Significant management judgment is required in the forecasts of future operating results used for this methodology. 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.

ASC Topic 815 "Derivatives and Hedging" generally provides criteria that, if met, require companies to bifurcate conversion options from their host instruments and account for them as freestanding derivative financial instruments. These three criteria are: (i) the economic characteristics and risks of the embedded derivative instrument are not clearly and closely related to the economic characteristics and risks of the host contract, (ii) the hybrid instrument that embodies both the embedded derivative instrument and the host contract is not re-measured at fair value under otherwise applicable GAAP with changes in fair value reported in earnings, and (iii) a separate instrument with the same terms as the embedded derivative instrument would be considered a derivative instrument subject to the requirements of Topic 815. In determining whether the embedded derivative should be bifurcated, the Company considers all other scope exceptions provided by that topic. One scope exception particularly relevant to convertibles is whether the embedded conversion feature is both indexed to and classified in the Company's equity.

See Note 13C to our audited financial statements for the year ended December 31, 2014, for the determination of the Beneficial Conversion Feature in the Company's Series F debentures, as well as Note 13E for the measurement of the equity component in Jazz 2014 convertible notes, according to ASC 470-20.

### 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.

#### Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") amended the existing accounting standards for revenue recognition, ASU 2014-09, "Revenue from Contracts with Customers". The amendments are based on the principle that revenue should be recognized to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The Company is required to adopt the amendments in the first quarter of 2017. Early adoption is not permitted. The amendments may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of initial application. The Company is currently evaluating the impact of these amendments and the transition alternatives on its consolidated financial statements.

In August 2014, the FASB issued amended guidance related to disclosure of uncertainties about an entity's ability to continue as a going concern. The new guidance requires management to evaluate whether there is substantial doubt about the entity's ability to continue as a going concern and, as necessary, to provide related footnote disclosures. The guidance has an effective date of December 31, 2016. The Company believes that the adoption of this new standard will not have a material impact on its consolidated financial statements.

## 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, |   |       |    |       |    |
|--------------------------------------------------------------|-------------------------|---|-------|----|-------|----|
|                                                              | 2014                    |   | 2013  |    | 2012  |    |
| Statement of Operations Data:                                |                         |   |       |    |       |    |
| Revenues                                                     | 100                     | % | 100   | %  | 100   | %  |
| Cost of revenues                                             | 92.3                    |   | 94.4  |    | 87.7  |    |
| Gross profit                                                 | 7.7                     |   | 5.6   |    | 12.3  |    |
| Research and development expenses, net                       | 6.3                     |   | 6.5   |    | 4.9   |    |
| Marketing, general and administrative expenses               | 7.1                     |   | 8.5   |    | 7.0   |    |
| Nishiwaki Fab impairment                                     | 5.7                     |   | --    |    | --    |    |
| Nishiwaki Fab restructuring costs                            | 1.0                     |   | --    |    | --    |    |
| Merger related costs                                         | 0.1                     |   | --    |    | 0.9   |    |
| Amortization related to a lease agreement early termination  | --                      |   | 1.5   |    | --    |    |
| Operating loss                                               | (12.5                   | ) | (10.9 | )  | (0.4  | )  |
| Interest expenses, net                                       | (4.0                    | ) | (6.5  | )  | (5.0  | )  |
| Other non-cash financing expense, net                        | (6.7                    | ) | (5.5  | )  | (4.3  | )  |
| Gain from acquisition                                        | 20.1                    |   | --    |    | --    |    |
| Other expenses, net                                          | --                      |   | (0.2  | )  | (0.2  | )  |
| Income tax benefit (expense)                                 | 2.9                     |   | 1.9   |    | (1.1  | )  |
| Loss for the Period                                          | (0.2                    | ) | (21.2 | )  | (11.0 | )  |
| Net loss attributable to the non-controlling interest        | 0.7                     |   | --    |    | --    |    |
| Net profit (loss) for the period attributable to the company | 0.5                     | % | (21.2 | )% | (11.0 | )% |

Our consolidated financial statements include TPSCo results from April 1, 2014, as detailed in Note 3 to the consolidated financial statements for the year ended December 31, 2014.

## Year Ended December 31, 2014 compared to Year Ended December 31, 2013

Revenue. Revenue for the year ended December 31, 2014 amounted to 828.0\$ million compared to 505.0\$ million for the year ended December 31, 2013. The increase in revenue of 64% was mainly due to a higher amount of wafers shipped of 20% and 35% higher average selling price per wafer manufactured and shipped to our customers. This revenues increase is comprised of (i) an increase of 239\$ million in revenues deriving from our Japanese manufacturing sites (comprised of TPSCo fabs revenues in 2014 and TJP fab revenues in 2013 and (2014 and (ii) an

increase of 84\$ million in revenues in 2014 as compared with 2013 from all of our non-Japanese manufacturing sites.

**Cost of Revenues.** Cost of revenues for the year ended December 31, 2014 amounted to 764.2\$ million, as compared to \$476.9 million for the year ended December 31, 2013. This increase was mainly due to the inclusion of the cost of revenues of the newly acquired TPSCo, including all of its manufacturing related costs as well as its non-cash depreciation and amortization cost resulted from the fair value attributed to its fixed assets and other assets as of the acquisition date, in accordance with GAAP.

**Gross Profit.** Gross profit for the year ended December 31, 2014 amounted to 63.8\$ million, as compared to 28.1\$ million for the year ended December 31, 2013. This increase in gross profit resulted from the above described increase in revenues, partially offset by the above described increase in cost of revenues.

**Research and Development Expenses.** Research and development expenses for the year ended December 31, 2014 amounted to 51.8\$ million, as compared to 33.1\$ million for the year ended December 31, 2013. This increase was mainly attributed to the addition of TPSCo's research and development head count and the inclusion of their employment related expenses.

**Marketing, General and Administrative Expenses.** Marketing, general and administrative expenses for the year ended December 31, 2014 amounted to 58.8\$ million, as compared to 42.9\$ million for the year ended December 31, 2013. This increase was mainly attributed to the addition of TPSCo's marketing, general and administrative expenses.

**Nishiwaki Fab Restructuring Costs and Impairment.** Nishiwaki fab restructuring costs and impairment for the year ended December 31, 2014 reflected a one-time allowance of 55.5\$ million resulting from the cessation of the Nishiwaki fab operations in Japan as part of the re-organization of our Japanese business, mainly reflecting a non-cash fixed-assets impairment. See also Note 4 to our consolidated financial statements as of December 31, 2014.

**Amortization related to an Early Termination of a Lease Agreement.** Operating expenses for the year ended December 31, 2014 did not include the non-cash amortization expenses related to an early termination of an office building lease contract, which amounted to 7.5\$ million for the year ended December 31, 2013.

**Operating Loss.** Operating loss for the year ended December 31, 2014 was 103.6\$ million, as compared to 55.3\$ million for the year ended December 31, 2013. This increase in operating loss was mainly due to the Nishiwaki Fab restructuring costs and impairment of 55.5\$ million. Operating loss excluding the above described Nishiwaki Fab restructuring costs and non-cash impairment of 55.5\$ million, improved by 7.3\$ million from 2013 to 2014.

**Interest Expense, Net.** Interest expense, net for the year ended December 31, 2014 was \$33.4 million, similar to the interest expenses, net of \$33.0 million recorded in the year ended December 31, 2013.

**Other Financing Expense, Net.** Other non-cash \$476.and 3flyd of aprproximately LAST BOD MTG]NUE/COST]MMENTS!] CIOST ON JPY-- OS WE NEED TO RETURN THEM SOMETIME]HOLDERS WILLfinancing expense, net for the year ended December 31, 2014 amounted to \$55.4 million, as compared to \$27.8 million for the year ended December 31, 2013. This increase was mainly attributed to Series F debentures' non-cash accretion calculated in 2012 in accordance with GAAP and acceleration of such accretion, which resulted in \$39 million of such expenses in the year ended December 31, 2014, an increase of \$26 million as compared to the accretion expense in the year ended December 31, 2013, which resulted from accretion and amortization over the Beneficial Conversion Feature established in 2012. See also Note 13C to our consolidated financial statements as of December 31, 2014. These increased costs associated with said debentures (which are maturing in two equal installments in 2015 and 2016) included in 2014 non-cash accretion costs which would otherwise have been recorded in 2015 and 2016. Such accelerated non-cash costs have been recorded in 2014 in the amount of \$16 million as a result of early conversions of Series F debentures to ordinary shares,in the amount of \$34 million. In addition, said conversions increased shareholders' equity, reduced the Company's debt and improved future profitability due to the accelerated recognition of such accretion costs. Any partial or full conversion of Series F debentures into ordinary shares will further increase shareholders' equity, reduce debt liabilities and accelerate the recognition of such financing expenses, thereby creating higher accretion and amortization costs included in other financing expense in the period such conversion is recorded, which will be offset by lower financing expense in the periods thereafter; from January 1, 2015 to March 31, 2015, Series F debentures in the amount of approximately \$162 million were converted into ordinary shares, resulting in approximately \$70 million of added non-cash accelerated accretion and amortization costs and approximately \$5.8 million inherent benefit attributed to the reduced conversion ratio, which will be included in other non-cash financing expense for the first quarter of 2015, as well as reduced liabilities and increased shareholders' equity. This will further reduce our future financing expenses and improve our profitability in the following periods after the first quarter of 2015.

**Gain from Acquisition.** Gain from acquisition, for the year ended December 31, 2014, amounted to \$166.4 million, attributed to the acquisition of TPSCo. As the fair value of the net assets acquired exceeded their purchase price, we recognized a gain on the acquisition, which derived from the high value assigned to Tower's stake in TPSCo. See also Note 3 to our consolidated financial statements as of December 31, 2014.

**Income Tax Benefit.** Income tax benefit for the year ended December 31, 2014 of \$24.7 million resulted mainly from cancellation of deferred tax liabilities related to the Nishiwaki Fab, and deferred taxes related to TPSCo; for the year ended December 31, 2013, the entire \$9.4 million resulted from our subsidiaries' losses before tax.

**Net Profit (Loss) Attributable to the Company.** Net profit attributable to the Company for the year ended December 31, 2014 was \$4.3 million as compared to a loss of \$107.7 million for the year ended December 31, 2013. The increase in our net profit in the amount of \$112.0 million is mainly comprised of the above described increase in revenues and gain from acquisition of TPSCo, offset by the above described increase in cost of revenues and other costs, including the Nishiwaki Fab one-time restructuring costs and non-cash impairment.

#### Year Ended December 31, 2013 compared to Year Ended December 31, 2012

**Revenues.** Revenue for the year ended December 31, 2013 amounted to \$505.0 million, as compared to \$638.8 million for the year ended December 31, 2012. This decrease in revenues was attributed to: (i) the previously disclosed contractual decrease in the volumes of wafers manufactured in our Fab 4 in Japan under our committed volume agreement which we entered into with Micron in June 2011, resulted in periodic pre-scheduled reductions of revenue from Micron, amounted to \$139.4 million lower revenue in 2013 as compared to 2012 (which trend we expect to continue due to the expiration of this contract from June 2014 and the cessation of Fab 4 operations; See Item 5.B. "our operations in Japan"); (ii) a definitive agreement we entered in November 2009 with an Asian entity for the capacity ramp-up and upgrade of the entity's eight inch refurbished wafer fabrication facility (see note 16D(2) to our financial statements) resulted in approximately \$13.4 million lower revenue in 2013 as compared to 2012; and offset by (iii) \$19.0 million increase in revenue in 2013 as compared with 2012, reflecting 5.45% year over year growth in our revenues, excluding items (i) and (ii) detailed above, from \$348.1 million to \$367.0 million.

**Cost of Revenues.** Cost of revenues for the year ended December 31, 2013 amounted to \$476.9 million, as compared to \$560.0 million for the year ended December 31, 2012. The \$83.1 million improvement in cost of revenues was mainly due to efficiency measures and cost reduction measures we put in place, including the workforce reduction executed during the second quarter of 2012, as well as the pre-scheduled manufacturing volume reduction from Micron described above.

**Gross Profit.** Gross profit for the year ended December 31, 2013 was \$28.1 million, as compared to \$78.8 million for the year ended December 31, 2012, a decrease of \$50.7 million, resulting from the above described \$133.8 million revenue decrease offset by the above described \$83.1 million reduced cost of revenues.

**Research and Development Expenses.** Research and development expenses for the year ended December 31, 2013 amounted to \$33.1 million, as compared to \$31.1 million for the year ended December 31, 2012.

**Marketing, General and Administrative Expenses.** Marketing, general and administrative expenses for the year ended December 31, 2013 amounted to \$42.9 million, as compared to \$44.4 million for the year ended December 31, 2012.

**Reorganization Costs.** In 2012, the Company executed a plan of reorganization to increase the efficiency of Fab 4, including a reduction in workforce at the facility, resulting in \$5.8 million of reorganization costs in the year ended December 31, 2012.

**Amortization related to a lease agreement early termination.** Operating expenses for the year ended December 31, 2013 included \$7.5 million in non-cash amortization expenses related to an early termination of an office building lease contract.

**Operating Loss.** Operating loss for the year ended December 31, 2013 was \$55.3 million, as compared to \$2.5 million operating loss for the year ended December 31, 2012, resulting mainly from the above described decrease of \$50.7 million in gross profit.

**Interest Expenses, Net.** Interest expenses, net for the year ended December 31, 2013 were \$33.0 million compared to interest expenses, net of \$31.8 million for the year ended December 31, 2012.

**Other Financing Expenses, Net.** Other financing expenses, net for the year ended December 31, 2013 were \$27.8 million compared to other financing expenses, net of \$27.6 million for the year ended December 31, 2012. Financing expenses, net composition is described in details in Note 19B to the consolidated financial statements as of December 31, 2013.

**Income Tax Benefit.** Income tax benefit resulting from some portions of the losses before taxes, amounted to \$9.4 million in the year ended December 31, 2013 as compared to \$7.3 million income tax expense for the year ended December 31, 2012.

**Loss.** Loss for the year ended December 31, 2013 was \$107.7 million as compared to \$70.3 million for the year ended December 31, 2012. The increase in the net loss was mainly due to the \$52.8 million increase in operating loss offset partially by the increase in the income tax benefit as described above.

#### 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 appreciation of the USD against the NIS. During the year ended December 31, 2014, the USD appreciated against the NIS by 12.0% and the Israeli Consumer Price Index ("CPI") decreased by 0.2% (during the year ended December 31, 2013, the USD depreciated against the NIS by 7.0% and the Israeli Consumer Price Index ("CPI") increased by 1.8% ). We estimate that each 1% appreciation in the USD against the NIS will result in approximately \$1 million positive cash impact per annum on our financial results, mainly due to payroll, utilities and general and administrative costs associated with our two Israeli fabs.

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 amounts of revenues and costs of our operations in Japan are influenced by the changes in the US dollar to the Japanese Yen (JPY) exchange rate, however on a net basis there is a reduced impact to the USD to JPY exchange rate changes since it is naturally hedged by the revenue in 2014 being denominated entirely in JPY while the costs being primarily also denominated in JPY. During the year ended December 31, 2014, the USD appreciated against the JPY by 13.8% (during the year ended December 31, 2013 the USD appreciated against the JPY by 21.8%). We estimate that each 1% appreciation of the JPY against the US dollar will result in approximately \$3.5 million positive impact on our TPSCo revenue per annum, offset primarily by increased costs denominated in JPY at similar amounts, resulting in immaterial impact on the statements of operations.





Nearly all of the cash generated from our operations and from our financing and investing activities is denominated in US dollars, JPY and NIS. Our expenses and costs are denominated in NIS, US Dollars and JPY. 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 TPSCo's bank loans interest is based on the TIBOR 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.

Debentures Series D with an outstanding principal of approximately \$12 million as of December 31, 2014, are denominated in NIS and linked to the Israeli CPI and therefore we are exposed to fluctuation of the US dollar to NIS 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, 2014, we had an aggregate amount of \$187.2 million in cash and cash equivalents, as compared to \$122.9 million of cash, cash equivalents and interest bearing deposits as of December 31, 2013, which included \$10 million of designated deposits.

The increase in cash balance during the year was attributed mainly to \$125.3 million cash generated from operating activities including interest payments of \$34.0 million (or \$159.3 million excluding these \$34.0 interest payments) and excluding Japanese employee retirement related payments; investments of \$99.4 million in fixed assets, net \$57.6 million of cash in TPSCo associated with its establishment; repayment of \$51.4 million of debt; proceeds from exercise of options and bond issuance of \$19.6 million; and a receipt of an \$85.9 million loan from JA Mitsui Leasing, Ltd. and Bank of Tokyo (BOT) Lease Co., Ltd, two Japanese banks, that was used to repay the bridge loan previously received from Panasonic; in addition, funds received from Nishiwaki assets sale, net of Japanese employee retirement related payments, amounted to \$12.6 million.

As of December 31, 2014, loans from banks are presented in our balance sheet in the amount of \$169.8 million, of which \$10.0 million are presented as current maturities. As of such date, we presented an aggregate of \$217.3 million of debentures in our balance sheet, of which \$110.0 million are presented as current maturities.

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, 2014, Tower's outstanding debt under its credit facility with Bank Leumi and Bank Hapoalim (together, "Lender Banks") was approximately \$101 million.



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

For detailed information see Notes 12B and 16 to the 2014 annual consolidated financial statements for the year ended December 31, 2014.

In 2014, Tower signed with its Lender Banks an amendment to its facility agreement, according to which the \$101 million outstanding as of December 31, 2014 currently carries an annual interest rate of USD LIBOR plus 3.90% ("Facility Agreement"). The principal payments' schedule of said loan is \$10 million during 2015, \$14 million during 2016, \$56 million during 2017 and approximately \$21 million during 2018.

We have registered liens in favor of the State of Israel and the banks on substantially all of our present and future assets, including on our subsidiaries' equity holdings and all our contracts.

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, Lender Banks were to accelerate Tower's obligations, Tower would be obligated, among other matters, to immediately repay all loans made by Lender Banks (which as of December 31, 2014 amounted to approximately \$101 million) plus penalties, and Lender 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, among others, (i) there are covenants on changes of ownership which generally require that Kenon holds a minimum of approximately 3.2 million of our ordinary shares, and that Kenon 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); (ii) subject to certain exceptions, Tower is restricted from assuming liability for indebtedness or other obligations of its subsidiaries, and is restricted from providing guarantees for its subsidiaries; (iii) subject to certain exceptions Tower cannot invest in, finance, loan or transfer any amounts to, any of its subsidiaries or otherwise expend any funds in the operation of its subsidiaries, and (iv) additional conditions and covenants, including restrictions on incurring new debt and new equity investments by Tower and a prohibition on the distribution of dividends. Following Kenon's announcement that it has decided to pursue a change of holding that will affect its shareholdings in Tower (whether by distribution of shares to Kenon's shareholders and/or in any manner), and in the event such a change of holding is executed to the extent it will conflict with (i) above, a consent or a waiver will be required from the Lender Banks in order to avoid an event of default under the Facility Agreement.

#### Investment Center Grants

In February 2011, we received an official approval certificate ("ktav ishur") from the Israeli Investment Center, for an expansion program for investments in fixed assets in Israel, according to which we received approximately \$36 million, for eligible investments made by Tower from 2006 to 2012. Final investments report was filed and pending final approval of the Israeli Investment Center.

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 ("Investments Law") and the regulations promulgated thereunder. In the event Tower fails to comply with such conditions, Tower may be required to repay all or a portion of the grants received plus interest and certain inflation adjustments. In order to secure fulfillment of the conditions related to the receipt of investment grants, floating liens were registered in favor of the State of Israel on substantially all of Tower's assets.

For information in regards to the grants programs, see Note 8B to the 2014 annual consolidated financial statements included in this report.

## Other Recent Financing Transactions

### Tower Debentures Series F

In 2010 and 2012, Tower issued un-secured and subordinated long-term debentures, which are fully linked to the US dollar, carry an interest rate of 7.8% per annum payable semiannually, and which are repayable in two equal installments in December 2015 and December 2016. As of March 31, 2015, the aggregate outstanding amount of such debentures was approximately \$35 million as compared with \$197 million as of December 31, 2014, following conversions to shares totaling \$162 million which occurred in the first quarter of 2015, including an accelerated conversion offer of our Series F Debentures for ordinary shares, or the Exchange Offer, under which we converted approximately NIS 300 million principal amount of our Series F Debentures for 8.6 million ordinary shares.

As of March 31, 2015, the aggregate outstanding amount of such debentures is approximately \$35 million. Any outstanding debentures are convertible into Tower's ordinary shares until December 2016, at a conversion ratio of approximately \$10 par value of debentures into one ordinary share.

For more information regarding Tower's debentures, see Note 13 to the 2014 annual consolidated financial statements included in this report.

### Wells Fargo Asset-Based Revolving Credit Line

In December 2013, Jazz entered into an agreement with Wells Fargo Capital Finance, part of Wells Fargo & Company ("Wells Fargo"), for a five-year secured asset-based revolving credit line in the total amount of up to \$70 million, maturing in December 2018 (the "Credit Line Agreement"). Loans under the Credit Line Agreement bear interest at a rate equal to, at lender's option, either the lender's prime rate plus a margin ranging from 0.50% to 1.0% or the LIBOR rate plus a margin ranging from 1.75% to 2.25% per annum.

The outstanding borrowing availability varies from time to time based on the levels of Jazz's eligible accounts receivable, eligible equipment, eligible inventories and other terms and conditions described in the Credit Line Agreement. The Credit Line Agreement is secured by the assets of Jazz and its subsidiaries. The Credit Line Agreement contains customary covenants and other terms, including customary events of default. If any event of default occurs, Wells Fargo may declare due immediately all borrowings under the facility and foreclose on the collateral. Borrowing availability under the Credit Line Agreement as of December 31, 2014, was approximately \$54 million of which approximately \$24 million has been utilized as of such date (including \$19 million through loans and approximately \$5 million through letters of credit). As of December 31, 2014, Jazz was in compliance with all the covenants under this facility. Jazz's debt and obligations, including its obligations pursuant to the Credit Line Agreement, are not guaranteed by Tower.

### Notes Issued by Jazz in 2010

In July 2010, Jazz issued notes in the principal amount of approximately \$94 million due 2015 (the "2010 Notes"). Interest on the 2010 Notes was a rate of 8% per annum was payable semiannually.

As of December 31, 2014, approximately \$45 million in principal amount of the 2010 Notes were outstanding. As of January 7, 2015, the 2010 Notes were fully redeemed through: (i) an early redemption of approximately \$45 million outstanding amount, as permitted by the terms of the indenture governing the 2010 Notes, completed in January 2015; and (ii) the 2014 Exchange Agreement as described in “Jazz 2014 Notes” below.

#### Jazz 2014 Notes

In March 2014, Jazz, together with certain of its domestic subsidiaries and Tower entered into an exchange agreement (the “2014 Exchange Agreement”) with certain 2010 Notes holders (the “2014 Participating Holders”) according to which Jazz issued new un-secured convertible senior notes due December 2018 (the “2014 Notes”) in exchange for approximately \$45 million in aggregate principal amount out of the 2010 Notes that were originally due June 2015.

In addition, Jazz, Tower and certain of the 2014 Participating Holders (the “Purchasers”) entered into a purchase agreement (the “Purchase Agreement”) pursuant to which the Purchasers agreed to purchase \$10 million aggregate principal amount of 2014 Notes for cash consideration.

Holders of the 2014 Notes may submit a conversion request with respect to their 2014 Notes to be settled through cash or ordinary shares of Tower, in which event the conversion price is set to \$10.07 per share, reflecting a 20 percent premium over the average closing price for Tower’s ordinary shares for the five trading days ending on the day prior to the signing date of the 2014 Exchange Agreement and Purchase Agreement. Interest on the 2014 Notes at a rate of 8% per annum is payable semiannually.

The 2014 Notes are unsecured senior obligations of Jazz, rank equally with all other existing and future unsecured senior indebtedness of Jazz, and are effectively subordinated to all existing and future secured indebtedness of Jazz, including Jazz’s up to \$70 million secured Credit Line Agreement with Wells Fargo, to the extent of the value of the collateral securing such indebtedness. The 2014 Notes rank senior to all existing and future subordinated debt. The 2014 Notes are jointly and severally guaranteed on a senior unsecured basis by Jazz’s domestic subsidiaries. The 2014 Notes are not guaranteed by Tower.

As of December 31, 2014, approximately \$58 million principal amount of 2014 Notes was outstanding.

For additional information regarding the Jazz 2014 Notes, see Note 13 to the 2014 annual consolidated financial statements included in this report.

#### GE Credit Line with TJP

In May 2012, TJP signed a definitive credit line agreement with GE Capital to provide a three-year secured asset-based revolving credit line of up to 4 billion Japanese Yen (approximately \$40 million). Loans under this credit line carried an interest of the higher of TIBOR rate or LIBOR rate plus 2.6% per annum.

In 2014, as part of the cessation of operations of TJP, the loan was fully repaid and the contract has been terminated.

#### Long Term Loan Agreement with JA Mitsui Leasing, Ltd. and Bank of Tokyo (BOT)

In June 2014, TPSCo entered into a long term loan agreement with JA Mitsui Leasing, Ltd. and Bank of Tokyo Lease Co., Ltd (BOT), under which it has borrowed approximately 8.8 billion Japanese Yen (approximately \$74 million as of December 31, 2014).

The loan carries an annual interest of the TIBOR (Tokyo Interbank Offered Rate) six months' rate plus 1.65% per annum with the principal amount to be repaid in seven semi-annual equal installments starting June 2016 and ending June 2019. The loan is secured by an assignment of TPSCo's right to receive any amounts under its manufacturing and production related services agreements with Panasonic.

#### Our Operations in Japan

For details regarding the acquisition of TPSCo and restructuring our operation in Japan, see Notes 3 and 4 to the annual consolidated financial statements for the year ended December 31, 2014 included in this report.

During 2014, the Company decided to restructure its business and activities in Japan. In connection with this restructuring, Tower acquired 51% of the shares of TPSCo from Panasonic, to which Panasonic transferred license use rights of its semiconductor wafer manufacturing process and transferred its capacity tools of 8 inch and 12 inch at three of its fabs located in Hokuriku Japan (Uozu, Tonami CD and Arai), in consideration for the issuance of ordinary shares of Tower to Panasonic valued at approximately \$7.4 million.

The purchase price has been allocated on the basis of the estimated fair value of the assets purchased and the liabilities assumed. The estimated fair value of the assets, net amounted to approximately \$181 million. As the fair value of the net assets acquired less the non-controlling interest exceeded the purchase price, Tower recognized a gain on the acquisition in the amount of approximately \$166 million.

As part of the acquisition of TPSCo, Tower, TPSCo and Panasonic also agreed to the following, among others: (i) a five-year manufacturing agreement between Panasonic and TPSCo, under which Panasonic will acquire products from TPSCo; (ii) a five-year production related and complimentary services agreement between Panasonic and TPSCo, under which Panasonic will acquire services from TPSCo; (iii) TPSCo will license certain technologies from Panasonic in order to utilize certain Panasonic process technologies for the manufacturing of products; (iv) Panasonic will provide TPSCo with various transition services and support; (v) TPSCo will lease the manufacturing buildings and related facilities infrastructure from Panasonic; and (iv) TPSCo will receive services from Tower including marketing, sales, general and administration services. In June 2014, Panasonic transferred its shares in TPSCo and its rights and obligations under the relevant ancillary agreements to PSCS, its wholly-owned subsidiary.

In connection with the restructuring of the Company's business and activities in Japan, the operations of TJP's fab ceased. As a result, the agreements with vendors and others, including TJP's work force, were terminated and TJP's fab equipment was sold. In addition, the Company moved certain customers and products from TJP to the Company's other fabrication facilities in Japan, US and Israel.

#### C. RESEARCH AND DEVELOPMENT, PATENTS AND LICENSES

Our research and development activities are related primarily to our manufacturing process by way of improvements, upgrades and development for our use in manufacturing of our customers products and have been sponsored and funded by us with some participation by the Israeli government. Our research and development expenses for the years ended December 31, 2014, 2013 and 2012 were \$51.8 million, \$33.1 million and \$31.1 million net of government participation of \$0.6 million, \$0.4 million and \$1.8 million respectively. Tower also incurred costs in connection with

the transfer of technology for use in Fab 2, some of which has been amortized over the estimated economic life of the technology following the commencement of production in Fab 2 during the third quarter of 2003 (see also in this Item “Critical Accounting Policies – Depreciation and Amortization”).



For a description of our research & development policies and our patents and licenses, see “Item 4. Information on the Company-4.B. Business Overview”.

D. TREND INFORMATION

The Company operates in the semiconductor industry. The semiconductor industry has historically been highly cyclical on a seasonal and long-term basis. From the second half of 2009 to date, the semiconductor industry has experienced accelerated growth rates and high utilization rates.

On a long-term basis, the market fluctuates, cycling through periods of weak demand, production excess capacity, excess inventory and lower sales prices and periods of strong demand, full capacity utilization, product shortages and higher sales prices.

There is a trend within the semiconductor industry toward ever-smaller features and ever-growing wafer sizes. State-of-the-art fabs are currently supporting process geometries of 35-nanometer and below and wafer sizes of 300-mm. As demand for smaller geometries increases, there is downward pressure on the pricing of larger geometry products and increasing underutilization of fabs that are limited to manufacturing larger geometry products, which results in less profitability for manufacturers of larger geometry products. However, our strategy to focus on specialty technologies within the nodes we have enables us to achieve higher product selling prices as compared to the manufacture of plain vanilla platform products such as other manufacturers in the industry. The Company currently offers process geometries of 0.35, 0.50, 0.55, 0.60, 0.80-micron and above on 150-mm wafers and 0.35, 0.18, 0.16, 0.13 and 0.11-micron on 200-mm wafers and 65 nanometer and 45 nanometer on 300-mm wafers. We continue to invest in our portfolio of specialty process technologies to address the key product attributes that make its customers' products more competitive.

Another key element of our strategy is to target large, growing and diversified end markets. We target end markets characterized by high growth and high performance for which we believe our specialty process technologies have a high value proposition, including the wireless and high-speed wireline communications, consumer electronics, automotive and industrial markets. For example, we believe that our specialty process technologies can provide performance and cost advantages over current GaAs and CMOS solutions in the realization of switches and power amplifiers for wireless handsets. In addition, we continue to grow and diversify our business by attracting new customers and expanding our customer base.

During recent years, we have accelerated our plans to expand our manufacturing capacity. We have significantly increased our capacity in Fab 1, Fab 2 and Fab 3 and acquired fabs in Japan (for more details see “Our Operations in Japan”), to meet our customers' demand. We are focused on achieving successful integration of all our fabs and increasing the utilization of the acquired fabs by attracting new customers and opportunities. We also seek to maintain capital efficiency by leveraging our capacity and manufacturing model to ensure cost-effective manufacturing.

E. OFF-BALANCE SHEET ARRANGEMENTS

We are not a party to any material off-balance sheet arrangements except for the purchase commitments, standby letters of credit and guarantees detailed in section F below.

## F. TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS

The following table summarizes our contractual obligations and commercial commitments as of December 31, 2014:

|                                                           | Total   | Payment Due               |         |         |         |         | After 5<br>years |
|-----------------------------------------------------------|---------|---------------------------|---------|---------|---------|---------|------------------|
|                                                           |         | Less than<br>1<br>year    | 2 Years | 3 Years | 4 Years | 5 Years |                  |
|                                                           |         | (in thousands of dollars) |         |         |         |         |                  |
| Contractual Obligations                                   |         |                           |         |         |         |         |                  |
| Short term<br>liabilitie(1)                               | 166,931 | 166,931                   | --      | --      | --      | --      | --               |
| Loans from banks<br>(2)                                   | 206,616 | 14,629                    | 39,236  | 80,023  | 62,207  | 10,521  | --               |
| Debentures (3)                                            | 357,291 | 170,429                   | 116,893 | 4,665   | 65,304  | --      | --               |
| Operating leases                                          | 58,978  | 16,776                    | 15,494  | 12,409  | 11,326  | 2,973   | --               |
| Construction &<br>equipment<br>purchase<br>agreements (4) | 7,823   | 7,823                     | --      | --      | --      | --      | --               |
| Other long-term<br>liabilities                            | 15,865  | 4,129                     | 746     | 839     | 923     | 989     | 8,239            |
| Purchase<br>obligations                                   | 31,684  | 12,373                    | 10,680  | 6,686   | 1,145   | 800     | --               |
| Total contractual<br>obligations                          | 845,188 | 393,090                   | 183,049 | 104,622 | 140,905 | 15,283  | 8,239            |

(1) Short-term liabilities include primarily our trade accounts payable for equipment and services as well as payroll related commitments.

(2) Loans from banks include principal and interest payments in accordance with the terms of agreements with the banks.

(3) Debentures include total amount of principal and interest payments for the presented periods.

As of December 31, 2014 approximately \$255 million of such debentures were convertible into ordinary shares, of which \$162 million has already been converted during the first quarter of 2015.

(4) Construction & equipment purchase agreements include amounts related to ordered equipment that has not yet been received.

In addition to these contractual obligations, we have committed approximately \$8 million in standby letters of credit and guarantees.

The above table does not include other contractual obligations or commitments we have, such as undertakings pursuant to royalty agreements, commissions and service agreements. We are unable to reasonably estimate the total amounts or the time table for such payments to be paid under the terms of these agreements, as the royalties, commissions and required services are a function of future revenues, the volume of business and hourly-based fees. In addition, the above table does not include our liability with respect to our customers, which as of December 31, 2014, amounted to approximately \$11.7 million that may be utilized by them against future purchases of products. We are unable to reasonably estimate the total amounts that may be utilized by our customers since we cannot reasonably estimate their future orders in the periods set forth in the above chart. The table above reflects our commitments and

contingencies which are known to us as of December 31, 2014. Any new developments in our business plans, our modification of engagements with supply and service providers as well as changes in our commitments and contingencies following the date hereof, including the \$162 million accelerated conversion of Series F Debentures that occurred in the first quarter of 2015, are not included in this table and actual payments may vary significantly from those presented above.

## ITEM 6.

## DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

## A.

## DIRECTORS AND SENIOR MANAGEMENT

Set forth below is information regarding our senior management and directors as of March 31, 2015.

| Officer | Senior Managements' Name | Age | Title                                                                                                                                                                                                                                      |
|---------|--------------------------|-----|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| A       | Russell<br>C. Ellwanger  | 60  | Chief Executive Officer of Tower, and Chairman of the Board of Directors of its wholly-owned subsidiaries, Tower Semiconductor USA, Inc., Jazz Technologies, Inc. Jazz Semiconductor, Inc. and TowerJazz Panasonic Semiconductor Co., Ltd. |
| B       | Oren Shirazi             | 45  | Chief Financial Officer, Senior Vice President of Finance                                                                                                                                                                                  |
| C       | Dr. Itzhak Edrei         | 55  | President                                                                                                                                                                                                                                  |
| D       | Rafi Mor                 | 51  | Chief Operating Officer                                                                                                                                                                                                                    |
| E       | Dalit Dahan              | 46  | Senior Vice President of Human Resources and IT                                                                                                                                                                                            |
| F       | Nati Somekh              | 39  | Senior Vice President, Chief Legal Officer and Corporate Secretary                                                                                                                                                                         |
| G       | Yossi Netzer             | 50  | Senior Vice President of Corporate Planning                                                                                                                                                                                                |
| H       | Dr. Marco Racanelli      | 48  | Senior Vice President and General Manager of RF/High Performance Analog and Power Business Groups, General Manager of US Aerospace & Defense Business Group and Newport Beach Site Manager                                                 |
| I       | Ilan Rabinovich          | 58  | Vice President of Quality and Reliability                                                                                                                                                                                                  |
| J       | Ephie Koltin             | 53  | Former Chief Operating Officer                                                                                                                                                                                                             |
|         | Directors' Name          | Age | Title                                                                                                                                                                                                                                      |
| K       | Amir Elstein             | 59  | Chairman of the Board                                                                                                                                                                                                                      |
| L       | Sagi Kabla               | 38  | Director                                                                                                                                                                                                                                   |
| M       | Yoav Doppelt             | 46  | Director                                                                                                                                                                                                                                   |
| N       | Kalman Kaufman           | 69  | Independent Director                                                                                                                                                                                                                       |
| O       | Alex Kornhauser          | 68  | Independent and External Director                                                                                                                                                                                                          |
| P       | Dana Gross               | 47  | Independent Director                                                                                                                                                                                                                       |
| Q       | Ilan Flato               | 58  | Independent and External Director                                                                                                                                                                                                          |
| R       | Rami Guzman              | 76  | Director                                                                                                                                                                                                                                   |

As required by the Israeli Companies Law, 1999 (the “Israeli Companies Law”), during 2013, we adopted a compensation policy regarding the terms of office and employment of our office holders and directors, including compensation, equity-based awards, indemnification and insurance, severance and other benefits, see Item 6B below. Specified below is the individual data outlining the actual compensation granted to our five most highly compensated officers and directors with respect to the year ended December 31, 2014 (collectively referred to herein as the “Covered Officers”). The Covered Officers, consist of A, K, H, C and J who were granted total compensation (in cash and/or in equity values, including employer’s cost) with respect to the year ended December 31, 2014 in the total amount of \$6.8 million, including value of equity vehicles such as options as described below, as well as employer’s cost of all social benefits and expenses reimbursement.

Russell C. Ellwanger has served as our Chief Executive Officer since May 2005. Mr. Ellwanger also serves as Chairman of the Board of Directors of our wholly-owned subsidiaries, Tower Semiconductor USA, Inc., Jazz Technologies, Inc., Jazz Semiconductor, Inc. and TowerJazz Panasonic Semiconductor Co., Ltd., and a board member of TowerJazz Japan, Ltd. He also served as a director of the Company between May 2005 and April 2013. From 1998 to 2005, Mr. Ellwanger served in various executive positions for Applied Materials Corporation, including Group Vice President, General Manager of the Applied Global Services (AGS), from 2004 to 2005, Group Vice President, General Manager of the CMP and Electroplating Business Group, from 2002 to 2004. Mr. Ellwanger also served as Corporate Vice President, General Manager of the Metrology and Inspection Business Group, from 2000 to 2002, during which he was based in Israel. From 1998 to 2000, Mr. Ellwanger served as Vice President of Applied Materials’ 300-mm Program Office, USA. Mr. Ellwanger served as General Manager of Applied Materials’ Metal CVD Division from 1997 to 1998 and from 1996 to 1997, Mr. Ellwanger served as Managing Director of CVD Business Development, during which he was based in Singapore. In addition, Mr. Ellwanger held various managerial positions in Novellus System from 1992 to 1996 and in Philips Semiconductors from 1980 to 1992.

Oren Shirazi has served as our Chief Financial Officer and Senior VP Finance since November 2004. Mr. Shirazi serves as a board member of Jazz Semiconductor, Inc. Mr. Shirazi joined us in October 1998 and served as our controller since July 2000, after serving as vice controller since October 1998. Prior to joining us, Mr. Shirazi was employed as an audit manager in the accounting firm of Ratzkovski-Fried & Co., which merged into Ernst & Young (Israel). Mr. Shirazi is a Certified Public Accountant in Israel (CPA). He has an MBA from the Graduate School of Business of Haifa University with honors and a B.A. in economics and accounting from the Haifa University.

Dr. Itzhak Edrei has served as our President since November 2011 after serving as Executive Vice President of Business Groups since September 2008 and as Senior Vice President of Product Lines and Sales since August 2005. Dr. Edrei serves as a board member of Jazz Semiconductor, Inc. and TowerJazz Panasonic Semiconductor Co., Ltd. From August 2001 to August 2005 Dr. Edrei served as Vice President of Research and Development, having served as Director of Research and Development since 1996. From 1994 to 1996, Dr. Edrei served as our Device and Yield Department Manager. Prior to joining Tower, Dr. Edrei was employed by National Semiconductor as Device Section Head. Dr. Edrei earned his Ph.D. in physics from Bar Ilan University and his post-doctorate from Rutgers University.

Rafi Mor was appointed as Chief Operation Officer of TowerJazz in August 2014. Mr. Mor serves as a board member of Jazz Semiconductor, Inc. and TowerJazz Panasonic Semiconductor Co., Ltd. Previously Mr. Mor served as Chief Executive Officer of TowerJazz Japan from October 2011, after serving as Senior Vice President and General Manager of Jazz Semiconductor (Tower’s wholly-owned subsidiary) Newport Beach, California site since September 2008. In October 2010, Rafi was nominated to be the manager of our Newport Beach Fab, in addition to his GM role. Previously, Mr. Mor served in Tower Semiconductor Ltd. as Vice President of Business Development since April 2007, after serving as Vice President and Fab 2 Manager since August 2005, and as Fab 1 Manager since March 2003. From November 2000 to March 2003, Mr. Mor served as Senior Director of Process Device & Yield of Fab 1. From 1998 to 2000, Mr. Mor served as Director of Equipment Reliability & Support of Fab 1. Previously, Mr. Mor

was employed by National Semiconductor in various engineering and management capacities. Mr. Mor holds an MA and B.A. in chemical engineering from Ben Gurion University.

Dalit Dahan serves as Senior Vice President of Human Resources and IT after being appointed IT Manager in January 2008, after serving as Vice President of Human Resources since April 2004. Ms. Dahan joined us in November 1993 and served as Personnel Manager since April 2000, after having served as Compensation & Benefits Manager and in various other positions in the Human Resources Department. Prior to joining us, Ms. Dahan served as Manager of the North Branch of O.R.S - Manpower Company for 3 years. Ms. Dahan holds a B.A. in social science from Haifa University and an MBA from the University of Derby.

Nati Somekh serves as Senior Vice President, Chief Legal Officer and Corporate Secretary, after serving as Vice President, Chief Legal Officer and Corporate Secretary since September 2008, after serving as Corporate Secretary and General Counsel since March 2005, and as Associate General Counsel since May 2004. From 2001 to 2004, Ms. Somekh was employed by Goldsobel & Kirshen, Adv. Ms. Somekh holds an LL.M. and J.D. from Boston University and a B.A. from Johns Hopkins University. She is a member of the Israeli Bar Association and is admitted as an attorney in the State of New York.

Yossi Netzer was appointed Senior Vice President of Corporate Planning in July 2012 after serving as VP of Corporate Planning since November 2008, as General Manager of Mixed Signal, RF & Power Management Product Line since 2005 and as Director, FAB 2 Yield & Device Engineering Manager since 2000. From 1995 to 2000, Mr. Netzer served in various engineering management positions within the R&D division dealing with CMOS, Mixed Signal, RF, and NVM Technologies. Prior to joining Tower, Mr. Netzer was employed at National Semiconductor and the Technion – Israel Institute of Technology. Mr. Netzer holds a B.Sc. degree in electrical engineering from the Technion – Israel Institute of Technology.

Dr. Marco Racanelli was appointed Newport Beach Site Manager in April 2014 and also serves as Senior Vice President & General Manager, Power Business Group since June 2012 and General Manager, RF & High Performance Analog Business Group and Aerospace & Defense Group since September 2008. Previously, he served as Vice President of Technology & Engineering, Aerospace & Defense General Manager for Jazz Semiconductor. Prior to Jazz, Dr. Racanelli held several positions at Conexant Systems and Rockwell Semiconductor since 1996 in the area of technology development where he helped establish industry leadership in SiGe and BiCMOS and MEMS technology, and built a strong design support organization. Prior to Rockwell, Dr. Racanelli worked at Motorola, Inc., where he contributed to bipolar, SiGe and SOI development for its Semiconductor Products Sector. Dr. Racanelli received a Ph.D. and a M.S. in Electrical and Computer Engineering from Carnegie Mellon University, and a B.Sc. in Electrical Engineering from Lehigh University. He holds over 35 U.S. patents.

Ilan Rabinovich was appointed Vice President of Quality and Reliability and General Manager of CMOS Business Unit in January 2015, Previously Mr. Rabinovich served as Vice President, Customer Support and General Manager, CMOS Business Unit from December 2009. Prior to joining TowerJazz, from 2005 to 2009, Mr. Rabinovich served as Vice President of Operations, Opto Fab, Vishay Ltd. (formerly CyOptics Ltd.), a subsidiary of Vishay Intertechnology. From 2000 to 2005, Mr. Rabinovich served as President and Vice President of Product Development at CyOptics Ltd. From 1995-2000, Mr. Rabinovich worked as a Process Engineering Manager and Director of Engineering for Tower Semiconductor Ltd. From 1983 to 1995, Mr. Rabinovich held various engineering and management positions in National Semiconductor Company and in Tower Semiconductor, Israel. Mr. Rabinovich holds a M.Sc. in Physics from Tel Aviv University and a B.Sc. in Physics and Mathematics from Hebrew University, Jerusalem.

Ephie Koltin served as Chief Operating Officer until mid-2014, after serving as Executive Vice President of Worldwide Operations since June 2009 and as Vice President of Business Development since January 2009. Mr. Koltin served as a board member of Jazz Semiconductor, Inc. Previously, Mr. Koltin served as Vice President Fab 1 since April 2007, and has served as Test and Facility Manager since January 2008, after serving as Vice President of Business Development since August 2005, as Vice President, General Foundry and Mixed Signal Technology since 2003 and as Senior Director, FAB 2 Process Engineering since 2000. From 1995 to 1999, Mr. Koltin served in several senior positions as Director, NVM Technology, CIS technology and ERS manager, Fab 1. Prior to joining Tower, Mr. Koltin was employed at National Semiconductor and the Technion – Israel Institute of Technology. Mr. Koltin holds a B.Sc. in mechanical engineering and M.Sc. in materials engineering from the Technion – Israel Institute of Technology. During 2014, Ephie ceased to be employed in our company.

Amir Elstein was appointed as Chairman of the Board in January 2009. Mr. Elstein serves as Director in the Board of Directors of Teva Pharmaceutical Industries Ltd. During 2010-2013, Mr. Elstein served as Chairman of the Board of Directors of Israel Corporation, which has been a major shareholder of the Company from 1993 until 2013. Mr. Elstein serves as Chairman of The Israel Democracy Institute, and as Chairman of the Board of Governors of the Jerusalem College of Engineering. He also serves as chairman/member of the board of several academic, scientific and educational, social and cultural institutions. Mr. Elstein was a member of Teva Pharmaceutical Industries senior management team from 2005 to 2008, where he ultimately held the position of the Executive Vice President at the Office of the CEO, overseeing Global Pharmaceutical Resources. Prior thereto, he was an executive at Intel Corporation, where he worked for 23 years, eventually serving as General Manager of Intel Electronics Ltd., an Israeli subsidiary of Intel. Mr. Elstein received his B.Sc. in physics and mathematics from the Hebrew University in 1980 and his M.Sc. in the Solid State Physics Department of Applied Physics from the Hebrew University in 1982. In 1992, Mr. Elstein received his diploma of Senior Business Management from the Hebrew University.

Sagi Kabla has served as a director since December 2013. Mr. Kabla is serving as Senior Director of Business Development, Strategy and IR of Israel Corporation, which has been a major shareholder of the Company from 1993 until 2013, and has been with Israel Corp. since March 2011. He previously held several advisory and corporate finance executive positions in Israeli based branches of international firms. Mr. Kabla led various advisory and corporate finance activities in the technology, energy and natural resources industries. Mr. Kabla holds MBA (Finance) from COMAS, B.A. degree in Economics and Accounting from Bar-Ilan University and is a qualified as CPA (Isr.).

Yoav Doppelt has served as a director since October 2011. Since 2014, Mr. Doppelt is the Chief Executive Officer of Kenon Holdings, a major shareholder of the Company. Previous to that, he was the Chief Executive Officer of Ofer Investments Group, an affiliate the company and of Israel Corp, which has been a major shareholder of the Company. He joined the Ofer Group in 1996 and has been with Ofer Hi-Tech from its inception in 1997, defining the vision and operational methodology of its private equity and high-tech investments. Mr. Doppelt currently serves as a member of the boards of directors of a number of companies, including Israel Corporation Ltd., Lumenis Ltd, Enzymotec Ltd., MGVS Ltd., Yozma III Management and Investments Ltd. and RayV Inc. and is actively involved in numerous investments within the Israeli private equity and high-tech arenas. Mr. Doppelt has extensive business experience in growth companies and has successfully led several private equity exit transactions. Mr. Doppelt has held various finance and managerial positions in the Ofer Group since joining the group. He holds a bachelor's degree in economics and management from the Faculty of Industrial Management at the Technion – Israel Institute of Technology and an MBA degree from Haifa University.



Kalman Kaufman has served as a director and as a member of our Stock Option and Compensation Committee from May 2008 until February 2013 and as chairman from February 2011 until February 2013. Mr. Kaufman has served as a member of our Audit Committee from August 2005. Mr. Kaufman also served as Corporate Vice President at Applied Materials from 1994 to 2005. Between 1985 and 1994, Mr. Kaufman served as President of KLA Instruments Israel, a company he founded, and General Manager of Kulicke and Soffa Israel. Mr. Kaufman is currently the Chairman of the board of directors of Medasense and Invisia, and serves as a director in Jordan Valley Semiconductors, Optimal Test and is a member of the management board of the Kinneret College. He holds engineering degrees from the Technion - Israel Institute of Technology.

Alex Kornhauser has served as an independent and external director, as a member of the Audit Committee since August 2008 and as chairman of the Audit Committee since January 2011. Mr. Kornhauser has served as a member of the Compensation Committee since June 2009. Mr. Kornhauser served as Senior VP, General Manager of Global Operations at Numonyx Corporation from March 2008 to August 2010. From January 1978 to March 2008, Mr. Kornhauser held many positions at Intel Corporation from design engineer, project manager, department manager, engineering manager and general manager of certain groups, segments and plants. More specifically, from August 2000 to May 2007 he served as Intel Israel Site GM, from January 2006 until March 2008 he served as VP of the Flash Memory Group, from December 2004 to December 2005 Mr. Kornhauser served as VP of TMG NVM Strategic Segment, from January 2001 to November 2004 he served as VP of TMG F18 Plant Manager and from January 1996 to December 2000 he served as F18 General Manager. Mr. Kornhauser holds a B.S. in electronics from Bucharest Polytechnic Institute in Romania.

Dana Gross has served as an independent director since November 2008, as a member of the Compensation Committee since February 2013 and has served as a director on the board of Jazz Semiconductor, Inc. since March 2009. Mrs. Gross was the CEO of Btendo, a start-up company that developed MEMS based PICO projection solutions, until it was acquired by ST Microelectronic in 2012. In 2008, Mrs. Gross joined Carmel Ventures, a leading Israeli Venture Capital firm as a Venture Partner. From 2006 to 2008, Mrs. Gross was a Senior VP, Israel Country Manager at SanDisk Corporation. From 1992 to 2006, Mrs. Gross held various senior positions at M-Systems, including Chief Marketing Officer, VP World Wide Sales, President of M-Systems Inc. (US Subsidiary) and CFO, VP Finance and Administration. In addition, Mrs. Gross served as a director of M-Systems Ltd., Audiocodes Ltd. and Power Dsine Ltd. Mrs. Gross holds a B.Sc. in industrial engineering from Tel-Aviv University and an M.A. in business administration from San Jose State University.

Ilan Flato has served as an independent and external director and as a member of the Audit Committee since April 2009. Since 2012, Mr. Flato has served as President of The Association of Publicly Traded Companies on the Tel-Aviv Stock Exchange. Since 2011, Mr. Flato has been a member of the Israeli Bar Association. Since 2009, Mr. Flato has served as director in two Provident Funds and also as Chairman of the Business Executive of Kibbutz Kfar Blum. Since 2004, Mr. Flato has functioned as an independent financial adviser. Until 2004, Mr. Flato served as the VP for planning, economics and online banking in United Mizrahi Bank and as the Chief Economist of the bank. From 1992 until 1996, Mr. Flato served as the Economic Advisor to the Prime Minister of Israel. Prior to that position, Mr. Flato has served in the Treasury Office as the deputy director of the budget department. In addition, Mr. Flato served as a member of the board of directors of many government owned companies. Mr. Flato holds a B.A. in economics from Tel-Aviv University, an LL.B. from Netanya College, an LL.M from Bar-Ilan University and an MSIT from Clark University.

Rami Guzman has served as a director since February 2009 and has served as a member of our Audit Committee since August 2011. Mr. Guzman is a director in Bank Leumi, a member of professional committees in the Israel Credit Insurance Company and the Israel Infrastructure Fund, and consultant and advisor to technology based companies. Mr. Guzman held various senior positions at Motorola Inc. and Motorola Israel Ltd. since 1985, including VP of Motorola Inc. and Director of Motorola Israel Ltd. In addition, until July 2004, Mr. Guzman was the CFO of Motorola Israel Ltd. Prior to joining Motorola, Mr. Guzman worked for the Ministry of Finance first as senior assistant and deputy to the Director of the Budget and then as Government-wide MIS and IT Commissioner. Mr. Guzman holds a B.A. in economics (1963) and an M.A. in business and public administration (1969) from the Hebrew University of Jerusalem. He was a Research Fellow at Stanford University and Stanford Research Institute, California, USA, and completed Ph.D. studies at the Hebrew University of Jerusalem.

## B. COMPENSATION

For the year ended December 31, 2014, we paid to all our directors and senior management described in Item 6A. above, as a group, an aggregate of \$6.4 million, in salaries, fees, payments upon termination and bonuses. The total employer cost for personal vehicle, relocation expenses, amounts set aside or accrued to provide for insurance, severance, retirement, vacation and similar benefits for such persons was approximately \$1.4 million in the year ended December 31, 2014.

As required by the Israeli Companies Law, during 2013, Tower adopted a compensation policy regarding the terms of office and employment of our office holders and directors, including compensation, equity-based awards, indemnification and insurance, severance and other benefits. This compensation policy has been created by the Compensation Committee, recommended for approval by the Board of Directors, which approved it and then approved by the shareholders' meeting in September 2013. Since the adoption of the compensation policy in 2013, the terms of compensation of the Company's officers and directors are based on this policy. Our compensation policy is performance based and is designed to align our officers' and directors' interests with those of the Company and its shareholders in order to enhance shareholder value. Its structure allows Tower to provide incentives that reflect short-term, mid-term and long-term goals and performance, as well as achieving a positive impact on Company targets, while providing compensation that is competitive in the global marketplace in which we recruit our senior management.

In December 2012, Amendment 20 to the Israeli Companies Law-1999 ("Amendment 20") went into effect. Amendment 20 requires, among other provisions, that the board of directors of Israeli publicly traded companies appoint a Compensation Committee comprised of at least three members, that all external directors be members of the Compensation Committee, that the following persons cannot be members of the Compensation Committee: (i) the chairman of the board of directors (ii) any director employed by or otherwise providing services to the company or to the controlling shareholder or entity under such controlling shareholder's control, (iii) any director who derives his salary primarily from a controlling shareholder, (iv) a controlling shareholder, or (v) any relative of a controlling shareholder, and that the chairman of the Compensation Committee be an external director.

The responsibilities of the Compensation Committee include the following:

1. To recommend to the Board of Directors as to a compensation policy for officers, as well as to recommend, once every three years to extend the compensation policy subject to receipt of the required corporate approvals;
2. To recommend to the Board of Directors as to any updates to the compensation policy which may be required;
3. To review the implementation of the compensation policy by the Company;
4. To approve transactions relating to terms of office and employment of certain Company office holders, which require the approval of the Compensation Committee pursuant to the Companies Law; and
5. To exempt, under certain circumstances, a transaction relating to terms of office and employment from the requirement of approval of the shareholders meeting.

Our Board of Directors appointed Mr. Ilan Flato, Mr. Alex Kornhauser and Ms. Dana Gross as members of the Compensation Committee, and Mr. Ilan Flato as chairman of the Compensation Committee. The Compensation Committee has been charged by the board of directors to act in accordance with the powers and prerogatives delegated to it by the Israeli Companies Law and take any decisions and make any recommendations to the Board all as set forth in the Israeli Companies Law. The board of directors also delegated to the Compensation Committee the review and approval of option grants to non-officers.

Under Section 267B(a) and Parts A and B of Annex 1A of the Companies Law, which were legislated as part of Amendment 20, a company's compensation policy shall be determined with consideration of the following parameters:

- a. advancement of the goals of the Company, its working plan and its long term policy;
- b. the creation of proper incentives for the office holders while taking into consideration, inter alia, the Company's risk management policies;
- c. the Company's size and nature of its operations;
- d. with respect to compensation paid to officers which includes variable components - the contributions of the relevant office holders in achieving the goals of the Company and profit in the long term in light of their positions;
- e. the education, skills, expertise and achievements of the relevant office holders;
- f. the role of the office holders, areas of their responsibilities and their previous agreements regarding salary; and
- g. the correlation of the proposed compensation with the compensation of other employees of the Company, and the effect of such differences in compensation on the employment relations in the company.

In addition, the compensation policy must set forth standards and rules on the following issues: (a) with respect to variable components of compensation - basing the compensation on long term performance and measurable criteria (though an insubstantial portion of the variable components can be discretion based awards taking into account the contribution of the officer holder to the company); (b) establishing the appropriate ratio between variable components and fixed components and placing a cap on such variable components; (c) setting forth a rule requiring an office holder to return amounts paid, in the event that it is later revealed that such amounts were paid on the basis of data which prove to be erroneous and resulted in an amendment and restatement of the company's financial statements; (d) determining minimum holding or vesting periods for equity based variable components of compensation, while taking into consideration appropriate long term incentives; and (e) setting a cap on grants or benefits paid upon termination.

The board of directors of a company is obligated to adopt a compensation policy after considering the recommendations of the compensation committee. The final adoption of the compensation policy is subject to the approval of the shareholders of the company, which such approval is subject to certain special majority requirements, as set forth in Amendment 20, pursuant to which one of the following must be met:

- (i) the majority of the votes includes at least a majority of all the votes of shareholders who are not controlling shareholders of the company or who do not have a personal interest in the compensation policy and participating in the vote; abstentions shall not be included in the total of the votes of the aforesaid shareholders; or
- (ii) the total of opposing votes from among the shareholders described in subsection (i) above does not exceed 2% of all the voting rights in the company.

Our compensation committee and board of directors shall review and reassess the adequacy of this Policy from time to time, as required by the Companies Law, and in setting the compensation of the officers and directors, the compensation committee and the board of directors consider, among other things, the following factors:

- the educational background, professional experience and achievements of the officer or director;
- the officer or director's position, responsibilities and prior salary and compensation arrangements;
- compensation data for comparably situated executives at peer companies, including companies in the industry and/or geographic market;
  - data of other senior executives of the Company;
  - macroeconomic environment;
  - Company's own performance;
- the officer or director's expected contribution to the Company's future growth and profitability;
- global competition and environment in which the Company operates and recruits employees;
- the relationship between the compensation paid to the officer or director and the average and median compensation of the Company's employees and contractors, as well as whether such variation has an effect on employment relations; and
  - any other requirements prescribed by applicable law from time to time.

The policy's objectives and goals are to maintain competitiveness by attracting, motivating and retaining highly talented and experienced personnel with the necessary capabilities to promote creativity and manage global operations. These abilities are critical to our short term as well as mid-term and long-term success and in order to provide a leadership role for the Company, and enhance shareholder value, while supporting a performance culture that is based on merit, motivates individuals to perform at their highest level, differentiates and rewards excellent performance, and recognizes Tower's values. Due to our unique position as an Israeli company with a global footprint, we aim to adopt compensation policies and procedures that match global companies of similar complexity, including semiconductor companies and other companies which compete with Tower for similar talent.



To that end, the compensation policy is designed, among others:

- o To align the interests of the officers and directors of the Company with those of Tower and its shareholders in order to enhance shareholder value;
- o To provide the officers and directors with a structured compensation package, including competitive salaries and performance-based cash and equity incentive programs;
  - o To maintain and increase the level of motivation and ambition;
  - o To provide appropriate awards for superior individual and corporate performance;
  - o To improve the business results and increase income and profitability over time; and
  - o To support the implementation of the Company's business strategy.

Compensation instruments under our Compensation Policy may include the following:

- Base salary;
- Benefits and perquisites;
- Performance-based cash bonuses;
- Equity based compensation; and
- Retirement, termination and other arrangements.

Our Compensation Policy aims to optimize the mix of fixed compensation and variable compensation (both as defined therein) in order to, among other things, appropriately incentivize office holders to meet our goals while considering our management of business risks, and sets maximum ratios between the two types of compensation elements.

Under our Compensation Policy, the Board of Directors shall have the discretion to unilaterally reduce an office holder's variable compensation.

All compensation arrangements of office holders are required to be approved in the manner prescribed by applicable law (including shareholder approval in certain cases – see Item 10 Additional Information - "The Companies Law"). In accordance with our Compensation Policy, office holders, including External Directors or Independent Directors, may waive their entitlement to their compensation, subject to applicable law.

The base salary varies between the different officers and directors, and is individually determined according to the past performance, educational background, place of residence, professional experience, qualifications, specializations, role, business responsibilities and achievements of the officer or director and the prior salary and compensation arrangements therewith. Since a competitive base salary is essential to our ability to attract and retain highly skilled professionals, in accordance with the Compensation Policy Tower will seek to establish and maintain base salaries that are based on competitive market analyses. The comparative peer group will include direct competitors, or companies that operate in similar industries, with similar market capitalization, enterprise value, and/or revenues, active in similar geographic locations. Base salary (gross) granted by the Company to the Covered Officers A, K, H, C and J with respect to the year ended December 31, 2014, amounted to \$0.68 million, \$0, \$0.3 million, \$0.3 million and \$0.2 million, respectively. Officers and directors will be entitled to social and other benefits as per applicable law and based on the practice of peer companies, and may also be entitled to additional benefits, taking into consideration their rank, seniority in the territory they reside in, global market and local market practice and applicable law. Such additional benefits, which shall be subject to approval of the Compensation Committee and the Board of Directors, may include, inter alia, annual vacation, sick leave, medical insurance, allocations to pensions, long term disability, contribution to education fund (up to the maximum allowable by law), car expenses, contribution to managers' insurance, cellular phone and laptop computer, as well as taxes and expenses which may be incurred in relation to such benefits being borne by the Company. The cost to the Company of such social and other benefits granted to the Covered Officers A, K, H, C and J with respect to the year ended December 31, 2014, amounted to \$0.13 million, \$0, \$0.06 million, \$0.15 million and \$0.14 million, respectively. In addition, when relevant, and subject to approval of the Compensation Committee, the Board of Directors and the Company's shareholders as may be required under applicable law, certain Covered Officers are entitled to relocation related and reimbursement expenses and benefits until termination, including housing costs, family flights and related repatriation costs, which shall not exceed \$280,000 on an annual basis. Such relocation related and reimbursement expenses granted to the Covered Officers A, K, H, C and J with respect to the year ended December 31, 2014, amounted to \$0.28 million, \$0, \$0, \$0 and \$0, respectively.

For purposes of attracting high quality personnel, we may offer an officer or director a sign-on bonus as an incentive to join the Company, which may be comprised of cash and/or equity and shall not exceed an amount equal to the officer's or director's annual base salary. No such payment or accrual was made or earned in 2014.

Our policy is to allow annual cash bonuses, which may be awarded to the office holders upon the attainment of pre-set annual measurable objectives and personal performance, which are set in the first quarter of the year, and include minimum thresholds for performance. The Compensation Policy sets forth a pre-defined mechanism which includes bonus criteria based on measurable components and the weight of each component (in percentage terms) of each group of component measures as a portion of the annual criteria, as well as a minimum threshold below which no bonus will be awarded for the component. Office holders may also receive a special bonus for substantial achievements on certain types of special transactions that are unexpected when determining our annual management by objective plan. It is clarified that this special bonus mechanism will not be awarded as a matter of routine and granted only in situations where it is warranted as described below. The cash bonus gross amounts granted by the Company to the Covered Officers A, K, H, C and J during the year ended December 31, 2014, amounted to \$1.23 million, \$0, \$0.1 million, \$0.44 million and \$0.22 million, respectively, considering the successful execution of the Panasonic transaction.

The equity based compensation offered by us is intended to be in a form of stock options and/or other equity forms, such as restricted stock units (or "RSUs"), in accordance with our equity based compensation policies and programs in place from time to time and in accordance with the compensation policy. Equity based compensation awarded by us shall not be in excess of 10% of our share capital on a fully diluted basis. The equity based compensation, shall be granted automatically as either an annual grant and/or from time to time and be individually determined and awarded according to the performance, educational background, professional experience, qualifications, specializations, role, personal responsibilities and achievements of the officer or director and the prior salary and compensation arrangements therewith, and subject to legal limitations. As a general policy, options for our officers and directors shall gradually vest per passage of time over a period of 3 years (or more) and the RSUs shall be subject to time and/or performance based vesting. There shall be no vesting before the end of the first year from date of grant. We will calculate the fair market value of the equity based compensation for the officers and directors, at the time of grant according to the Black and Scholes model, binomial model or any other best practice or commonly accepted equity based compensation valuation model as calculated in the actual award, when such award is approved by the Compensation Committee and Board of Directors. The aggregate three year value of such calculated fair market value shall not exceed, (i) for an officer (not a director) three annual base salaries of such office holder, and (ii) for a director, \$180,000 per 3 years, subject to applicable law and regulations. The exercise price and expiration of the options shall be as set forth in Section 14 of the compensation policy. The exercise price of options granted to the office holders shall be equal to the arithmetic average closing price of Tower's shares, as quoted on the NASDAQ market (or if Tower's shares will not be traded on NASDAQ, the Tel-Aviv Stock Exchange or any principal national securities exchange upon which Tower's shares are listed or traded) for the 30 trading days prior to the date of grant. The options may contain a mandatory exercise provision for vested options which shall provide for an automatic exercise upon reaching a certain share price and may also trigger the sale of the underlying shares. The expiration of options granted to such officers shall be seven years from date of grant. In addition, the members of Tower's Board may be granted equity based compensation which shall vest over a period of 3 years, and which in the aggregate shall not exceed, with respect to each director, \$180,000 per 3 years, subject to applicable law and regulations. The exercise price and expiration of the options shall be in accordance with the above described terms. The chairman of the board may be entitled to cash and/or equity based remuneration which in the aggregate shall not exceed \$600,000 on an annual basis (together with reimbursement of expenses) in accordance with our policy as approved by the Compensation Committee and Board of Directors.

Total value of equity based compensation granted to the Covered Officers A, K, H, C and J during the year ended December 31, 2014 (calculated based on the Black and Scholes economic model for all awarded equity based compensation granted to said Covered Officers during 2014), amounted to \$0, \$1.8 million, \$0.67 million, \$0 and \$0, respectively.

We may provide officers (not including directors) with a prior notice of termination of up to six (6) months but not less than three (3) months (unless termination is for cause), during which they may be entitled to all of the compensation elements, and to the continuation of vesting of their equity based compensation. Officers (not including directors) shall provide us with prior notice of resignation of at least three (3) months. During this advance notice period, at our discretion, such officers may be requested to remain on our payroll and provide services to us. During this period, such officers shall be paid their base salary and benefits and may be entitled to a partial or full annual bonus, based on their actual period of service or employment within this period, and based on the Company's performance during the period, the contribution of the office holder to achieving our targets and profits and the circumstances of the termination. Upon resignation, such officers who are Israeli employees may receive severance pay according to Israeli law. All other employees shall receive severance pay according to the applicable local laws. Upon dismissal, office holders who are Israeli employees may receive severance pay equal to his/her last monthly base salary multiplied by the number of years employed by us. All other employees shall receive severance pay according to their local labor laws. The total amount paid to such officers for the aforementioned severance compensation shall not exceed an amount of twenty-four (24) monthly base salaries, subject however to any amounts



which would have to be paid to such officer in accordance with the local labor law. The termination compensation (including redemption of accrued vacation days) provided to the Covered Officers A, B, C, D and E with respect to the year ended December 31, 2014 amounted to \$0, \$0, \$0, \$0 and \$0.15 million, respectively.

Under the Compensation Policy, the Company may grant its officers (not including directors) a change of control bonus, subject to receipt of applicable corporate approvals as required by law. The change of control bonus would allow for a bonus in connection with a corporate transaction involving a change of control and subject to the termination of such officer upon the change of control. The change of control bonus may be in an amount of up to one annual base salary and acceleration of all unvested options for exercise for the Company's chief executive officer and in an amount of up to nine (9) months' base salary and acceleration of all unvested options for exercise for the other officers (excluding directors). No such payment or accrual was made or earned in 2014.

In connection with a corporate transaction involving a change of control, the chairman of the board and other directors may be entitled to acceleration of all unvested options for exercise.

The CEO is eligible for a termination grant upon termination of his employment. Such termination grant shall be in an amount up to a lump sum of twelve (12) monthly base salaries without benefits. The amount granted shall take into consideration the period of employment, his service and employment conditions in the course of said period, our performance during the period, his contribution to the achievement of our targets and profits and the circumstances surrounding the termination of employment. No such payment or accrual was made or earned in 2014.

In September 2013, our shareholders approved certain amendments to the employment agreement of our CEO, including an increase to our CEO's base salary to \$680,000 per annum (in addition to expenses reimbursement, options grants and other compensation components to which he was entitled before) and a performance-based bonus that shall not exceed 225% of our his annual base salary. For further details, see Tower's proxy statement to its shareholders filed on July 30, 2013.

The members of Tower's board may (and, in the case of external directors, shall) be entitled to remuneration and refund of expenses according to the provisions of the Companies Regulations (Rules on Remuneration and Expenses of Outside Directors), 2000, as amended by the Companies Regulations (Relief for Public Companies Traded in Stock Exchange Outside of Israel), 2000, as such regulations may be amended from time to time.

Directors shall be entitled to:

- An annual fee which shall be capped at up to \$60,000.
- Per meeting fee shall be capped at up to \$2,000.
- Reasonable travel expenses.

#### Share Option Plans

##### Tower's 2013 Share Incentive Plan (the "2013 Plan")

As set forth in the Company's approved Compensation Policy, in 2013, the Company adopted a new share incentive plan to directors, officers, employees and its subsidiaries' employees (the "2013 Plan"). Options to be granted under this plan will bear an exercise price which equals an average of the closing price in the thirty trading days immediately prior to the date of grant, vest over up to a three year period and are not exercisable beyond seven years from the grant date. As of December 31, 2014, approximately 3.5 million options were outstanding under the 2013 Plan to our directors and senior management of which approximately 0.8 million were outstanding to our CEO and approximately 0.6 million were outstanding for our Chairman (in addition to 0.3 million and 0.8 million granted to them, respectively, prior to the 2013 Plan). Further grants may be approved in accordance with a decision of the Board of Directors of the Company.

In January 2014 our shareholders approved the grant of 620,431 options to our chairman of the board of directors under the 2013 Plan in accordance with the Company's approved Compensation Policy. This grant was approved by our shareholders in January 2014 following approval by the Compensation Committee and Board in 2013. The options have a three year vesting schedule vesting 50% on the date of the second anniversary from the date of grant and 50% on the date of the third anniversary from the date of grant and are not exercisable beyond seven years from the grant date.

In April 2015, our shareholders approved the grant of 10,000 options to each of Ilan Flato, Alex Kornhauser, Rami Guzman, Dana Gross, Sagi Kabla and Kalman Kaufman under the 2013 Plan, in accordance with the Company's approved Compensation Policy. The options have a three year vesting schedule, vesting 50% on the date of the second anniversary from the date of grant and 50% on the date of the third anniversary from the date of grant and are not exercisable beyond seven years from the grant date. The exercise price of these options shall be calculated based on the average closing price of Tower's ordinary shares as quoted on the NASDAQ market during the 30 trading days prior to the date of the grant but shall not be lower than the nominal value of Tower's ordinary shares, unless otherwise determined by the Board of Directors in accordance with the provisions set forth in the option plan. The options so granted shall expire seven (7) years from date of grant.

In addition, the Compensation Committee and Board approved to amend the 2013 Plan under which the employees shall not be liable to pay the nominal price of the shares underlying the RSUs.

For further information concerning our employee stock option plans and outstanding employee stock options, see Note 17B to the consolidated financial statements for the year ended December 31, 2014 included in this report.

#### C. BOARD PRACTICES

Our Articles of Association provide that the Board of Directors shall consist of at least five and no more than 11 members. All directors, except for external directors, hold office until their successors are elected at the next annual general meeting of shareholders.

Our Articles of Association provide that any director may, by written notice to us and subject to the approval of the Board of Directors, appoint another person to serve as an alternate director, and may cancel such appointment. Any person who is not already a director may act as an alternate, and the same person may not act as the alternate for more than one director at a time. The term of appointment of an alternate director may be for one meeting of the Board of Directors or for a specified period or until notice is given of the cancellation of the appointment.

Board members are not entitled to benefits in the event of termination of service.

The Israeli Companies Law – 1999 (the “Companies Law”) requires Israeli companies with shares that have been offered to the public in or outside of Israel to appoint no less than two external directors. No person may be appointed as an external director if the person or the person's relative, partner, employer or any entity under the person's control, has or had, on or within the two years preceding the date of the person's appointment to serve as external director, any affiliation with the company or any entity controlling, controlled by or under common control with the company. The term “affiliation” includes:

- an employment relationship;
- a business or professional relationship maintained on a regular basis;
- control; and



- service as an office holder.
- relatives of the controlling shareholder may not be appointed as external directors of a company.
- if the company does not have a controlling shareholder or a shareholder who holds company shares entitling him to vote at least 25% of the votes in a shareholders meeting, no person may be appointed as an external director if the person or the person's relative, partner, employer or any entity under the person's control, has or had, on or within the two years preceding the date of the person's appointment to serve as external director, any affiliation on the date of the person's appointment with the chairman of the Board, chief executive officer, substantial shareholder (who holds at least 5% of the issued and outstanding shares of the company or voting rights which entitle him to vote at least 5% of the votes in a shareholders meeting) or chief financial officer.
- No person may serve as an external director if the person, the person's relative, spouse, employer or any entity controlling or controlled by the person, has a business or professional relationship with someone with whom affiliation is prohibited, even if such relationship is not maintained on a regular basis, except negligible relationships.
- A public company, entity controlling or entity under common control with the company may not grant an external director, his/her spouse or child, any benefit, and may not appoint him/her, his/her spouse or child, to serve as an officer of the company or of an entity under common control with the company, may not employ or receive professional services in consideration from him/her or an entity controlled by him/her unless two years have passed as of the end of service as external director in the company, and regarding a relative who is not a spouse or child – one year as of the end of service as external director.

A person shall be qualified to serve as an external director only if he or she possesses accounting and financial expertise or professional qualifications. At least one external director must possess accounting and financial expertise. The conditions and criteria for possessing accounting and financial expertise and professional qualifications were determined in regulations promulgated by the Israeli Minister of Justice in consultation with the Israeli Securities Authority. The regulations mandate that a person is deemed to have "expertise in finance and accounting" if his or her education, experience and qualifications provide him or her with expertise and understanding in business - accounting matters and financial statements, in a way that allows him or her to understand, in depth, the company's financial statements and to encourage discussion about the manner in which the financial data is presented.

The company's board of directors must evaluate the proposed external director's expertise in finance and accounting, by considering, among other things, his or her education, experience and knowledge in the following: (i) accounting and auditing issues typical to the field in which the company operates and to companies of a size and complexity similar to such company; (ii) a company's external public accountant's duties and obligations; and (iii) preparing company financial statements and their approval in accordance with the Companies Law and the Israeli Securities Law.

A director is deemed to be "professionally qualified" if he or she meets any of the following criteria: (i) has an academic degree in any of the following professions: economics, business administration, accounting, law or public administration; (ii) has a different academic degree or has completed higher education in a field that is the company's main field of operations, or a field relevant to his or her position; or (iii) has at least five years experience in any of the following, or has a total of five years experience in at least two of the following: (A) a senior position in the business management of a corporation with significant operations, (B) a senior public position or a senior position in public service, or (C) a senior position in the company's main field of operations. The board of directors here too must evaluate the proposed external director's "professional qualification" in accordance with the criteria set forth above.



The candidate to serve as an external director must sign a declaration stating that the abovementioned criteria are met as required by law for the appointment of such candidate as an external director.

No person may serve as an external director if the person's position or other business activities create, or may create, a conflict of interest with the person's responsibilities as an external director or may otherwise interfere with the person's ability to serve as an external director. If, at the time external directors are to be appointed, all current members of the board of directors who are not controlling shareholders or relatives of such shareholders are of the same gender, then at least one external director must be of the other gender.

External directors are to be elected by a majority vote at a shareholders' meeting, provided that either:

- the majority of shares voted at the meeting, including more than one-half of the shares held by non-controlling and disinterested shareholders that voted at the meeting, vote in favor of election of the director; or
- the total number of shares held by non-controlling and disinterested shareholders that voted against the election of the director does not exceed two percent of the aggregate voting rights in the company.

The initial term of an external director is three years and may be extended twice for additional three year terms, provided that with respect to the appointment for each such additional three-year term, one of the following has occurred: (i) the reappointment of the external director has been proposed by one or more shareholders holding together 1% or more of the aggregate voting rights in the company and the appointment was approved at the general meeting of the shareholders by a simple majority, provided that: (1)(x) in calculating the majority, votes of controlling shareholders or shareholders having a personal interest in the appointment as a result of an affiliation with a controlling shareholder and abstentions are disregarded and (y) the total number of votes of shareholders who do not have a personal interest in the appointment (other than an interest solely as a result of an affiliation with a controlling shareholder) or who are not controlling shareholders, present and voting in favor of the appointment exceed 2% of the aggregate voting rights in the company, and (2) pursuant to a recently enacted amendment to the Companies Law ("Amendment 22"), effective as of January 10, 2014, the external director who has been nominated in such fashion is not a linked or competing shareholder, and does not have or has not had, on or within the two years preceding the date of such person's appointment to serve as another term as external director, any affiliation with a linked or competing shareholder. The term "linked or competing shareholder" means the shareholder(s) who nominated the external director for reappointment or a material shareholder of the company holding more than 5% of the shares in the company, provided that at the time of the reappointment, such shareholder(s) of the company, the controlling shareholder of such shareholder(s) of the company, or a company under such shareholder(s) of the company's control, has a business relationship with the company or are competitors of the company; the Israeli Minister of Justice, in consultation with the Israeli Securities Authority, may determine that certain matters will not constitute a business relationship or competition with the company; or (ii) the reappointment of the external director has been proposed by the board of directors and the appointment was approved by the majority of shareholders required for the initial appointment of an external director; or (iii) pursuant to a recently enacted Amendment 26 to the Companies Law, effective as of November 25, 2014, the external director has proposed himself for reappointment and the reappointment was approved as provided in sub-section (i) above. The term of office for external directors for Israeli companies traded on certain foreign stock exchanges, including the NASDAQ Capital Market, may be further extended, indefinitely, in increments of additional three-year terms, in each case provided that, in addition to re-election in such manner described above: (1) the audit committee and subsequently the board of directors of the company confirm that, in light of the external director's expertise and special contribution to the work of the board of directors and its committees, the re-election for such additional period is beneficial to the company; and (2) prior to the approval of the reelection of the external director, the company's shareholders have been informed of the term previously served by such nominee and of the reasons why the board of directors and audit committee recommended the extension of such nominee's term. External directors may be removed only by the same majority required for their election as stipulated herein above, or

by a court, and then only if the external directors cease to meet the statutory qualifications for their appointment or if they violate their duty of loyalty to the company. Each committee of a company's board of directors which has been granted any authority normally reserved for the board of directors must include at least one external director.



Mr. Ilan Flato and Mr. Alex Kornhauser currently serve as our external directors. Mr. Kornhauser was appointed for an initial three-year term expiring in August 2011 and was reappointed for an additional three-year term commencing such date. Mr. Flato was appointed for an initial three-year term expiring in April 2012 and was subsequently reappointed by the shareholders for an additional three-year term commencing such date.

An external director is entitled to compensation, as provided in regulations adopted under the Israeli Companies Law, and is otherwise prohibited from receiving any other compensation, directly or indirectly, in connection with service provided as an external director.

The Companies Law requires public companies to appoint an audit committee. Mr. Ilan Flato, Mr. Alex Kornhauser, Rami Guzman and Mr. Kalman Kaufman serve on Tower's audit committee, and Mr. Alex Kornhauser serves as the Audit Committee chairman. Under the Israeli Companies Law, the responsibilities of the audit committee include reviewing the company's financial statements, monitoring the company's independent auditors, identifying irregularities in the management of the company's business and approving related party transactions as required by law, classifying company transactions as extraordinary transactions or non-extraordinary transactions and as material or non-material transactions in which an officer has an interest (which will have the effect of determining the kind of corporate approvals required for such transaction) and approving such interested party transactions, where the approval of the audit committee is required, assessing the proper function of the company's internal audit regime and determining whether its internal auditor has the requisite tools and resources required to perform his role, and reviewing the work plan and the scope of work of the company's independent accountants and their fees, and implementing a whistleblower protection plan with respect to employee complaints of business irregularities. Pursuant to Amendment 22, effective as of January 10, 2014, the responsibilities of the audit committee under the Companies Law also include the following matters: (i) to establish procedures to be followed in respect of related party transactions with a controlling shareholder (where such are not extraordinary transactions), which may include, where applicable, the establishment of a competitive process for such transaction, under the supervision of the audit committee, or individual, or other committee or body selected by the audit committee, in accordance with criteria determined by the audit committee; and (ii) to determine procedures for approving certain related party transactions with a controlling shareholder, which were determined by the audit committee not to be extraordinary transactions, but which were also determined by the audit committee not to be negligible transactions. An audit committee must consist of at least three directors, including all of the external directors of the company. A majority of the members of the audit committee must be independent or external directors. The Companies Law defines independent directors as either external directors or directors who: (1) meet certain of the requirements of an external director, (2) have been directors in the company for an uninterrupted duration of less than 9 years (and any interim period during which such person was not a director which is less than 2 years shall not be deemed to interrupt the duration), and (3) were classified as such by the company. The chairman of the board of directors, any director employed by or otherwise providing services to a controlling shareholder or any corporation controlled by such controlling shareholder, any director who derives his salary primarily from the controlling shareholder, and a controlling shareholder or its relative, may not be a member of the audit committee.

The chairman of the audit committee must be an external director, and all audit committee decisions must be made by a majority of the committee members, of which the majority of members present are independent and external directors and at least one external director is present. Any person who is not eligible to serve on the audit committee is further restricted from participating in its meetings and votes, unless the chairman of the audit committee determines that such person's presence is necessary in order to present a certain matter, provided however, that company employees who are not controlling shareholders or relatives of such shareholders may be present in the meetings but not in the actual votes and resolutions, and company counsel and secretary who are not controlling shareholders or relatives of such shareholders may be present in meetings and decisions if such presence is requested by the audit committee.

Under the Companies Law, the board of directors must appoint an internal auditor, who is recommended by the audit committee. The role of the internal auditor is to examine, among other matters, whether the company's actions comply with the law and orderly business procedure. Under the Companies Law, the internal auditor may be an employee of the company but not an office holder, an interested party, or a relative of an office holder or interested party, and he may not be the company's independent auditor or its representative. Joseph Ginossar of Fahn Kanne, an affiliate of Grant Thornton International, serves as our internal auditor.

In December 2012, the recently adopted Amendment 20 to the Israeli Companies Law-1999 ("Amendment 20") went into effect. see Item 6B above.

## D.

## EMPLOYEES

The following table sets forth for the last three fiscal years, the number of our employees engaged in the specified activities.

|                                                 | As of December 31, |       |       |
|-------------------------------------------------|--------------------|-------|-------|
|                                                 | 2014               | 2013  | 2012  |
| Process and product engineering, R&D and design | 917                | 848   | 866   |
| Manufacturing and operations                    | 2,431              | 1,538 | 1,602 |
| Manufacturing support                           | 293                | 239   | 209   |
| Sales and marketing, finance & administration.. | 270                | 194   | 218   |
| Total                                           | 3,911              | 2,819 | 2,895 |

Except for an arrangement regarding pension contributions, Tower has no collective bargaining agreements with any of its Israeli employees. However, in Israel we are subject to certain labor statutes and national labor court precedent rulings, as well as to certain provisions of the collective bargaining agreements between the Histadrut (General Federation of Labor in Israel) and the Coordination Bureau of Economic Organizations, by virtue of expansion orders issued in accordance with relevant labor laws by the Israeli Ministry of Labor and Welfare, and which apply such agreement provisions to our employees even though they are not directly part of a union that has signed a collective bargaining agreement. The laws and labor court rulings that apply to our employees principally concern the minimum wage laws, procedures for dismissing employees, determination of severance pay, leaves of absence (such as annual vacation or maternity leave), sick pay and other conditions for employment. The expansion orders which apply to our employees principally concern the requirement for length of the work day and workweek, mandatory contributions to a pension fund, annual recreation allowance, travel expenses payment and other conditions of employment. In accordance with these provisions, the salaries of our employees are partially indexed to the Consumer Price Index in Israel.



Under the special collective bargaining agreement to which we are party in regard to our Israeli employees, we are required to contribute funds to an employee's "Manager's Insurance" fund and/or pension fund. Such funds generally provide a combination of savings plans, insurance and severance pay benefits to the employee, securing his or her right to receive pension or giving the employee a lump sum payment upon retirement, under certain circumstances, if legally entitled, upon termination of employment. To the Manager's Insurance fund, the employee usually contributes an amount equal to 5% of his or her wages and the employer usually contributes an additional 13.3% to 15.8%. To the pension fund the employee usually contributes an amount equal to between 5% and 6% of his or her wages and the employer usually contributes an additional 13.7% to 17.3%. Israeli law generally requires severance pay upon the retirement or death of an employee or termination of employment without due cause. Under our special collective bargaining agreement, we are exempt from such severance pay as long as, and for period during which, we contribute on monthly basis the above mentioned benefits to such employee's pension fund and/or Manager's Insurance.

A portion of Jazz's employees at its Newport Beach, California fab are represented by a union and covered by a collective bargaining agreement. Jazz maintains a defined benefit pension plan for certain of its employees covered by a collective bargaining agreement that provides for monthly pension payments to eligible employees upon retirement. The pension benefits are based on years of service and specified benefit amounts. In addition, the bargaining agreement includes a postretirement medical plan to certain employees. For certain eligible bargaining unit employees who terminate employment, Jazz provides a lump-sum benefit payment.

Labor agreements pertaining to the employees of TJP determine the obligation of TJP to make payments to employees upon retirement or upon termination. The liability for termination benefits is based upon length of service and the employee's monthly salary multiplied by a certain ratio. TJP does not cover the termination liability through deposits to benefit funds. Following the cessation of operations in TJP and the termination of employees, the accrued retirement was fully paid to employees by February 2015.

Most of TPSCo's employees at its Japan fabs are represented by a union and covered by a collective bargaining agreement. TPSCo established a Defined Contribution Retirement Plan (the "DC Plan") for its employees through which TPSCo contributes approximately 10% with employee average match of 1% from employee base salary to the DC Plan. Such contribution releases the employer from further obligation to any payments upon termination of employment. The contribution is remitted either to third party benefits funds that are responsible to invest the funds based on employee preference, or directly, to those employees who elected not to enroll in the DC Plan.

E.

## SHARE OWNERSHIP

As of April 08, 2015, our directors and senior managers held options to purchase an aggregate of 4.7 million of our ordinary shares. These options have an average exercise price of \$5.8 per share and the options expire between 2016 and 2022. No individual director or senior manager beneficially owns 1.00% or more of our outstanding ordinary shares, except our CEO, who beneficially owns 1.37% of our outstanding shares and our chairman of the board of directors who beneficially owns 1.79% of our outstanding shares, as of March 31, 2015.

## ITEM 7.

## MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

A.

## MAJOR SHAREHOLDERS

The following set forth information, as of May 7, 2015 unless otherwise noted below, concerning the beneficial ownership (as defined in Rule 13d-3 under the Securities Exchange Act of 1934, as amended), and on a diluted basis, of ordinary shares by any person who is known to own at least 5% of our issued and outstanding ordinary shares. As of such date, approximately 77 million ordinary shares were issued and outstanding. The voting rights of our major shareholders do not differ from the voting rights of other holders of our ordinary shares.

| Identity of Person or Group | Percent of Class(1) |   | Percent of Class (Diluted)(2) |   |
|-----------------------------|---------------------|---|-------------------------------|---|
| Kenon Holdings Ltd. (3)     | 25.05               | % | 18.71                         | % |
| Rima Senvest Management (4) | 5.40                | % | 3.95                          | % |

(1) Assumes the holder's beneficial ownership of all Tower ordinary shares and all securities that the holder has a right to purchase within 60 days. Also assumes that no other exercisable or convertible securities held by other shareholders has been exercised or converted into shares of the Company.

(2) Assumes that all currently outstanding securities to purchase ordinary shares, other than those which cannot be calculated as of the date of the date referred to above, have been exercised by all holders.

(3) Based on schedule 13D/A filed by Kenon on May 7, 2015 it has as of May 1, 2015 approximately 18.0 million shares, in addition to warrants exercisable to acquire approximately 1.67 million shares and 2,668 Ordinary Shares issuable upon the exercise of options.

(4) Based on information provided by Rima Senvest Management as of March 31, 2015 it had approximately 4.1 million shares and debentures (Series F) convertible into approximately 0.03 million shares.

Tower's major shareholders do not have different voting rights from their shares holding percentage.

As of March 31, 2015, there were a total of 14 holders of record of our ordinary shares, of which 9 were registered with addresses in the United States. Such United States record holders (which include non-US shareholders) were, as of such date, the holders of record of approximately 41.0% of our outstanding ordinary shares. The number of record holders in the United States is not representative of the number of beneficial holders nor is it representative of where such beneficial holders are resident since many of these ordinary shares were held of record by brokers or other nominees (including one U.S. nominee company, CEDE & Co., which held approximately 41% of our outstanding ordinary shares as of said date, including those held for the benefit of the Tel Aviv Stock Exchange clearing house as a member of Depository Trust Company).

**B. RELATED PARTY TRANSACTIONS**

For information related to transactions with related parties see Note 21 to the consolidated financial statements. The table presented in Note 21 includes \$14.9 million relating to electricity purchased from an affiliated company of a major shareholder.

**C. INTERESTS OF EXPERTS AND COUNSEL**

Not applicable.

**ITEM 8. FINANCIAL INFORMATION**

**A. CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION**

See Item 18.

**Legal Proceedings**

From time to time we are a party to various litigation matters incidental to the conduct of our business. As of today, there is no pending or threatened legal proceeding to which we are a party, that, in the opinion of our management, is likely to have a material adverse effect on our future financial results or financial condition.

**B. SIGNIFICANT CHANGES**

No significant change has occurred since December 31, 2014, except as disclosed in this annual report.

**ITEM 9. THE OFFER AND LISTING**

Our ordinary shares are listed and traded on the NASDAQ Stock Market (on the NASDAQ Global Market through March 16, 2012 and on the NASDAQ Capital Market since that date) and on the Tel Aviv Stock Exchange (TASE) under the symbol "TSEM".

The following table sets forth, for the periods indicated, the high and low reported sales prices of the ordinary shares on the NASDAQ Stock Market and Tel Aviv Stock Exchange:

| Period              | NASDAQ Stock Market |          | Tel Aviv Stock Exchange |           |
|---------------------|---------------------|----------|-------------------------|-----------|
|                     | High (\$)           | Low (\$) | High (NIS)              | Low (NIS) |
| April 2015          | 17.98               | 14.38    | 70.65                   | 58.90     |
| March 2015          | 18.29               | 16.16    | 73.79                   | 63.80     |
| February 2015       | 16.84               | 13.01    | 63.79                   | 50.45     |
| January 2015        | 16.59               | 12.41    | 64.21                   | 49.90     |
| December 2014       | 14.26               | 12.32    | 56.00                   | 48.10     |
| November 2014       | 13.33               | 9.78     | 50.48                   | 36.83     |
| First quarter 2015  | 18.29               | 12.41    | 73.79                   | 49.90     |
| Fourth quarter 2014 | 14.26               | 8.64     | 56.00                   | 32.90     |
| Third quarter 2014  | 12.26               | 9.07     | 43.78                   | 30.74     |
| Second quarter 2014 | 10.06               | 7.56     | 34.68                   | 26.02     |
| First quarter 2014  | 9.64                | 5.44     | 32.88                   | 19.20     |
| Fourth quarter 2013 | 7.53                | 3.85     | 22.70                   | 13.40     |
| Third quarter 2013  | 5.18                | 4.15     | 18.37                   | 14.65     |
| Second quarter 2013 | 7.85                | 4.60     | 28.66                   | 15.83     |
| First quarter 2013  | 8.67                | 6.16     | 32.40                   | 22.72     |
| 2014                | 14.26               | 5.44     | 56.00                   | 19.20     |
| 2013                | 8.67                | 3.85     | 32.40                   | 13.40     |
| 2012*               | 15.30               | 6.75     | 57.90                   | 27.58     |
| 2011*               | 23.10               | 9.00     | 82.41                   | 34.05     |
| 2010*               | 28.05               | 14.85    | 105.29                  | 55.65     |

\* Adjusted to reflect the reverse share split of our outstanding ordinary shares in a ration of 1:15, effected in August 2012.

#### ITEM 10.

#### ADDITIONAL INFORMATION

##### Articles of Association

##### Registration Number and Purposes

Our registration number with the Israeli Companies Registrar is 520041997. Pursuant to Section 4 of our Articles of Association (“Articles”), Tower’s objective is to engage in any lawful activity.

## Articles of Association

Our Articles were adopted in November 2000, and as amended most recently in May 2013, provide for an authorized share of 150 million ordinary shares with par value of NIS 15.00 each. In August 2012, we effected a reverse share split of our outstanding ordinary shares in a ratio of 1:15. All our securities presented in this annual report were adjusted to reflect such reverse split. Tower has currently outstanding only one class of equity securities, ordinary shares, par value NIS 15.00 per share. Holders of Tower ordinary shares have one vote per share, and are entitled to participate equally in the payment of dividends and share distributions and, in the event of liquidation of Tower, in the distribution of assets after satisfaction of liabilities to creditors. No preferred shares are currently authorized.

Our Articles require that we hold our annual general meeting of shareholders each year no later than 15 months from the last annual meeting, at a time and place determined by the Board of Directors, upon at least 21 days' prior notice to our shareholders. Two or more shareholders holding at least 33% of the voting rights personally or by proxy will constitute a quorum for the meeting. Shareholders may vote in person or by proxy, and are required to prove title to their shares as required by the Companies Law pursuant to procedures established by the Board of Directors. Resolutions regarding the following matters shall be passed by an ordinary majority of those voting at the general meeting.

- amendments to our Articles;
- appointment and termination of our independent auditors;
- appointment and dismissal of directors (except of external directors);
- approval of acts and transactions requiring general meeting approval under the Companies Law;
- increase or reduction of authorized share capital or the rights of shareholders or a class of shareholders;
- any merger as provided in section 320 of the Companies Law; and
- the exercise of the Board of Directors' powers by the general meeting, if the Board of Directors is unable to exercise its powers and the exercise of any of its powers is essential for Tower's proper management, as provided in section 52(a) of the Companies Law.

A special meeting may be convened by the request of two directors or by the request of one or more shareholders holding at least 5% of our issued share capital and 1% of the voting rights or one or more shareholders holding at least 5% of the voting rights. Shareholders requesting a special meeting must submit their proposed resolution with their request. Within 21 days of receipt of the request, the Board must convene a special meeting and send out notices setting forth the date, time and place of the meeting. Subject to exceptions, such notice must be given at least 21 days but not more than 35 days prior to the special meeting.

Our ordinary shares may generally be freely transferred under the Articles, unless the transfer is restricted or prohibited by applicable law or the rules of the stock exchange on which the shares are traded. The ownership or voting of our ordinary shares by non-residents of Israel is not restricted in any way by our Articles or the laws of the State of Israel, except under certain circumstances for ownership by nationals of certain countries that are, or have been, in a state of war with Israel.

## Exemption and Indemnification Agreements with Directors and Office Holders



Tower entered into exemption and indemnification agreements with the members of its Board of Directors and other Office Holders, which were amended to reflect certain amendments to the Israeli Securities Law and the Israeli Companies Law, pursuant to which, subject to the limitations set forth in the Israeli Companies Law, the Israeli Securities Law and the Articles, they will be exempt from liability for breaches of the duty of care owed by them to the Company or indemnified for certain costs, expenses and liabilities with respect to events specified in the exemption and indemnification agreements. Tower's shareholders approved these amended exemption and indemnification agreements.

## The Companies Law

We are subject to the provisions of the Companies Law. The Companies Law codifies the fiduciary duties that “office holders,” including directors and executive officers, owe to a company. An office holder, as defined in the Companies Law, is a general manager, chief business manager, deputy general manager, vice general manager, another manager directly subordinate to the general manager or any other person assuming the responsibilities of any of the foregoing positions without regard to such person’s title, or a director. Each person listed in the table in “Item 6. Directors, Senior Management and Employees” above is an office holder of the Company.

The Companies Law requires an office holder to promptly disclose any personal interest that he or she may have and all related material information known to him or her, in connection with any existing or proposed transaction by the company. In addition, if the transaction is an extraordinary transaction, the office holder must also disclose any personal interest held by the office holder’s spouse, siblings, parents, grandparents, descendants, and spouse’s descendants, siblings and parents, and the spouse of any of the foregoing, or any corporation in which the office holder is a 5% or greater shareholder, holder of 5% or more of the voting power, director or general manager or in which he or she has the right to appoint at least one director or the general manager. An extraordinary transaction is defined as a transaction not in the ordinary course of business, not on market terms, or one that is likely to have a material impact on the company’s profitability, assets or liabilities.

The Companies Law requires that specific types of transactions, actions and arrangements be approved as provided for in a company’s articles of association and in some circumstances by the company’s audit committee or compensation committee, board of directors and shareholders. For example, the Companies Law requires that agreements regarding the terms of compensation, insurance or indemnification of directors be approved by the company’s compensation committee, board of directors and shareholders. Agreements regarding the terms of compensation, insurance or indemnification of officers will need to be approved by the company’s compensation committee and board of directors, and in certain instances by shareholders as well. In the case of a transaction with an office holder that is not an extraordinary transaction, after the office holder complies with the above disclosure requirements, only board approval is required, unless the Articles provide otherwise. The transaction must be in the company’s interests. If the transaction is an extraordinary transaction, then, in addition to any approval required by the Articles it must be approved first by the audit committee and then by the board of directors, and, in specific circumstances, by a meeting of the shareholders. Subject to exceptions set forth in the Companies Law, an any individual who has a personal interest in a matter that is considered at a meeting of the board of directors or the audit committee may not be present during the relevant discussion at such meeting or vote on such matter.

The Companies Law applies the same disclosure requirements to a controlling shareholder of a public company. The term “controlling shareholder” is defined as a shareholder who has the ability to direct the activities of a company, other than if this power derives solely from the shareholder’s position on the board of directors or any other position with the company, and the definition of “controlling shareholder” in connection with matters governing: (i) extraordinary transactions with a controlling shareholder or in which a controlling shareholder has a personal interest, (ii) certain private placements in which the controlling shareholder has a personal interest, (iii) certain transactions with a controlling shareholder or relative with respect to services provided to or employment by the company, (iv) the terms of employment and compensation of the general manager, and (v) the terms of employment and compensation of office holders of the company when such terms deviate from the company’s compensation policy, also includes shareholders that hold 25% or more of the voting rights if no other shareholder owns more than 50% of the voting rights in the company (and the holdings of two or more shareholders which each have a personal interest in such matter will be aggregated for the purposes of determining such threshold). Extraordinary transactions with a controlling shareholder or in which a controlling shareholder has a personal interest, require the approval of the audit committee, the board of directors and the shareholders of the company. Agreements relating to the terms of office and employment of a controlling shareholder require the approval of the compensation committee, the board of directors

and the shareholders of the company. The shareholder approval for the above noted matters must either include more than one-half of the shares held by disinterested shareholders who are present, in person or by proxy, at the meeting, or, alternatively, the total shareholdings of the disinterested shareholders who vote against the transaction must not represent more than two percent of the voting rights in the company.

Extraordinary transactions between the Company and a controlling shareholder or in which a controlling shareholder has personal interest and with duration exceeding three years are subject to re-approval once every three years by the audit committee (or compensation committee, as applicable), board of directors and the shareholders of the company. Extraordinary transactions with a controlling shareholder or in which a controlling shareholder has a personal interest may be approved in advance for a period exceeding three years if the audit committee determines such approval reasonable under the circumstances. In addition, agreements and extraordinary transactions with duration exceeding three years which were approved prior to May 14, 2011 will need to be re-approved by the proper corporate actions at the later of (i) the first general meeting held after May 14, 2011, (ii) November 14, 2011 or (iii) the expiration of three years from the date on which they were originally approved, even though they were properly approved prior to the passing of the amendment to the Companies Law.

The board of directors of a public company is obligated to adopt a compensation policy after considering the recommendations of the compensation committee. The final approval of the compensation committee is subject to the approval of the shareholders of the company. Such shareholder approval is subject to certain special majority requirements, as set forth in the Companies Law, pursuant to which the shareholder majority approval must also either include more than one-half of the shares held by non-controlling and disinterested shareholders who actively participate in the voting process (without taking abstaining votes into account), or, alternatively, the total shareholdings of the non-controlling and disinterested shareholders who voted against the transaction must not represent more than two percent of the voting rights in the company.

Nonetheless, even if the shareholders of the company do not approve the compensation policy, the board of directors of a company may approve the compensation policy, provided that the compensation committee and, thereafter, the board of directors resolved, based on detailed, documented, reasons and after a second review of the proposed compensation policy, that the approval of the compensation policy is for the benefit of the company.

Pursuant to the Companies Law, the terms of office and employment of an office holder in a public company should be in accordance with the company's compensation policy. Nonetheless, provisions were established that allow a company, under special circumstances, to approve terms of office and employment that deviate from the approved compensation policy. Additionally, the Companies Law also sets for the provisions governing the approval requirements for the compensation and/or terms of office of a specific office holder.

Terms of office and employment of office holders who are neither directors nor the general manager require approval by the (i) compensation committee; and (ii) the board of directors. Approval of terms of office and employment for such office holders which do not comply with the compensation policy may nonetheless be approved subject to two cumulative conditions: (i) the compensation committee and thereafter the board of directors, approved the terms after having taken into account the various policy considerations and mandatory requirements set forth in the Companies Law with respect to office holder compensation, and (ii) the shareholders of the company approved the terms of office and employment for such office holders by means of the special majority required for approving the compensation policy (as detailed above).

Terms of office and employment of the general manager require approval by the (i) compensation committee; (ii) the board of directors and (iii) the shareholders of the company by means of the special majority required for approving the compensation policy (as detailed above). Approval of terms of office and employment for the general manager which do not comply with the compensation policy may nonetheless be approved subject to two cumulative conditions: (i) the compensation committee and thereafter the board of directors, approved the terms after having taken into account the various policy considerations and mandatory requirements set forth in the Companies Law with respect to office holder compensation, and (ii) the shareholders of the company approved the terms of office and employment for the general manager which deviate from the compensation policy by means of the special majority required for approving the compensation policy (as detailed above). Notwithstanding the foregoing, a company may be exempted from receiving shareholder approval with respect to the terms of office and employment of a proposed candidate for general manager if such candidate meets certain independence criteria, the terms of office and employment are in line with the compensation policy, and the compensation committee has determined for specified reasons that presenting the matter for shareholder approval would thwart the proposed engagement.

Terms of office and employment of office holders (including the general manager) that are not directors may nonetheless be approved by the company despite shareholder rejection, provided that a company's compensation committee and thereafter the board of directors have determined to approve such terms of office and employment, based on detailed reasoning, after having re-examined the terms of office and employment, and having taken the shareholder rejection into consideration.

Terms of office and employment of directors require approval by the (i) compensation committee; (ii) the board of directors and (iii) the shareholders of the company. Approval of terms of office and employment for directors of a company which do not comply with the compensation policy may nonetheless be approved subject to two cumulative conditions: (i) the compensation committee and thereafter the board of directors, approved the terms after having taken into account the various policy considerations and mandatory requirements set forth in the Companies Law with respect to office holder compensation, and (ii) the shareholders of the company have approved the terms by means of the special majority required for approving the compensation policy (as detailed above).

In addition to approval by a company's board of directors, a private placement in a public company requires approval by a company's shareholders in the following cases:

- A private placement that meets all of the following conditions:
  - o 20 percent or more of the voting rights in the company prior to such issuance are being offered;
  - o The private placement will increase the relative holdings of a shareholder that holds five percent or more of the company's outstanding share capital (assuming the exercise of all of the securities convertible into shares held by that person), or that will cause any person to become, as a result of the issuance, a holder of five percent or more of the company's outstanding share capital; and

o All or part of the consideration for the offering is not cash or registered securities, or the private placement is not being offered at market terms.

- A private placement which results in anyone becoming a controlling shareholder.

The above transactions must be for the benefit of the company.

Under the Companies Law, a shareholder has a duty to act in good faith towards the company and other shareholders and refrain from abusing his power in the company, including, among other things, vote in the general meeting of shareholders on the following matters:

- any amendment to the Articles;
- an increase of the company's authorized share capital;
- a merger; or
- approval of interested party transactions that require shareholder approval.

In addition, any controlling shareholder, any shareholder who knows that it possesses power to determine the outcome of a shareholder vote and any shareholder who has the power to appoint or prevent the appointment of an office holder in the company is under a duty to act with fairness towards the company. The Companies Law does not describe the substance of this duty, but provides that laws applicable to a breach of contract, adjusted according to the circumstances shall apply to a breach of such duties. With respect to the obligation to refrain from acting discriminatorily, a shareholder that is discriminated against can petition the court to instruct the company to remove or prevent the discrimination, as well as provide instructions with respect to future actions.

**Tender Offer.** A person wishing to acquire shares or any class of shares of a publicly traded Israeli company and who would as a result hold over 90% of the company's issued and outstanding share capital or of a class of shares, is required by the Companies Law to make a tender offer to all of the company's shareholders for the purchase of all of the issued and outstanding shares of the company. If the shares represented by the shareholders who did not tender their shares in the tender offer constitute less than 5% of the issued and outstanding share capital of the company, and (following the Amendment Date) more than half of the shareholders without a personal interest in accepting the offer tendered their shares, then all of the shares that the acquirer offered to purchase will be transferred to the acquirer by operation of law. If the dissenting shareholders hold more than 5% of the issued and outstanding share capital of the company, the acquirer may not acquire additional shares of the company from shareholders who accepted the tender offer to the extent that following such acquisition the acquirer would then own over 90% of the company's issued and outstanding share capital; provided, however, if the dissenting shareholders constitute less than 2% of the issued and outstanding share capital of the company then the full tender will be accepted and all of the shares that the acquirer offered to purchase will be transferred to the acquirer by operation of law. The Companies Law provides for an exception regarding this threshold requirement for a shareholder that on February 1, 2000 held over 90% of the public Israeli company's issued and outstanding share capital. Shareholders may petition the court to alter the consideration for the acquisition, provided, however, and subject to certain exceptions, the terms of the tender offer may state that a shareholder that accepts the offer waives such right.

The Companies Law provides that, subject to certain exceptions, an acquisition of shares of an Israeli public company must be made by means of a tender offer if as a result of the acquisition the purchaser would become a holder of 25% or more of the voting rights in the company. This rule does not apply if there is already another shareholder of the company that holds 25% or more of the voting rights in the company. Similarly, the Companies Law provides that,

subject to certain exceptions, an acquisition of shares in a public company must be made by means of a tender offer if as a result of the acquisition the purchaser would become a holder of more than 45% of the voting rights in the company, if there is no shareholder that holds more than 45% of the voting rights in the company.

Merger. The Companies Law permits merger transactions if approved by each party's board of directors and the majority of each party's shares voted on the proposed merger at a shareholders' meeting called on at least 35 days prior notice. Under the Companies Law, merger transactions may be approved by holders of a simple majority of our shares present, in person or by proxy, at a general meeting and voting on the transaction. In determining whether the required majority has approved the merger, if shares of a company are held by the other party to the merger, or by any person holding at least 25% of the outstanding voting shares or 25% of the means of appointing directors of the other party to the merger, then a vote against the merger by holders of the majority of the shares present and voting, excluding shares held by the other party or by such person, or anyone acting on behalf of either of them, is sufficient to reject the merger transaction, provided, however, if the transaction is an extraordinary transaction with a controlling shareholder or in which a controlling shareholder has an interest, then the approvals required will be the corporate approvals under the Companies Law for such extraordinary transaction (i.e. approval of the audit committee, board of directors and shareholders vote, which shareholder approval must either include more than one-half of the shares held by disinterested shareholders who are present, in person or by proxy, at the meeting, or, alternatively, the total shareholdings of the disinterested shareholders who vote against the transaction must not represent more than two percent). If the transaction would have been approved but for the exclusion of the votes of certain shareholders as provided above, a court may still approve the merger upon the request of holders of at least 25% of the voting rights of a company, if the court holds that the merger is fair and reasonable, taking into account the value of the parties to the merger and the consideration offered to the shareholders. Upon the request of a creditor of either party to the proposed merger, the court may delay or prevent the merger if it concludes that there exists a reasonable concern that, as a result of the merger, the surviving company will be unable to satisfy the obligations of any of the parties to the merger. In addition, a merger may not be consummated unless at least 30 days have passed from the receipt of the shareholders' approval and 50 days have passed from the time that a merger proposal has been filed with the Israeli Registrar of Companies.

#### Companies Law Amendments

As stated above, the Israeli legislature, the Knesset, approved Amendment 16 to the Israeli Companies Law which came into effect during 2011, Amendment 20 which came into effect at the end of 2012, Amendment 22 which came into effect at the beginning of 2014 and Amendment 26 which came into effect at the end of 2014. The purposes of these amendments to the Companies Law were to revise and enhance existing provisions governing corporate governance practices of Israeli companies, to regulate executive pay in Israeli publicly traded companies and to revise and enhance existing provisions governing approval of executive compensation.

The principal provisions set forth in these amendments to the Companies Law are incorporated into the above discussions in Item 10 "The Companies Law" and Item 6.B. Additional changes to the Companies Law pursuant to these recently passed amendments include:

- **Code of Corporate Conduct.** A code of recommended corporate governance practices has been attached to the Companies Law. In the explanatory notes to the legislation, the Knesset noted that an "adopt or disclose non-adoption" regulation would be issued by the Israeli Securities Authority with respect to such code. As of the date of this Annual Report, the Israeli Securities Authority has issued reporting instructions with respect to this code which are applicable only to publicly traded companies whose securities are traded solely on the Tel Aviv Stock Exchange and which report solely to the Israeli Securities Authority.



- Fines. The Israeli Securities Authority shall be authorized to impose fines on any person or company performing a violation, in connection with a publicly traded company which reports to the Israeli Securities Authority, and specifically designated as a violation under the Companies Law.

Although we expect to be in compliance with the Companies Law, there is no assurance that we will not be required to adjust our current corporate governance practices, as discussed in this annual report, pursuant to the provisions of the Companies Law and recently passed amendments to the Companies Law.

#### The Israeli Securities Law- 1968 and the Securities Law Amendment

On February 27, 2011, an amendment to the Israeli Securities Law- 1968 (the "Israeli Securities Law") came into effect (the "Securities Law Amendment"), which applies to Israeli public companies, including companies the securities of which are also listed on NASDAQ Stock Market. The main purpose of the Securities Law Amendment is creating an administrative enforcement procedure to be used by the Israeli Securities Authority ("ISA") to enhance the efficacy of enforcement in the securities market in Israel. The new administrative enforcement procedure may be applied to any company or person (including director, officer or shareholder of a company) performing any of the actions specifically designated as breaches of law under the Securities Law Amendment.

Furthermore, the Securities Law Amendment requires that the chief executive officer of a company supervise and take all reasonable measures to prevent the company or any of its employees from breaching the Israeli Securities Law. The chief executive officers is presumed to have fulfilled such supervisory duty if the company adopts internal enforcement procedures designed to prevent such breaches, appoints a representative to supervise the implementation of such procedures and takes measures to correct the breach and prevent its reoccurrence. The Company is currently in the process of implementing an internal enforcement plan to allow for a higher level of monitoring compliance with the Israeli Securities Law.

Under the Securities Law Amendment, a company cannot obtain insurance against or indemnify a third party (including its officers and/or employees) for any administrative procedure and/or monetary fine (other than for payment of damages to an injured party). The Securities Law Amendment permits insurance and/or indemnification for certain expenses related to an administrative procedure, such as reasonable legal fees, provided that it is permitted under the company's articles of association.

In June 2011, each of our Audit Committee and Board of Directors approved a new form of Indemnification Agreement with our directors and officers so as to reflect this amendment, subject to approval of our shareholders to the relevant changes required to our Articles of Association. Our shareholders approved these amendments to the Articles of Association and a revised form of Indemnification Agreement for directors at the Annual General Meeting of the Shareholders held on August 11, 2011. In addition, our approved Compensation Policy states that we shall indemnify our directors and executive officers to the fullest extent permitted by applicable law, for any liability and expense that may be imposed on the executive officer, as provided in the exemption and indemnification agreement between such individuals and the Company, all subject to applicable law.

## NASDAQ Marketplace Rules and Home Country Practices

As permitted by the NASDAQ Listing Rule 5615(a)(3) in lieu of certain corporate governance requirements we have chosen to follow the practices of our home country with respect to the following:

- We do not supply an annual report but make our audited financial statements available to our shareholders prior to our annual general meeting.
- The majority of our Board of Directors is not comprised of directors who meet the definition of independence contained in the NASDAQ Listing Rules. Under the Companies Law a majority of the Board of Directors is not required to be comprised of independent directors. In keeping with the requirements of the Companies Law two of the members of our Board of Directors are external directors, and are independent as defined under Rule 10A-3 of the Securities Act.
- Our Board has not adopted a policy of conducting regularly scheduled meetings at which only our independent directors are present. The Companies Law does not require our external directors to conduct regularly scheduled meetings at which only they are present.
- We follow the provisions of the Israeli Companies Law with respect to matters in connection with the composition and responsibilities of our compensation committee, office holder compensation, and any required approval by the shareholders of such compensation. Israeli law, and our amended and restated articles of association, do not require that a compensation committee composed solely of independent members of our board of directors determine (or recommend to the board of directors for determination) an executive officer's compensation, as required under NASDAQ's recently adopted listing standards related to compensation committee independence and responsibilities; nor do they require that the Company adopt and file a compensation committee charter. Instead, our compensation committee has been established and conducts itself in accordance with provisions governing the composition of and the responsibilities of a compensation committee as set forth in the Israeli Companies Law. Furthermore, the compensation of our chief executive officer and all other executive officers is not determined, or recommended to the Board for determination, in the manner required by the NASDAQ Listing Rules. In accord with the Companies Law the compensation of directors, the chief executive officer and all other officers requires the approval of our Compensation Committee and Board of Directors, and under circumstances as detailed in this annual report also requires the approval of our shareholders. Such compensation will either be in consistency with our previously approved Compensation Policy or, in special circumstances in deviation therefrom, taking into account certain considerations set forth in the Israeli Companies Law. Thus, we will seek shareholder approval for all corporate actions with respect to office holder compensation requiring such approval under the requirements of the Israeli Companies Law, including seeking prior approval of the shareholders for the Compensation Policy and for certain office holder compensation, rather than seeking approval for such corporate actions in accordance with NASDAQ Listing Rules.
- Director nominees are not selected, or recommended for the Board's selection, as required by the NASDAQ Listing Rules. With the exception of our external directors, our directors are elected for terms of one year or until the following annual meeting, by a general meeting of our shareholders. The nominations for director which are presented to our shareholders are generally made by our board of directors. According to the Companies Law, one or more shareholders of a company holding at least one percent of the voting power of the company may nominate a currently serving external director for an additional three year term.
- Israeli law does not require the adoption of and our Board of Directors has not adopted a formal written charter or board resolution addressing the nomination process and such related matters as may be required under United States federal securities laws, as required by the NASDAQ Listing Rules.



- Although we have adopted a formal written audit committee charter, there is no requirement under the Companies Law to do so and the charter as adopted may not specify all the items enumerated in the NASDAQ Listing Rule 5605(c)(1).
- Although we have adopted a formal written compensation committee charter, there is no requirement under the Companies Law to do so and the charter as adopted may not specify all the items enumerated in the NASDAQ Listing Rule 5605(d)(1).
- Our audit committee does not meet with all of the requirements of the NASDAQ Marketplace Rules, as permitted by the Companies Law though all members are independent as such term is defined under Rule 10A-3 of the Exchange Act.
- Under Israeli law a company is entitled to determine in its articles of association the number of shareholders and percentage of holdings required for a quorum at a shareholders meeting. Our articles of association do not provide for a quorum of not less than 33 1/3% of the outstanding shares of our voting ordinary shares for meetings of our ordinary shareholders, as required by the NASDAQ Listing Rules. Our articles of association presently require a quorum consisting of two shareholders holding a combined 33% of our ordinary shares.
- We review and approve all related party transactions in accordance with the requirements and procedures for approval of interested party acts and transactions, set forth in sections 268 to 275 the Companies Law, which do not fully reflect the requirements of the NASDAQ Listing Rules.
- We seek shareholder approval for all corporate action requiring such approval, in accordance with the requirements of the Companies Law, which does not fully reflect the requirements of the NASDAQ Listing Rules.
- We do not necessarily seek shareholder approval for the establishment of, and amendments to, stock option or equity compensation plans (as set forth in NASDAQ Listing Rule 5635(c)), as such matters are not subject to shareholder approval under Israeli law. We will attempt to seek shareholder approval for our stock option or equity compensation plans (and the relevant annexes thereto) to the extent required in order to ensure they are tax qualified for our employees in the United States. However, even if such approval is not received, then the stock option or equity compensation plans will continue to be in effect, but the Company will be unable to grant options to its U.S. employees that qualify as Incentive Stock Options for U.S. federal tax purpose. Our stock option or other equity compensation plans are also available to our non-U.S. employees, and provide features necessary to comply with applicable non-U.S. tax laws.

#### Material Contracts

For information regarding material contracts see Notes 3, 4, 8, 12, 13, 15, 16 and 17 to our consolidated financial statements for the year ended December 31, 2014 and the agreements described under the caption “Item 5. Operating and Financial Review and Prospects - B. Liquidity and Capital Resources”.

#### TPSCo Agreements

In December 2013, we signed a definitive agreement with Panasonic to create a new company (TPSCo) in Japan to manufacture products for Panasonic and potentially other third parties, using Panasonic's three semiconductor manufacturing facilities (Uozu E, Tonami CD and Arai E) in Hokuriku, Japan.



In accordance with said agreement, upon closing the transaction in March 2014, Panasonic transferred its semiconductor wafer manufacturing process and 8 inch and 12 inch capacity tools at its three fabs (Uozu E, Tonami CD and Arai E) to TPSCo, and entered into a manufacturing agreement for a period of at least five years of volume production. We received 51% of the shares of TPSCo (with PSCS holding the remaining shares), and as consideration for our 51% equity holding in TPSCo, at the closing of the transaction, we issued to Panasonic 870,454 of our ordinary shares valued at approximately \$7.4 million.

Several agreements were signed between Tower and/or TPSCo and Panasonic.

A shareholders' agreement was signed by Tower and Panasonic, stating, among others, that Panasonic understands that the number of products to be manufactured for Panasonic by TPSCo will not be less than the minimum number of Panasonic products to be ordered by Panasonic per month as set forth in the agreement.

A manufacturing agreement was entered into between Panasonic and TPSCo which sets forth the terms under which TPSCo shall operate its fabs and manufacture semiconductor device wafer products for Panasonic. Panasonic will order such products by providing TPSCo with a six month rolling forecast. The quantities set forth in such forecast shall be fully binding with respect to specific lead times (determined per each category of products). Panasonic will pay for such products (provided they meet specified yield rates) based on the pricing specified in the agreement. The initial term of the manufacturing agreement is five years and thereafter it will renew for consecutive one year periods unless written notice is received terminating the agreement.

An intellectual property license agreement was entered into between Panasonic and TPSCo, to which Tower is a third party beneficiary, sets forth the terms pursuant to which Panasonic granted TPSCo a license to use Panasonic's intellectual property rights to manufacture products for Panasonic and other third parties during the term of the agreement. The license to manufacture products for Panasonic is royalty free while TPSCo is required to pay royalties pursuant to the license agreement when manufacturing products for third parties. Under the terms of the agreement, TPSCo is allowed to sublicense the licenses granted to Tower and other third parties, subject in certain cases to the prior written consent of Panasonic, and subject to payment of royalties. The initial term of the agreement shall be for five years and may be extended with the parties' consent.

A business transfer agreement was entered into between Panasonic and TPSCo designates the mechanism and process pursuant to which Panasonic assigned and transferred the joint venture assets, including the three fabrication facilities and their underlying assets, to TPSCo.

In addition to, and in connection with such transactions, additional ancillary agreements were entered into at the closing between Panasonic, TPSCo and/or Tower. In June 2014, Panasonic transferred its shares in TPSCo and its rights and obligations under the relevant ancillary agreements to PSCS, its wholly-owned subsidiary.

For details concerning Tower's Facility Agreement with the Lender Banks and its debentures' related contract, as well as Jazz's credit line and its notes related contracts, see "Item 5. Operation and Financial Review – B. Liquidity and Capital Resources."

For details concerning Tower's long term loan agreement with JA Mitsui Leasing, Ltd and Bank of Tokyo (BOT), see "Item 5. Operation and Financial Review – B. Liquidity and Capital Resources – Long Term Loan Agreement with JA Mitsui Leasing, Ltd. and Bank of Tokyo (BOT)."

## Exchange Controls

Under Israeli law, non-residents of Israel who purchase ordinary shares with certain non-Israeli currencies (including US dollars) may freely repatriate in such non-Israeli currencies all amounts received in Israeli currency in respect of the ordinary shares, whether as a dividend, as a liquidating distribution, or as proceeds from any sale in Israel of the ordinary shares, provided in each case that any applicable Israeli income tax is paid or withheld on such amounts. The conversion into the non-Israeli currency must be made at the rate of exchange prevailing at the time of conversion.

There are currently no Israeli currency control restrictions on remittances of dividends on our ordinary shares, proceeds from the sale of the shares or interest or other payments to non-residents of Israel, except under certain circumstances, for shareholders who are subjects of countries that are, or have been, in a state of war with Israel.

## Taxation

The below discussion does not purport to be an official interpretation of the tax law provisions mentioned therein or to be a comprehensive description of all tax law provisions which might apply to our securities or to reflect the views of the relevant tax authorities, and it is not meant to replace professional advice in these matters. The below discussion is based on current, applicable tax law, which may be changed by future legislation or reforms. Non-residents should obtain professional tax advice with respect to the tax consequences of holding or selling our securities under the laws of their countries of residence of holding or selling our securities.

### Israeli Taxation

An individual is subject to a tax at a rate of 25% on real capital gains derived from the sale of shares, as long as the individual is not a “substantial shareholder” (generally a shareholder with 10% or more of the right to profits, right to nominate a director or voting rights) in the company issuing the shares.

An individual who is a substantial shareholder is subject to tax at a rate of 30% in respect of real capital gains derived from the sale of shares issued by the company in which he or she is a substantial shareholder. The determination of whether the individual is a substantial shareholder will be made on the date that the securities are sold. In addition, the individual will be deemed to be a substantial shareholder if at any time during the 12 months preceding this date he or she had been a substantial shareholder.

An additional income tax at a rate of 2% will be imposed on high earners individuals whose annual income or gain exceeds NIS 811,560.

Corporations are subject to corporate tax with respect to total income, including capital gains, at a rate of 26.5%.

Non-Israeli residents are exempt from Israeli capital gains tax on any gains derived from the sale of shares in an Israeli corporation publicly traded on the TASE and/or on a foreign stock exchange, provided such gains do not derive from a permanent establishment of such shareholders in Israel and that such shareholders did not acquire their shares prior to the issuer’s initial public offering. However, non-Israeli corporations will not be entitled to such exemption if Israeli residents (i) have a controlling interest of more than 25% in such non-Israeli corporation, or (ii) are the beneficiaries of or is entitled to 25% or more of the revenues or profits of such non-Israeli corporation, whether directly or indirectly.

In some instances where our shareholders may be liable to Israeli tax on the sale of their ordinary shares, the payment of the consideration may be subject to Israeli withholding tax.





### Israeli Tax on Interest Income and on Original Issuance Discount

Interest and Original Issuance Discount (OID) on our debentures are, in general, subject to Israeli tax of up to 25% (which would be withheld at source) if received by an individual. However, tax at the marginal rate (up to 50%), if one of the following applies:

- a. if the interest or OID are business income in the hands of the recipient,
- b. if the interest is recorded or should be recorded in the individual's accounting books,
- c. if the recipient is a substantial shareholder of our company,
- d. if financing expenses related to the purchase of the debentures were deducted by the individual in the calculation of the individual's Israeli taxable income, or
- e. if the individual is an employee, supplier, or service provider of the company and the tax authorities have not been persuaded that the payment of interest was not affected by the relationship between the parties.

Interest and OID paid on our debentures to Israeli corporations will, in general, be subject to withholding tax at a rate of 26.5%.

Interest and OID paid on our debentures to non-Israeli residents may be subject to lower withholding tax in an applicable tax treaty. For example, under the US-Israel Tax Treaty, the maximum Israeli tax withheld on interest and OID paid to a US resident (other than a US bank, savings institution or company or with respect to payments attributed to a permanent establishment in Israel) is 17.5%.

Interest, OID or inflation linkage differentials paid to a non-Israeli resident which does not have a permanent establishment in Israel, on debentures issued by an Israeli corporation and which are traded on the TASE, are generally exempt from taxes in Israel. However, this exemption from taxes will not apply (and consequently tax will be withheld at source at a rate of 25%, unless a lower rate applies according to a relevant tax treaty):

- a. if the recipient is a substantial shareholder of the corporation,
- b. if the recipient is an affiliate of the issuer of the debentures, or
- c. if the individual is an employee, supplier, or service provider of the company and the tax authorities have not been persuaded that the Payment was not affected by the relationship between the parties.

### Israeli Tax on Dividend Income

On distributions of dividends other than bonus shares, or stock dividends, to Israeli and non-Israeli resident individuals and non-Israeli resident corporations we would be required to withhold income tax at the rate of 25% (or 30% if such non-Israeli resident individual is a "substantial shareholder" at the time receiving the dividend or on any date in the 12 months preceding such date). If the income out of which the dividend is being paid is attributable to a privileged Enterprise or Preferred Enterprise under the Law for the Encouragement of Capital Investments, 1959 ("the Investment Law"), the rate is generally not more than 20%. A different rate may be provided for in an applicable tax treaty.

Under the US-Israel Tax Treaty, Israeli withholding tax on dividends paid to a US resident may not, in general, exceed 25%, or 15% in the case of dividends paid out of the profits of a corporation entitled to the benefits of the Investment Law , subject to certain conditions. Where the recipient is a US corporation owning 10% or more of the voting stock of the paying corporation and the dividend is not paid from the profits of a corporation entitled to the benefits of the Investment Law , the Israeli tax withheld may not exceed 12.5%, subject to certain conditions.

### Significant changes to the Investment Law

Effective January 1, 2011 significant changes have been made to the Investment Law, which revamped the tax incentive regime in Israel. The main changes are, inter alia, as follows:

- Industrial companies meeting the criteria set out by the Investment Law for a “Preferred Income” of a “Preferred Enterprise” (as defined below) will be eligible for flat tax rates of 9% or 16% as of 2014, with the actual tax rates determined by the location of the enterprise. The tax incentives offered by the Investment Law are no longer dependant neither on minimum qualified investments nor on foreign ownership.
- A company can enjoy both government grants and tax benefits concurrently. Governmental grants will not necessarily be dependent on the extent of enterprise’s investment in assets and/or equipment. The approval of “Preferred Enterprise” status by either the Israeli Tax Authorities or the Investment Center will be accepted by the other. Therefore a Preferred Enterprise may be eligible to receive both tax incentives and government grants, under certain conditions.
- Under the transition provisions, any tax benefits obtained prior to 2011 shall continue to apply until expired, unless the company elects to apply the provisions of the new provisions to its income.

“Preferred Income” is defined as income from a preferred enterprise, as specified below, all less discounts granted, with the condition that the income was produced or arose in the course of the enterprise's ordinary activity in Israel: income from the sale of products of the Preferred Enterprise (including components that were produced by other enterprises); income from the sale of semiconductors by other non related enterprises which use the Preferred Enterprise’s self-developed know-how; income for providing a right to use the Preferred Enterprise’s know how or software; royalties from the use of the know-how or software which was confirmed by the Head of The Investment Center to be related to the production activity of the Preferred Enterprise and services with respect to the aforementioned sales. In addition, the definition of “Preferred Income” also includes income from the provision of industrial R&D services to foreign residents to the extent that the services were approved by the Head of Research for the Industrial Development and Administration.

A “Preferred Enterprise” is defined as an Industrial Enterprise (including, inter alia, an enterprise which develops software, an enterprise which provides approved R&D services to foreign residents and an enterprise which the Chief Scientist confirmed is carrying out R&D in the field of alternative energy), which generally more than 25% of its business income is from export. As mentioned above, the new tax incentives no longer depend on minimum qualified investments nor on foreign ownership.

The Investment Law also determines the conditions and limitations applying to the tax benefits offered to a “Special Preferred Enterprise” (as defined below). A “Special Preferred Enterprise” will be able to enjoy corporate income tax rate in a rate of 5% if located in a preferred zone and 8% if not located in a preferred zone.

A “Special Preferred Enterprise” is defined as a Preferred Enterprise which meets all of the following conditions, during the relevant tax year: (a) its Preferred Income is equal to or exceeds NIS 1.5 billion; (b) the total income of the company which owns the Preferred Enterprise or which operates in the same field of the Preferred Enterprise and which consolidates in its financial reports the company that owns the Preferred Enterprise equals or exceeds NIS 20 billions; and (c) its business plan was approved by the authorities as significantly benefitting the Israeli economy, either by an investment of at least NIS 400 - 800 million in assets; 100 -150 million NIS in R&D or the employment of at least 250 to 500 new employees, for preferred zones and regular zones, respectively.

Dividends paid out of income attributed to a Preferred Enterprise are generally subject to withholding tax at source at a rate of 20% or such lower rate as may be provided in an applicable tax treaty upon a request submitted by the recipient of such dividends. However, if such dividends are paid to an Israeli company no tax will be withheld. Such an exemption may apply under the transition rules also to dividends distributed to an Israeli company by an Israeli company which owns a an Approved Enterprise or a Benefited Enterprise and which elected to convert to the new law until 30 June 2015 (in respect to their existing programs).

#### U.S. Federal Income Tax Considerations

The following discussion is a description of the material U.S. federal income tax considerations applicable to an investment in the ordinary shares by U.S. Holders who acquire our ordinary shares and hold them as capital assets for U.S. federal income tax purposes. As used in this section, the term “U.S. Holder” means a beneficial owner of an ordinary share who is:

- an individual citizen or resident of the United States;

- a corporation created or organized in or under the laws of the United States or of any state of the United States or the District of Columbia;

- an estate, the income of which is subject to U.S. federal income taxation regardless of its source; or

- a trust if the trust has elected validly to be treated as a United States person for U.S. federal income tax purposes or if a U.S. court is able to exercise primary supervision over the trust’s administration and one or more United States persons have the authority to control all of the trust’s substantial decisions.

The term “Non-U.S. Holder” means a beneficial owner of an ordinary share who is not a U.S. Holder. The tax consequences to a Non-U.S. Holder may differ substantially from the tax consequences to a U.S. Holder. Certain aspects of U.S. federal income tax relevant to a Non-U.S. Holder also are discussed below.

This description is based on provisions of the U.S. Internal Revenue Code of 1986, as amended, referred to in this discussion as the Code, existing and proposed U.S. Treasury regulations and administrative and judicial interpretations, each as available and in effect as of the date of this annual report. These sources may change, possibly with retroactive effect, and are open to differing interpretations. This description does not discuss all aspects of U.S. federal income taxation that may be applicable to investors in light of their particular circumstances or to investors who are subject to special treatment under U.S. federal income tax law, including:

- insurance companies;



dealers in stocks, securities or currencies;

financial institutions and financial services entities;

real estate investment trusts;

regulated investment companies;

persons that receive ordinary shares as compensation for the performance of services;

tax-exempt organizations;

persons that hold ordinary shares as a position in a straddle or as part of a hedging, conversion or other integrated instrument;

individual retirement and other tax-deferred accounts;

expatriates of the United States;

persons (other than Non-U.S. Holders) having a functional currency other than the U.S. dollar; and

direct, indirect or constructive owners of 10% or more, by voting power or value, of us.

This discussion also does not consider the tax treatment of persons or partnerships that hold ordinary shares through a partnership or other pass-through entity or the possible application of United States federal gift or estate tax or alternative minimum tax.

We urge you to consult with your own tax advisor regarding the tax consequences of investing in the ordinary shares, including the effects of federal, state, local, foreign and other tax laws.

#### Distributions Paid on the Ordinary Shares

Subject to the discussion below under “PFIC Rules,” a U.S. Holder generally will be required to include in gross income as ordinary dividend income the amount of any distributions paid on the ordinary shares, including the amount of any Israeli taxes withheld, to the extent that those distributions are paid out of our current or accumulated earnings and profits as determined for U.S. federal income tax purposes. Subject to the discussion below under “PFIC Rules” distributions in excess of our earnings and profits will be applied against and will reduce the U.S. Holder’s tax basis in its ordinary shares and, to the extent they exceed that tax basis, will be treated as gain from a sale or exchange of those ordinary shares. Our dividends will not qualify for the dividends-received deduction applicable in some cases to U.S. corporations. Dividends paid in NIS, including the amount of any Israeli taxes withheld, will be includible in the income of a U.S. Holder in a U.S. dollar amount calculated by reference to the exchange rate in effect on the date they are included in income by the U.S. Holder, regardless of whether the payment in fact is converted into U.S. dollars. Any gain or loss resulting from currency exchange fluctuations during the period from the date the dividend is includible in the income of the U.S. Holder to the date that payment is converted into U.S. dollars generally will be treated as ordinary income or loss.



A non-corporate U.S. holder's "qualified dividend income" is subject to tax at reduced rates not exceeding 20 % for tax years beginning 2012 (15% for 2011 and prior years) . For this purpose, "qualified dividend income" generally includes dividends paid by a foreign corporation if either:

- (a) the stock of that corporation with respect to which the dividends are paid is readily tradable on an established securities market in the U.S., or
- (b) that corporation is eligible for benefits of a comprehensive income tax treaty with the U.S. which includes an information exchange program and is determined to be satisfactory by the U.S. Secretary of the Treasury. The Internal Revenue Service has determined that the U.S.-Israel Tax Treaty is satisfactory for this purpose.

In addition, under current law a U.S. Holder must generally hold his ordinary shares for more than 60 days during the 121 day period beginning 60 days prior to the ex-dividend date, and meet other holding period requirements for qualified dividend income.

Dividends paid by a foreign corporation will not qualify for the reduced rates, if the dividend is paid in a tax year of the recipient beginning after December 31, 2002, unless such corporation is treated, for the tax year in which the dividend is paid or the preceding tax year, as a "passive foreign investment company" for U.S. federal income tax purposes. We do not believe that we will be classified as a "passive foreign investment company" for U.S. federal income tax purposes for our current taxable year. However, see the discussion under "PFIC Rules" below.

Subject to the discussion below under "Information Reporting and Back-up Withholding," a Non-U.S. Holder generally will not be subject to U.S. federal income or withholding tax on dividends received on ordinary shares unless that income is effectively connected with the conduct by that Non-U.S. Holder of a trade or business in the United States.

#### Foreign Tax Credit

Any dividend income resulting from distributions we pay to a U.S. Holder with respect to the ordinary shares generally will be treated as foreign source income for U.S. foreign tax credit purposes, which may be relevant in calculating such holder's foreign tax credit limitation. Subject to certain conditions and limitations, Israeli tax withheld on dividends may be deducted from taxable income or credited against a U.S. Holder's U.S. federal income tax liability. The limitation on foreign taxes eligible for credit is calculated separately with respect to specific classes of income. The rules relating to the determination of foreign source income and the foreign tax credit are complex, and the availability of a foreign tax credit depends on numerous factors. Each prospective purchaser who would be a U.S. Holder should consult with its own tax advisor to determine whether its income with respect to the ordinary shares would be foreign source income and whether and to what extent that purchaser would be entitled to the credit.

#### Disposition of Ordinary Shares

Upon the sale or other disposition of ordinary shares, subject to the discussion below under "PFIC Rules" a U.S. Holder generally will recognize capital gain or loss equal to the difference between the amount realized on the disposition and the holder's adjusted tax basis in the ordinary shares. U.S. Holders should consult their own advisors with respect to the tax consequences of the receipt of a currency other than U.S. dollars upon such sale or other disposition.

In the event there is an Israeli income tax on gain from the disposition of ordinary shares, such tax should generally be the type of tax that is creditable for U.S. tax purposes; however, because it is likely that the source of any such gain would be a U.S. source, a U.S. foreign tax credit may not be available. U.S. shareholders should consult their own tax



advisors regarding the ability to claim such credit.

Gain or loss upon the disposition of the ordinary shares will be treated as long-term if, at the time of the sale or disposition, the ordinary shares were held for more than one year. Long-term capital gains realized by non-corporate U.S. Holders are generally subject to a lower marginal U.S. federal income tax rate than ordinary income, other than qualified dividend income, as defined above. The deductibility of capital losses by a U.S. Holder is subject to limitations. In general, any gain or loss recognized by a U.S. Holder on the sale or other disposition of ordinary shares will be U.S. source income or loss for U.S. foreign tax credit purposes. U.S. Holders should consult their own tax advisors concerning the source of income for U.S. foreign tax credit purposes and the effect of the U.S.-Israel Tax Treaty on the source of income.

Subject to the discussion below under “Information Reporting and Back-up Withholding”, a Non-U.S. Holder generally will not be subject to U.S. federal income or withholding tax on any gain realized on the sale or exchange of ordinary shares unless:

that gain is effectively connected with the conduct by the Non-U.S. Holder of a trade or business in the United States, or

in the case of any gain realized by an individual Non-U.S. Holder, that holder is present in the United States for 183 days or more in the taxable year of the sale or exchange, and other conditions are met.

#### Information Reporting and Back-up Withholding

Holders generally will be subject to information reporting requirements with respect to dividends paid in the United States on ordinary shares. In addition, Holders will be subject to back-up withholding tax on dividends paid in the United States on ordinary shares unless the holder provides an IRS certification or otherwise establishes an exemption. Holders will be subject to information reporting and back-up withholding tax on proceeds paid within the United States from the disposition of ordinary shares unless the holder provides an IRS certification or otherwise establishes an exemption. Information reporting and back-up withholding may also apply to dividends and proceeds paid outside the United States that are paid by certain “U.S. payors” or “U.S. middlemen,” as defined in the applicable Treasury regulations, including:

- (1) a U.S. person;
- (2) the government of the U.S. or the government of any state or political subdivision of any state (or any agency or instrumentality of any of these governmental units);
- (3) a controlled foreign corporation;
- (4) a foreign partnership that is either engaged in a U.S. trade or business or whose United States partners in the aggregate hold more than 50% of the income or capital interests in the partnership;
- (5) a foreign person that derives 50% or more of its gross income for certain periods from the conduct of a trade or business in the U.S.; or
- (6) a U.S. branch of a foreign bank or insurance company.

The back-up withholding tax rate is 28%. Back-up withholding and information reporting will not apply to payments made to Non-U. S. Holders if they have provided the required certification that they are not United States persons.



In the case of payments by a payor or middleman to a foreign simple trust, foreign grantor trust or foreign partnership, other than payments to a holder that qualifies as a withholding foreign trust or a withholding foreign partnership within the meaning of the Treasury regulations and payments that are effectively connected with the conduct of a trade or business in the United States, the beneficiaries of the foreign simple trust, the person treated as the owner of the foreign grantor trust or the partners of the foreign partnership will be required to provide the certification discussed above in order to establish an exemption from backup withholding tax and information reporting requirements.

The amount of any back-up withholding may be allowed as a credit against a U.S. Holder's U.S. federal income tax liability and may entitle the holder to a refund, provided that required information is furnished to the IRS.

#### PFIC Rules

A non-US corporation will be classified as a passive foreign investment company, or a PFIC, for US federal income tax purposes if either (i) 75% or more of its gross income for the taxable year is passive income, or (ii) on a quarterly average for the taxable year by value (or, if it is not a publicly traded corporation and so elects, by adjusted basis), 50% or more of its gross assets produce or are held for the production of passive income.

We do not believe that we satisfied either of the tests for PFIC status in 2014 or in any prior year. However, there can be no assurance that we will not be a PFIC in 2015 or a later year. If, for example, the "passive income" earned by us exceeds 75% or more of our "gross income", we will be a PFIC under the "income test". Passive income for PFIC purposes includes, among other things, gross interest, dividends, royalties, rent and annuities. For manufacturing businesses, gross income for PFIC purposes should be determined by reducing total sales by the cost of goods sold. Although not free from doubt, if our cost of goods sold exceeds our total sales by an amount greater than our passive income, such that we are treated as if we had no gross income for PFIC purposes, we believe that we would not be a PFIC as a result of the income test. However, the tests for determining PFIC status are applied annually and it is difficult to make accurate predictions of future income and assets, which are relevant to the determination of PFIC status.

If we were to be a PFIC at any time during a US holder's holding period, such US holder would be required to either: (i) pay an interest charge together with tax calculated at maximum ordinary income tax rates on "excess distributions," which is defined to include gain on a sale or other disposition of ordinary shares, or (ii) so long as the ordinary shares are "regularly traded" on a qualifying exchange, elect to recognize as ordinary income each year the excess in the fair market value, if any, of its ordinary shares at the end of the taxable year over such holder's adjusted basis in such ordinary shares and, to the extent of prior inclusions of ordinary income, recognize ordinary loss for the decrease in value of such ordinary shares (the "mark to market" election). For this purpose, the NASDAQ Capital Market is a qualifying exchange. US holders are strongly urged to consult their own tax advisers regarding the possible application and consequences of the PFIC rules.

#### Documents on Display

We are required to file reports and other information with the SEC under the Securities Exchange Act of 1934 and the regulations thereunder applicable to foreign private issuers. Reports and other information filed by us with the SEC may be inspected and copied at the SEC's public reference facilities described below. Although as a foreign private issuer we are not required to file periodic information as frequently or as promptly as United States companies, we generally do publicly announce our quarterly and year-end results promptly and file periodic information with the SEC under cover of Form 6-K. As a foreign private issuer, we are also exempt from the rules under the Exchange Act prescribing the furnishing and content of proxy statements and our officers, directors and principal shareholders are exempt from the reporting and other provisions in Section 16 of the Exchange Act.



You may review and copy our filings with the SEC, including any exhibits and schedules, at the SEC's public reference room at 100 F Street N.E., Washington, D.C. 20549. You may call the SEC at 1-800-SEC-0330 for further information on this public reference room. As a foreign private issuer, all documents which were filed after November 4, 2002 on the SEC's EDGAR system will be available for retrieval on the SEC's website at [www.sec.gov](http://www.sec.gov). These SEC filings are also available to the public on the Israel Securities Authority's Magna website at [www.magna.isa.gov.il](http://www.magna.isa.gov.il), the Tel Aviv Stock Exchange website at <http://www.maya.tase.co.il>, and from commercial document retrieval services. We also generally make available on our own web site ([www.towerjazz.com](http://www.towerjazz.com)) our quarterly and year-end financial statements as well as other information. We do not intend for any information contained on our website to be considered part of this annual report, and we have included our website address in this annual report solely as an inactive textual reference. We will post on our website any materials required to be posted on such website under applicable corporate or securities laws and regulations, including posting any XBRL interactive financial data required to be filed with the SEC, and any notices of general meetings of our shareholders.

Any statement in this annual report about any of our contracts or other documents is not necessarily complete. If the contract or document is filed as an exhibit to a registration statement, the contract or document is deemed to modify the description contained in this annual report. We urge you to review the exhibits themselves for a complete description of the contract or document.

## ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

### Risk of Interest Rate Fluctuation

We are subject to interest rate exposure (i) in connection with the approximately \$101 million debt outstanding as of December 31, 2014 under the Tower amended facility agreement, as such debt bears interest at a rate of the USD LIBOR plus 3.9% per annum, (ii) in connection with the approximately \$19 million of Jazz's long-term bank loans as such debt bears interest at a rate equal to, at the borrowers' option, either the lender's prime rate plus a margin ranging from 0.50% to 1.0% or the USD LIBOR rate (as defined in the credit line agreement) plus a margin ranging from 1.75% to 2.25% per annum, and (iii) in connection with the approximately \$74 million of TPSCO's long term loan as such debt bears interest at a rate equal to the TIBOR (Tokyo Interbank Offered Rate) six months' rate plus 1.65% per annum.

Under current terms of Tower and Jazz loans, we have determined that an assumed 10% upward shift in the USD LIBOR rate at December 31, 2014 (from 0.31% to 0.34%), will not have a material effect on our yearly interest payments in 2015. Under current terms of the TPSCO loans, we have determined that a 10% upward shift in the TIBOR rate at December 31, 2014 (from 0.27% to 0.3%), will not have a material effect on TPSCO's interest payments in 2015.

Our cash equivalents and interest-bearing deposits are exposed to market risk due to fluctuation in interest rates, which may affect our interest income and the fair market value of our deposits investments. We manage this exposure by performing ongoing evaluations of our investments in those deposits. Due to the short maturities of our investments, their carrying value approximates their fair value.

We have market risk exposure to changes in interest rates on our debt obligations with floating interest rates. We have entered into debt obligations to support our capital expenditures and needs. From time to time we enter into interest rate collar agreements to modify our exposure to interest rate movements and to reduce our borrowing costs. These agreements limit our exposure to the risks of fluctuating interest rates by allowing us to convert a portion of the interest on our borrowings from a variable rate to a limited variable rate. As of December 31, 2014, we had no such open transactions.

#### Foreign Exchange Risk

We are exposed to the risk of fluctuation in the US dollar to NIS exchange rate with respect to Tower's debentures Series D issued in 2007. As of December 31, 2014 the outstanding principal amount of these debentures Series D was approximately \$12 million. Debentures Series D bear annual interest at the rate of 8%. The 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 dollar. In addition, the dollar amount of any repayment on account of the principal of these debentures will increase as well.

From the date of the issuance of Series D in the second half of 2007 until December 31, 2014, the Israel consumer price index increased by approximately 21% and the US dollar depreciated against the NIS by approximately 10%.

We are exposed to the risk of fluctuation in the USD to Japanese Yen exchange rate with respect to the 8.8 billion JPY loan of TPSCo denominated in JPY.

Series F debentures issued in 2010 and 2012, are fully linked to the USD and bear annual interest at the rate of 7.8%. The 2014 Notes issued by Jazz are denominated in USD and bear annual interest at the rate of 8%.

Therefore, we are not subject to cash flow exposure to interest rate fluctuations with respect to debentures Series D, debentures Series F or to Jazz 2014 Notes. However, in the event that the actual market interest rates are lower than the interest rate provided under the debentures or notes, our actual finance costs would be higher than they otherwise could have been had our debentures or notes provided for interest at a floating interest rate.

As the functional currency of Tower is the USD and part of Tower's expenses are denominated in NIS, Tower enters from time to time, into exchange rate agreements to protect against the volatility of future cash flows caused by changes in foreign exchange rates on NIS denominated expenses.

The realized profit from these transactions for the year ended December 31, 2014 was recorded in the statements of operations. As of December 31, 2014 there were no open exchange rate agreements. As of March 31, 2015, there were approximately \$50 million outstanding in such transactions to hedge NIS fluctuations against the USD until January 2016.

Unrealized gain/loss from these transactions will be recorded to other comprehensive income. We are exposed to currency risk in the event of default by the other parties of the exchange transaction. We estimate the likelihood of such default to occur is remote, as the other parties are widely recognized and reputable.

Revenue from Panasonic in TPSCo are denominated in Japanese Yen, and most of the expenses of TPSCo are in Japanese Yen, which limits the exposure of fluctuations of the USD to Japanese Yen exchange rate on the TPSCo's results (the impact on the revenue will be mostly offset by the impact on the expenses).





Assuming a 10% appreciation of the NIS against the US dollar on December 31, 2014 (from 3.89 to 3.500), the effective fair value of our liabilities net of assets denominated in NIS (mainly vendors, debentures and liabilities in regard to employees) would be higher by approximately \$5 million.

#### Impact of Inflation

We believe that the rate of inflation in Israel has had a minor effect on our business to date. However, our dollar costs in Israel will increase if inflation in Israel exceeds the devaluation of the NIS against the US dollar.

#### Risks Related to Obligations Indexed to our Own Securities and market yields fluctuations.

Under US GAAP, certain of our obligations (including warrants to issue shares), convertible into our ordinary shares, are not part of our shareholders' equity and are either carried at fair value in its entirety or its equity component is carried at fair value. The effect of carrying such obligations at fair value is that the value of the obligations increases as our share price increases. This may significantly increase our non-cash financing expenses, which may cause our potential gross and operating profits to result in a net loss or may increase our net loss or reduce our net profits. This non-cash appreciation in our obligations and financing expenses will either eventually be reversed or be converted into equity, or a combination thereto. As for December 31, 2014, an immaterial amount of our warrants were carried at fair value.

Non-cash financing expenses related to debentures Series F and acceleration of the non cash financing expenses due to conversions

See under "Risk Factors". "Fluctuations in the market price of our traded securities, including our share and debenture price, may significantly affect our reported GAAP non-cash financing expenses and our ability to issue new securities."

Non-cash financing expenses related to our Israeli banks loans

In addition, under US GAAP our Israeli banks loans are carried at fair market value based on the prevailing market yields of our securities and based on other similar securities yields available to us. Increase in the yields of our debt securities and other similar securities yield can result in non-cash financing income and vis-versa in case of decrease in the prevailing market yield of our debt securities.

#### ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

Not applicable.

#### PART II

#### ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

None.

#### ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS

Not applicable.



ITEM 15.

CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the “Act”) as of the end of the period covered by this annual report on Form 20-F. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that these disclosure controls and procedures were effective as of such date, at a reasonable level of assurance, in ensuring that the information required to be disclosed by our company in the reports we file or submit under the Act is (i) accumulated and communicated to our management (including the Chief Executive Officer and Chief Financial Officer) in a timely manner, and (ii) recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms.

Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the criteria in “Internal Control - Integrated Framework (1992)” issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation, management has concluded that our internal control over financial reporting was effective as of December 31, 2014.

As permitted for acquired businesses, the scope of our assessment of the effectiveness of internal control over financial reporting does not include TPSCo., of which a 51% equity stake was acquired on March 31, 2014. TPSCo represented 38% and 38% percent of our consolidated assets and revenues, respectively, as of and for the year ended December 31, 2014. Our assessment of internal control over financial reporting for fiscal year 2015 will include TPSCo.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Attestation Report of the Registered Public Accounting Firm

The effectiveness of our internal control over financial reporting as of December 31, 2014 has been audited by Brightman Almagor Zohar & Co., a member firm of Deloitte Touche Tohmatsu, an independent registered public accounting firm, as stated in their report which appears herein.

Changes in Internal Control over Financial Reporting

There has been no change in our internal control over financial reporting during the period covered by this Annual Report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.



## ITEM 16. [RESERVED]

## ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our board of directors has determined that two members of our audit committee, Mr. Ilan Flato and Mr. Rami Guzman, are audit committee financial experts under applicable SEC rules and are independent as defined by NASDAQ Marketplace Rules.

## ITEM 16B. CODE OF ETHICS

We adopted a code of ethics that applies to all of our directors, officers and employees, including our Chief Executive Officer, Chief Financial Officer, controller, and persons performing similar functions. We have posted our code of ethics on our website, [www.towerjazz.com](http://www.towerjazz.com) under “About Tower”.

## ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The following table presents payments fees for professional services rendered by our independent registered public accounting firm for audit services, audit-related services and for tax services:

|                        | 2014                      | 2013 |
|------------------------|---------------------------|------|
|                        | (US dollars In Thousands) |      |
| Audit Fees (1)         | 856                       | 561  |
| Audit Related Fees (2) | 67                        | 12   |
| Tax Fees (3)           | 77                        | 53   |
| All Other Fees         | --                        | --   |
|                        | 1,000                     | 626  |

- (1) Audit Fees consist of fees for professional services rendered for the audit of our financial statements. Services in connection with statutory and regulatory filings and engagements (including audit of our internal control over financial reporting) and reviews of our quarterly financial results submitted on Form 6-K. The main increase is attributed to the audit services in regards to the newly acquired TPSCo
- (2) Audit-related fees consist of assurance and related services by the principal accountant that are reasonably related to the performance of the audit of our financial statements and are not reported under “Audit Fees”. These services include, among others: due diligence services, accounting consultations and audits in connection with acquisitions, internal control reviews, attest services related to financial reporting that are not required by statute or regulation and consultation concerning financial accounting, consent letters for our SEC filings and reporting standards.
- (3) Tax fees consist of fees for tax compliance services and tax returns services.

Our audit committee’s charter states that the audit committee is responsible for receiving specific information on the independent auditor’s proposed services and for pre-approving all audit services annually and separately approving any other permitted non-audit related services. All of the non-audit services were pre-approved without reliance on the Waiver Provisions in paragraph (c)(7)(i)(C) of Regulations-X.

ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES.

Not Applicable.

ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS.

Not Applicable.

ITEM 16F CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT

Not applicable.

ITEM 16G. CORPORATE GOVERNANCE

As a foreign private issuer whose shares are listed on NASDAQ Capital Market, we are permitted to follow certain home country corporate governance practices instead of certain requirements of the NASDAQ Marketplace Rules. See Item 10.B "Additional Information – NASDAQ Marketplace Rules and Home Country Practices" for a detailed description of the significant ways in which the registrant's corporate governance practices differ from those followed by U.S. companies under the listing standards of the NASDAQ Capital Market.

ITEM 16H. MINE SAFETY DISCLOSURE

Not applicable.

PART III

ITEM 17. FINANCIAL STATEMENTS

Not applicable.

ITEM 18. FINANCIAL STATEMENTS

Our consolidated financial statements and related auditors' report for the year ended December 31, 2014 are included in this Annual Report beginning on page F-1.

ITEM 19. EXHIBITS

1.1 Articles of Association of the Registrant, approved by shareholders on November 14, 2000, as amended (incorporated by reference to Exhibit 3.1 of the Registrant's Registration Statement on Form F-1, File No. 333-126909, "Form F-1 No. 333-126909").

1.2 Amendment to Articles of Association of the Registrant (approved by shareholders on December 7, 2003) (incorporated by reference to exhibit 4.2 to the Registration Statement on Form S-8 No. 333-117565 ("Form S-8 No. 333-117565")).

1.3 Amendment to the Articles of Association of the Registrant (approved by shareholders on September 28, 2006) (incorporated by reference to Exhibit 4.2 of the Registrant's Registration Statement on Form S-8, File No. 333-138837 (the "2006 Form S-8")).



- 1.4 Amendment to Articles of Association of Registrant (approved by shareholders on September 24, 2008) (incorporated by reference to Exhibit 3.4 of the Registrant's Registration Statement on Form S-8, File No. 333-153710 (the "2008 Form S-8").
- 1.5 Amendment to Articles of Association of Registrant (approved by shareholders on August 11, 2011) (incorporated by reference to exhibit 99.1 of the Form 6-K furnished to the SEC on January 17, 2012).
- 1.6 Amendment to Articles of Association of Registrant (approved by shareholders on August 2, 2012) (incorporated by reference to proposals 1 and 2 of the proxy statement filed on Form 6-K furnished to the SEC on June 12, 2012, and the Form 6-K furnished to the SEC on August 2, 2012)
- 1.7 Amendment to Articles of Association of Registrant (approved by shareholders on May 23, 2013) (incorporated by reference to Proposal 5 of the proxy statement filed on Form 6-K furnished to the SEC on April 16, 2013).
- 2.1 Registration Rights Agreement, dated January 18, 2001, by and between SanDisk Corporation, Israel Corporation, Alliance Semiconductor Ltd. and Macronix International Co., Ltd. (incorporated by reference to exhibit 2.2 to the 2000 Form 20-F).
- 4.1 Form of Grant Letter for Non-Employee Directors Share Option Plan 2001/4 (incorporated by reference to exhibit 4.9 to the Form S-8 No. 333-83204).
- 4.2 Investment Center Agreement related to Fab 1, dated November 13, 2001 (English translation of Hebrew original) (incorporated by reference to exhibit 10.2 to the Registrant's Registration Statement on Form F-2, No. 333-97043).
- 4.3 Employee Share Option Plan 2004 (incorporated by reference to Exhibit 4.3 to the Registrant's Registration Statement on Form S-8 No. 333-117565 ("Form S-8 No. 333-117565").
- 4.4 Form of Grant Letter to Israeli Employees (incorporated by reference to Exhibit 4.4 to Form S-8 No. 333-117565).
- 4.5 Form of Grant Letter to US Employees (incorporated by reference to Exhibit 4.5 to Form S-8 No. 333-117565).
- 4.6 Employee Share Option Plan 2005, as amended (incorporated by reference to Exhibit 4.1 of the 2008 Form S-8).
- 4.7 Form of Grant Letter to Israeli Employees (incorporated by reference to Exhibit 4.4 of the 2006 Form S-8).
- 4.8 Form of Grant Letter to US Employees (incorporated by reference to Exhibit 4.5 of the 2006 Form S-8).
- 4.9 Form of Grant Letter for grants to Jazz employees under the Employee Share Option Plan 2005 (incorporated by reference to Exhibit 4.4 of the 2008 Form S-8).
- 4.10 Jazz Technologies, Inc. 2006 Equity Incentive (incorporated by reference to Exhibit 4.5 of the 2008 Form S-8)



4.11 Form of Assumption Letter from the Registrant to holders of Jazz Technologies, Inc. 2006 Equity Incentive Plan options (incorporated by reference to Exhibit 4.6 of the 2008 Form S-8)

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- 4.12 Form of Option Agreement under the Jazz Technologies, Inc. 2006 Equity Incentive Plan (incorporated by reference to Exhibit 4.7 of the 2008 Form S-8)
- 4.13 CEO Share Option Plan 2005 (incorporated by reference to Exhibit 4.6 of the 2006 Form S-8).
- 4.14 Option Grant Letter Agreement - CEO Share Option Plan 2005 from the Registrant to our CEO, dated July 15, 2005 (incorporated by reference to Exhibit 4.7 of the 2006 Form S-8).
- 4.15 Option Grant Letter Agreement - CEO Share Option Plan 2005 from the Registrant to our CEO, dated September 28, 2006 (incorporated by reference to Exhibit 4.8 of the 2006 Form S-8).
- 4.16 Option Grant Letter Agreement - CEO Share Option Plan 2005 from Tower Semiconductor USA, Inc. to our CEO, dated July 15, 2005 (incorporated by reference to Exhibit 4.9 of the 2006 Form S-8).
- 4.17 Equity Convertible Capital Note, dated September 28, 2006, issued to Israel Corporation Ltd. (incorporated by reference to Exhibit 99.4 of the Form 6-K for the month of November 2006 No. 6 filed on November 7, 2006 (the "November 2006 Form 6-K"))).
- 4.18 2009 Chairman Share Incentive Plan (incorporated by reference to Exhibit 4.20 to the 2010 20-F).
- 4.19 Registration Rights Agreement, dated September 28, 2006, with Israel Corporation Ltd. (incorporated by reference to Exhibit 99.5 of the November 2006 Form 6-K).
- 4.20 Conversion Agreement, dated September 28, 2006, with Bank Hapoalim B.M. (incorporated by reference to Exhibit 99.8 of the November 2006 Form 6-K).
- 4.21 Conversion Agreement, dated September 28, 2006, with Bank Leumi Le-Israel B.M. (incorporated by reference to Exhibit 99.9 of the November 2006 Form 6-K).
- 4.22 Registration Rights Agreement, dated September 28, 2006, with Bank Hapoalim B.M. (incorporated by reference to Exhibit 99.10 of the November 2006 Form 6-K).
- 4.23 Registration Rights Agreement, dated September 28, 2006, with Bank Leumi Le-Israel B.M. (incorporated by reference to Exhibit 99.11 of the November 2006 Form 6-K).
- 4.24 Equity Convertible Capital Note, dated September 28, 2006, issued to Bank Hapoalim B.M. (incorporated by reference to Exhibit 99.12 of the November 2006 Form 6-K).
- 4.25 Equity Convertible Capital Note, dated April 13, 2014, issued to bank Leumi Le-Israel B.M. (incorporated by reference to exhibit 4.25 to the 2013 20-F).
- 4.26 Form of Securities Purchase Agreement (incorporated by reference to Exhibit 99.2 of the Form 6-K for the month of March 2007 No.1 filed on March 15, 2007 (the "March 2007 Form 6-K"))).
- 4.27 Form of Registration Rights Agreement (incorporated by reference to Exhibit 99.4 of the March 2007 Form 6-K).
- 4.28 Agreement and Plan of Merger and Reorganization, dated May 19, 2008, between the Registrant, Jazz Technologies, Inc. and Armstrong Acquisition Corp. (incorporated by reference to Exhibit 2.1 of the May 20, 2008

Form 6-K),

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- 4.29 Facility Agreement, as amended and restated by the parties through September 29, 2008. (incorporated by reference to Exhibit 4.86 to the 2008 20-F)
- 4.30 Conversion Agreement, dated September 25, 2008, with Bank Hapoalim B.M. (incorporated by reference to Exhibit 4.87 to the 2008 20-F)
- 4.31 Conversion Agreement, dated September 25, 2008, with Bank Leumi Le-Israel B.M. (incorporated by reference to Exhibit 4.88 to the 2008 20-F)
- 4.32 Conversion Agreement, dated September 25, 2008, with the Israel Corporation Ltd. (incorporated by reference to Exhibit 4.89 to the 200820-F)
- 4.33 Pledge Agreement, dated September 25, 2008, with Bank Hapoalim B.M. and Bank Leumi Le-Israel B.M. (incorporated by reference to Exhibit 4.90 to the 2008 20-F)
- 4.34 Amended and Restated Registration Rights Agreement, dated September 25, 2008, with Bank Hapoalim B.M. (incorporated by reference to Exhibit 4.91 to the 2008 20-F)
- 4.35 Amended and Restated Registration Rights Agreement, dated September 25, 2008, with Bank Leumi Le-Israel B.M. (incorporated by reference to Exhibit 4.92 to the 2008 20-F)
- 4.36 Undertaking by Israel Corporation Ltd., dated September 25, 2008. (incorporated by reference to Exhibit 4.93 to the 2008 20-F)
- 4.37 Securities Purchase Agreement, dated September 25, 2008, with the Israel Corporation Ltd. (incorporated by reference to Exhibit 4.94 to the 2008 20-F)
4. 38 Equity Convertible Capital Note, dated October 29, 2012, issued to Bank Hapoalim B.M. (incorporated by reference to Exhibit 4.38 to the 2012 20-F)
- 4.39 Equity Convertible Capital Note, dated July 30, 2013, issued to Bank Hapoalim B.M. (incorporated by reference to exhibit 4.39 to the 2013 20-F).
4. 40 Equity Convertible Capital Note, in the principal amount of \$30 million, dated September 25, 2008, issued to the Israel Corporation Ltd. in connection with the conversion of debt. (incorporated by reference to Exhibit 4.97 to the 2008 20-F)
4. 41 Equity Convertible Capital Note, in the principal amount of \$20 million, dated September 25, 2008, issued to the Israel Corporation Ltd. in connection with the conversion of debt. (incorporated by reference to Exhibit 4.98 to the 2008 20-F)
4. 42 Equity Convertible Capital Note, in the principal amount of \$20 million, dated September 25, 2008, issued to the Israel Corporation Ltd. in connection with the investment. (incorporated by reference to Exhibit 4.99 to the 2008 20-F)
4. 43 Equity Convertible Capital Note, in the principal amount of \$20 million, dated January 7, 2008, issued to the Israel Corporation Ltd. in connection with the investment. (incorporated by reference to Exhibit 4.100 to the 2008 20-F)

4.44 Amended and Restated Registration Rights Agreement, dated September 25, 2008, with the Israel Corporation Ltd. (incorporated by reference to Exhibit 4.101 to the 2008 20-F).

4.45 Amendment to Undertaking by the Israel Corporation Ltd., dated January 6, 2009 (incorporated by reference to Exhibit 4.102 to the 2008 20-F).

- 4.46 Exchange Agreement dated July 9, 2010 by and among Jazz Technologies, Inc., Tower Semiconductor, Ltd., Jazz Semiconductor, Inc., Newport Fab, LLC, Zazove Associates, LLC and certain holders of Jazz Technologies, Inc.'s 8% Senior Notes due 2011 (incorporated by reference to Exhibit 10.48 to Jazz Technologies, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2010).
- 4.47 Indenture dated July 15, 2010 by and among Jazz Technologies, Inc., Jazz Semiconductor, Inc., Newport Fab, LLC and U.S. Bank National Association (incorporated by reference to Exhibit 4.15 to Jazz Technologies, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2010).
- 4.48 Warrant Agreement dated July 15, 2010 between Tower Semiconductor, Ltd. and American Stock Transfer & Trust Company, LLC as warrant agent (incorporated by reference to Exhibit 4.54 to 2010 20-F).
- 4.49 Form of Series J Warrant (incorporated by reference to Exhibit 4.55 to 2010 20-F).
- 4.50 Master Agreement by and among Micron Technology, Inc., Micron Japan, Ltd. and Tower Semiconductor Ltd. dated May 25, 2011 (incorporated by reference to Exhibit 10.1 to the Registrant's Registration Statement on Form F-3 (No. 333-178166)).
- 4.51 Credit Support and Subordination Agreement, by and among Micron Technology, Inc., Micron Japan, Ltd., Tower Semiconductor Ltd., TowerJazz Japan, Ltd., and TowerJazz Japan, Ltd. dated June 3, 2011 (incorporated by reference to Exhibit 10.2 to the Registrant's Registration Statement on Form F-3 (No. 333-178166)).
- 4.52 Receivables Pledge Agreement, dated March 26, 2015, with Bank Hapoalim B.M. and Bank Leumi Le-Israel B.M.
- 4.53 Shareholder Rights and Restrictions Agreement between Micron Technology, Inc. and Tower Semiconductor Ltd. dated June 3, 2011 (incorporated by reference to Exhibit 10.3 to the Registrant's Registration Statement on Form F-3 (No. 333-178166)).
- 4.54 2013 Share Incentive Plan.
- 4.55 The Compensation Policy of the Company, filed by us as Annex A to Proposal 1 found in Exhibit 99.1 to the Form 6-K as furnished to the Securities and Exchange Commission on July 30, 2013, and incorporated herein by reference.
- 4.56 Exchange Agreement dated as of March 19, 2014 by and among Jazz Technologies, Inc., Tower Semiconductor, Ltd., Jazz Semiconductor, Inc., Newport Fab, LLC and certain holders of the Jazz Technologies, Inc. 8% Senior Notes due 2015 (incorporated by reference to Exhibit 4.59 to 2013 20-F).
- 4.57 Purchase Agreement dated as of March 19, 2014 by and among Jazz Technologies, Inc., Tower Semiconductor, Ltd., Jazz Semiconductor, Inc., Newport Fab, LLC and certain holders of the Jazz Technologies, Inc. 8% Senior Notes due 2015 (incorporated by reference to Exhibit 4.60 to 2013 20-F).
- 4.58 Indenture dated as of March 25, 2014 by and among Jazz Technologies, Inc., Tower Semiconductor, Ltd., Jazz Semiconductor, Inc., Newport Fab, LLC and U.S. Bank National Association (incorporated by reference to Exhibit 4.61 to 2013 20-F).



4.59 Registration Rights Agreement dated as of March 25, 2014 by and among Tower Semiconductor, Ltd., and holders of the Jazz Technologies, Inc. 8% Convertible Senior Notes due 2018 (incorporated by reference to Exhibit 4.1 to the Registrant's Registration Statement on Form F-3 (No. 333-195200)).

4.60 Joint Venture Formation Agreement among Tower Semiconductor Ltd. and Panasonic Corporation, dated as of December 20, 2013 (incorporated by reference to Exhibit 4.63 Registrant's Form 20-F/A filed on November 17, 2014).

4.61 Shareholders Agreement between Tower Semiconductor Ltd., Panasonic Corporation and TowerJazz Panasonic Semiconductor Co., Ltd., dated as of April 1, 2014 (incorporated by reference to Exhibit 4.64 to the Registrant's Form 20-F/A filed on November 17, 2014).

4.62 Business Transfer Agreement between Panasonic Corporation and TowerJazz Panasonic Semiconductor Co., Ltd., dated as of April 1, 2014 (incorporated by reference to Exhibit 4.65 to the Registrant's Form 20-F/A filed on November 17, 2014).

4.63 Manufacturing Agreement between Panasonic Corporation and TowerJazz Panasonic Semiconductor Co., Ltd., dated as of April 1, 2014 (incorporated by reference to Exhibit 4.66 to the Registrant's Form 20-F/A filed on November 17, 2014).

#8.1 List of Subsidiaries.

#12.1 Certification by Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

#12.2 Certification by Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

#13.1 Certification by Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

#13.2 Certification by Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

#15.1 Consent of Brightman Almagor Zohar & Co., Certified Public Accountants, a member of Deloitte Touche Tohmatsu.

#101 The following financial information from Tower Semiconductor Ltd.'s Annual Report on Form 20-F for the year ended December 31, 2014, formatted in XBRL (eXtensible Business Reporting Language):

(i) Consolidated Balance Sheets at December 31, 2014 and 2013;

(ii) Consolidated Statements of Operations for the years ended December 31, 2014, 2013 and 2012;

(iii) Consolidated Statements of Changes in Shareholders' Equity for the years ended December 31, 2014, 2013 and 2012;

(iv) Consolidated Statements of Cash Flows for the years ended December 31, 2014, 2013 and 2012; and

(v) Notes to Consolidated Financial Statements, tagged as blocks of text.



Users of this data are advised, in accordance with Rule 406T of Regulation S-T promulgated by the SEC, that this Interactive Data File is deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of Section 18 of the Exchange Act, and otherwise is not subject to liability under these sections.

#Filed herewith

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SIGNATURES

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the registrant hereby certifies that it meets all the requirements for filing on Form 20-F and has duly caused and authorized the undersigned to sign this Annual Report to be signed on its behalf.

TOWER SEMICONDUCTOR LTD.

By: /s/ Russell C. Ellwanger  
Russell C. Ellwanger  
Chief Executive Officer

May 14, 2015

TOWER SEMICONDUCTOR LTD.  
AND SUBSIDIARIES  
CONSOLIDATED FINANCIAL STATEMENTS  
AS OF DECEMBER 31, 2014

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES  
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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and the shareholders of  
Tower Semiconductor Ltd.

We have audited the accompanying consolidated balance sheets of Tower Semiconductors Ltd. (the "Company") and its subsidiaries as of December 31, 2014 and 2013, and the related consolidated statements of operations, comprehensive loss, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2014. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2014 and 2013, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2014, in conformity with accounting principles generally accepted in the United States of America.

As described in Note 22, the consolidated financial statements include a reconciliation of the company's financial statements from the accounting principles generally accepted in the United States of America to International Financial Reporting Standards.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control — Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 4, 2015 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/S/ Brightman Almagor Zohar & Co.  
Certified Public Accountants

A Member of Deloitte Touche Tohmatsu Limited

Tel Aviv, Israel

March 4, 2015

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#### REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To Board of Directors and the shareholders of  
Tower Semiconductor Ltd.

We have audited the internal control over financial reporting of Tower Semiconductor Ltd. and subsidiaries (the "Company") as of December 31, 2014, based on criteria established in Internal Control — Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). As described in Management's Report on Internal Control over Financial Reporting, management excluded from its assessment the internal control over financial reporting at TowerJazz Panasonic Semiconductor Co. Ltd (TPSCO), which was acquired on March 31, 2014 and whose financial statements constitute 38% and 38% of the Company's consolidated assets and consolidated revenues, respectively, as of and for the year ended December 31, 2014. Accordingly, our audit did not include the internal control over financial reporting at TPSCO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on

the financial statements.

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Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on the criteria established in Internal Control — Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2014 of the Company and our report dated March 4, 2015 expressed an unqualified opinion on those financial statements.

/S/ Brightman Almagor Zohar & Co.  
Certified Public Accountants  
A Member of Deloitte Touche Tohmatsu Limited

Tel Aviv, Israel  
March 4, 2015

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(dollars and shares in thousands)

|                                                                   | As of<br>December<br>31,<br>2014 | As of<br>December<br>31,<br>2013 |
|-------------------------------------------------------------------|----------------------------------|----------------------------------|
| <b>A S S E T S</b>                                                |                                  |                                  |
| <b>CURRENT ASSETS</b>                                             |                                  |                                  |
| Cash and cash equivalents                                         | \$187,167                        | \$112,871                        |
| Designated Interest bearing deposits                              | --                               | 10,000                           |
| Trade accounts receivable                                         | 99,166                           | 80,316                           |
| Other receivables                                                 | 5,759                            | 10,943                           |
| Inventories                                                       | 87,873                           | 64,804                           |
| Other current assets                                              | 14,119                           | 11,480                           |
| Total current assets                                              | 394,084                          | 290,414                          |
| <b>LONG-TERM INVESTMENTS</b>                                      |                                  |                                  |
|                                                                   | 11,896                           | 14,494                           |
| <b>PROPERTY AND EQUIPMENT, NET</b>                                |                                  |                                  |
|                                                                   | 419,111                          | 350,039                          |
| <b>INTANGIBLE ASSETS, NET</b>                                     |                                  |                                  |
|                                                                   | 42,037                           | 32,393                           |
| <b>GOODWILL</b>                                                   |                                  |                                  |
|                                                                   | 7,000                            | 7,000                            |
| <b>OTHER ASSETS, NET</b>                                          |                                  |                                  |
|                                                                   | 10,018                           | 11,547                           |
| <b>TOTAL ASSETS</b>                                               | <b>\$884,146</b>                 | <b>\$705,887</b>                 |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                       |                                  |                                  |
| <b>CURRENT LIABILITIES</b>                                        |                                  |                                  |
| Current maturities of loans and debentures                        | \$119,999                        | \$36,441                         |
| Trade accounts payable                                            | 98,632                           | 66,358                           |
| Deferred revenue and short-term customers' advances               | 5,478                            | 3,166                            |
| Employee related liabilities, inc. Nishiwaki retirement allowance | 59,597                           | 25,957                           |
| Other current liabilities                                         | 16,619                           | 7,994                            |
| Total current liabilities                                         | 300,325                          | 139,916                          |
| <b>LONG-TERM LOANS FROM BANKS</b>                                 |                                  |                                  |
|                                                                   | 159,776                          | 108,739                          |
| <b>DEBENTURES</b>                                                 |                                  |                                  |
|                                                                   | 107,311                          | 208,146                          |
| <b>LONG-TERM CUSTOMERS' ADVANCES</b>                              |                                  |                                  |
|                                                                   | 6,272                            | 7,187                            |
| <b>EMPLOYEE RELATED LIABILITIES</b>                               |                                  |                                  |
|                                                                   | 16,699                           | 65,337                           |

|                                                                                                                                                                                                                                                                                                          |             |             |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------|-------------|
| DEFERRED TAX LIABILITY                                                                                                                                                                                                                                                                                   | 75,278      | 13,611      |
| OTHER LONG-TERM LIABILITIES                                                                                                                                                                                                                                                                              | 22,924      | 21,703      |
| Total liabilities                                                                                                                                                                                                                                                                                        | 688,585     | 564,639     |
| Ordinary shares                                                                                                                                                                                                                                                                                          | 235,117     | 192,776     |
| Ordinary shares of NIS 15 par value;<br>Authorized: 150,000 shares<br>as of December 31, 2014 and 2013, respectively;<br>Issued: 58,120 and 47,956 shares<br>as of December 31, 2014 and 2013, respectively;<br>Outstanding: 58,034 and 47,870 shares<br>as of December 31, 2014 and 2013, respectively. |             |             |
| Additional paid-in capital                                                                                                                                                                                                                                                                               | 1,137,946   | 1,084,011   |
| Capital notes                                                                                                                                                                                                                                                                                            | 60,704      | 92,549      |
| Cumulative stock based compensation                                                                                                                                                                                                                                                                      | 50,017      | 45,380      |
| Accumulated other comprehensive loss                                                                                                                                                                                                                                                                     | (25,726 )   | (16,126 )   |
| Accumulated deficit                                                                                                                                                                                                                                                                                      | (1,244,007) | (1,248,270) |
|                                                                                                                                                                                                                                                                                                          | 214,051     | 150,320     |
| Treasury stock, at cost - 86 shares                                                                                                                                                                                                                                                                      | (9,072 )    | (9,072 )    |
| THE COMPANY'S SHAREHOLDERS' EQUITY                                                                                                                                                                                                                                                                       | 204,979     | 141,248     |
| Non controlling interest                                                                                                                                                                                                                                                                                 | (9,418 )    | --          |
| TOTAL EQUITY                                                                                                                                                                                                                                                                                             | 195,561     | 141,248     |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY                                                                                                                                                                                                                                                               | \$884,146   | \$705,887   |

See notes to consolidated financial statements.

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS

(dollars in thousands, except per share data)

|                                                                | 2014       | Year ended<br>December 31,<br>2013 | 2012         |
|----------------------------------------------------------------|------------|------------------------------------|--------------|
| REVENUES                                                       | \$ 828,008 | \$ 505,009                         | \$ 638,831   |
| COST OF REVENUES                                               | 764,220    | 476,900                            | 560,046      |
| GROSS PROFIT                                                   | 63,788     | 28,109                             | 78,785       |
| OPERATING COSTS AND EXPENSES                                   |            |                                    |              |
| Research and development                                       | 51,841     | 33,064                             | 31,093       |
| Marketing, general and administrative                          | 58,783     | 42,916                             | 44,413       |
| Nishiwaki Fab impairment                                       | 47,472     | --                                 | --           |
| Nishiwaki Fab restructuring costs                              | 8,028      | --                                 | --           |
| Amortization related to a lease agreement<br>early termination | --         | 7,464                              | --           |
| Acquisitions related and reorganization costs                  | 1,229      | --                                 | 5,789        |
|                                                                | 167,353    | 83,444                             | 81,295       |
| OPERATING LOSS                                                 | (103,565 ) | (55,335 )                          | (2,510 )     |
| INTEREST EXPENSES, NET                                         | (33,409 )  | (32,971 )                          | (31,808 )    |
| OTHER FINANCING EXPENSE, NET                                   | (55,404 )  | (27,838 )                          | (27,583 )    |
| GAIN FROM ACQUISITION                                          | 166,404    | --                                 | --           |
| OTHER EXPENSE, NET                                             | (140 )     | (904 )                             | (1,042 )     |
| LOSS BEFORE INCOME TAX                                         | (26,114 )  | (117,048 )                         | (62,943 )    |
| INCOME TAX BENEFIT (EXPENSE)                                   | 24,742     | 9,388                              | (7,326 )     |
| PROFIT (LOSS)                                                  | (1,372 )   | (107,660 )                         | (70,269 )    |
| Net loss attributable to non controlling<br>interest           | 5,635      | --                                 | --           |
| NET PROFIT (LOSS) ATTRIBUTABLE<br>TO THE COMPANY               | \$ 4,263   | \$ (107,660 )                      | \$ (70,269 ) |
| BASIC EARNING (LOSS) PER<br>ORDINARY SHARE                     |            |                                    |              |

|                           |         |            |            |
|---------------------------|---------|------------|------------|
| Earnings (loss) per share | \$ 0.08 | \$ (2.72 ) | \$ (3.17 ) |
|---------------------------|---------|------------|------------|

|                                                                          |        |        |        |
|--------------------------------------------------------------------------|--------|--------|--------|
| Weighted average number of ordinary<br>shares outstanding - in thousands | 51,798 | 39,633 | 22,173 |
|--------------------------------------------------------------------------|--------|--------|--------|

#### DILUTED EARNING PER ORDINARY SHARE

|                    |         |
|--------------------|---------|
| Earnings per share | \$ 0.07 |
|--------------------|---------|

|                                                                          |        |
|--------------------------------------------------------------------------|--------|
| Weighted average number of ordinary<br>shares outstanding - in thousands | 63,182 |
|--------------------------------------------------------------------------|--------|

See notes to consolidated financial  
statements.

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES  
CONSOLIDATED COMPREHENSIVE LOSS  
(dollars in thousands)

|                                                                                                                                                                             | 2014       | Year ended<br>December 31,<br>2013 | 2012        |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------|------------------------------------|-------------|
| Net loss                                                                                                                                                                    | \$(1,372 ) | \$(107,660 )                       | \$(70,269 ) |
| Other comprehensive income (loss), net of tax:                                                                                                                              |            |                                    |             |
| Foreign currency translation adjustment                                                                                                                                     | (16,643 )  | (14,242 )                          | (9,097 )    |
| Change in employees plan assets and benefit obligations, net of taxes<br>\$1,774, \$1,268 and \$1,591 for the years ended December 31, 2014, 2013<br>and 2012, respectively | (3,860 )   | 2,350                              | 2,440       |
| Unrealized gains (losses) on derivatives                                                                                                                                    | --         | (759 )                             | 1,090       |
| Comprehensive loss                                                                                                                                                          | (21,875 )  | (120,311 )                         | (75,836 )   |
| Comprehensive loss attributable to non-controlling interest                                                                                                                 | 16,538     | --                                 | --          |
| Comprehensive loss attributable to the Company                                                                                                                              | \$(5,337 ) | \$(120,311 )                       | \$(75,836 ) |

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES  
STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY  
(dollars and share data in thousands)

|                                                                                   | THE COMPANY'S SHAREHOLDERS' EQUITY |                                  |                                  |                  |                          |                                               |                                    |                        |                   |
|-----------------------------------------------------------------------------------|------------------------------------|----------------------------------|----------------------------------|------------------|--------------------------|-----------------------------------------------|------------------------------------|------------------------|-------------------|
|                                                                                   | Ordinary<br>Shares<br><br>issued   | Ordinary<br>Shares<br><br>Amount | Additional<br>paid-in<br>capital | Capital<br>notes | unearned<br>compensation | Accumulated<br>other<br>comprehensive<br>loss | Foreign<br>currency<br>translation | Accumulated<br>deficit | Treasury<br>stock |
| BALANCE AS<br>OF JANUARY<br>1, 2012                                               | 21,306                             | \$83,020                         | \$820,443                        | \$311,472        | \$37,089                 | \$(1,637 )                                    | \$3,729                            | \$(1,070,341)          | \$(9,072)         |
| Changes during<br>the period:                                                     |                                    |                                  |                                  |                  |                          |                                               |                                    |                        |                   |
| Issuance of<br>shares and<br>warrants                                             | 200                                | 796                              | 4,319                            |                  |                          |                                               |                                    |                        |                   |
| Exercise of<br>options                                                            | 125                                | 486                              | 52                               |                  |                          |                                               |                                    |                        |                   |
| Beneficial<br>conversion<br>feature                                               |                                    |                                  | 109,768                          |                  |                          |                                               |                                    |                        |                   |
| Employee<br>stock-based<br>compensation                                           |                                    |                                  |                                  |                  | 5,737                    |                                               |                                    |                        |                   |
| Capital notes                                                                     | 767                                | 2,978                            | 3,232                            | (6,210 )         |                          |                                               |                                    |                        |                   |
| Other<br>comprehensive<br>income:                                                 |                                    |                                  |                                  |                  |                          |                                               |                                    |                        |                   |
| Profit (loss)                                                                     |                                    |                                  |                                  |                  |                          |                                               |                                    | (70,269 )              |                   |
| Foreign currency<br>translation<br>adjustments                                    |                                    |                                  |                                  |                  |                          |                                               | (9,097 )                           |                        |                   |
| Change in<br>employees plan<br>assets and benefit<br>obligations, net<br>of taxes |                                    |                                  |                                  |                  |                          | 2,440                                         |                                    |                        |                   |
| Unrealized gains<br>on derivatives                                                |                                    |                                  |                                  |                  |                          | 1,090                                         |                                    |                        |                   |
| Comprehensive<br>income                                                           |                                    |                                  |                                  |                  |                          |                                               |                                    |                        |                   |
| BALANCE AS<br>OF DECEMBER<br>31, 2012                                             | 22,398                             | \$87,280                         | \$937,814                        | \$305,262        | \$42,826                 | \$1,893                                       | \$(5,368 )                         | \$(1,140,610)          | \$(9,072)         |

Changes during  
the period:Issuance of  
shares and  
warrants

8,148 33,986 4,889

Exercise of  
options

24 100 5

## Capital notes

17,386 71,410 141,303 (212,713)

Employee  
stock-based  
compensation

2,735

Tax benefit relating to  
stock based compensation

(181 )

Other  
comprehensive  
income:

## Profit (loss)

(107,660 )

Foreign currency  
translation  
adjustments

(14,242)

Change in employees plan assets and benefit  
obligations, net of taxes

2,350

Unrealized losses  
on derivatives

(759 )

Comprehensive  
incomeBALANCE AS  
OF DECEMBER

31, 2013 47,956 \$192,776 \$1,084,011 \$92,549 \$45,380 \$3,484 \$(19,610) \$(1,248,270) \$(9,072)

Changes during  
the period:Establishment of  
a subsidiaryIssuance of  
shares and  
warrants

5,470 22,563 38,550

Exercise of  
options

763 3,274 44

## Capital notes

3,931 16,504 15,341 (31,845 )

Employee  
stock-based  
compensation

4,637

Other  
comprehensive  
income:

## Profit (loss)

4,263



|                                          |          |
|------------------------------------------|----------|
| Foreign currency translation adjustments | (5,740 ) |
|------------------------------------------|----------|

|                                                                       |          |
|-----------------------------------------------------------------------|----------|
| Change in employees plan assets and benefit obligations, net of taxes | (3,860 ) |
|-----------------------------------------------------------------------|----------|

|                      |  |
|----------------------|--|
| Comprehensive income |  |
|----------------------|--|

|                        |  |
|------------------------|--|
| BALANCE AS OF DECEMBER |  |
|------------------------|--|

|          |        |           |             |          |          |          |            |               |           |
|----------|--------|-----------|-------------|----------|----------|----------|------------|---------------|-----------|
| 31, 2014 | 58,120 | \$235,117 | \$1,137,946 | \$60,704 | \$50,017 | \$(376 ) | \$(25,350) | \$(1,244,007) | \$(9,072) |
|----------|--------|-----------|-------------|----------|----------|----------|------------|---------------|-----------|

|                                                                   |  |
|-------------------------------------------------------------------|--|
| OUTSTANDING SHARES, NET OF TREASURY STOCK AS OF DECEMBER 31, 2014 |  |
|-------------------------------------------------------------------|--|

|        |
|--------|
| 58,034 |
|--------|

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(dollars in thousands)

|                                                                                                               | 2014       | Year ended<br>December 31,<br>2013 | 2012        |
|---------------------------------------------------------------------------------------------------------------|------------|------------------------------------|-------------|
| <b>CASH FLOWS - OPERATING ACTIVITIES</b>                                                                      |            |                                    |             |
| NET PROFIT (LOSS) ATTRIBUTABLE TO THE COMPANY                                                                 | \$4,263    | \$(107,660 )                       | \$(70,269 ) |
| Net loss attributable to non controlling interest                                                             | (5,635 )   | --                                 | --          |
| Net profit (loss)                                                                                             | (1,372 )   | (107,660 )                         | (70,269 )   |
| Adjustments to reconcile net loss for the period<br>to net cash provided by operating activities:             |            |                                    |             |
| Income and expense items not involving cash flows:                                                            |            |                                    |             |
| Depreciation and amortization                                                                                 | 243,362    | 164,824                            | 173,585     |
| Effect of indexation, translation and fair value measurement on debt                                          | (3,667 )   | 4,091                              | 13,544      |
| Financing costs relating to Jazz notes exchange                                                               | 9,817      | --                                 | --          |
| Other expense, net                                                                                            | 140        | 904                                | 6,831       |
| Gain from acquisition                                                                                         | (166,404 ) | --                                 | --          |
| Changes in assets and liabilities:                                                                            |            |                                    |             |
| Trade accounts receivable                                                                                     | (24,021 )  | (5,194 )                           | (6,857 )    |
| Other receivables and other current assets                                                                    | 49,934     | (3,647 )                           | (843 )      |
| Inventories                                                                                                   | (1,758 )   | (780 )                             | 2,316       |
| Trade accounts payable                                                                                        | 11,107     | 25                                 | (7,603 )    |
| Deferred revenue and customers' advances                                                                      | 1,915      | 1,202                              | (4,475 )    |
| Other current liabilities                                                                                     | 25,744     | (38 )                              | (23,942 )   |
| Deferred tax liability, net                                                                                   | (23,977 )  | (11,453 )                          | 9,126       |
| Other long-term liabilities                                                                                   | 4,517      | (6 )                               | 3,840       |
| Net cash provided by operating activities excluding Nishiwaki<br>fab closure employee related retirement cost | 125,337    | 42,268                             | 95,253      |
| Nishiwaki fab closure employee related retirement cost                                                        | (27,572 )  | --                                 | (20,074 )   |
| Net cash provided by operating activities                                                                     | 97,765     | 42,268                             | 75,179      |
| <b>CASH FLOWS - INVESTING ACTIVITIES</b>                                                                      |            |                                    |             |
| Investments in property and equipment, net (a)                                                                | (50,209 )  | (77,044 )                          | (103,830 )  |
| Investments in other assets, intangible assets and others                                                     | (76 )      | (409 )                             | (4,498 )    |
| Acquisition of subsidiary consolidated for the first time (b)                                                 | 57,582     | --                                 | --          |
| Investment grants received                                                                                    | --         | --                                 | 2,618       |
| Interest bearing deposits, including designated deposits                                                      | 10,000     | --                                 | (10,000 )   |
| Net cash provided by (used in) investing activities                                                           | 17,297     | (77,453 )                          | (115,710 )  |
| <b>CASH FLOWS - FINANCING ACTIVITIES</b>                                                                      |            |                                    |             |
| Proceeds on account of shareholders' equity and notes                                                         | 19,613     | 38,956                             | 104,690     |
| Proceeds from long-term loans                                                                                 | 85,884     | --                                 | 14,443      |
| Short-term loan repayment to Panasonic                                                                        | (85,884 )  | --                                 | --          |

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|                                                     |            |            |            |
|-----------------------------------------------------|------------|------------|------------|
| Short-term bank debt                                | --         | --         | 3,800      |
| Debt repayment                                      | (51,411 )  | (6,540 )   | (55,854 )  |
| Net cash provided by (used in) financing activities | (31,798 )  | 32,416     | 67,079     |
| Effect of foreign exchange rate change              | (8,968 )   | (7,758 )   | (4,299 )   |
| INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS    | 74,296     | (10,527 )  | 22,249     |
| CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD     | 112,871    | 123,398    | 101,149    |
| CASH AND CASH EQUIVALENTS - END OF PERIOD           | \$ 187,167 | \$ 112,871 | \$ 123,398 |

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(dollars in thousands)

|                                                                                                                                                                                    | 2014       | Year ended<br>December 31,<br>2013 | 2012      |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------|------------------------------------|-----------|
| <b>NON-CASH ACTIVITIES</b>                                                                                                                                                         |            |                                    |           |
| Investments in property and equipment                                                                                                                                              | \$27,495   | \$11,161                           | \$8,737   |
| Beneficial conversion feature                                                                                                                                                      | \$--       | \$--                               | \$109,768 |
| Equity increase arising from exchange of straight to convertible debt                                                                                                              | \$9,609    | \$--                               | \$--      |
| Conversion of convertible debentures to share capital                                                                                                                              | 34,822     | \$--                               | \$--      |
| <b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>                                                                                                                            |            |                                    |           |
| Cash paid during the period for interest                                                                                                                                           | \$34,042   | \$33,298                           | \$46,454  |
| Cash paid (received) during the period for income taxes                                                                                                                            | \$(1,563 ) | \$190                              | \$852     |
| (a) Including proceeds related to sale and disposal of property and equipment in the amounts of \$45,464 and \$4,775 for the years ended December 31, 2014 and 2013, respectively. |            |                                    |           |
| (b) ACQUISITION OF SUBSIDIARY CONSOLIDATED FOR THE FIRST TIME, SEE ALSO NOTE 3:                                                                                                    |            |                                    |           |
| Assets and liabilities of the subsidiary as of April 1, 2014:                                                                                                                      |            |                                    |           |
| Working capital (excluding cash and cash equivalents)                                                                                                                              |            |                                    | \$32,406  |
| Fixed assets                                                                                                                                                                       |            |                                    | 245,278   |
| Intangible assets                                                                                                                                                                  |            |                                    | 24,520    |
| Short-term loan                                                                                                                                                                    |            |                                    | (85,249 ) |
| Long-term liabilities                                                                                                                                                              |            |                                    | (93,602 ) |
|                                                                                                                                                                                    |            |                                    | 123,353   |
| Less :                                                                                                                                                                             |            |                                    |           |
| Share capital                                                                                                                                                                      |            |                                    | 14,531    |
| Paid-in capital                                                                                                                                                                    |            |                                    | 166,404   |
|                                                                                                                                                                                    |            |                                    | 180,935   |
| Cash received from the acquisition of a subsidiary consolidated for the first time                                                                                                 |            |                                    | \$57,582  |

See notes to consolidated financial statements.

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

NOTE 1 - DESCRIPTION OF BUSINESS AND GENERAL

The consolidated financial statements of Tower Semiconductor Ltd. (“Tower”) include the financial statements of Tower, and: (i) its wholly-owned subsidiaries (1) Jazz Technologies, Inc., and its wholly-owned subsidiary, Jazz Semiconductor, Inc., an independent semiconductor foundry focused on specialty process technologies for the manufacture of analog intensive mixed-signal semiconductor devices (Jazz Technologies and its wholly-owned subsidiaries are collectively referred to herein as “Jazz”), and (2) TowerJazz Japan Ltd. (“TJP”), an independent semiconductor foundry in Nishiwaki, Japan; and (ii) since March 31, 2014, its majority-owned subsidiary, TowerJazz Panasonic Semiconductor Co., Ltd. (“TPSCo”), an independent semiconductor foundry which includes three semiconductor manufacturing facilities located in Uozu, Tonami and Arai, in Hokuriku, Japan. Tower and its subsidiaries are collectively referred to as the “Company”. The Company is a global specialty foundry leader manufacturing integrated circuits, offering a broad range of customizable process technologies including: SiGe, BiCMOS, mixed-signal/CMOS, RF CMOS, CMOS image sensor, integrated power management (BCD and 700V), and MEMS. The Company also provides a world-class design enablement platform for a quick and accurate design cycle as well as Transfer Optimization and development Process Services (TOPS) to Integrated Device Manufacturers (“IDM”) and fabless companies that need to expand capacity. To provide multi-fab sourcing and extended capacity for its customers, the Company operates two manufacturing facilities in Israel (150mm and 200mm), one in the U.S. (200mm) and three additional facilities in Japan through TPSCo (two 200mm and one 300mm), which provide leading edge 45nm CMOS, 65nm RF CMOS and 65nm 1.12um pixel technologies, including advanced image sensor technologies.

Tower’s ordinary shares are traded on the NASDAQ Global Select Market and on the Tel-Aviv Stock Exchange (“TASE”) under the symbol TSEM.

The Company operates in the semiconductor industry and competes internationally with dedicated foundry services providers, which, in addition to providing leading edge CMOS process technologies, also have capacity for some specialty process technologies. The Company also competes with IDMs that have internal semiconductor manufacturing capacity or foundry operations. In addition, several new dedicated foundries have specialized operations and compete directly with the Company in certain areas, flows and technology capabilities. In addition, there are a number of smaller participants in the specialty process arena. The Company believes that most of the large dedicated foundry service providers compete primarily in standard CMOS product types, while they also have capacity for specialty process technologies; hence its main industry competitors are the smaller participants which focus in the specialty process arena.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Company’s consolidated financial statements are presented in accordance with U.S. generally accepted accounting principles (“US GAAP”).

A. Use of Estimates in Preparation of Financial Statements

The preparation of financial statements in conformity with GAAP requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

B. Principles of Consolidation

The Company's consolidated financial statements include the financial statements of Tower and its subsidiaries. The Company's consolidated financial statements are presented after elimination of inter-company transactions and balances. The Company's consolidated financial statements include TPSCo's balance sheet since March 31, 2014 and TPSCo's results of operations from April 1, 2014.

C. Cash and Cash - Equivalents

Cash and cash equivalents consist of banks deposits and short-term investments (primarily time deposits and certificates of deposit) with original maturities of three months or less.

D. Allowance for Doubtful Accounts

The allowance for doubtful accounts is computed mainly on the specific identification basis for accounts whose collectability, in the Company's estimation, is uncertain.

E. Inventories

Inventories are stated at the lower of cost or market. Cost is determined for raw materials and supplies mainly on the basis of the weighted average moving price per unit.

Cost is determined for work in process and finished goods on the basis of actual production costs.

F. Property and Equipment

(1) Property and equipment are presented at cost, including capitalizable costs. Capitalizable costs include only costs that are identifiable with, and related to, the property and equipment and are incurred prior to their initial operation. Identifiable incremental, direct costs include costs associated with constructing, establishing and installing property and equipment, and costs directly related to pre-production test runs of property and equipment that are necessary to get it ready for its intended use. Maintenance and repairs are charged to expense as incurred.

Property and equipment are presented net of investment grants received, and less accumulated depreciation and amortization.

Depreciation is calculated based on the straight-line method over the estimated economic lives commonly used in the industry of the assets or terms of the related leases, as follows:

|                                                                         |             |
|-------------------------------------------------------------------------|-------------|
| Buildings and building improvements (including facility infrastructure) | 10-25 years |
| Machinery and equipment, software and hardware                          | 3-7 years   |

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

F. Property and Equipment (cont.)

(2) Impairment examinations and recognition are performed and determined based on the accounting policy outlined in R below.

G. Intangible Assets

Intangible assets include the valuation amount attributed to the intangible assets as part of the purchase price allocation made at the times of acquisition of Jazz and TPSCo.

The amounts attributed to intangible assets as part of the purchase price allocations for the acquisitions of Jazz and TPSCo are amortized over the expected estimated economic life of the intangible assets commonly used in the industry.

Impairment examinations and recognition are performed and determined based on the accounting policy outlined in R below.

H. Other Assets

Prepaid Long-Term Land Lease

Prepaid lease payments to the Israel Land Administration (“ILA”) as detailed in Note 16C are amortized over the lease period.

I. Convertible Debentures

Under 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.

ASC Topic 815 “Derivatives and Hedging” generally provides criteria that, if met, require companies to bifurcate conversion options from their host instruments and account for them as freestanding derivative financial instruments. These three criteria are: (i) the economic characteristics and risks of the embedded derivative instrument are not clearly and closely related to the economic characteristics and risks of the host contract, (ii) the hybrid instrument that embodies both the embedded derivative instrument and the host contract is not re-measured at fair value under otherwise applicable GAAP with changes in fair value reported in earnings, and (iii) a separate instrument with the same terms as the embedded derivative instrument would be considered a derivative instrument subject to the requirements of Topic 815. In determining whether the embedded derivative should be bifurcated, the Company considers all other scope exceptions provided by that topic. One scope exception particularly relevant to convertibles is whether the embedded conversion feature is both indexed to and classified in the Company's equity.

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

I. Convertible Debentures (cont.)

See Note 13C for the determination of the Beneficial Conversion Feature in the Company's Series F debentures, as well as Note 13E for the measurement of the equity component in Jazz 2014 convertible notes, according to ASC 470-20.

J. Stock-Based Instruments in Financing Transactions

The Company calculates the fair value of stock-based instruments included in the units issued in its financing transactions. That fair value is recognized in equity, if determined to be eligible for equity classification. The fair value of such stock-based instruments, when included in issuance of debt that is not itself accounted at fair value is considered a discount on the debt and results in an adjustment to the yield of the debt.

K. Revenue Recognition

The Company's net revenues are generated principally from sales of semiconductor wafers. The Company also derives revenues from engineering and design support and other technical and support services. The majority of the Company's sales are achieved through the effort of its direct sales force.

In accordance with ASC Topic 605 "Revenue Recognition", the Company recognizes 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 criteria prior to formal customer acceptance.

The Company provides for sales returns allowance relating to specified yield or quality commitments as a reduction of revenues at the time of shipment based on historical experience and specific identification of events necessitating an allowance.

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.

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

L. Research and Development

Research and development costs are charged to operations as incurred. Amounts received or receivable from the government of Israel and others, as participation in research and development programs, are offset against research and development costs. The accrual for grants receivable is determined based on the terms of the programs, provided that the criteria for entitlement have been met.

M. Income Taxes

The Company accounts for income taxes in accordance with ASC 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.

N. Earnings (Loss) Per Ordinary Share

Basic earnings (losses) per share is calculated, in accordance with ASC Topic 260, "Earnings Per Share", by dividing profit or loss attributable to ordinary equity holders of Tower (the numerator) by the weighted average number of ordinary shares outstanding (the denominator) during the reported period. Diluted earnings per share is calculated if relevant, by adjusting profit attributable to ordinary equity holders of Tower, and the weighted average number of ordinary shares taking into effect all potential dilutive ordinary shares.

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

O. Comprehensive Income (Loss)

In accordance with ASC Topic 220, “Comprehensive Income”, comprehensive income (loss) represents the change in shareholders’ equity during a reporting period from transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a reporting period except those resulting from investments by owners and distributions to owners. Other comprehensive income (loss) represents gains and losses that are included in comprehensive income but excluded from net income.

P. Functional Currency and Exchange Rate Losses

The currency of the primary economic environment in which Tower and Jazz conduct their operations is the U.S. dollar (“dollar”). Thus, the dollar is the functional and reporting currency of Tower and Jazz. Accordingly, monetary accounts maintained in currencies other than the dollar are remeasured into dollars in accordance with ASC 830-10, “Foreign Currency Matters”. All transaction gains and losses from the re-measurement of monetary balance sheet items are reflected in the statements of operations as financial income or expenses, as appropriate. The financial statements of TJP and TPSCo, whose functional currency is Japanese Yen, have been translated into dollars. The assets and liabilities of both TJP and TPSCo have been translated using the exchange rates in effect on the balance sheet date. The statement of operations amounts for both TJP and TPSCo has been translated using the average exchange rate for the period. The resulting translation adjustments are charged or credited to other comprehensive income (loss).

Q. Stock-Based Compensation

The Company applies the provisions of ASC Topic 718 “Compensation - Stock Compensation”, under which employee share-based equity awards are accounted for under the fair value method. Accordingly, stock-based compensation to employees and directors is measured at the grant date, based on the fair value of the award. The Company uses the straight-line attribution method to recognize stock-based compensation costs over the vesting period of the award.

R. Impairment of Assets

Impairment of Property, Equipment and Intangible Assets

The Company reviews long-lived 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.

The Company recognizes an impairment loss based upon the difference between the carrying amount and the fair value of such assets, in accordance with ASC 360-10, “Property, Plant and Equipment”.

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

R. Impairment of Assets (cont.)

Impairment of Goodwill

Goodwill is subject to an impairment test at least on an annual basis or upon the occurrence of certain events or circumstances. The goodwill impairment test is performed according to the following principles: An initial qualitative assessment of the likelihood of impairment may be performed. If this step does not result in a more likely than not indication of impairment, no further impairment testing is required. If it does result in a more likely than not indication of impairment, the impairment test is performed.

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.

The Company uses the income approach methodology of valuation that includes discounted cash flows to determine the fair value of the unit. Significant management judgment is required in the forecasts of future operating results used for this methodology.

S. Derivatives

Tower enters into derivatives from time to time, whether embedded or freestanding, that are denominated in currency other than its functional currency (generally in New Israel Shekels or “NIS”). Instruments settled with Tower’s shares that are denominated in a currency other than the Company’s functional currency are not eligible to be included in equity.

T. Classification of liabilities and equity

Tower applies EITF Issue No. 07-5, “Determining Whether an Instrument (or an Embedded Feature) is indexed to an Entity’s Own Stock”. The consensus is an amendment to ASC 815-40 “Contract in Entity’s Own Equity”. The amendment sets the criteria as to when an instrument that may be settled in the company’s shares is also considered indexed to a company’s own stock, for the purpose of classification of the instrument as a liability or equity.

U. Reclassification and presentation

Certain amounts in prior years’ financial statements have been reclassified in order to conform to the 2014 presentation.

All amounts of shares and other securities convertible into shares of the Company and per share data in these financial statements have been adjusted to reflect the effect of the reverse stock split completed in August 2012, see Note 17.

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

V. Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") amended the existing accounting standards for revenue recognition, ASU 2014-09, "Revenue from Contracts with Customers". The amendments are based on the principle that revenue should be recognized to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The Company is required to adopt the amendments in the first quarter of 2017. Early adoption is not permitted. The amendments may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of initial application. The Company is currently evaluating the impact of these amendments and the transition alternatives on its consolidated financial statements.

In August 2014, the FASB issued amended guidance related to disclosure of uncertainties about an entity's ability to continue as a going concern. The new guidance requires management to evaluate whether there is substantial doubt about the entity's ability to continue as a going concern and, as necessary, to provide related footnote disclosures. The guidance has an effective date of December 31, 2016. The Company believes that the adoption of this new standard will not have a material impact on its consolidated financial statements.

NOTE 3 - TOWERJAZZ PANASONIC SEMICONDUCTOR CO., LTD. ESTABLISHMENT

Pursuant to agreements signed between Panasonic Corporation ("Panasonic") and Tower, Panasonic formed a fully-owned subsidiary named TPSCo in March 2014. Further to said agreements, (a) Panasonic transferred licenses use rights of its semiconductor wafer manufacturing process and transferred its capacity tools of 8 inch and 12 inch at three of its fabs located in Hokuriku Japan (Uozu, Tonami and Arai) to TPSCo; and (b) Tower acquired 51% of the shares of TPSCo in consideration for the issuance of ordinary shares of Tower to Panasonic valued at approximately \$7,411.

The purchase price has been allocated on the basis of the estimated fair value of the assets purchased and the liabilities assumed. The estimated fair value of the assets, net amounted to \$180,935. As the fair value of the net assets acquired less the non-controlling interest exceeded the purchase price, Tower recognized a gain on the acquisition in the amount of \$166,404.

The Company believes that the gain realized from the acquisition mainly derived from the fact that Panasonic's fabs were not fully utilized in recent years and were anticipated to remain so in the coming years, hence any volume manufacturing and revenue resulting from the transaction with Tower, due to Tower's customer base, contacts, technologies and foundry management and operations expertise will benefit Panasonic and directly increase the value of the transferred assets.

## TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

## NOTE 3 - TOWERJAZZ PANASONIC SEMICONDUCTOR CO., LTD. ESTABLISHMENT (cont.)

The allocation of fair value to the assets acquired and liabilities assumed is as follows:

|                                                   | As of<br>March 31,<br>2014 |
|---------------------------------------------------|----------------------------|
| Current assets                                    | \$ 91,414                  |
| Machinery and equipment                           | 245,278                    |
| Intangible assets                                 | 24,520                     |
| Total assets as of acquisition date               | \$ 361,212                 |
| Current liabilities                               | \$ 1,426                   |
| Long-term Loan                                    | 85,249                     |
| Deferred tax liability                            | 93,602                     |
| Total liabilities as of acquisition date          | \$ 180,277                 |
| Total net assets acquired                         | \$ 180,935                 |
| The fair value non-controlling interests in TPSCo | 7,120                      |
| Tower's consideration                             | 7,411                      |
| Gain on acquisition                               | \$ 166,404                 |

The fair value of the non-controlling interest in the table above was derived based on the purchase price paid by Tower to Panasonic in consideration for the acquisition of 51% of TPSCo's shares.

The fair values set forth above are based on a valuation of TPSCo's assets and liabilities performed by third party professional valuation experts hired by the Company to appraise the fair value of the assets in accordance with ASC 805-10 "Business Combinations".

TPSCo, Tower and Panasonic also agreed to the following, among others: (i) a five-year manufacturing agreement between Panasonic and TPSCo, under which Panasonic will acquire products from TPSCo; (ii) a five-year production related and complimentary services agreement between Panasonic and TPSCo, under which Panasonic will acquire services from TPSCo; (iii) TPSCo will license certain technologies from Panasonic in order to utilize certain Panasonic process technologies for the manufacturing of products; (iv) Panasonic will provide TPSCo with various transition services and support; (v) TPSCo will lease the manufacturing buildings and related facilities infrastructure from Panasonic; and (iv) TPSCo will receive services from Tower including marketing, sales, general and administration services.

Pro forma financial information is not presented since the financial information of the acquire was prepared for internal use within its group and is not representative of the financial statements of the acquire had it been standalone entity.

## TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

## NOTE 4 - RESTRUCTURING OF JAPAN OPERATIONS

During 2014, the Company decided to restructure its business and activities in Japan. In connection with this restructuring, the Company ceased the operations of TJP's fab as well as terminated vendor and other agreements, released for sale TJP fab assets and terminated TJP's work force. In addition, the Company moved certain customers and a product from TJP to the Company's other fabrication facilities in Japan, US and Israel. Consequently, the Company recorded impairment and restructuring costs of approximately \$47,472 and \$8,028 respectively for the year ended December 31, 2014.

As of December 31, 2014 the restructuring accruals include approximately \$5,000 for facility closure and related costs.

## NOTE 5 - OTHER RECEIVABLES

Other receivables consist of the following:

|                        | As of December 31, |           |
|------------------------|--------------------|-----------|
|                        | 2014               | 2013      |
| Government receivables | \$ 3,848           | \$ 4,435  |
| Others                 | 1,911              | 6,508     |
|                        | \$ 5,759           | \$ 10,943 |

## NOTE 6 - INVENTORIES

Inventories consist of the following:

|                 | As of December 31, |           |
|-----------------|--------------------|-----------|
|                 | 2014               | 2013      |
| Raw materials   | \$ 21,564          | \$ 19,647 |
| Work in process | 62,269             | 36,627    |
| Finished goods  | 4,040              | 8,530     |
|                 | \$ 87,873          | \$ 64,804 |

Work in process and finished goods are presented net of aggregate write-downs to net realizable value of \$1,486 and \$2,445 as of December 31, 2014 and 2013, respectively.

## NOTE 7 - LONG-TERM INVESTMENTS

Long-term investments consist of the following:

|                                   | As of December 31, |           |
|-----------------------------------|--------------------|-----------|
|                                   | 2014               | 2013      |
| Severance pay funds (see Note 15) | \$ 10,214          | \$ 12,522 |
| Others                            | 1,682              | 1,972     |
|                                   | \$ 11,896          | \$ 14,494 |



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## TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

## NOTE 8 - PROPERTY AND EQUIPMENT, NET

| A.                                            | Composition        |              |
|-----------------------------------------------|--------------------|--------------|
|                                               | As of December 31, |              |
|                                               | 2014               | 2013         |
| Original cost:                                |                    |              |
| Buildings (including facility infrastructure) | \$ 304,919         | \$ 306,674   |
| Machinery and equipment                       | 1,630,834          | 1,400,213    |
|                                               | 1,935,753          | 1,706,887    |
| Accumulated depreciation:                     |                    |              |
| Buildings (including facility infrastructure) | (189,971 )         | (173,696 )   |
| Machinery and equipment                       | (1,326,671 )       | (1,183,152 ) |
|                                               | (1,516,642 )       | (1,356,848 ) |
|                                               | \$ 419,111         | \$ 350,039   |

As of December 31, 2014 and 2013, the original cost of buildings, machinery and equipment was reflected net of investment grants (see B below) in the aggregate of \$284,406.

## B. Investment Grants

In February 2011, Tower received an approval certificate from the Israeli Investment Center for an expansion program for investments in fixed assets in Israel, according to which Tower received grants in the amount of approximately NIS 135 million (approximately \$36,000) for eligible investments made by Tower from 2006 to 2012.

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 ("Investments Law") and the regulations promulgated thereunder. In the event Tower fails to comply with such conditions, Tower may be required to repay all or a portion of the grants received plus interest and certain inflation adjustments. In order to secure fulfillment of the conditions related to the receipt of investment grants, floating liens were registered in favor of the State of Israel on substantially all of Tower's assets.

## TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

## NOTE 9 - INTANGIBLE ASSETS, NET

Intangible assets, net consist of the following:

|                                        | Useful Life | As of December 31, |           |
|----------------------------------------|-------------|--------------------|-----------|
|                                        |             | 2014               | 2013      |
| Facilities lease rights                | 5; 19       | \$ 15,699          | \$ 16,988 |
| Technologies, patents and other rights | 4;5;9       | 21,154             | 11,300    |
| Trade name                             | 9           | 3,499              | 2,146     |
| Customer relationships                 | 15          | 1,510              | 1,684     |
| Others                                 |             | 175                | 275       |
|                                        |             | \$ 42,037          | \$ 32,393 |

## NOTE 10 - OTHER ASSETS, NET

Other assets, net consist of the following:

|                                                            | As of December 31, |           |
|------------------------------------------------------------|--------------------|-----------|
|                                                            | 2014               | 2013      |
| Prepaid long-term land lease, net (see Note 16C)           | \$ 3,779           | \$ 3,899  |
| Debenture issuance expenses and deferred financing charges | 3,995              | 5,719     |
| Prepaid expenses - long-term and others                    | 2,244              | 1,929     |
|                                                            | \$ 10,018          | \$ 11,547 |

## NOTE 11 - OTHER CURRENT LIABILITIES

Other current liabilities consist of the following:

|                                            | As of December 31, |          |
|--------------------------------------------|--------------------|----------|
|                                            | 2014               | 2013     |
| Government payables                        | \$ 7,344           | \$ 1,332 |
| Capital leases                             | 559                | 637      |
| Interest payable in relation to debentures | 2,207              | 3,727    |
| TJP facility closure related accruals      | 4,603              | --       |
| Other                                      | 1,906              | 2,298    |
|                                            | \$ 16,619          | \$ 7,994 |

## TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

## NOTE 12 - LONG-TERM LOANS FROM BANKS

## A. Composition

|                                                   | As of<br>December<br>31, 2014 | As of<br>December<br>31, 2013 |
|---------------------------------------------------|-------------------------------|-------------------------------|
| In U.S. Dollars, see also B and C below           | \$ 120,155                    | \$ 150,155                    |
| In JPY, see also D below                          | 73,647                        | 10,954                        |
| Total long-term loans from banks-principal amount | 193,802                       | 161,109                       |
| Fair value adjustments                            | (24,026 )                     | (22,370 )                     |
| Total long-term loans from banks                  | 169,776                       | 138,739                       |
| Current maturities                                | (10,000 )                     | (30,000 )                     |
|                                                   | \$ 159,776                    | \$ 108,739                    |

## B. Facility Agreement with Tower

In 2014, Tower signed with the two largest Israeli banks, Bank Leumi and Bank Ha'poalim ("the Israeli Banks"), an amendment to its facility agreement according to which, as of December 31, 2014, Tower had an amount of approximately \$101,000 of loan outstanding carrying an annual interest rate of USD LIBOR plus 3.90% ("Facility Agreement") and outstanding letters of credit amounting to approximately \$3,300.

The principal payments' schedule of said loan is \$10,000 during 2015, \$14,000 during 2016, \$56,000 during 2017 and approximately \$21,000 during 2018.

Pursuant to the Facility Agreement, Tower has registered liens in favor of the Israeli Banks on substantially all of its present and future assets. The Facility Agreement restricts Tower's ability to place liens on its assets (other than existing liens in favor of the State of Israel in respect of Investment Center grants - see Note 8B), without the prior consent of the Israeli Banks. The Facility Agreement also contains certain restrictive financial ratios and covenants. Satisfying these financial ratios and covenants is a material provision of the Facility Agreement. If, as a result of any default, the Israeli Banks were to accelerate Tower's obligations, Tower would be obligated, to, among other things, immediately repay all loans made by the Israeli Banks plus penalties, and the Israeli Banks would be entitled to exercise the remedies available to them under the Facility Agreement, including enforcement of their liens against all of Tower's assets. The Facility Agreement contains, among others, (i) a mechanism for early repayment of certain principal amounts based on excess cash flow Tower may incur; (ii) required financial ratios and covenants Tower has to meet, as well as definitions of event of defaults.

Loans received under the Facility Agreement, as amended to date, are presented at fair value, with changes in value reflected in the statements of operations, following adoption by the Company of ASC 825-10 "Fair Value Option" and Tower's election to apply the fair value option to the Facility Agreement.

The effects of the Facility Agreement, as revised and amended, have been included in the measurement of the fair value of the loans at the relevant periods.



TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(dollars in thousands, except per share data)

NOTE 12 - LONG-TERM LOANS FROM BANKS (cont.)

C. Wells Fargo Asset-Based Revolving Credit Line

In December 2013, Jazz entered into an agreement with Wells Fargo Capital Finance, part of Wells Fargo & Company (“Wells Fargo”), for a five-year secured asset-based revolving credit line in the total amount of up to \$70,000, maturing in December 2018 (the “Credit Line Agreement”). Loans under the Credit Line Agreement bear interest at a rate equal to, at lender’s option, either the lender’s prime rate plus a margin ranging from 0.50% to 1.0% or the LIBOR rate plus a margin ranging from 1.75% to 2.25% per annum.

The outstanding borrowing availability varies from time to time based on the levels of Jazz’s eligible accounts receivable, eligible equipment, eligible inventories and other terms and conditions described in the Credit Line Agreement. The Credit Line Agreement is secured by the assets of Jazz. The Credit Line Agreement contains customary covenants and other terms, including covenants, as well as customary events of default. If any event of default will occur, Wells Fargo may declare all borrowings under the facility and foreclose on the collateral due immediately.

Borrowing availability under the Credit Line Agreement as of December 31, 2014 was approximately \$54,000, of which approximately \$24,000 has been utilized as of such date (including \$19,100 through loans and approximately \$5,000 through letters of credit).

As of December 31, 2014, Jazz was in compliance with all of the covenants under this facility.

D. GE Capital Asset-Based Revolving Line

In May 2012, TJP signed a definitive credit line agreement with GE Capital to provide a three-year secured asset-based revolving credit line of up to 4 billion Japanese Yen. Loans obtained under this credit line carried an interest of the higher of TIBOR rate or LIBOR rate plus 2.6% per annum.

In 2014, as part of the cessation of operations of TJP, the loan was fully repaid and the contract has been terminated.

As of December 31, 2013, the total availability amounted to approximately \$25,000, of which approximately \$11,000 was outstanding.

## TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

## NOTE 12 - LONG-TERM LOANS FROM BANKS (cont.)

## E. Long Term Loan Agreement with JA Mitsui Leasing, Ltd. and Bank of Tokyo (BOT)

In June 2014, TPSCo entered into a long term loan agreement with JA Mitsui Leasing, Ltd. and Bank of Tokyo (BOT) Lease Co., Ltd, under which it has borrowed approximately 8.8 billion Japanese Yen (approximately \$74,000 as of December 31, 2014).

The loan carries an annual interest of the TIBOR (Tokyo Interbank Offered Rate) six months' rate plus 1.65% per annum with the principal amount to be repaid in seven semi-annual equal installments starting June 2016 and ending June 2019. The loan is secured by an assignment of TPSCo's right to receive any amounts under its manufacturing and production related services agreements with Panasonic.

## NOTE 13 - DEBENTURES

## A. Composition by repayment schedule (carrying amount):

| As of December 31, 2014                      |                  |            |           |       |           |
|----------------------------------------------|------------------|------------|-----------|-------|-----------|
|                                              | Interest<br>rate | 2015       | 2016      | 2017  | 2018      |
| Debentures Series D                          | 8%               | \$ 5,796   | \$ 5,796  | \$ -- | \$ --     |
| Debentures Series F                          | 7.8%             | 58,626     | 58,626    | --    | --        |
| Jazz's 2010 Notes (as<br>defined in D below) | 8%               | 45,577     | --        | --    | --        |
| Jazz's 2014 Notes (as<br>defined in E below) | 8%               | --         | --        | --    | 42,889    |
|                                              |                  | \$ 109,999 | \$ 64,422 | \$ -- | \$ 42,889 |

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(dollars in thousands, except per share data)

NOTE 13 - DEBENTURES (cont.)

A. Composition by repayment schedule (carrying amount) (cont.):

The outstanding principal amounts of the debentures as of December 31, 2014 and 2013 were approximately \$312,000 and \$345,000, respectively, and following redemption of Jazz 2010 Notes described in D below and conversions of Series F described in C below, the outstanding principal amounts of all the company's debentures has been reduced to approximately \$208,000 as of February 15, 2015.

Tower debentures and interest thereon are unsecured and subordinated to Tower's existing and future secured indebtedness, including indebtedness to the Israeli Banks under the Facility Agreement, see Note 16A(1), and to the government of Israel, see Note 8B. For details in regards to Jazz Notes, see E below.

If on a payment date of the principal or interest on any series of the Tower debentures, there is a breach of certain covenants and conditions under the Facility Agreement, the dates for payment of interest and principal on the debentures may be postponed until such covenant or condition is satisfied.

B. Debentures Series D Issued in 2007

During 2007, Tower issued (i) \$27,000 aggregate principal amount of long-term non-convertible debentures, repayable in six equal annual installments beginning in December 2011 and ending in December 2016, linked to the CPI and carrying an annual interest rate of 8% ("Series D").

Series D non-convertible debenture outstanding principal amounts as of December 31, 2014 and 2013, were approximately \$12,000 and \$20,000, respectively.

C. Debentures Series F

In 2010 and 2012, Tower issued un-secured and subordinated long-term debentures, which are fully linked to the US dollar, carry an interest rate of 7.8% per annum payable semiannually, which are repayable in two equal installments in December 2015 and December 2016. As of December 31, 2014 and 2013, the aggregate outstanding amount of such debentures was approximately \$197,000 and \$231,000, respectively. As of February 15, 2015, the aggregate outstanding amount of such debentures is approximately \$138,000.

The debentures are convertible into Tower's ordinary shares until December 2016, at a conversion ratio of approximately \$10 par value of debentures into one ordinary share.

The determination of the conversion ratio in September 2012 triggered the examination of whether a contingent beneficial conversion feature ("BCF") existed as of past issuance dates of these debentures. In accordance with ASC 470-20 (formerly EITF 98-5 and EITF 00-27), and specifically the guidance over "Contingently Adjustable Conversion Ratios", the Company concluded that a BCF existed. The BCF, in accordance with such guidance, amounted to approximately \$110,000 which was classified as an increase in shareholders' equity with a corresponding decrease by the same amount in the carrying values of Series F presented in long term liabilities.





TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

NOTE 13 - DEBENTURES (Cont.)

C. Debentures Series F (cont.)

The approximately \$110,000 amount is being recorded as accretion and amortization costs included in other financing expenses, net from 2012 to 2016 (term of said debentures) using the effective interest method, resulting in non-cash accretion and amortization costs included in other financing expenses, net being recognized at increasing amounts over the term of the debentures. Any partial or full conversion of debentures F into ordinary shares will increase shareholders' equity, will reduce debt liabilities and accelerate the recognition of such financing expenses, thereby creating higher accretion and amortization costs included in other financing expenses in the period of conversion occurrence, which will be offset by lower financing expenses in the periods thereafter.

Following conversions of approximately \$34,000 of Series F debentures into ordinary shares that occurred in 2014, an amount of approximately \$16,000 was recorded due to acceleration of accretion and amortization costs included in other financing expenses, net in the statements of operations report, which will result in future reduced financing expenses, improved profitability in the following periods, as well as reduced liabilities and increased shareholders' equity. Any additional conversions during 2015 will have similar impact on the future financial statements; from January 1, 2015 to February 15, 2015, an additional approximately \$59,000 of Series F debentures were converted into ordinary shares resulting in approximately \$24,000 of accelerated accretion and amortization costs included in other financing expenses, as well as reduced liabilities and increased shareholders' equity, which amount will further reduce future financing expenses and improve profitability in the following periods.

D. Notes Issued By Jazz in 2010

In July 2010, Jazz issued notes in the principal amount of approximately \$94,000 due 2015 (the "2010 Notes"). Interest on the 2010 Notes was a rate of 8% per annum was payable semiannually.

As of the approval date of this financial statements the 2010 Notes were fully redeemed through: (i) an early redemption of approximately \$45,000 outstanding amount, as permitted by the terms of the indenture governing the 2010 Notes, completed in January 2015, thereby saving approximately \$1,000 of interest payments; (ii) an Exchange Agreement as described in E below.

As of December 31, 2014, approximately \$45,000, in principal amount of the 2010 Notes were outstanding, which were fully paid in January 2015. The outstanding balance of the 2010 Notes as of December 31, 2013 was \$94,000, see also E.

E. Jazz 2014 Notes Transaction

In March 2014, Jazz, certain of its domestic subsidiaries and Tower entered into an exchange agreement (the "2014 Exchange Agreement") with certain 2010 Notes holders (the "2014 Participating Holders") according to which Jazz issued new unsecured convertible senior notes due December 2018 (the "2014 Notes") in exchange for approximately \$45,000 in aggregate principal amount of the 2010 Notes that were originally due June 2015.

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

NOTE 13 - DEBENTURES (Cont.)

E. Jazz 2014 Notes Transaction (cont.)

Also in March 2014, Jazz, Tower and certain of the 2014 Participating Holders (the “Purchasers”) entered into a purchase agreement (the “Purchase Agreement”) pursuant to which the Purchasers purchased \$10,000 in aggregate principal amount of the 2014 Notes for cash consideration.

Holders of the 2014 Notes may submit a conversion request with respect to their 2014 Notes to be settled through cash or ordinary shares of Tower, in which event the conversion price is set to \$10.07 per share, reflecting a 20 percent premium over the average closing price for Tower’s ordinary shares for the five trading days ending on the day prior to the signing date of the 2014 Exchange Agreement and Purchase Agreement. Interest on the 2014 Notes at a rate of 8% per annum is payable semiannually.

The 2014 Notes are unsecured senior obligations of Jazz, rank equally with all other existing and future unsecured senior indebtedness of Jazz, and are effectively subordinated to all existing and future secured indebtedness of Jazz, including the Wells Fargo Credit Line Agreement (see Note 12C above), to the extent of the value of the collateral securing such indebtedness. The 2014 Notes rank senior to all existing and future subordinated debt. The 2014 Notes are not guaranteed by Tower.

Holders of the 2014 Notes are entitled, subject to certain conditions and restrictions, to require Jazz to repurchase the 2014 Notes at par plus accrued interest and a 1% redemption premium in the event of certain change of control transactions as set forth in the Indenture governing the 2014 Notes.

The Indenture contains certain customary covenants including covenants restricting the ability of Jazz and the ability of its subsidiaries to, among other things, incur additional debt, incur additional liens, make specified payments and make certain asset sales.

Jazz’s obligations under the 2014 Notes are guaranteed by Jazz’s wholly owned domestic subsidiaries. Jazz has not provided condensed consolidated financial information for such subsidiaries because the subsidiaries have no independent assets or operations, the subsidiary guarantees are full and unconditional and joint and several and the subsidiaries of Jazz, other than the subsidiary guarantors, are minor.

As of December 31, 2014, approximately \$58,000 principal amount of 2014 Notes was outstanding.

The Jazz Credit Line Agreement imposes certain limitations on the ability to repay the notes and/or to incur additional indebtedness without Wells Fargo’s consent. Any default on payment or refinancing of the notes prior to the notes maturity, in a form satisfactory to Wells Fargo, would trigger a cross default under the Credit Line Agreement, , which would permit the lenders to accelerate the obligations thereunder, potentially requiring Jazz to repay or refinance the Credit Line Agreement.

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

NOTE 13 - DEBENTURES (Cont.)

E. Jazz 2014 Notes Transaction (cont.)

Jazz concluded that the exchange should not be recognized as a troubled debt restructuring in accordance with the provisions of ASC 470-60 "Modifications and Extinguishments". In accordance with the provisions of ASC 470-50, Jazz concluded that said exchange resulted in an extinguishment of the old debt and the issuance of a new convertible debt to be recorded at fair value. As described above, certain of the 2014 Notes were issued in exchange for certain of the 2010 Notes. Since the 2014 Notes were not traded and no quotes were available, Jazz determined the fair value of the 2014 Notes using the present value technique. The 2014 Exchange Agreement resulted in an expense of approximately \$9,800, which has been recorded in the statement of operations report as non-cash one-time financing expense for the year ended December 31, 2014. The convertible feature has been measured as the difference between the fair value of the liability component and the fair value of the note as a whole, and recorded in equity in accordance with ASC 470-20.

NOTE 14 - FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS

The Company makes certain disclosures with regard to financial instruments, including derivatives. These disclosures include, among other matters, the nature and terms of derivative transactions, information about significant concentrations of credit risk and the fair value of financial assets and liabilities.

A. Exchange Rate Transactions

As the functional currency of Tower is the USD and part of Tower's expenses are denominated in NIS, Tower enters from time to time, into exchange rate agreements to protect against the volatility of future cash flows caused by changes in foreign exchange rates on NIS denominated expenses.

As of December 31, 2014, there were no open exchange rate agreements.

B. Concentration of Credit Risks

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, short-term bank deposits, trade receivables and government receivables. The Company's cash and cash equivalents are maintained with large and reputable banks, and the composition and maturities of investments are regularly monitored by the Company. Generally, these securities may be redeemed upon demand and bear minimal risk.

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

NOTE 14 - FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS (cont.)

B. Concentration of Credit Risks (cont.)

The Company generally does not require collateral for insurance of receivables; however, in certain circumstances, the Company obtains credit insurance or may require letters of credit. An allowance for doubtful accounts is determined with respect to those amounts that were determined to be doubtful of collection. The Company performs ongoing credit evaluations of its customers.

The Company is exposed to credit-related losses in respect of derivative financial instruments in a manner similar to the credit risk involved in the realization or collection of other types of assets.

C. Fair Value of Financial Instruments

The estimated fair values of the Company's financial instruments, excluding debentures and banks' loans, do not materially differ from their respective carrying amounts as of December 31, 2014 and 2013. The fair values of Tower and Jazz's debentures, based on quoted market prices or other valuation as of December 31, 2014 and 2013, were approximately \$402,000 and \$319,000, respectively, compared to carrying amounts of approximately \$217,000 and \$215,000, for the above dates, respectively.

D. Fair Value Measurements

Valuation Techniques:

In general, and where applicable, the Company uses quoted prices in active markets for identical assets or liabilities to determine fair value. This pricing methodology applies to the Company's Level 1 assets and liabilities. If quoted prices in active markets for identical assets and liabilities are not available to determine fair value, then the Company uses quoted prices for similar assets and liabilities or inputs other than the quoted prices that are observable, either directly or indirectly. This pricing methodology applies to the Company's Level 2 and Level 3 assets and liabilities.

Level 2 Measurements:

Over the counter derivatives - the Company used the market approach using quotations from banks.

## TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

## NOTE 14 - FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS (Cont.)

## D. Fair Value Measurements (cont.)

## Level 3 Measurements:

Warrants - the Company utilized the Black Scholes Merton formula. The assumptions included in the Black-Scholes model were (i) the market price of Tower's shares, (ii) the exercise price of the warrant, (iii) risk-free interest, (iv) term available to exercise or redeem the security, and (v) the volatility of the share during the relevant term. The Company determines the volatility of its share using daily historical quotes of the share. The risk free interest rate is determined as the interest rate on governmental bonds with maturity commensurate with the term of the warrant.

Tower's loans - for Tower's loans from the Israeli Banks, fair value is based on the income approach using a present value technique under which the cash flows used in the technique reflect the cash stream expected to be used to satisfy the obligation over its economic life. Tower discounted expected cash flows as forecasted each quarter using the appropriate discount rate for the applicable maturity based on the expected contractual payments, by observing yields on similar traded debts.

## Recurring Fair Value Measurements Using the Indicated Inputs:

|                                                 | December<br>31, 2014 | Quoted<br>prices in<br>active<br>market for<br>identical<br>liability<br>(Level 1) | Significant<br>other<br>observable<br>inputs<br>(Level 2) | Significant<br>unobservable<br>inputs<br>(Level 3) |
|-------------------------------------------------|----------------------|------------------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|
| Tower's loans (including current maturities)(*) | \$ 77,029            | \$ --                                                                              | \$ --                                                     | \$ 77,029                                          |
| Others                                          | 34                   | --                                                                                 | --                                                        | 34                                                 |
|                                                 | \$ 77,063            | \$ --                                                                              | \$ --                                                     | \$ 77,063                                          |

(\*) Includes only loans under Tower's Facility Agreement with the Israeli Banks.

## Liabilities measured on a recurring basis using significant unobservable inputs (Level 3):

|                                                                                      | Tower's loans<br>(including<br>current<br>maturities) | Others   |
|--------------------------------------------------------------------------------------|-------------------------------------------------------|----------|
| As of January 1, 2014 - at fair value                                                | \$ 108,685                                            | \$ 47    |
| Loan Repayment                                                                       | (30,000 )                                             | --       |
| Total losses (gains) unrealized in earnings                                          | (1,656 )                                              | (13 )    |
| As of December 31, 2014 - at fair value                                              | \$ 77,029                                             | \$ 34    |
| Unrealized losses (gains) recognized in earnings from liabilities held at period end | \$ (1,656 )                                           | \$ (13 ) |

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## TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

## NOTE 14 - FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS (cont.)

## D. Fair Value Measurements (cont.)

## Recurring Fair Value Measurements Using the Indicated Inputs:

|                                                 | December<br>31, 2013 | Quoted<br>prices in<br>active<br>market for<br>identical<br>liability<br>(Level 1) | Significant<br>other<br>observable<br>inputs<br>(Level 2) | Significant<br>unobservable<br>inputs<br>(Level 3) |
|-------------------------------------------------|----------------------|------------------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|
| Tower's loans (including current maturities)(*) | \$ 108,685           | \$ --                                                                              | \$ --                                                     | \$ 108,685                                         |
| Others                                          | (18 )                | --                                                                                 | (65 )                                                     | 47                                                 |
|                                                 | \$ 108,667           | \$ --                                                                              | \$ (65 )                                                  | \$ 108,732                                         |

(\*) Includes only loans under Tower's Facility Agreement with the Israeli Banks.

## Liabilities measured on a recurring basis using significant unobservable inputs (Level 3):

|                                                                                      | Tower's loans<br>(including<br>current<br>maturities) | Others    |
|--------------------------------------------------------------------------------------|-------------------------------------------------------|-----------|
| As of January 1, 2013 - at fair value                                                | \$ 106,645                                            | \$ 295    |
| Total losses (gains) unrealized in earnings                                          | 2,040                                                 | (248 )    |
| As of December 31, 2013 - at fair value                                              | \$ 108,685                                            | \$ 47     |
| Unrealized losses (gains) recognized in earnings from liabilities held at period end | \$ 2,040                                              | \$ (248 ) |

## NOTE 15 - EMPLOYEE RELATED LIABILITIES

## A. Employee Termination Benefits

Israeli law, labor agreements and corporate policy determine the obligations of Tower to make severance payments to dismissed Israeli employees and to Israeli employees leaving employment under certain circumstances. Generally, the liability for severance pay benefits, as determined by Israeli law, is based upon length of service and the employee's monthly salary. This liability is primarily covered by regular deposits made each month by Tower into recognized severance and pension funds and by insurance policies maintained by Tower, based on the employee's salary for the relevant month. The amounts so funded and the liability are reflected separately on the balance sheets in long-term investments and long-term employee related liabilities in the amounts of \$10,214 and \$12,282, respectively, as of December 31, 2014. Commencing January 1, 2005, Tower implemented a labor agreement with regard to most of its employees, according to which monthly deposits into recognized severance and pension funds or insurance policies will release it from any additional severance obligation in excess of the balance in such accounts to such Israeli



employees and, therefore, Tower incurs no liability or asset with respect to such severance obligations and deposits, since that date. Any net severance pay amount as of such date will be released on the employee's termination date. Payments relating to Israeli employee termination benefits were \$3,801, \$3,756 and \$3,450 for 2014, 2013 and 2012, respectively.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

NOTE 15 - EMPLOYEE RELATED LIABILITIES (cont.)

A. Employee Termination Benefits (cont.)

Labor agreements pertaining to the employees of TJP determine the obligation of TJP to make payments to employees upon retirement or upon termination. The liability for termination benefits, as determined by said agreements is based upon length of service and the employee's monthly salary multiplied by a certain ratio. In case of resignation, the employee is entitled to 50% of the termination benefits. TJP does not cover the termination liability through deposits to benefit funds.

Following the cessation of operations in TJP and the termination of employees, a portion of the accrued retirement was paid to employees and the remaining outstanding amount is payable in 2015. The outstanding retirement liability as of December 31, 2014 and 2013 was \$22,133 and \$49,385, respectively. TJP's payments relating to employee termination benefits were \$27,366 for 2014 and \$ 924 for 2013.

TPSCo established a Defined Contribution Retirement Plan (the "DC Plan") for its employees through which TPSCo contributes approximately 10% with employee average match of 1% from employee base salary to the DC Plan. Such contribution releases the employer from further obligation to any payments upon termination of employment. The contribution is remitted either to third party benefits funds that are responsible to invest the funds based on employee preference, or directly, to those employees who elected not to enroll in the DC Plan. Total payments under the DC Plan in 2014 amounted to \$4,011.

B. Jazz Employee Benefit Plans

The following information provided recognizes the changes in 2014, 2013 and 2012 periodic expenses and benefit obligations due to the bargaining agreement effective December 19, 2009 entered into by Jazz with its collective bargaining unit employees.

## TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

## NOTE 15 - EMPLOYEE RELATED LIABILITIES (cont.)

## B. Jazz Employee Benefit Plans (cont.)

## Postretirement Medical Plan

The components of the net periodic benefit cost and other amounts recognized in other comprehensive income (loss) for postretirement medical plan expense are as follows:

|                                                                                                | Year ended<br>December<br>31, 2014 | Year ended<br>December<br>31, 2013 | Year ended<br>December<br>31, 2012 |
|------------------------------------------------------------------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| Net periodic benefit cost                                                                      |                                    |                                    |                                    |
| Service cost                                                                                   | \$ 24                              | \$ 32                              | \$ 146                             |
| Interest cost                                                                                  | 118                                | 126                                | 399                                |
| Expected return on the plan's assets                                                           | --                                 | --                                 | --                                 |
| Amortization of transition obligation (asset)                                                  | --                                 | --                                 | --                                 |
| Amortization of prior service costs                                                            | (1,737 )                           | (1,703 )                           | (244 )                             |
| Amortization of net (gain) or loss                                                             | (227 )                             | (132 )                             | --                                 |
| Total net periodic benefit cost                                                                | \$ (1,822 )                        | \$ (1,677 )                        | \$ 301                             |
| Other changes in plan assets and benefits obligations recognized in other comprehensive income |                                    |                                    |                                    |
| Prior service cost for the period                                                              | \$ --                              | \$ (91 )                           | \$ (3,851 )                        |
| Net (gain) or loss for the period                                                              | 558                                | (668 )                             | (1,355 )                           |
| Amortization of transition obligation (asset)                                                  | --                                 | --                                 | --                                 |
| Amortization of prior service costs                                                            | 1,737                              | 1,703                              | 244                                |
| Amortization of net gain or (loss)                                                             | 227                                | 132                                | --                                 |
| Total recognized in other comprehensive income (expense)                                       | \$ 2,522                           | \$ 1,076                           | \$ (4,962 )                        |
| Total recognized in net periodic benefit cost and other comprehensive income                   | \$ 700                             | \$ (601 )                          | \$ (4,661 )                        |
| Weighted average assumptions used:                                                             |                                    |                                    |                                    |
| Discount rate                                                                                  | 5.20 %                             | 4.30 %                             | 5.20 %                             |
| Expected return on plan assets                                                                 | N/A                                | N/A                                | N/A                                |
| Rate of compensation increases                                                                 | N/A                                | N/A                                | N/A                                |
| Assumed health care cost trend rates:                                                          |                                    |                                    |                                    |
| Health care cost trend rate assumed for current year                                           |                                    |                                    |                                    |
| (Pre-65/Post-65)                                                                               | 7.75%/25.00 %                      | 8.25/35.00 %                       | 8.25/35.00 %                       |
| Ultimate rate (Pre-65/Post-65)                                                                 | 5.00%/5.00 %                       | 5.00/5.00 %                        | 5.00/5.00 %                        |
| Year the ultimate rate is reached (Pre-65/Post-65)                                             | 2022/2022                          | 2022/2022                          | 2022/2022                          |
| Measurement date                                                                               | December 31, 2014                  | December 31, 2013                  | December 31, 2012                  |

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## TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

## NOTE 15 - EMPLOYEE RELATED LIABILITIES (cont.)

## A. Jazz Employee Benefit Plans (cont.)

## Post-retirement Medical Plan (cont.)

Impact of one-percentage point change in assumed health care cost trend rates as of December 31, 2014:

|                                             | Increase | Decrease  |
|---------------------------------------------|----------|-----------|
| Effect on service cost and interest cost    | \$ 10    | \$ (8 )   |
| Effect on postretirement benefit obligation | \$ 254   | \$ (198 ) |

The components of the change in benefit obligation, change in plan assets and funded status for postretirement medical plan are as follows:

|                                                  | Year ended<br>December<br>31,<br>2014 | Year ended<br>December<br>31,<br>2013 | Year ended<br>December<br>31,<br>2012 |
|--------------------------------------------------|---------------------------------------|---------------------------------------|---------------------------------------|
| Change in benefit obligation:                    |                                       |                                       |                                       |
| Benefit obligation at beginning of period        | \$ 2,317                              | \$ 2,995                              | \$ 7,749                              |
| Service cost                                     | 24                                    | 32                                    | 146                                   |
| Interest cost                                    | 118                                   | 126                                   | 399                                   |
| Benefits paid                                    | (40 )                                 | (77 )                                 | (93 )                                 |
| Change in plan provisions                        | --                                    | (91 )                                 | (3,851 )                              |
| Actuarial gain                                   | 558                                   | (668 )                                | (1,355 )                              |
| Benefit obligation end of period                 | \$ 2,977                              | \$ 2,317                              | \$ 2,995                              |
| Change in plan assets:                           |                                       |                                       |                                       |
| Fair value of plan assets at beginning of period | \$ --                                 | \$ --                                 | \$ --                                 |
| Actual return on plan assets                     | --                                    | --                                    | --                                    |
| Employer contribution                            | 40                                    | 77                                    | 93                                    |
| Benefits paid                                    | (40 )                                 | (77 )                                 | (93 )                                 |
| Fair value of plan assets at end of period       | \$ --                                 | \$ --                                 | \$ --                                 |
| Funded status                                    | \$ (2,977 )                           | \$ (2,317 )                           | \$ (2,995 )                           |

## TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

## NOTE 15 - EMPLOYEE RELATED LIABILITIES (cont.)

## B. Jazz Employee Benefit Plans (cont.)

## Post-retirement Medical Plan (cont.)

|                                                                     | As of<br>December 31,<br>2014 | As of<br>December 31,<br>2013 | As of<br>December 31,<br>2012 |
|---------------------------------------------------------------------|-------------------------------|-------------------------------|-------------------------------|
| Amounts recognized in statement of financial position:              |                               |                               |                               |
| Non-current assets                                                  | \$ --                         | \$ --                         | \$ --                         |
| Current liabilities                                                 | (83 )                         | (89 )                         | (132 )                        |
| Non-current liabilities                                             | (2,894 )                      | (2,228 )                      | (2,863 )                      |
| Net amount recognized                                               | \$ (2,977 )                   | \$ (2,317 )                   | \$ (2,995 )                   |
| Weighted average assumptions used:                                  |                               |                               |                               |
| Discount rate                                                       | 4.30 %                        | 5.20 %                        | 4.30 %                        |
| Rate of compensation increases                                      | N/A                           | N/A                           | N/A                           |
| Assumed health care cost trend rates:                               |                               |                               |                               |
| Health care cost trend rate assumed for next year (Pre 65/ Post 65) |                               |                               |                               |
|                                                                     | 7.00%/20.00 %                 | 7.75/25.00 %                  | 8.25/35.00 %                  |
| Ultimate rate (Pre 65/ Post 65)                                     | 4.50%/5.00 %                  | 5.00/5.00 %                   | 5.00/5.00 %                   |
| Year the ultimate rate is reached (Pre 65/ Post 65)                 |                               |                               |                               |
|                                                                     | 2025/2022                     | 2022/2022                     | 2022/2022                     |

The following benefit payments are expected to be paid in each of the next five fiscal years and in the aggregate for the five fiscal years thereafter:

| Fiscal Year | Other<br>Benefits |
|-------------|-------------------|
| 2015        | \$ 83             |
| 2016        | 76                |
| 2017        | 96                |
| 2018        | 114               |
| 2019        | 125               |
| 2020 - 2024 | \$ 699            |

Jazz adopted several changes to the postretirement medical plan in 2012 that cumulatively reduced obligations by approximately \$3,900. The changes in the plan will be implemented through 2015 and include the phase out of spousal coverage, introduction of an employer-paid cap, and acceleration of increases in retiree contribution rates.

## Jazz Pension Plan

Jazz has a pension plan that provides for monthly pension payments to eligible employees upon retirement. The pension benefits are based on years of service and specified benefit amounts. Jazz uses a December 31 measurement date. Jazz makes quarterly contributions in accordance with the minimum actuarially determined amounts.

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## TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

## NOTE 15 - EMPLOYEE RELATED LIABILITIES (cont.)

## B. Jazz Employee Benefit Plans (cont.)

## Jazz Pension Plan (cont.)

The components of the change in benefit obligation, the change in plan assets and funded status for Jazz's pension plan are as follows:

|                                                                                                                          | Year ended<br>December<br>31, 2014 | Year ended<br>December<br>31, 2013    | Year ended<br>December<br>31, 2012 |
|--------------------------------------------------------------------------------------------------------------------------|------------------------------------|---------------------------------------|------------------------------------|
| Net periodic benefit cost                                                                                                |                                    |                                       |                                    |
| Service cost                                                                                                             | \$ --                              | \$ --                                 | \$ --                              |
| Interest cost                                                                                                            | 796                                | 732                                   | 761                                |
| Expected return on plan assets                                                                                           | (1,257 )                           | (948 )                                | (817 )                             |
| Amortization of transition obligation(asset)                                                                             | --                                 | --                                    | --                                 |
| Amortization of prior service costs                                                                                      | 3                                  | --                                    | --                                 |
| Amortization of net (gain) or loss                                                                                       | --                                 | 97                                    | 70                                 |
| Total net periodic benefit cost                                                                                          | \$ (458 )                          | \$ (119 )                             | \$ 14                              |
| Other changes in plan assets and benefits obligations<br>recognized in other comprehensive income:                       |                                    |                                       |                                    |
| Prior service cost for the period                                                                                        | \$ --                              | \$ 93                                 | \$ --                              |
| Net (gain) or loss for the period                                                                                        | 3,117                              | (4,696 )                              | 1,000                              |
| Amortization of transition obligation (asset)                                                                            | --                                 | --                                    | --                                 |
| Amortization of prior service costs                                                                                      | (3 )                               | --                                    | --                                 |
| Amortization of net gain or (loss)                                                                                       | --                                 | (97 )                                 | (70 )                              |
| Total recognized in other comprehensive income<br>(expense)                                                              | \$ 3,114                           | \$ (4,700 )                           | \$ 930                             |
| Total recognized in net periodic benefit cost and<br>other comprehensive income (expense)                                | \$ 2,656                           | \$ (4,819 )                           | \$ 944                             |
| Weighted average assumptions used:                                                                                       |                                    |                                       |                                    |
| Discount rate                                                                                                            | 5.10 %                             | 4.30 %                                | 5.10 %                             |
| Expected return on plan assets                                                                                           | 7.50 %                             | 7.50 %                                | 7.50 %                             |
| Rate of compensation increases                                                                                           | N/A                                | N/A                                   | N/A                                |
|                                                                                                                          | Year ended<br>December<br>31, 2014 | Year<br>ended<br>December<br>31, 2013 | Year ended<br>December<br>31, 2012 |
| Estimated amounts that will be amortized from accumulated other comprehensive income in<br>the next fiscal year ending : |                                    |                                       |                                    |
| Transition obligation (asset)                                                                                            | \$ --                              | \$ --                                 | \$ --                              |
| Prior service cost                                                                                                       | 3                                  | 3                                     | --                                 |
| Net actuarial (gain) or loss                                                                                             | \$ 31                              | \$ --                                 | \$ 97                              |



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## TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

## NOTE 15 - EMPLOYEE RELATED LIABILITIES (Cont.)

## B. Jazz Employee Benefit Plans (Cont.)

## Jazz Pension Plan (cont.)

The components of the change in benefit obligation, change in plan assets and funded status for Jazz's pension plan are as follows:

|                                                       | Year ended<br>December<br>31, 2014 | Year ended<br>December<br>31, 2013 | Year ended<br>December<br>31, 2012 |
|-------------------------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| Change in benefit obligation:                         |                                    |                                    |                                    |
| Benefit obligation at beginning of period             | \$ 15,873                          | \$ 17,272                          | \$ 15,134                          |
| Service cost                                          | --                                 | --                                 | --                                 |
| Interest cost                                         | 796                                | 732                                | 761                                |
| Benefits paid                                         | (532 )                             | (437 )                             | (293 )                             |
| Change in plan provisions                             | --                                 | 93                                 | --                                 |
| Actuarial loss (gain)                                 | 3,167                              | (1,787 )                           | 1,670                              |
| Benefit obligation end of period                      | \$ 19,304                          | \$ 15,873                          | \$ 17,272                          |
| Change in plan assets                                 |                                    |                                    |                                    |
| Fair value of plan assets at beginning of period      | \$ 16,652                          | \$ 12,543                          | \$ 10,842                          |
| Actual return on plan assets                          | 1,307                              | 3,857                              | 1,488                              |
| Employer contribution                                 | 709                                | 689                                | 506                                |
| Benefits paid                                         | (532 )                             | (437 )                             | (293 )                             |
| Fair value of plan assets at end of period            | \$ 18,134                          | \$ 16,652                          | \$ 12,543                          |
| Funded status                                         | \$ (1,170 )                        | \$ 779                             | \$ (4,729 )                        |
| Accumulated benefit obligation                        | \$ 19,304                          | \$ 15,873                          | \$ 17,272                          |
| Amounts recognized in statement of financial position |                                    |                                    |                                    |
| Non-current assets                                    | \$ --                              | \$ 779                             | \$ --                              |
| Current liabilities                                   | --                                 | --                                 | --                                 |
| Non-current liabilities                               | (1,170 )                           | --                                 | (4,729 )                           |
| Net amount recognized                                 | \$ (1,170 )                        | \$ 779                             | \$ (4,729 )                        |
| Weighted average assumptions used                     |                                    |                                    |                                    |
| Discount rate                                         | 4.20 %                             | 5.10 %                             | 4.30 %                             |
| Rate of compensation increases                        | N/A                                | N/A                                | N/A                                |

## TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

## NOTE 15 - EMPLOYEE RELATED LIABILITIES (cont.)

## B. Jazz Employee Benefit Plans (cont.)

## Jazz Pension Plan (cont.)

The following benefit payments are expected to be paid in each of the next five fiscal years and in the aggregate for the five fiscal years thereafter:

| Fiscal Year | Other Benefits |
|-------------|----------------|
| 2015        | \$ 600         |
| 2016        | 670            |
| 2017        | 743            |
| 2018        | 809            |
| 2019        | 864            |
| 2020 - 2024 | \$ 5,150       |

The Plan's assets measured at fair value on a recurring basis consisted of the following as of as of December 31, 2014:

|                                 | Level 1 | Level 2   | Level 3 |
|---------------------------------|---------|-----------|---------|
| Investments in Mutual Funds     | \$ --   | \$ 18,134 | \$ --   |
| Total plan assets at fair value | \$ --   | \$ 18,134 | \$ --   |

The Plan's assets measured at fair value on a recurring basis consisted of the following as of as of December 31, 2013:

|                                 | Level 1 | Level 2   | Level 3 |
|---------------------------------|---------|-----------|---------|
| Investments in Mutual Funds     | \$ --   | \$ 16,652 | \$ --   |
| Total plan assets at fair value | \$ --   | \$ 16,652 | \$ --   |

Jazz's pension plan weighted average asset allocations on December 31, 2014, by asset category are as follows:

| Asset Category:   | December 31, 2014 |   | Target allocation 2015 |   |
|-------------------|-------------------|---|------------------------|---|
| Equity securities | 60                | % | 60                     | % |
| Debt securities   | 40                | % | 40                     | % |
| Total             | 100               | % | 100                    | % |

Jazz's primary policy goals regarding the plan's assets are cost-effective diversification of plan assets, competitive returns on investment, and preservation of capital. Plan assets are currently invested in mutual funds with various debt and equity investment objectives. The target asset allocation for the plan assets is 40% debt, or fixed income securities, and 60% equity securities. Individual funds are evaluated periodically based on comparisons to benchmark indices and peer group funds and necessary investment decisions are made by Jazz in accordance with the policy goals of the investments managements. Actual allocation to each asset category fluctuates and might be outside the target

range due to changes in market conditions.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(dollars in thousands, except per share data)

NOTE 15 - EMPLOYEE RELATED LIABILITIES (cont.)

B. Jazz Employee Benefit Plans (cont.)

Jazz Pension Plan (cont.)

The estimated expected return on assets of the plan is based on assumptions derived from, among other things, the historical return on assets of the plan, the current and expected investment allocation of assets held by the plan and the current and expected future rates of return in the debt and equity markets for investments held by the plan. The obligations under the plan could differ from the obligation currently recorded if management's estimates are not consistent with actual investment performance.

NOTE 16 - COMMITMENTS AND CONTINGENCIES

A. Commitments and Contingencies Relating to Fab 2

(1) Facility Agreement

Liens

The Company has liens on its assets. For Liens regarding Tower's Facility Agreement, see Note 12B; for liens relating to Jazz Credit Line Agreement, see Note 12C.

Offer by the Israeli Banks

If one or more of certain bankruptcy related events occur, the Israeli Banks are entitled to bring a firm offer made by a potential investor to purchase Tower's ordinary shares ("the Offer") at a price provided in the Offer. In such case, Tower shall be required thereafter to procure a rights offering to invest up to 30% of the amount of the Offer on the same terms. If the Offer is conditioned on the offeror purchasing a majority of Tower's outstanding share capital, the rights offering will be limited to allow for this as stipulated in the Facility Agreement as amended.

For further details in regard to the Facility Agreement, see Note 12B.

(2) Approved Enterprise Status

For details regarding Approved Enterprise Status relating to Fab 2, see Note 20A and Note 8B.

## TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

## NOTE 16 - COMMITMENTS AND CONTINGENCIES (cont.)

## B.

## License Agreements

The Company enters into intellectual property and licensing agreements with third parties from time to time. The effect of each of them on the Company's total assets and results of operations is immaterial. Certain of these agreements call for royalties to be paid by the Company to these third parties.

## C.

## Leases

Tower's administrative offices and corporate headquarters, Fab 1 and Fab 2 manufacturing operations are located in a building complex situated in an industrial park in Migdal Ha'emek, in the northern part of Israel. The premises where the administrative offices and Fab 1 are located are under a long-term lease from the ILA, which expires in 2032. Tower has no obligation for lease payments related to this lease through the year 2032. Tower entered into a long-term lease agreement with the ILA relating to Fab 2 for a period ending in 2049. The lease payments through 2049 relating to this lease have been paid in advance and are expensed through the operational lease period.

Tower occupies certain other premises under various operating leases. The obligations under such leases were not material as of December 31, 2014.

Jazz leases its fabrication facilities under lease contracts that may be extended until 2027, through the exercise of options at Jazz's sole discretion to extend the lease periods from 2017 to 2022 and from 2022 to 2027. In the amendments to its leases, Jazz secured various contractual safeguards designed to limit and mitigate any adverse impact of construction activities on its fabrication operations. In addition, the most recent lease amendment set forth certain obligations of Jazz and the landlord, including certain noise abatement actions at the fabrication facility.

Aggregate rental expense under Jazz operating leases, was approximately \$2,600 for the year ended December 31, 2014 and approximately \$2,400 for each of the years ended 2013 and 2012, respectively.

Future minimum payments under non-cancelable operating building lease are as follows:

|                  | 2015     | 2016     | 2017   | 2018   | 2019   | Total    |
|------------------|----------|----------|--------|--------|--------|----------|
| Operating leases | \$ 2,665 | \$ 2,674 | \$ 851 | \$ 413 | \$ 383 | \$ 6,986 |

## TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

## NOTE 16 - COMMITMENTS AND CONTINGENCIES (cont.)

## C.

## Leases (cont.)

In 2014, TPSCo entered into a 5-year lease agreement with Panasonic to lease the building and facilities of its 3 fabs in Hukuriko, Japan for the manufacturing business of TPSCo. The parties agreed to have good faith discussions regarding the terms and conditions for extension of the term of the lease agreement, taking into account the terms provided thereunder prior to the expiration thereof and the fair market prices existing at the time of the extension.

Future minimum payments under non-cancelable operating building and facilities lease are as follows:

|                  | 2015      | 2016      | 2017      | 2018      | 2019     | Total     |
|------------------|-----------|-----------|-----------|-----------|----------|-----------|
| Operating leases | \$ 13,273 | \$ 12,771 | \$ 11,558 | \$ 10,913 | \$ 2,590 | \$ 51,105 |

## D.

## Other Principal Agreements

The Company, from time to time in the ordinary course of business, enters into long-term agreements with various entities for the joint development of products and processes utilizing technologies owned separately by either the other entity or the Company, or owned jointly by both parties, as applicable.

## E.

## Environmental Affairs

The Company's operations are subject to a variety of laws and state and governmental regulations relating to the use, discharge and disposal of toxic or otherwise hazardous materials used in the production processes. Operating permits and licenses are required for the operation of the Company's facilities and these permits and licenses are subject to revocation, modification and renewal. Government authorities have the power to enforce compliance with these regulations, permits and licenses. As of the approval date of the financial statements, the Company is not aware of any noncompliance with the terms of said permits and licenses.

#### F. Trusted Foundry Manufacturer for the Defense Security Service of the United States Department of Defense and Special Security Agreement with DSS

In connection with the company's aerospace and defense business, its facility in New Port Beach, CA, has a security clearance and a trusted foundry status. It is considered a "Trusted Foundry" under the U.S Government and aerospace and defense business definitions. Since 2008, the Company and Jazz have worked with the Defense Security Service of the United States Department of Defense ("DSS") to re-gain the company's trusted foundry clearance and mitigate any concern of foreign ownership, control or influence over the operations of Jazz specifically relating to protection of classified information and prevention of potential unauthorized access thereto by creating Jazz Semiconductor Trusted Foundry ("JSTF") as a subsidiary of Jazz (which is a subsidiary of the Company) and limiting possession of all classified information solely to JSTF. Tower and Jazz have further agreed to operate JSTF under a special security agreement signed with DSS.

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

NOTE 16 - COMMITMENTS AND CONTINGENCIES (cont.)

G.

Other Commitments

Receipt of certain research and development grants from the government of Israel is subject to various conditions. In the event Tower fails to comply with such conditions, Tower may be required to repay all or a portion of the grants received. In Tower's opinion, Tower has been in full compliance with the conditions through December 31, 2014. For details in regard to Investment Center grants, see Note 8B.

NOTE 17 - SHAREHOLDERS' EQUITY

A.

Description of Ordinary Shares

As of December 31, 2014, Tower had 150 million authorized ordinary shares, par value NIS 15.00 each, of which approximately 58 million were issued and outstanding (net of approximately 0.1 million ordinary shares held by Tower as of such date). Holders of ordinary shares are entitled to participate equally in the payment of cash dividends and bonus share (stock dividend) distributions and, in the event of the liquidation of Tower, in the distribution of assets after satisfaction of liabilities to creditors. Each ordinary share is entitled to one vote on all matters to be voted on by shareholders. In August 2012, Tower completed a reverse split of its ordinary shares at a ratio of 1 for 15. Proportional adjustments were made to all of Tower's outstanding convertible securities. All numbers of shares and other convertible securities of the Company in these financial statements is post- reverse share split.

B.

Share Option Plans

(1)General

The Company has granted to its employees and directors options to purchase ordinary shares under several option plans adopted by the Company. The particular provisions of each plan and grant vary as to vesting period, exercise price, exercise period and other terms. Generally, the exercise price will not be lower than the nominal value of the Shares, the options (i) are granted at an exercise price which equals either the closing market price of the ordinary shares immediately prior to the date of grant, or, in relation to grants made from September 2013, an average of the closing price during the thirty trading days immediately prior to the date of grant, (ii) vest over up to a three or four year period according to various vesting schedules, and are not exercisable beyond seven or ten years from the grant date.

Except for those plans described below, as of December 31, 2014, there are approximately 0.4 million options outstanding under the Company's option plans (the "Old Plans").

No further options may be granted under Old Plans.



TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

NOTE 17 - SHAREHOLDERS' EQUITY (cont.)

B. Share Option Plans (cont.)

(2) Tower's 2009 Share Incentive Plans (the "2009 Plans")

In 2009, the Company adopted new share incentive Plans for directors officers, employees and its subsidiaries. Options were granted at an exercise price which equals the closing market price of the ordinary shares immediately prior to the date of grant, vest over up to a three-year period, and are not exercisable beyond seven years from the grant date.

As of December 31, 2014, approximately 1.3 million options were outstanding under the 2009 Plans.

(3) Tower's 2013 Share Incentive Plan (the "2013 Plan")

In 2013, the Company adopted a new share incentive Plan for directors, officers, employees and its subsidiaries. Options granted under the plan bear an exercise price which equals an average of the closing price during the thirty trading days immediately prior to the date of grant, vest over up to a three year period and are not exercisable beyond seven years from the grant date.

As of December 31, 2014, approximately 5.7 million options were outstanding under the 2013 Plan. Further grants may be approved subject to Compensation Committee, Board of Directors and shareholders' approval as may be required by law.

(4) Independent Directors' Option Plan

In January 2007, our shareholders approved, following approval by the Audit Committee and Board, the grant to each independent director of the Company who is not affiliated with our major shareholders and is not an employee of the Company ("Independent Director") a grant of 10,000 initial options to purchase Tower's ordinary shares at an exercise price which equals the closing market price of the ordinary shares immediately prior to the date of grant. The initial options vest over 3 years.

Upon the third anniversary of the initial grant of options to an Independent Director, each such Independent Director shall be granted an additional 10,000 options to purchase Tower's ordinary shares, which will vest over 3 years. The exercise price shall be the closing price of Tower's ordinary shares on the trading day immediately prior to the relevant grant date. Subject to certain conditions, the options that have vested shall be exercisable by an Independent Director for a period of ten years following the date on which the relevant options as the case may be, first vested.

## TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

## NOTE 17 - SHAREHOLDERS' EQUITY (cont.)

## B. Share Option Plans (cont.)

## (4)Independent Directors' Option Plan (cont.)

As of December 31, 2014, approximately 0.1 million options were outstanding under the Independent Directors' plan. No further grants are made under this plan since September 2013.

## (5)Summary of the Status of all the Company's Employee and Director Share Options

|                                       | 2014                          |                                          | 2013                          |                                          | 2012                          |                                          |
|---------------------------------------|-------------------------------|------------------------------------------|-------------------------------|------------------------------------------|-------------------------------|------------------------------------------|
|                                       | Number<br>of share<br>options | Weighted<br>average<br>exercise<br>price | Number<br>of share<br>options | Weighted<br>average<br>exercise<br>price | Number<br>of share<br>options | Weighted<br>average<br>exercise<br>price |
| Outstanding as of beginning of year   | 8,066,749                     | \$6.31                                   | 4,351,487                     | \$15.21                                  | 4,483,793                     | \$14.97                                  |
| Granted                               | 746,431                       | 5.81                                     | 5,402,961                     | 4.54                                     | 30,336                        | 12.64                                    |
| Exercised                             | (762,607 )                    | 4.36                                     | (23,932 )                     | 4.35                                     | (125,260 )                    | 4.36                                     |
| Terminated                            | (30,901 )                     | 35.40                                    | (4,273 )                      | 52.79                                    | (411 )                        | 63.57                                    |
| Forfeited                             | (482,453 )                    | 5.86                                     | (1,659,494)                   | 23.76                                    | (36,971 )                     | 20.23                                    |
| Outstanding as of end of year         | 7,537,219                     | 6.37                                     | 8,066,749                     | 6.31                                     | 4,351,487                     | 15.21                                    |
| Options exercisable as of end of year | 1,834,281                     | \$11.54                                  | 2,419,180                     | \$9.03                                   | 3,553,662                     | \$14.28                                  |

## (6)Summary of Information about Employee Share Options Outstanding

The following table summarizes information about employee share options outstanding as of December 31, 2014:

| Outstanding as of December 31, 2014 |                       |                                                                       |                                          | Exercisable as of December 31, 2014 |                                          |
|-------------------------------------|-----------------------|-----------------------------------------------------------------------|------------------------------------------|-------------------------------------|------------------------------------------|
| Range of<br>exercise<br>Prices      | Number<br>outstanding | Weighted<br>average<br>remaining<br>contractual<br>life<br>(in years) | Weighted<br>average<br>exercise<br>price | Number<br>exercisable               | Weighted<br>average<br>exercise<br>price |
| \$3.15                              | 10,000                | 5.25                                                                  | \$3.15                                   | 10,000                              | \$3.15                                   |
| 4.35-13.20                          | 6,733,734             | 5.27                                                                  | 4.81                                     | 1,030,796                           | 5.39                                     |
| 15.90-20.85                         | 418,202               | 3.34                                                                  | 16.85                                    | 418,202                             | 16.85                                    |
| \$21.00-32.25                       | 375,283               | 2.37                                                                  | \$22.76                                  | 375,283                             | \$22.76                                  |
|                                     | 7,537,219             |                                                                       |                                          | 1,834,281                           |                                          |



## TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

## NOTE 17 - SHAREHOLDERS' EQUITY (cont.)

## B. Share Option Plans (cont.)

## (6) Summary of Information about Employee Share Options Outstanding (cont.)

|                                              | Year Ended December 31, |        |        |
|----------------------------------------------|-------------------------|--------|--------|
|                                              | 2014                    | 2013   | 2012   |
| The intrinsic value of options exercised     | \$ 3,680                | \$ 42  | \$ 927 |
| The original fair value of options exercised | \$ 2,661                | \$ 158 | \$ 819 |

Stock-based compensation expenses were recognized in the following line items in the statement of operations as follows:

|                                                        | Year Ended December 31, |          |          |
|--------------------------------------------------------|-------------------------|----------|----------|
|                                                        | 2014                    | 2013     | 2012     |
| Component of income before provision for income taxes: |                         |          |          |
| Cost of revenue                                        | \$ 753                  | \$ 597   | \$ 902   |
| Research and development, net                          | 1,034                   | 527      | 714      |
| Selling, general and administrative                    | 2,897                   | 1,658    | 4,121    |
| Stock-based compensation expense                       | \$ 4,684                | \$ 2,782 | \$ 5,737 |

## (7) Weighted Average Grant-Date Fair Value of Options Granted to Employees

The weighted average grant-date fair value of the options granted during 2014, 2013 and 2012 to employees and directors amounted to \$3.10, \$2.10 and \$6.00 per option, respectively. The Company utilizes the Black-Scholes model. The Company estimated the fair value, utilizing the following assumptions for the years 2014, 2013 and 2012 (all in weighted averages):

|                            | 2014       | 2013       | 2012       |
|----------------------------|------------|------------|------------|
| Risk-free interest rate    | 1.3%-1.8%  | 0.8%-1.8%  | 0.6%-1.0%  |
| Expected life of options   | 4.75 years | 4.75 years | 4.75 years |
| Expected annual volatility | 47%-57%    | 51%-65%    | 52%-55%    |
| Expected dividend yield    | None       | None       | None       |

Risk free interest rate - is based on yield curve rates published by the US Department of Treasury.

Expected life of options - is based upon historical experience and represents the period of time that options granted are expected to be outstanding.

Expected annual volatility - is based on the volatility of the Tower's ordinary share prior to the options grant for the term identical to expected life.

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

NOTE 17 - SHAREHOLDERS' EQUITY (cont.)

C. Equity-Equivalent Capital Notes and Banks' Warrants

All issued and outstanding equity equivalent capital notes, totaling approximately 4.5 million as of December 31, 2014, have no voting rights, no maturity date, no dividend rights, are not tradable, are not registered, do not carry interest, are not linked to any index and are not redeemable. The equity equivalent capital notes are classified in shareholders' equity. As of December 31, 2014, Bank Hapo'alim is the sole holder of such capital notes (Bank Le'umi and Israel Corporation, which previously held such capital notes, converted the entire quantities they had to ordinary shares through 2014, and have no capital notes as of December 31, 2014).

As of December 31, 2014, the Israeli Banks hold a total of approximately 0.7 million warrants received under the Facility Agreement exercisable until December 2018, at various exercise prices between \$10.50 and \$92.55 per share.

D. Treasury Stock

During 1999 and 1998, the Company funded the purchase by a trustee of an aggregate of 86,667 of Tower's ordinary shares. These shares are classified as treasury shares.

E. Dividend Restriction

According to the Facility Agreement, as amended to date, Tower undertook not to distribute any dividends prior to the date that all amounts payable under the Facility Agreement have been paid in full.

F. Warrants J and Warrants 7

In connection with the issuance of the Jazz 2010 Notes, the note holders received warrants ("Warrants J"), which are exercisable for up to approximately 1.7 million Tower ordinary shares based on an exercise price of \$25.50 per one ordinary share, for a period until June 2015.

In connection with the issuance of Series F Debentures in 2012, the debenture holders received warrants ("Warrants 7"), which were exercisable during a period of two years starting on March 2, 2014 and ending on March 1, 2016 for up to approximately 1.9 million ordinary shares of Tower based on an exercise price of approximately \$7.2 per one ordinary share. As of December 31, 2014, following exercises occurred through 2014, Warrants 7 are exercisable for up to approximately 1.1 million ordinary shares of Tower.

G. Securities Issuance Pursuant to the Acquisition of TJP

As part of the acquisition of TJP on June 2011, the Company had issued 1.3 million ordinary shares to Micron. Those shares were subject to a lock-up arrangement, which expired on June 3, 2013.

## TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

## NOTE 17 - SHAREHOLDERS' EQUITY (cont.)

## H.

## Rights Offering

In June 2013, the Company distributed to its shareholders and certain other security holders rights to purchase ordinary shares and two series of warrants. As a result of the rights offering, the Company received aggregate proceeds of approximately \$40,000, including approximately \$19,000 through the exercise of Series 8 Warrants issued in this rights offering and exercised in July 2013. The remaining Series 8 Warrants, which were not exercised, expired on July 2013. Those who exercised their rights also received an aggregate of approximately 5.5 million Series 9 Warrants exercisable by June 2017 for the purchase of ordinary shares for a cash payment to Tower of \$7.33 per share. As of December 31, 2014, following conversions occurred through 2014, the outstanding Series 9 Warrants are exercisable for up to approximately 5.1 million ordinary shares of Tower.

## I.

## Debentures

With regard to Debentures, see Notes 13C and 13E.

## NOTE 18 - INFORMATION ON GEOGRAPHIC AREAS AND MAJOR CUSTOMERS

## A.

## Revenues by Geographic Area - as percentage of total sales

|          | Year ended December 31, |   |      |   |      |   |
|----------|-------------------------|---|------|---|------|---|
|          | 2014                    |   | 2013 |   | 2012 |   |
| USA      | 45                      | % | 77   | % | 81   | % |
| Japan    | 40                      |   | 2    |   | 1    |   |
| Asia *   | 11                      |   | 14   |   | 13   |   |
| Europe * | 4                       |   | 7    |   | 5    |   |
| Total    | 100                     | % | 100  | % | 100  | % |

\* Represents revenues from individual countries of less than 10% each.

The basis of attributing revenues from external customers to geographic area is based on the headquarters location of the customer issuing the purchase order.

## TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

## NOTE 18 - INFORMATION ON GEOGRAPHIC AREAS AND MAJOR CUSTOMERS (cont.)

## B. Property and equipment, net - by Geographic Area

Long-Lived Assets by Geographic Area - Substantially all of Tower's long-lived assets are located in Israel, substantially all of Jazz's long-lived assets are located in the United States and substantially all of TPSCo's long-lived assets are located in Japan.

|               | As of December 31, |            |
|---------------|--------------------|------------|
|               | 2014               | 2013       |
| Israel        | \$ 145,816         | \$ 180,976 |
| United States | 66,953             | 75,040     |
| Japan         | 206,342            | 94,023     |
| Total         | \$ 419,111         | \$ 350,039 |

## C. Major Customers - as percentage of net accounts receivable balance

Accounts receivable from significant customers representing 10% or more of the net accounts receivable balance as of December 31, 2014 and 2013, consist of the following customers:

|            | As of December 31, |   |      |   |
|------------|--------------------|---|------|---|
|            | 2014               |   | 2013 |   |
| Customer 1 | 35                 | % | --   | % |
| Customer 2 | 16                 | % | 9    | % |
| Customer 3 | --                 | % | 20   | % |

## D. Major Customers - as percentage of total sales

|                     | Year ended December 31, |   |      |   |      |   |
|---------------------|-------------------------|---|------|---|------|---|
|                     | 2014                    |   | 2013 |   | 2012 |   |
| Customer A          | 38                      | % | --   | % | --   | % |
| Customer B          | 7                       |   | 27   |   | 43   |   |
| Other customers (*) | 16                      |   | 16   |   | 10   |   |

(\*)Represents sales to two different customers accounted for between 7% and 9% of sales during 2014 and 2013 and to two different customers accounted for between 4% and 6% of sales during 2012.

## NOTE 19 - INTEREST EXPENSES, NET AND OTHER FINANCING EXPENSES, NET

## A. Interest Expenses, Net

Interest expenses net, for the years ended December 31, 2014, 2013 and 2012 were \$33,409, \$32,971 and \$31,808, respectively.





## TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

## NOTE 19 - INTEREST EXPENSES, NET AND OTHER FINANCING EXPENSES, NET (cont.)

## B. Other Financing Expenses, Net

Other financing expenses, net consist of the following:

|                                                                                                                                         | Year ended December 31, |           |           |
|-----------------------------------------------------------------------------------------------------------------------------------------|-------------------------|-----------|-----------|
|                                                                                                                                         | 2014                    | 2013      | 2012      |
| Debentures Series F accretion and amortization including accelerated accretion associated with Debentures Series F (see Note 13C above) | \$ 39,494               | \$ 13,113 | \$ 5,365  |
| Jazz Notes accretion and amortization                                                                                                   | 9,307                   | 6,770     | 5,705     |
| Jazz 2014 Exchange Agreement related financing costs, see Note 13E                                                                      | 9,817                   | --        | --        |
| Changes in fair value (total level 3 changes in fair value as reported in Note 14D)                                                     | (1,669 )                | 1,792     | 10,827    |
| Changes in fair value on debentures, derivatives and warrants - other than level 3                                                      | --                      | --        | 1,284     |
| Exchange rate difference                                                                                                                | (5,352 )                | 4,038     | 2,707     |
| Other                                                                                                                                   | 3,807                   | 2,125     | 1,695     |
| Other financing expenses, net                                                                                                           | \$ 55,404               | \$ 27,838 | \$ 27,583 |

## NOTE 20 - INCOME TAXES

## A. Approved Enterprise Status

Substantially all of Tower's existing facilities and other capital investments have been granted approved enterprise status, as provided by the Investments Law.

Pursuant to the Investments Law and the approval certificates, Tower's income is taxed at a rate of 20% in 2014. The portion of Tower's taxable income that is not attributable to approved enterprise status is taxed at a rate of 26.5% in 2014 ("Regular Company Tax").

The tax benefits are also conditioned upon fulfillment of the requirements stipulated by the letter of approval regarding Tower's facilities and other capital investments' approved enterprise status ("Ktav Ishur"), as well as by the Investments Law and the regulations promulgated thereunder, as well as the criteria set forth in the certificates of approval. In the event of a failure by Tower to comply with these conditions, the tax benefits could be canceled, in whole or in part, and Tower would be required to refund the amount of the canceled benefits, plus interest and certain inflation adjustments. In the Company's opinion, Tower has been in compliance with the conditions through the approval date of the financial statements; See Note 8B.

## TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

## NOTE 20 - INCOME TAXES (cont.)

## B. The company's Income Tax provision is as follows

|                                 | December<br>31, 2014 | Year Ended<br>December<br>31, 2013 | December<br>31, 2012 |
|---------------------------------|----------------------|------------------------------------|----------------------|
| Current tax expense (benefit):  |                      |                                    |                      |
| Foreign                         | \$ 2,814             | \$ (534 )                          | \$ (1,800 )          |
| Total current                   | 2,814                | (534 )                             | (1,800 )             |
| Deferred tax expense (benefit): |                      |                                    |                      |
| Foreign                         | (27,556 )            | (8,854 )                           | 9,126                |
| Total deferred                  | (27,556 )            | (8,854 )                           | 9,126                |
| Income tax provision (benefit)  | \$ (24,742 )         | \$ (9,388 )                        | \$ 7,326             |

  

|                                  | December<br>31, 2014 | Year Ended<br>December<br>31, 2013 | December<br>31, 2012 |
|----------------------------------|----------------------|------------------------------------|----------------------|
| Profit (loss) before taxes       |                      |                                    |                      |
| Domestic                         | \$ 78,677            | \$ (90,497 )                       | \$ (83,049 )         |
| Foreign                          | (104,791 )           | (26,551 )                          | 20,106               |
| Total income (loss) before taxes | \$ (26,114 )         | \$ (117,048 )                      | \$ (62,943 )         |

## C. Components of Deferred Tax Asset/Liability

The following is a summary of the components of the deferred tax benefit and liability reflected on the balance sheets as of the respective dates:

|                                        | As of December 31, |          |
|----------------------------------------|--------------------|----------|
|                                        | 2014               | 2013     |
| Net deferred tax benefit - current     |                    |          |
| Net operating loss carryforwards       | \$ 938             | \$ 2,026 |
| Employees benefits and compensation    | 5,170              | 4,003    |
| Debt discount                          | 1,253              | --       |
| Accruals, reserves and others          | 3,809              | 2,760    |
|                                        | 11,170             | 8,789    |
| Valuation allowance                    | (3,354 )           | (2,779 ) |
| Total net current deferred tax benefit | \$ 7,816           | \$ 6,010 |

## TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

## NOTE 20 - INCOME TAXES (cont.)

## C. Components of Deferred Tax Asset/Liability (cont.)

|                                                        | As of December 31, |              |
|--------------------------------------------------------|--------------------|--------------|
|                                                        | 2014               | 2013         |
| Net deferred tax benefit - long-term                   |                    |              |
| Deferred tax assets -                                  |                    |              |
| Net operating loss carryforwards                       | \$ 320,954         | \$ 284,446   |
| Employees benefits and compensation                    | 2,663              | 4,605        |
| Research and development                               | 1,940              | 2,005        |
| Others                                                 | 1,237              | 1,212        |
|                                                        | 326,794            | 292,268      |
| Valuation allowance                                    | (293,670)          | (255,899)    |
|                                                        | \$ 33,124          | \$ 36,369    |
| Deferred tax liability - depreciation and amortization | (30,293 )          | (41,255 )    |
| Deferred tax related to gain on acquisition            | (66,722 )          | --           |
| Intangible assets                                      | (6,318 )           | (6,929 )     |
| Debt discount                                          | (4,200 )           | (884 )       |
| Others                                                 | (869 )             | (912 )       |
| Total net long-term deferred tax liability             | \$ (75,278 )       | \$ (13,611 ) |

Deferred tax asset in the amounts of \$7,816 and \$6,010 as of December 31, 2014 and 2013, respectively are presented in other current assets.

Deferred tax liability in the amounts of \$75,278 and \$13,611 as of December 31, 2014 and 2013, respectively, are presented in deferred tax liability.

The Company establishes a valuation allowance for deferred tax assets, when it is unable to conclude that it is more likely than not that such deferred tax assets will be realized. In making this determination, the Company evaluates both positive and negative evidence. Jazz's state deferred tax assets exceed the reversal of taxable temporary differences. Without other significant positive evidence, Jazz has determined that the state deferred tax assets are not more likely than not to be realized and Tower has determined that its deferred tax assets are not more likely than not to be realized during the coming years.

On December 31, 2014 and 2013, the Company recorded a valuation allowance against its deferred tax assets in the amounts of \$297,024 and \$258,678, respectively, to offset the related net deferred tax assets as the Company is unable to conclude that it is more likely than not that such deferred tax assets will be realized.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

|                                             | Unrecognized<br>tax benefits |
|---------------------------------------------|------------------------------|
| Balance at January 1, 2014                  | \$ 25,676                    |
| Additions for tax positions of current year | 51                           |

|                                            |           |
|--------------------------------------------|-----------|
| Reductions for tax positions of prior year | --        |
| Translation differences                    | (766 )    |
| Balance at December 31, 2014               | \$ 24,961 |

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## TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

## NOTE 20 - INCOME TAXES (cont.)

## C. Components of Deferred Tax Asset/Liability (cont.)

|                                             | Unrecognized<br>tax benefits |
|---------------------------------------------|------------------------------|
| Balance at January 1, 2013                  | \$ 27,414                    |
| Additions for tax positions of current year | 12                           |
| Reductions for tax positions of prior year  | (371 )                       |
| Translation differences                     | (1,379 )                     |
| Balance at December 31, 2013                | \$ 25,676                    |

|                                            | Unrecognized<br>tax benefits |
|--------------------------------------------|------------------------------|
| Balance at January 1, 2012                 | \$ 32,377                    |
| Reductions for tax positions of prior year | (275 )                       |
| Translation differences                    | (719 )                       |
| Settlements                                | (3,969 )                     |
| Balance at December 31, 2012               | \$ 27,414                    |

The statute of limitation with respect to Jazz's tax year 2010 is expected to expire in March 2015, unless further extended by the US tax authorities. The expiration of the statute of limitation will result in cancellation of the respective unrecognized tax benefit for such year in the amount of approximately \$11,000.

The Company accounts for its uncertain tax provisions in accordance with ASC 740. The Company's policy is to recognize interest and penalties that would be assessed in relation to the settlement value of unrecognized tax benefits as a component of income tax expense.

## D. Effective Income Tax Rates

The reconciliation of the statutory tax rate to the effective tax rate is as follows:

|                                                          | Year ended December 31, |              |              |
|----------------------------------------------------------|-------------------------|--------------|--------------|
|                                                          | 2014                    | 2013         | 2012         |
| Tax expense (benefit) computed at statutory rates        | \$ (6,920 )             | \$ (29,262 ) | \$ (15,736 ) |
| Effect of different tax rates in different jurisdictions | (18,453 )               | 1,408        | 7,514        |
| Gain on acquisition of TPSCo                             | (33,280 )               | -            | -            |
| Tax benefits for which deferred taxes were not recorded  | 27,757                  | 20,139       | 15,955       |
| Permanent differences and other, net                     | 6,154                   | (1,673 )     | (407 )       |
| Income tax provision (benefit)                           | \$ (24,742 )            | \$ (9,388 )  | \$ 7,326     |

## E. Net Operating Loss Carry forward

On December 31, 2014, Tower had net operating loss carry forwards for tax purposes of approximately 1.4 billion USD which may be carried forward for an unlimited period of time.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

NOTE 20 - INCOME TAXES (cont.)

E. Net Operating Loss Carry forward (cont.)

The future utilization of Jazz's net operating loss carry forwards to offset future taxable income is subject to an annual limitation as a result of ownership changes that have occurred. Additional limitations could apply if ownership changes occur in the future. Jazz has had two "change in ownership" events that limit the utilization of net operating loss carry forwards. The first "change in ownership" event occurred in February 2007 upon Jazz Technologies' acquisition of Jazz Semiconductor. The second "change in ownership" event occurred on September 19, 2008, upon Tower's acquisition of Jazz. Jazz concluded that the net operating loss limitation for the change in ownership which occurred in September 2008 will be an annual utilization of approximately \$2,100 for the use in its tax return. On December 31, 2014, Jazz had federal net operating loss carry forwards of approximately \$31,000 that will begin to expire in 2022, unless previously utilized. On December 31, 2014, Jazz had state net operating loss carry forward of approximately \$141,000. The state tax loss carry forwards is expected to start expiring from 2015 onwards.

At December 31, 2014, TJP had net operating loss carry forwards of approximately \$9,000 which are expected to expire in 2015 following the decision to cease TJP operations.

At December 31, 2014, TPSCo had operating loss carry forwards of approximately \$12,000 which are expected to expire in 2023.

F. Final Tax Assessments

Tower possesses final tax assessments through the year 1998. In addition, the tax assessments for the years 1999-2010 are deemed final.

Jazz and its subsidiaries are subject to U.S. federal income tax as well as income tax in multiple state and foreign jurisdictions.

In 2013, the U.S. tax authorities commenced an audit of Jazz's 2011 tax returns, and asked Jazz for certain reports and data in connection with said year's tax returns. During September 2014, Jazz received correspondence from the U.S. tax authorities that they accepted the 2011 federal tax returns as filed without any audit adjustments.

Jazz is no longer subject to U.S. federal income tax examinations for years before 2010; state and local income tax examinations before 2010; and foreign income tax examinations before 2011. However, to the extent allowed by law, the tax authorities may have the right to examine prior periods where net operating losses were generated and carried forward, and make adjustments up to the amount of the net operating loss carry forward amount.

TJP was established in June 2011 and does not have final tax assessments.

TPSCo was established in March 2014 and has not yet filed any annual tax report.

## TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

## NOTE 21 - RELATED PARTIES BALANCES AND TRANSACTIONS

## A. Balances

| The nature of the relationships involved |                                            | As of December 31, |      |
|------------------------------------------|--------------------------------------------|--------------------|------|
|                                          |                                            | 2014               | 2013 |
| Long-term investment                     | Equity investment in a limited partnership | \$44               | \$60 |
| Trade accounts payable                   | Trade accounts payable                     | \$62               | \$90 |

## B. Transactions

| Description of the transactions     |                                                                       | Year Ended December 31, |          |           |
|-------------------------------------|-----------------------------------------------------------------------|-------------------------|----------|-----------|
|                                     |                                                                       | 2014                    | 2013     | 2012      |
| Sales                               | Sales to a limited partnership                                        | \$ --                   | \$ 59    | \$ 431    |
|                                     | Purchase of services and goods from affiliates of a major shareholder | \$ 14,883               | \$ 3,379 | \$ 2,853  |
| Cost of revenues                    | Mainly directors fees and reimbursement to directors                  | \$ 221                  | \$ 311   | \$ 238    |
| General and Administrative expenses | Equity loss (profit) in a limited partnership                         | \$ 16                   | \$ 144   | \$ (184 ) |

## NOTE 22 - ADDITIONAL INFORMATION- RECONCILIATION OF US GAAP TO IFRS

Since the initial listing of the Company on NASDAQ in the United States of America, The Company has followed accounting principles of the US GAAP, both for internal as well as external purposes, and since 2007 its main reporting was under US GAAP. Since the Company was an affiliate of Israel Corporation, Ltd., a public holding company traded in TASE, reporting under International Financial Reporting Standards rules ("IFRS"), during the years before and including 2014, and has become in January 2015 an affiliate of Kenon Holdings, Ltd., a public holding company traded in NYSE and TASE reporting under the IFRS, the Company is providing on a voluntary basis a reconciliation from U.S. GAAP to IFRS as detailed below (condensed balance sheet, statement of operations and additional information). IFRS differs in certain significant aspects from U.S. GAAP. The primary differences between US GAAP and IFRS related to the Company are the accounting for goodwill, financial instruments, pension plans and termination benefits.

## A. Goodwill

Adjustment arising from Goodwill of a subsidiary acquired in 2008.

The purchase consideration was paid in Tower's stocks. Under US GAAP the consideration was measured according to Tower's share price at the transaction announcement date. Under IFRS the consideration was measured according to Tower's share price at closing date. Accordingly, a lower purchase consideration was measured under IFRS than the purchase consideration measured under US GAAP. Consequently no purchase price was allocated to Goodwill under IFRS.





TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

NOTE 22 - ADDITIONAL INFORMATION- RECONCILIATION OF US GAAP TO IFRS (cont.)

B.

Financial instruments

Adjustments arising from allocation of proceeds from issuance of convertible debentures and warrants to liabilities and equity and the subsequent measurement of such liabilities.

The adjustment stems primarily from a convertible debt security sold by Tower in 2010, with a conversion ratio that have been determined in the third quarter of 2012 based on Tower's share price as of such date. Under ASC 815 and ASC 470-20, the related conversion feature was measured in the third quarter of 2012 based on its intrinsic value and recorded to equity, with a corresponding discount on the debt instrument. Under IAS 39 such conversion feature was bifurcated from its host contract at the date of issuance and measured as a liability at fair value at each cut-off date until the date of determination of the related conversion ratio, in which date such conversion feature was classified to equity

C.

Pension plans

Adjustments arising from defined benefit pension arrangements.

Under ASC 715 prior years' service cost, as well as actuarial gains and losses, are recorded in accumulated other comprehensive income, and amortized to the profit and loss statement over time. Under IAS 19, prior year service cost is recorded to the profit and lost statement in the period in which the underlying change was executed, while actuarial gains and losses, at the Company's election, are recorded directly to retained earnings with no impact on the profit and loss statement.

D.

Termination Benefits

Adjustment arising from benefits to be granted to certain Company officials upon termination.

Under IAS 19, such benefits are not reflected in the Company's financial statements until termination occurs. Under ASC 712 such benefits are recorded in earlier periods based on probability of occurrence.

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES  
BALANCE SHEETS RECONCILIATION OF US GAAP TO IFRS (CONDENSED)  
(dollars in thousands)

E. Balance sheet in accordance with IFRS

|                                                 |        | As of December 31, 2014 |              |            |
|-------------------------------------------------|--------|-------------------------|--------------|------------|
|                                                 | remark | US GAAP                 | Adjustments  | IFRS       |
| <b>A S S E T S</b>                              |        |                         |              |            |
| CURRENT ASSETS                                  |        | \$ 394,084              | \$ --        | \$ 394,084 |
| PROPERTY AND EQUIPMENT,<br>NET                  |        | 419,111                 | --           | 419,111    |
| LONG TERM ASSETS                                | I,J    | 70,951                  | (10,412 )    | 60,539     |
| TOTAL ASSETS                                    |        | \$ 884,146              | \$ (10,412 ) | \$ 873,734 |
| <b>LIABILITIES AND<br/>SHAREHOLDERS' EQUITY</b> |        |                         |              |            |
| CURRENT LIABILITIES                             | K      | \$ 300,325              | \$ 25,622    | \$ 325,947 |
| LONG-TERM LIABILITIES                           | L,M    | 388,260                 | 24,075       | 412,335    |
| Total liabilities                               |        | 688,585                 | 49,697       | 738,282    |
| TOTAL EQUITY                                    | G,H    | 195,561                 | (60,109 )    | 135,452    |
| TOTAL LIABILITIES AND<br>SHAREHOLDERS' EQUITY   |        | \$ 884,146              | \$ (10,412 ) | \$ 873,734 |

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES  
 STATEMENTS OF OPERATIONS RECONCILIATION OF US GAAP TO IFRS (CONDENSED)  
 (dollars in thousands)

F. Profit and loss in accordance with IFRS

|                                                                           | Year ended December 31, 2014 |             |           |
|---------------------------------------------------------------------------|------------------------------|-------------|-----------|
|                                                                           | US GAAP                      | Adjustments | IFRS      |
| PROFIT BEFORE INCOME TAX AND<br>EXCLUDING OTHER FINANCING EXPENSE,<br>NET | \$ 29,290                    | \$ (905 )   | \$ 28,385 |
| OTHER FINANCING EXPENSE, NET                                              | (55,404 )                    | 21,556      | (33,848 ) |
| LOSS BEFORE INCOME TAX BENEFIT                                            | (26,114 )                    | 20,651      | (5,463 )  |
| INCOME TAX BENEFIT                                                        | 24,742                       | --          | 24,742    |
| PROFIT (LOSS)                                                             | (1,372 )                     | 20,651      | \$ 19,279 |
| NET LOSS ATTRIBUTABLE TO NON<br>CONTROLLING INTEREST                      | 5,635                        | --          | 5,635     |
| NET PROFIT ATTRIBUTABLE TO THE<br>COMPANY                                 | \$ 4,263                     | \$ 20,651   | \$ 24,914 |

## TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

## NOTE 22 - ADDITIONAL INFORMATION- RECONCILIATION OF US GAAP TO IFRS (cont.)

## G. Reconciliation of net loss from US GAAP to IFRS:

|                                              | Year ended December 31, |              |              |
|----------------------------------------------|-------------------------|--------------|--------------|
|                                              | 2014                    | 2013         | 2012         |
| Net profit (loss) in accordance with US GAAP | \$ 4,263                | \$ (107,660) | \$ (70,269 ) |
| Financial Instruments                        | 21,556                  | (1,619 )     | 4,232        |
| Pension plans                                | (1,314 )                | (1,166 )     | --           |
| Termination Benefits                         | 409                     | 106          | 126          |
| Net loss in accordance with IFRS             | \$ 24,914               | \$ (110,339) | \$ (65,911 ) |

## H. Reconciliation of shareholders' equity from US GAAP to IFRS:

|                                                 | As of December 31, |            |
|-------------------------------------------------|--------------------|------------|
|                                                 | 2014               | 2013       |
| Shareholders' equity in accordance with US GAAP | \$ 195,561         | \$ 141,248 |
| Financial Instruments                           | (54,656 )          | (71,368 )  |
| Termination Benefits                            | 1,547              | 1,138      |
| Goodwill                                        | (7,000 )           | (7,000 )   |
| Shareholders' equity in accordance with IFRS    | \$ 135,452         | \$ 64,018  |

## I. Reconciliation of goodwill from US GAAP to IFRS:

|                                     | As of December 31, |          |
|-------------------------------------|--------------------|----------|
|                                     | 2014               | 2013     |
| Goodwill in accordance with US GAAP | \$ 7,000           | \$ 7,000 |
| Goodwill                            | (7,000 )           | (7,000 ) |
| Goodwill in accordance with IFRS    | \$ --              | \$ --    |

## J. Reconciliation of other assets from US GAAP to IFRS:

|                                         | As of December 31, |           |
|-----------------------------------------|--------------------|-----------|
|                                         | 2014               | 2013      |
| Other assets in accordance with US GAAP | \$ 10,018          | \$ 11,547 |
| Financial Instruments                   | (3,412 )           | (4,860 )  |
| Other assets in accordance with IFRS    | \$ 6,606           | \$ 6,687  |

## TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

## NOTE 22 - ADDITIONAL INFORMATION- RECONCILIATION OF US GAAP TO IFRS (cont.)

## K.Reconciliation of short term bank debt and current maturities of loans and debentures from US GAAP to IFRS:

|                                                                                                | As of December 31, |           |
|------------------------------------------------------------------------------------------------|--------------------|-----------|
|                                                                                                | 2014               | 2013      |
| Short term bank debt and current maturities of loans and debentures in accordance with US GAAP | \$ 119,999         | \$ 36,441 |
| Financial Instruments                                                                          | 25,622             | (93 )     |
| Short term bank debt and current maturities of loans and debentures in accordance with IFRS    | \$ 145,621         | \$ 36,348 |

## L. Reconciliation of long term debentures from US GAAP to IFRS:

|                                                 | As of December 31, |            |
|-------------------------------------------------|--------------------|------------|
|                                                 | 2014               | 2013       |
| Long term debentures in accordance with US GAAP | \$ 107,311         | \$ 208,146 |
| Financial Instruments                           | 25,622             | 66,508     |
| Long term debentures in accordance with IFRS    | \$ 132,933         | \$ 274,654 |

## M. Reconciliation of other long term liabilities from US GAAP to IFRS:

|                                                        | As of December 31, |           |
|--------------------------------------------------------|--------------------|-----------|
|                                                        | 2014               | 2013      |
| Other long term liabilities in accordance with US GAAP | \$ 22,924          | \$ 21,703 |
| Termination Benefits                                   | (1,547 )           | (1,138 )  |
| Other long-term liabilities in accordance with IFRS    | \$ 21,377          | \$ 20,565 |