

**TOWER SEMICONDUCTOR LTD.  
AND SUBSIDIARIES  
CONSOLIDATED FINANCIAL STATEMENTS  
AS OF DECEMBER 31, 2011**

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

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## 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. and subsidiaries (the "Company") as of December 31, 2011 and 2010, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2011. These financial statements are the responsibility of the Company's Board of Directors and 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, such consolidated financial statements present fairly, in all material respects, the financial position of Tower Semiconductors Ltd. and subsidiaries as of December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2011, in conformity with accounting principles generally accepted in the United States of America.

  
**Brightman Almagor Zohar & Co.**  
**Certified Public Accountants**  
**A Member Firm of Deloitte Touche Tohmatsu**

**Tel Aviv, Israel**  
**February 15, 2012**

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

	<u>As of</u> <u>December 31,</u> <u>2011</u>	<u>As of</u> <u>December 31,</u> <u>2010</u>
<b>A S S E T S</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 101,149	\$ 100,375
Interest bearing deposits, including designated deposits	--	98,007
Trade accounts receivable	75,350	67,415
Other receivables	5,000	5,344
Inventories	69,024	42,512
Other current assets	15,567	8,422
Total current assets	<u>266,090</u>	<u>322,075</u>
<b>LONG-TERM INVESTMENTS</b>	<u>12,644</u>	<u>31,051</u>
<b>PROPERTY AND EQUIPMENT, NET</b>	<u>498,683</u>	<u>375,325</u>
<b>INTANGIBLE ASSETS, NET</b>	<u>58,737</u>	<u>54,247</u>
<b>GOODWILL</b>	<u>7,000</u>	<u>7,000</u>
<b>OTHER ASSETS, NET</b>	<u>14,067</u>	<u>12,030</u>
<b>TOTAL ASSETS</b>	<u>\$ 857,221</u>	<u>\$ 801,728</u>
 <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Short-term bank debt and current maturities of debentures	\$ 48,255	\$ 122,179
Trade accounts payable	111,620	48,656
Deferred revenue and short-term customers' advances	5,731	40,273
Other current liabilities	64,654	38,914
Total current liabilities	<u>230,260</u>	<u>250,022</u>
<b>LONG-TERM LOANS FROM BANKS</b>	103,845	111,882
<b>DEBENTURES</b>	197,765	247,598
<b>LONG-TERM CUSTOMERS' ADVANCES</b>	7,941	9,257
<b>EMPLOYEE RELATED LIABILITIES</b>	97,927	27,891
<b>DEFERRED TAX LIABILITY</b>	20,428	9,876
<b>OTHER LONG-TERM LIABILITIES</b>	<u>24,352</u>	<u>27,420</u>
Total liabilities	<u>682,518</u>	<u>683,946</u>
<b>SHAREHOLDERS' EQUITY</b>	<u>174,703</u>	<u>117,782</u>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<u>\$ 857,221</u>	<u>\$ 801,728</u>

See notes to consolidated financial statements.

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(dollars in thousands, except per share data)

	Year ended December 31,		
	<u>2011</u>	<u>2010</u>	<u>2009</u>
<b>REVENUES</b>	\$ 611,023	\$ 509,262	\$ 298,812
<b>COST OF REVENUES</b>	<u>526,198</u>	<u>402,077</u>	<u>325,310</u>
<b>GROSS PROFIT (LOSS)</b>	<u>84,825</u>	<u>107,185</u>	<u>(26,498)</u>
<b>OPERATING COSTS AND EXPENSES</b>			
Research and development	24,886	23,876	23,375
Marketing, general and administrative	48,239	39,986	31,943
Acquisition related costs	<u>1,493</u>	<u>--</u>	<u>--</u>
	<u>74,618</u>	<u>63,862</u>	<u>55,318</u>
<b>OPERATING PROFIT (LOSS)</b>	10,207	43,323	(81,816)
<b>FINANCING EXPENSE, NET</b>	(40,302)	(72,925)	(45,710)
<b>GAIN FROM ACQUISITION</b>	19,467	--	--
<b>OTHER INCOME, NET</b>	<u>13,460</u>	<u>65</u>	<u>2,045</u>
<b>PROFIT (LOSS) BEFORE INCOME TAX</b>	2,832	(29,537)	(125,481)
<b>INCOME TAX BENEFIT (EXPENSE)</b>	<u>(21,362)</u>	<u>(12,830)</u>	<u>5,022</u>
<b>LOSS FOR THE PERIOD</b>	<u>\$ (18,530)</u>	<u>\$ (42,367)</u>	<u>\$ (120,459)</u>
<b>BASIC LOSS PER ORDINARY SHARE</b>			
Loss per share	<u>\$ (0.06)</u>	<u>\$ (0.18)</u>	<u>\$ (0.71)</u>
Weighted average number of ordinary shares outstanding - in thousands	<u>302,065</u>	<u>235,320</u>	<u>170,460</u>

See notes to consolidated financial statements.

**TOWER SEMICONDUCTOR LTD.**  
**STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
(dollars in thousands)

	Ordinary shares		Additional paid-in capital	Capital notes	Treasury stock	Accumulated Other comprehensive income (loss)	Foreign currency translation adjustments	Accumulated deficit	Comprehensive income (loss)	Total
	Shares-in thousands	Amount								
BALANCE - JANUARY 1, 2009	161,326	\$ 39,929	\$ 693,390	\$ 291,472	\$ (9,072)	\$ (2,367)	--	\$ (901,785)		\$ 111,567
Issuance of shares and warrants	36,114	9,572	24,534							34,106
Conversion of convertible debentures to shares	2,796	744	3,357							4,101
Employee stock-based compensation			2,841							2,841
Exercise of options	25	6	15							21
Stock-based compensation, Note 17B(5)			3,829							3,829
Reclassification of options and warrants			(13,661)					12,800		(861)
Capital notes				20,000						20,000
Other comprehensive income						869			869	869
Loss for the year								(120,459)	(120,459)	(120,459)
Comprehensive loss									(119,590)	(119,590)
BALANCE - DECEMBER 31, 2009	200,261	\$ 50,251	\$ 714,305	\$ 311,472	\$ (9,072)	\$ (1,498)	--	\$ (1,009,444)		\$ 56,014
Issuance of shares and warrants	42,573	11,336	47,454							58,790
Conversion of convertible debentures to shares	21,042	5,661	28,783							34,444
Tax benefit relating to stock based compensation			212							212
Employee stock-based compensation			6,413							6,413
Exercise of options	2,960	805	324							1,129
Stock-based compensation, Note 17B(5)			2,478							2,478
Other comprehensive income						669			669	669
Loss for the year								(42,367)	(42,367)	(42,367)
Comprehensive loss									(41,698)	(41,698)
BALANCE - DECEMBER 31, 2010	266,836	\$ 68,053	\$ 799,969	\$ 311,472	\$ (9,072)	\$ (829)	--	\$ (1,051,811)		\$ 117,782
Shares issued in consideration of acquisition of a subsidiary	19,678	5,777	16,853							22,630
Issuance of shares and warrants	27,087	7,557	27,251							34,808
Conversion of convertible debentures to shares	4,150	1,118	5,362							6,480
Tax benefit relating to stock based compensation			45							45
Employee stock-based compensation			8,107							8,107
Exercise of options	1,839	515	(55)							460
Foreign currency translation adjustments							3,729			3,729
Other comprehensive loss						(808)			(808)	(808)
Loss for the year								(18,530)	(18,530)	(18,530)
Comprehensive loss									(19,338)	(19,338)
BALANCE - DECEMBER 31, 2011	319,590	\$ 83,020	\$ 857,532	\$ 311,472	\$ (9,072)	\$ (1,637)	3,729	\$ (1,070,341)		\$ 174,703
BALANCE, NET OF TREASURY STOCK - DECEMBER 31, 2011		<u>318,290</u>								

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

	Year ended December 31,		
	2011	2010	2009
<b>CASH FLOWS - OPERATING ACTIVITIES</b>			
Loss for the period	\$ (18,530)	\$ (42,367)	\$ (120,459)
Adjustments to reconcile loss for the period to net cash provided by operating activities:			
Income and expense items not involving cash flows:			
Depreciation and amortization	162,679	143,023	143,404
Effect of indexation, translation and fair value measurement on debt	(9,312)	26,208	3,131
Other income, net	(15,899)	(65)	(2,045)
Gain from acquisition	(19,467)	--	--
Loss from notes exchange, net	--	2,350	--
Changes in assets and liabilities:			
Trade accounts receivable	(7,686)	(28,061)	5,256
Other receivables and other current assets	3,999	(2,316)	4,196
Inventories	(3,999)	(10,262)	8,649
Trade accounts payable	21,733	(2,834)	(6,185)
Deferred revenue and customers' advances	(35,858)	16,572	15,435
Other current liabilities	18,174	13,445	(5,595)
Deferred tax liability, net	4,791	1,130	(4,516)
Employee related liabilities and other long-term liabilities	7,368	4,622	(4,022)
Net cash provided by operating activities	107,993	121,445	37,249
<b>CASH FLOWS - INVESTING ACTIVITIES</b>			
Investments in property and equipment	(117,166)	(105,189)	(28,066)
Proceeds from investment realization	31,400	--	--
Proceeds related to sale and disposal of property and equipment	5,751	600	--
Acquisition of subsidiary (a)	(40,000)	--	--
Investment grants received	33,292	--	--
Investments in other assets, intangible assets and others	--	(1,521)	(1,472)
Interest bearing deposits, including designated deposits	98,007	(98,007)	--
Net cash provided by (used in) investing activities	11,284	(204,117)	(29,538)
<b>CASH FLOWS - FINANCING ACTIVITIES</b>			
Proceeds on account of shareholders' equity	22,653	158,825	52,922
Debts repayment	(141,242)	(57,599)	(13,670)
Net cash provided by (used in) financing activities	(118,589)	101,226	39,252
Effect of foreign exchange rate change	86	26	(73)
<b>INCREASE IN CASH AND CASH EQUIVALENTS</b>	774	18,580	46,890
<b>CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD</b>	100,375	81,795	34,905
<b>CASH AND CASH EQUIVALENTS - END OF PERIOD</b>	\$ 101,149	\$ 100,375	\$ 81,795

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

	Year ended December 31,		
	<u>2011</u>	<u>2010</u>	<u>2009</u>
<b>NON-CASH ACTIVITIES</b>			
Investments in property and equipment	\$ 15,546	\$ 7,896	\$ 5,703
Conversion of convertible debentures to share capital and exercise of warrant	\$ 7,006	\$ 37,567	\$ 4,101
Reclassification of warrant to shareholders' equity	\$ --	\$ --	\$ 404
Stock based compensation to the Banks	\$ --	\$ 2,478	\$ 3,829
Shares issued to the Banks in consideration for the interest reduction, following September 2006 amendment with the Banks as further amended	\$ 12,087	\$ --	\$ --
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>			
Cash paid during the period for interest	\$ 23,357	\$ 21,641	\$ 25,717
Cash paid during the period for income taxes	\$ 2,907	\$ 3,757	\$ 2,010
 (a) ACQUISITION OF SUBSIDIARY, SEE ALSO NOTE 3:			
Assets and liabilities of the subsidiary as of June 2, 2011			
The acquisition :			
Working capital (excluding cash and cash equivalents)	\$ (2,534)		
Property, plant, and equipment, including real estate	145,559		
Intangible assets	11,156		
Other assets	2,900		
Long-term liabilities	(74,984)		
	<u>82,097</u>		
Less :			
Issuance of share capital	22,630		
Gain from acquisition	19,467		
	<u>42,097</u>		
Cash paid for the acquisition of a subsidiary	<u>\$ 40,000</u>		

See notes to consolidated financial statements.



**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(dollars in thousands, except share data and 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 its wholly-owned subsidiaries (i) Jazz Technologies, the parent company 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 (ii) from June 2011, TowerJazz Japan Ltd. (“TJP”), a company which owns and operates the facility acquired in Nishiwaki, Japan. Tower and its wholly-owned subsidiaries are referred to as the “Company.” References to the “Company” for dates prior to the acquisition of TJP, shall exclude TJP.

The Company is a global specialty foundry leader, manufacturing integrated circuits with geometries ranging from 1.0 to 0.13-micron. The Company provides industry leading design enablement tools to allow complex designs to be achieved quickly and more accurately and offers a broad range of customizable process technologies including SiGe, BiCMOS, Mixed-Signal and RFCMOS, CMOS Image Sensor, Power Management (BCD), and Non-Volatile Memory (NVM) as well as MEMS capabilities. To provide multi-fab sourcing for its customers, the Company maintains two manufacturing facilities in Israel, one in the U.S., and one in Japan, with additional capacity available in China through manufacturing partnerships.

Tower’s ordinary shares are traded on the NASDAQ Global Market and on the Tel-Aviv Stock Exchange.

During the past two years, the Company experienced business and financial improvement, as reflected by the improvement in the Company’s revenue and margins as compared to the period prior to mid-2009 which was negatively affected by the global economic downturn that commenced in 2008. However, following the recent economic slowdown in Europe and worldwide and following the conditions in the financial markets, the semiconductor industry experienced weakening customer demand and reduced rate of growth. Market analysts are currently cautious in regards to the global economic conditions forecasted for 2012 and beyond, and there can be no assurance that the global economic conditions will not negatively affect the Company’s business and financial position. There is no assurance that another downturn in the semiconductor industry and/or in the global economy will not occur. The effects of another downturn 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. A downturn in the semiconductor industry and/or in the global economy may adversely affect the Company’s commercial relationships with its customers, suppliers, and creditors, including its lenders, its plans to continue its capacity growth, and the Company’s future financial results and position, including its ability to raise funds in the capital markets and to fulfill its debt obligations and other liabilities, comprised mainly of banks’ loans and debentures.

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

**NOTE 1 - DESCRIPTION OF BUSINESS AND GENERAL (cont.)**

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

See further details in Notes 7B, 12B, 13, 17.

**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 generally accepted accounting principles 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.

**B. Principles of Consolidation**

The Company's consolidated financial statements include the financial statements of Tower and its wholly-owned subsidiaries. The Company's consolidated financial statements are presented after elimination of inter-company transactions and balances.

**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.

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

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

**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 moving average cost 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 incremental direct costs that are identifiable with, and related to, the property and equipment and are incurred prior to its initial operation. Identifiable incremental direct costs include costs associated with the funding, acquiring, 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. Allocation, when appropriate, of capitalizable incremental direct costs is based on the Company's estimates and methodologies including time sheet inputs. Maintenance and repairs are charged to expense as incurred.

Cost is 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

(2) Impairment examinations and recognition are performed and determined based on the accounting policy outlined in Q 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 time of acquisition of Jazz and TJP. In addition these assets include the cost of acquiring the Fab 2 technologies and incremental direct costs associated with implementing them until they are ready for their intended use.

These costs in relation to Fab 2 technologies are amortized over the expected estimated economic life of the technologies commonly used in the industry. The amortization phase commences on the date on which the technology is ready for its intended use. The amounts

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)**

**G. Intangible Assets (cont.)**

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

Impairment examinations and recognition are performed and determined based on the accounting policy outlined in Q 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 or 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 generally accepted accounting principles 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.

*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.

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)**

**J. 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 the realizability of our deferred tax assets 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 we either record as a liability or as a reduction of deferred tax assets. Our policy is to include interest and penalties related to unrecognized income tax benefits as a component of income tax expense.

**K. Revenue Recognition**

The Company's net revenues are generated principally from sales of semiconductor wafers. The Company also derives revenues from engineering services and other support services. The majority of the Company's sales are achieved through the efforts 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,

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

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

**K. Revenue Recognition (cont.)**

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, hence, collection of payment for services is reasonably assured.

The Company provides for sales returns and allowances 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 and other services are recognized ratably over the contract term or as services are performed.

The Company's arrangements do not include multiple elements delivery. In very limited instances, engineering services agreements may specify also a price for future production of a semiconductor wafer (price option). In these agreements, the Company examines the price option to conclude if a significant discount exists by comparing the price option to the selling price of such wafers when sold separately. To date, the Company concluded that no significant discount exists in its arrangements and hence only one element exists. In the beginning of 2011 the Company adopted ASU 2009-13-“Multiple Deliverable Revenue Arrangements”. The above adoption did not have any impact on the Company revenue recognition policy.

Advances received from customers towards future engineering services, product purchases and in some cases capacity reservation are deferred until services are rendered, products are shipped to the customer, or the capacity reservation period ends.

Revenue relating to a turn-key agreement with an Asian entity, as detailed in Note 16D(2) are recognized based on ASC 605-35 (formerly SOP 81-1 “Accounting for Performance of Construction Type and Certain Production Type Contracts”) using the percentage of completion method. Measurement of the percentage toward completion is determined, based on the ratio of actual labor hours incurred to total labor hours estimated to be incurred over the duration of the contract. Such measurement involves management's estimates and judgment and are based on a detailed project plan, the Company's substantial experience in building a fab, transferring and implementing new technologies and sub-contractors' experts.

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(dollars in thousands, except share data and 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 has been met.

**M. Earnings (Loss) Per Ordinary Share**

Basic earnings 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 by adjusting profit or loss attributable to ordinary equity holders of Tower, and the weighted average number of shares outstanding, by the effect of all dilutive potential ordinary shares.

**N. 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.

**O. 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 re measured into dollars in accordance with ASC 830-10, "Foreign Currency Matters". All transaction gains and losses from the remeasurement of monetary balance sheet items are reflected in the statements of operations as financial income or expenses, as appropriate. The financial statements of TJP, whose functional currency is Japanese Yen have been translated into dollars. Assets and liabilities have been translated using the exchange rates in effect on the balance sheet date. Statement of operations amounts have been translated using the average exchange rate for the period. The resulting translation adjustments are charged or credited to other comprehensive income (loss).

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

**P. 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.

**Q. 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".

*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. 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 conducted an impairment check as of December 31, 2011. The Company used 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. As a result of this analysis, the carrying amount of the net assets, including goodwill were not considered to be impaired and the Company did not recognize any impairment of goodwill for the period ended December 31, 2011.



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

**R. 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 is not eligible to be included in equity.

**S. 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.

Upon initial adoption in January 1, 2009, the Company identified several instruments that are affected by the amendment all of which were, before the adoption, classified in equity and upon the adoption were reclassified from equity to liabilities. These instruments include warrants and a previously bifurcated conversion option, with either an anti-dilution feature or with an exercise price denominated in NIS. At the date of adoption and in accordance with the transition provisions of the consensus, the Company measured those instruments at fair value. The difference between the fair values and the amount previously recorded in equity was recognized as an adjustment to the opening balance of retained earnings.

The effect of the adoption on equity and retained earnings is as follows:

	January 1, 2009
Additional paid in capital	\$ (14,065)
Retained earnings	12,800
Fair value reclassified to liability	\$ (1,265)

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
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**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)**

**T. Recently Issued Accounting Standards**

ASU No. 2009-13 - Revenue Recognition (Topic 605): "Multiple-Deliverable Revenue Arrangements". This standard modifies the revenue recognition guidance for arrangements that involve the delivery of multiple elements, such as product, software, services and support, to a customer at different times as part of a single revenue generating transaction. This standard provides principles and application guidance to determine whether multiple deliverables exist, how the individual deliverables should be separated and how to allocate the revenue in the arrangement among those separate deliverables. The standard is effective for revenue arrangements entered into or modified in fiscal years beginning on or after June 15, 2010 with earlier adoption permitted. The Company adopted this standard in the beginning of the first quarter of 2011. The adoption of this update did not have a significant impact on the Company's consolidated financial statements.

In May 2011, the Financial Accounting Standards Board (FASB) issued amended standards to achieve a consistent definition of fair value and common requirements for measurement of and disclosure about fair value between U.S. GAAP and International Financial Reporting Standards. For assets and liabilities categorized as Level 3 and recognized at fair value, these amended standards require disclosure of quantitative information about unobservable inputs, a description of the valuation processes used by the entity, and a qualitative discussion about the sensitivity of the measurements. In addition, these amended standards require that we disclose the level in the fair value hierarchy for financial instruments disclosed at fair value but not recorded at fair value. These new standards are effective beginning in the first quarter of 2012; early adoption of these standards is prohibited. The Company does not expect these new standards to significantly impact its consolidated financial statements.

In June 2011, the FASB issued amended standards to increase the prominence of items reported in other comprehensive income. These amendments eliminate the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity and require that all changes in stockholders' equity except investments by, and distributions to, owners be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In addition, these amendments require that we present on the face of the financial statements reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statements where the components of net income and the components of other comprehensive income are presented. These new standards are effective beginning in the first quarter of 2012 and are to be applied retrospectively. These amended standards will impact the presentation of other comprehensive income but will not impact the Company's financial position or results of operations.

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
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**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)**

**T. Recently Issued Accounting Standards (cont.)**

In September 2011, the FASB issued amended standards to simplify how entities test goodwill for impairment. These amended standards permit an assessment of qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit in which goodwill resides is less than its carrying value. For reporting units in which this assessment concludes it is more likely than not that the fair value is more than its carrying value, these amended standards eliminate the requirement to perform further goodwill impairment testing as outlined in the previously issued standards. These amended standards are effective beginning in the first quarter of 2012. The Company does not expect these new standards to significantly impact its consolidated financial statements.

**U. Reclassification**

Certain amounts in prior years' financial statements have been reclassified in order to conform to the 2011 presentation.

**NOTE 3 - ACQUISITION OF NISHIWAKI FAB IN JAPAN**

On June 3, 2011 the Company acquired the fabrication facility in Nishiwaki City, Hyogo, Japan owned by a wholly owned Japanese subsidiary of Micron Technology Inc. ("Micron"). The acquisition was effected through a new wholly owned Japanese subsidiary of the Company, which acquired the shares of and subsequently merged with Micron's Japanese subsidiary that held the assets of the fabrication facility and related business, the merged entity is named TowerJazz Japan Ltd. ("TJP").

The fair value of the consideration the Company paid was \$62,630, of which \$40,000 was paid in cash and \$22,630 was paid through the issuance to Micron of 19.7 million ordinary shares of Tower. The costs incurred in connection with the acquisition were \$1,493 and are included in operating expenses.

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 \$82,097. As the purchase price was less than the fair value of net assets, the Company recognized a gross gain on the acquisition of \$19,467.

Net profit for the year ended December 31, 2011 includes approximately \$10,078 net positive effect from the acquisition, comprised of (i) approximately \$19,467 gross gain from the acquisition, and (ii) approximately \$9,389 of related tax provisions and other expenses directly associated with this acquisition.

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
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**NOTE 3 - ACQUISITION OF NISHIWAKI FAB IN JAPAN (cont.)**

The Company believes that the gain realized from the acquisition derived from (i) declining forecast and weakening demand for products currently manufactured by TJP, (ii) the fact that an acquisition of a fab as a whole is less costly than acquiring each fab component separately, (iii) limited opportunities to sell a fab while maintaining the employment level, and (iv) the natural disasters in Japan which occurred in March 2011.

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

	As of June 3, 2011
Current assets	\$ 25,783
Property, plant, and equipment, including real estate	145,559
Intangible assets	11,156
Other assets	2,900
<b>Total assets as of acquisition date</b>	<b>185,398</b>
Current liabilities	28,317
Long-term liabilities (mainly employees related termination benefits)	74,984
<b>Total liabilities as of acquisition date</b>	<b>103,301</b>
Net assets as of acquisition date	<b>\$ 82,097</b>

The fair values set forth above are based on a valuation of TJP 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-“Business Combinations”.

In addition, as part of said acquisition, TJP entered into a supply agreement with Micron. In accordance with this agreement, TJP will manufacture products for Micron at the Nishiwaki facility for at least three years with process technologies licensed from Micron under a technology licensing agreement signed between the companies at the closing of the acquisition. Under the supply agreement Micron is committed to purchase certain minimum volumes until the end of the second quarter of 2014. The companies also agreed to provide each other with transition services required for the duration of the transition period of approximately two to three years.

In order to ensure continued supply of wafers to Micron, Tower and Micron also executed a credit support agreement pursuant to which Tower and TJP, are subject to certain covenants and other protections until June 3, 2013.

Tower's ordinary shares issued to Micron are subject to lock-up arrangement with releases of 25% of the shares every six months ending on June 3, 2013.

The following unaudited pro forma financial information presents the Company's combined revenues and net loss as if TJP had been acquired as of the beginning of 2010. The pro forma financial information includes the accounting effects of the business combination, including adjustments to the amortization of intangible assets, depreciation of property, plant and equipment. The unaudited pro forma financial information below is not necessarily indicative of either future results of operations or results that might have been achieved had TJP been acquired as of the beginning of 2010.

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
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**NOTE 3 - ACQUISITION OF NISHIWAKI FAB IN JAPAN (cont.)**

	Year ended December 31,	
	2011	2010
	(Pro Forma)	
Revenues	\$ 745,740	\$ 860,501
Net loss	\$ (16,153)	\$ (26,659)

**NOTE 4 - OTHER RECEIVABLES**

Other receivables consist of the following:

	As of December 31,	
	2011	2010
Government agencies	\$ 4,774	\$ 4,210
Others	226	1,134
	<u>\$ 5,000</u>	<u>\$ 5,344</u>

**NOTE 5 - INVENTORIES**

Inventories consist of the following:

	As of December 31,	
	2011	2010
Raw materials	\$ 18,073	\$ 16,560
Work in process	37,451	21,989
Finished goods	13,500	3,963
	<u>\$ 69,024</u>	<u>\$ 42,512</u>

Work in process and finished goods are presented net of aggregate write-downs to net realizable value of \$5,778 and \$6,527 as of December 31, 2011 and 2010, respectively.

**NOTE 6 - LONG-TERM INVESTMENTS**

Long-term investments consist of the following:

	As of December 31,	
	2011	2010
Severance pay funds (see Note 15B)	\$ 11,374	\$ 12,465
Investment in HHNEC (see below)	--	17,100
Others,(see investment in limited partnership below)	1,270	1,486
	<u>\$ 12,644</u>	<u>\$ 31,051</u>

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
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**NOTE 6 - LONG-TERM INVESTMENTS (cont.)**

***Investment in Limited Partnership:***

In December 2007, Tower together with CMT Medical Technologies Ltd, a leading provider of advanced digital X-ray imaging systems for medical diagnosis, established a limited partnership to develop and market X-ray detectors for medical applications. Tower owns 38% of the limited partnership and accounts for the investment in the limited partnership using the equity method.

***Investment in HHNEC:***

As of December 31, 2010, Jazz had an investment in Hua Hong Semiconductor Ltd (“HHS�”), which owns 100% of Shanghai Hua Hong NEC Electronics Company Ltd. (also known as “HHNEC”). The investment represented a minority interest of approximately 10% in HHS�, hence the investment in HHS� was recorded at fair value as of the date of Tower’s merger with Jazz and subsequently carried using the cost method of accounting for investments, as Jazz did not have the ability to exercise significant influence.

During 2011, Jazz sold its 10% holdings in HHS�, in an HHS� buyback transaction for a gross amount of approximately \$32,000 in cash, before tax and other payments and recorded a gross gain of approximately \$15,000 from this transaction.

**NOTE 7 - PROPERTY AND EQUIPMENT, NET**

**A. Composition:**

	As of December 31,	
	2011	2010
<b>Cost:</b>		
Buildings (including facility infrastructure)	\$ 322,152	\$ 264,277
Machinery and equipment	1,266,559	1,050,842
Advances on account on property and equipment, net	--	25,420
	<u>1,588,711</u>	<u>1,340,539</u>
<b>Accumulated depreciation</b>		
Buildings (including facility infrastructure)	(139,541)	(122,355)
Machinery and equipment	(950,487)	(842,859)
	<u>(1,090,028)</u>	<u>(965,214)</u>
	<u>\$ 498,683</u>	<u>\$ 375,325</u>

As of December 31, 2011 and 2010, the cost of buildings, machinery and equipment was reflected net of investment grants (see B below) in the aggregate of \$282,512 and \$250,719 respectively.

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**NOTE 7 - PROPERTY AND EQUIPMENT, NET (cont.)**

**B. Investment Grants**

In December 2000, the Investment Center approved an investment program in connection with Fab 2 for expansion of Tower's plant. The approval certificate for the program entitled Tower to investment grants at a rate of 20% of qualified investments of up to \$1,250,000, or aggregate grants up to \$250,000. Under the terms of the program, investments in respect of Fab 2 were to have been completed by December 31, 2005, five years from the date the approval certificate was obtained. Due to the later than planned construction of Fab 2, market conditions and slower than planned ramp-up, Tower completed approximately 72% of the investments within the time frame stipulated in the approved enterprise program. Tower received an aggregate of approximately \$165,000 from the Investment Center for such investments completed through December 31, 2005 and received in January 2012, final Investment Center approval for the investments made.

In February 2011, Tower received approval from the Israeli Investment Center for a new expansion program for investments made commencing January 1, 2006, according to which Tower may receive up to NIS 150 million (approximately \$39,000) during the years 2011 through 2014, related to investments in fixed assets entitled for grants. The eligibility for the grants is subject to the Company compliance with the terms stipulated in the approval certificate and the applicable law.

As of December 31, 2011, Tower received NIS 125 million (\$33,292) of such grants for eligible investments made by the Company in the years 2006 to 2011.

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 regarding liens in favor of the Investment Center, see Note 12D.

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
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**NOTE 8 INTANGIBLE ASSETS, NET:**

Intangible assets, net consist of the following:

	Useful Life	As of December 31,	
		2011	2010
Facilities lease rights	19	\$ 27,549	\$ 29,359
Technologies including technologies in relation to Fab 2	3.6;4;9	15,562	6,966
Patents and other core technology rights	9	9,586	11,264
Trade name	9	3,301	3,879
Customer relationships	3.6; 15	2,264	2,204
Others		475	575
		<u>\$ 58,737</u>	<u>\$ 54,247</u>

**NOTE 9 - OTHER ASSETS, NET**

Other assets, net consist of the following:

	As of December 31,	
	2011	2010
Prepaid long-term land lease, net (see Note 16C)	\$ 4,141	\$ 4,261
Debenture issuance expenses, net and deferred financing charges	4,615	6,053
Prepaid expenses - long-term and others	5,311	1,716
	<u>\$ 14,067</u>	<u>\$ 12,030</u>

**NOTE 10 - ASSET-BASED REVOLVING CREDIT FACILITY**

In September 2008, Jazz entered into a loan and security agreement, with Wachovia (now Wells Fargo) for a three-year secured asset-based revolving credit facility in the total amount of up to \$55,000 (the "Loan Agreement").

In June 2010, Jazz entered into an amendment to the Loan Agreement, pursuant to which, the maturity date of the revolving credit facility was extended to September 2014, with available credit under the facility of up to \$45,000. The borrowing availability varies from time to time based on the levels of Jazz's accounts receivable, eligible equipment and other terms and conditions described in the Loan Agreement. Loans under the facility will bear interest at a rate equal to, at Jazz's option, either the lender's prime rate plus a margin ranging from 0.50% to 1.0% or the LIBOR rate (as defined in the Loan Agreement) plus a margin ranging from 2.25% to 2.75% per annum.



**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
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**NOTE 10 - ASSET-BASED REVOLVING CREDIT FACILITY (cont.)**

The Loan Agreement contains customary covenants and other terms, including covenants based on Jazz's EBITDA (as defined in the Loan Agreement), as well as customary events of default. The facility is secured by the assets of Jazz. If any event of default occurs, Wachovia may declare due immediately all borrowings under the facility and foreclose on the collateral. Furthermore, an event of default under the Loan Agreement would result in an increase in the interest rate on any amounts outstanding. As of December 31, 2011, Jazz was in compliance with all of the covenants under this Loan Agreement.

Borrowing availability under the Loan Agreement as of December 31, 2011 was approximately \$7,100. Outstanding borrowings were \$15,300, and \$1,300 of the facility was supporting outstanding letters of credit, on that date. Jazz considers outstanding borrowings of \$10,000 to be long-term debt as of December 31, 2011.

**NOTE 11 - OTHER CURRENT LIABILITIES**

Other current liabilities consist of the following:

	As of December 31,	
	2011	2010
Employees related liabilities	\$ 34,516	\$ 19,023
Interest payable (primarily in relation to debentures)	16,580	6,250
Other	13,558	13,641
	<u>\$ 64,654</u>	<u>\$ 38,914</u>

**NOTE 12 - LONG-TERM LOANS FROM BANKS**

**A. Composition:**

	As of December 31, 2011	
	Effective interest rate (*)	
In U.S. Dollar	3.1-3.4%	\$ 116,355
In U.S. Dollar	5.55%	30,000
Total long-term debt from Banks-principal amount		146,355
Fair value adjustments		(37,210)
Total long-term debt from Banks		<u>109,145</u>
Current maturities		5,300
		<u>\$ 103,845</u>

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
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**NOTE 12 - LONG-TERM LOANS FROM BANKS (cont.)**

**A. Composition (cont.):**

	As of December 31, 2010	
	Effective interest rate (*)	
In U.S. Dollar	2.8-3.1%	\$ 93,055
In U.S. Dollar	5.55%	90,000
Total long-term debt from Banks-principal amount		183,055
Fair value adjustments		(41,173)
Total long-term debt from Banks		141,882
Current maturities		30,000
		<u>\$ 111,882</u>

(\*) The effective interest rate as of December 31, 2011 and 2010 of loans in the amount of \$30,000 and \$90,000, respectively, takes into account the terms of the economic hedging agreements described in Note 14A.

**B. Facility Agreement**

**Introduction**

In January 2001, Tower entered into a credit facility agreement with two Israeli Banks, which has been revised several times, to fund the establishment and equipping of Fab 2 (“Facility Agreement”), under which the outstanding debt as of December 31, 2011, was approximately \$131,000, and the annual interest rate is the three-month USD LIBOR plus 2.75%. For details, see below.

***September 2006 Amendment***

In September 2006, Tower signed definitive agreements with the Israeli Banks and The Israel Corporation Ltd. (“TIC”). Pursuant to said agreements, among other things:

- (i) \$158,000 of the then current debt under the Facility Agreement was converted into equity equivalent capital notes of Tower, at a conversion ratio of \$3.04 per share, representing twice the average closing price per share during the ten days prior to signing the Memorandum of Understanding (“MOU”) that preceded the final amendment.

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
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**NOTE 12 - LONG-TERM LOANS FROM BANKS (cont.)**

**B. Facility Agreement (cont.)**

*September 2006 Amendment (cont.)*

- (ii) The interest rate then applicable for the quarterly actual interest payment on the loans was decreased from three-month USD LIBOR plus 2.5% per annum to three-month USD LIBOR plus 1.1% per annum, effective from May 17, 2006. As compensation for the decreased interest and subject to adjustment, it was agreed that in 2011 the Israeli Banks would be issued a number of Tower ordinary shares equal to the decrease in the interest divided by the average closing price of Tower's ordinary shares during the fourth quarter of 2010. In September 2008, the decreased interest amount was reduced due to the conversion of a portion of the loans into equity equivalent capital notes, see below "September 2008 Definitive Agreement with the Israeli Banks and TIC".

In February 2011 the Company issued approximately 8.5 million shares to the Israeli Banks in consideration for such decreased interest as described above.

- (iii) TIC invested \$100,000 in Tower in exchange for approximately 65.8 million equity equivalent capital notes exercisable into Tower's ordinary shares, based on the average closing price per share during the ten days prior to signing the MOU that preceded the final agreement.

*September 2008 Definitive Agreement with the Israeli Banks and TIC*

In September 2008, Tower signed and closed definitive agreements with the Israeli Banks and TIC. Pursuant to said agreements: (i) \$200,000 of Tower's then existing debt to the Israeli Banks was converted into equity equivalent capital notes of Tower at a conversion ratio of \$1.42, exercisable into Tower's ordinary shares, representing two times the average closing price per share on NASDAQ for the ten trading days prior to August 7, 2008 (the date of Tower's public announcement regarding its debt conversion negotiations with the Israeli Banks and TIC) (ii) the commencement date for the repayment of the remaining principal of the Israeli Banks' loans was postponed from September 2009 to September 2010 (which was further revised in the "August 2009 amendment to the Facility Agreement" and "2010 definitive agreements with the Israeli Banks" below); (iii) \$50,000 of debt owed by Tower to TIC (consisting of \$30,000 owed under a loan facility and \$20,000 of Tower's convertible debentures series B held by TIC) were converted into equity equivalent capital notes at a conversion ratio of \$1.42 exercisable into Tower's ordinary shares, representing two times the average closing price per share on NASDAQ for the ten trading days prior to August 7, 2008; and (iv) TIC invested \$20,000 in Tower in exchange for equity equivalent capital notes exercisable into approximately 28.2 million Tower's ordinary shares.

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

**B. Facility Agreement (cont.)**

*September 2008 Definitive Agreement with the Israeli Banks and TIC (cont.)*

Furthermore, TIC committed to invest up to an additional \$20,000 under certain conditions. In January 2009, such conditions were satisfied and TIC invested said amount in exchange for approximately 76.9 million equity equivalent capital notes of Tower, exercisable into ordinary shares of Tower.

The debt conversion to equity equivalent capital notes as detailed above resulted in a gain of \$130,698 that was recorded in the Company's statement of operations for 2008.

*August 2009 amendment to the Facility Agreement*

During 2009, the Israeli Banks and Tower entered into an amendment to the Facility Agreement to: (i) postpone the repayment schedule of the outstanding loans to provide for repayment in eight equal quarterly installments from September 2011 until June 2013; (ii) waive the financial covenants stipulated in the Facility Agreement through December 31, 2009; and (iii) provide for the payment by Tower upon certain circumstances, as stipulated in the amendment, and following receipt by Tower of significant amounts of proceeds from a certain source, of a portion of such proceeds on account of the outstanding loans prior to the due date specified above. As part of the terms of the amendment, Tower agreed to grant the Israeli Banks new warrants in three annual tranches with an aggregate exercise price of \$1,000 each, at a quantity and price to be calculated based on the market stock price prior to any such grant and pay the Israeli Banks fees in the aggregate amount of \$350. As of December 31, 2011 all such warrants had been granted. See Note 17B(5) below.

*2010 Definitive Agreements with the Israeli Banks*

During 2010, Tower signed and closed definitive agreements with the Israeli Banks. Pursuant to said agreements: (i) Tower pre-paid a total of approximately \$50,000 of its loans; (ii) the commencement date for the repayment of the remaining principal of the Israeli Banks' loans was extended to ten quarterly installments between September 2013 and December 2015; (iii) the interest rate on the remaining principal of the Israeli Bank's loans was set to be USD LIBOR plus 2.75% per annum; (iv) the Israeli Banks consented to the issuance by Tower of additional long-term notes, which issuance was made by Tower in October 2010, see Note 13E; (v) in certain circumstances stipulated in said agreements, following receipt by Tower of significant amounts of proceeds from certain sources, Tower agreed to early repayment of a certain amount of the outstanding loans; (vi) all warrants granted to the Israeli Banks were extended to December 2015; (vii) Tower agreed to pay fees to the Israeli Banks; and (viii) Tower agreed to place the net proceeds of the bond issuance in short-term pledged deposits for the purpose of securing future debt payments, which were presented in the balance sheet as designated deposits.

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
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**NOTE 12 - LONG-TERM LOANS FROM BANKS (cont.)**

**B. Facility Agreement (cont.)**

*2011 Letter Agreement with the Israeli Banks*

In February 2011, Tower entered into a letter agreement with the Israeli Banks pursuant to which: (i) the Israeli Banks gave their consent for the acquisition of Micron's fabrication facility in Japan, as detailed in Note 3 above; (ii) Tower and the Israeli Banks agreed that out of the total amount raised in the 2010 bond issuance (see above), \$50,000 would be placed in short-term pledged deposits reserved until the December 2011 payment of its debentures then due; and (iii) Tower agreed to prepay to the Israeli Banks \$15,000 on account of the outstanding loans on each of March 31, 2011 and December 31, 2011.

*Accounting for the Loans under the Facility Agreement*

Loans received under the Facility Agreement, as amended to date, are presented at fair value, with changes in value reflected on 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 September 2008 amendment was accounted for by calculating the fair value, as of September 2008, of the remaining outstanding obligation to the Israeli Banks. The excess of the fair value of the obligation prior to the amendment over the fair value of the remaining obligation was considered settled. A gain on conversion of debt was recognized in the amount of the excess of the settled amount over the fair value of the equity-equivalent capital notes issued. The fair value of the notes was calculated based on the price of the stock of Tower in September 2008, which was the time of signing and closing of the definitive agreements with the Israeli Banks and TIC.

The fair value following the August 2009 amendment reflects the effects of said amendment. The cost of the new warrants (all three tranches) granted pursuant to the August 2009 amendment and the additional cost associated with extension of the existing warrants, which is determined based on the fair value at the date of said amendment, were expensed and recorded in financing expenses.

The effects of the 2010 definitive agreements with the Israeli Banks and 2011 letter agreement with said Israeli Banks have also been included in the measurement of the fair value of the loans at the relevant periods.

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

**C. Repayment Schedule**

Upon certain circumstances stipulated in the Israeli Banks' agreements, including following receipt by Tower of significant amounts of proceeds from certain sources, Tower is required to pay a portion of such proceeds on account of the outstanding loans prior to the periods specified above. The principal amount of Tower's long-term loans as of December 31, 2011 is approximately \$131,000, payable in nine quarterly installments from September 2013 through September 2015, totaling \$25,000 in 2013, \$80,000 in 2014 and \$26,000 in 2015. Upon certain circumstances stipulated in the Facility Agreement, including following receipt by Tower of significant amounts of proceeds from certain sources, Tower is required to pay a portion of such proceeds on account of the outstanding loans prior to the periods specified above.

The principal amount of Jazz's long-term loans as of December 31, 2011 is approximately \$15,300, payable in September 2014, of which \$5,300 is classified as short term in the balance sheet.

**D.** The Facility Agreement with the Israeli Banks 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 7B), without the prior consent of the Israeli Banks. Furthermore, the agreements contain certain restrictive financial ratios and covenants. For further details concerning the Facility Agreement and its amendments, see Note 16A (2).

**E.** For long term bank loans of Jazz see Note 10.

**NOTE 13 - DEBENTURES**

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

	As of December 31, 2011					
	Interest rate	2012	2013	2014	2015	2016
2005 Debentures Series B	5%	\$ 10,236	\$ --	\$ --	\$ --	\$ --
Debentures Series D	8%	5,562	5,562	5,562	5,562	5,562
2007 Debentures series E, see Note 14	8%	27,157	--	--	--	--
2010 debentures Series F	7.8%				53,228	53,228
Jazz's New Notes (as defined in G below)	8%	--	--	--	69,061	--
		<u>\$ 42,955</u>	<u>\$ 5,562</u>	<u>\$ 5,562</u>	<u>\$ 127,851</u>	<u>\$ 58,790</u>

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**NOTE 13 - DEBENTURES (cont.)**

The outstanding principal amounts of Tower debentures as of December 31, 2011 and 2010 were \$177,249 and \$230,612, respectively.

The outstanding principal amounts of Jazz notes as of December 31, 2011 and 2010 were \$93,556 and \$137,247, respectively.

If on a payment date of the principal or interest on any series of the Tower debentures there exists 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 under various provisions of the Facility Agreement and the terms of such debentures until such covenant or condition is satisfied.

Jazz Loan Agreement imposes certain limitations on the ability to repay the notes and/or to incur additional indebtedness without Wachovia's consent. Any default on payment of the notes at maturity, such default would trigger a cross default under the Loan Agreement, which would permit the lenders to accelerate the obligations there under, potentially requiring to repay or refinance the Loan Agreement, see also Note 10.

The 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(2), and to the government of Israel - see Note 7B.

The Jazz debentures and interest thereon are unsecured and subordinated to Jazz's existing and future secured indebtedness, including indebtedness to Wells Fargo under the Loan Agreement, see Note 10.

**B. 2005 Convertible Debentures Series B**

In January 2006, Tower raised \$48,169 of convertible debentures by way of a rights offering. The debentures were listed for trade on the Tel-Aviv Stock Exchange and on the NASDAQ Capital Market ("Series B"). The debentures accrued annual interest at the rate of 5% which was paid, together with the principal of the remaining outstanding debentures, in one installment in January 2012. The outstanding principal amount of convertible debentures Series B as of December 31, 2011 and 2010 was \$10,291 and \$10,302 respectively, all of which were fully paid and redeemed in January 2012.

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**NOTE 13 - DEBENTURES (cont.)**

**C. 2006 Convertible Debentures Series C**

In 2006, Tower raised approximately \$31,219 in a public offering of convertible debentures linked to the CPI and issued at 85% of the par value.

The convertible debentures were convertible into Tower's ordinary shares at a conversion rate of one ordinary share per NIS 8.40 principal amount of convertible debentures. The conversion price was subject to a reduction feature until June 2008, pursuant to which the conversion rate of Series C was reduced in July 2008 from NIS 8.4 to NIS 4.31. The convertible debentures carried a zero coupon with principal payable at maturity in December 2011, at a premium of 37% over principal value, linked to the CPI. In December 2011, the outstanding amount was fully paid and the debentures were fully redeemed.

The outstanding principal amount of the convertible debentures as of December 31, 2010 was \$38,823 and has been fully paid and redeemed in December 2011.

The net proceeds received were allocated to each of the components in the units sold using the relative fair value method. Tower determined the fair values of each component using the average quoted prices on the first 2 days of trading. The allocation to each component was as follows:

	<u>Fair Values</u>	<u>Amount allocated at issuance</u>
Total net proceeds received for the units issued as of issuance date		\$ 28,752
Proceeds allocated to convertibles debentures as of issuance date based on relative fair value	\$ 31,402	\$ 26,735
Proceeds allocated to short term options to purchase additional debentures	246	210
Proceeds allocated to long term warrants	1,513	1,287
Proceeds allocated to short term warrants	611	520
Total allocated	<u>\$ 33,772</u>	<u>\$ 28,752</u>

Tower further bifurcated the conversion feature from the convertible debt using the "with and without" method. That bifurcation was done, as a next step, after the determination of the allocated proceeds described above. Following the adoption of EITF 07-5 as codified in ASC 815-40, on January 1, 2009, the conversion feature was reclassified from equity to liabilities.



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**NOTE 13 - DEBENTURES (cont.)**

**C. 2006 Convertible Debentures Series C (cont.)**

The embedded feature was measured at fair value using a valuation technique that utilizes the discounted cash flows of Black-Scholes and Monte Carlo simulation. The embedded conversion feature in 2006 Convertible Debentures Series C contained a feature that adjusts the exercise price. Since the Black-Scholes model cannot be modified to capture such adjustment, such embedded feature was measured using the Monte Carlo simulation. The feature that adjusts the exercise price expired in June 2008 and since then, the Company does not use the Monte Carlo method. The assumptions included in the Black-Scholes model were (i) the market price of the Company's shares, (ii) the exercise price of the warrant or conversion rate of the conversion feature, (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 rate is determined as the rate on governmental bonds with maturity commensurate with the term of the warrant.

**D. 2007 Non-Convertible Debentures Series D and Convertible Debentures Series E**

In the second half of 2007, Tower consummated a private placement with Israeli institutions followed by expansion in September 2007 in a public offering of long-term convertible and non-convertible debentures and warrants, in which 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"); (ii) \$ 30,000 aggregate principal amount of long-term convertible-debentures repayable in December 2012, linked to the CPI, carrying an annual interest of 8% ("Series E"), convertible into Tower's ordinary shares at a conversion rate of one ordinary share per NIS 17.2 principal amount of convertible debentures, and (iii) an aggregate of 2.7 million warrants series 6, each of which were exercisable until August 2011 for one Tower ordinary share at a price of \$2.04.

The conversion price of Series E was subject to adjustments under certain limited circumstances during a two year period which ended in June 2009. Pursuant to said terms, the conversion price was reduced to NIS 4.15. Series E are carried at fair value and the effect of the reduction in conversion price was reflected in the statement of operations in 2009 due to mark to market of the convertibles.

The exercise price of warrants series 6 was reduced from \$2.04 to \$1.06 under terms of the warrants. Warrants series 6 were classified as liabilities and carried at fair value because of the adjustment feature. After the exercise price was adjusted and the adjustment feature expired, the warrants were adjusted to fair value (with the adjustment reflected in the statement of operations in 2009) and the warrants were reclassified to equity. Warrants series 6 expired fully in August 2011.

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**NOTE 13 - DEBENTURES (cont.)**

**D. 2007 Non-Convertible Debentures Series D and Convertible Debentures Series E (cont.)**

The outstanding principal amounts of Series D as of December 31, 2011 and 2010 were \$29,464 and \$37,120, respectively.

The outstanding principal amounts of Series E as of December 31, 2011 and 2010 were \$27,361 and \$34,235, respectively.

**E. 2010 Convertible Debentures Series F**

In 2010, Tower filed a shelf prospectus in Israel, which became effective in September 2010. On the basis of this shelf, and pursuant to a prospectus supplement filed in Israel in October 2010, Tower raised an aggregate principal amount of approximately \$100,000 through the issuance of long-term debentures ("Series F Debentures"), due in two equal installments in December 2015 and December 2016. The Series F Debentures are fully linked to the US dollar, carry an interest rate of 7.8% per annum, and will be convertible into Tower's ordinary shares during the period commencing in September 2012 and ending in December 2016, with a conversion price that shall be equal to 120% of the average trading price of Tower's ordinary shares on the Tel-Aviv Stock Exchange during the 15 trading days before September 18, 2012, provided that in no event will the price be more than NIS 6.5 (subject to certain adjustments), and not less than NIS 1.0. All these amounts, although denominated in NIS, are fully linked to the US dollar, including conversion prices discussed above.

The Series F Debentures are carried at amortized cost. The Company evaluated the conversion feature in accordance with the criteria established in ASC 815-40 "Contracts in Entity's Own Equity" and concluded that bifurcation is not required.

**F. Convertible Notes Issued By Jazz in 2006**

In 2006, Jazz completed private placements of convertible notes. The convertible notes bore interest at a rate of 8% per annum payable semi-annually and were scheduled to mature in December 2011 ("Old Notes"). In October 2011, Jazz completed a voluntary transaction to redeem early the entire remaining outstanding amount of the Old Notes.

For details regarding the exchange in July 2010 of New Notes for the Old Notes, see G below.

As of December 31, 2010, \$43,691 in principal amount of the Old Notes was outstanding.

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**NOTE 13 - DEBENTURES (cont.)**

**G. Notes Issued By Jazz in 2010**

In July 2010, Jazz (together with its domestic subsidiaries) and Tower, entered into an exchange agreement with certain note holders (the "Participating Holders") holding approximately \$80,000 principal amount of Jazz's Old Notes. In the exchange, the participating holders exchanged their Old Notes for newly-issued 8% non-convertible notes of Jazz due June 2015 (the "New Notes") according to an exchange ratio of \$1.175 face amount of New Notes for each 1.000 of Old Notes. Interest is payable semiannually on June 30 and December 31 of each year.

In addition, the Participating Holders received warrants to purchase approximately 25.3 million ordinary shares of Tower at an exercise price of \$1.70 per share ("Warrants J").

The New Notes constitute unsecured obligations of Jazz, rank on parity in right of payment with all other indebtedness of Jazz, are effectively subordinated to all secured indebtedness of Jazz to the extent of the value of the collateral securing such indebtedness and are not guaranteed by Tower.

Jazz's obligations under the New Notes are guaranteed by Jazz's wholly owned domestic subsidiaries. Jazz has not provided condensed consolidated financial information for such subsidiaries because Jazz has no independent assets or operations, the subsidiary guarantees are full and unconditional and joint and several and subsidiaries of Jazz other than the subsidiary guarantors are minor. Other than the restrictions in the Loan Agreement, there are no significant restrictions on the ability of Jazz and its subsidiaries to obtain funds from their subsidiaries by loan or dividend.

Jazz applied the provisions of ASC 470-50 "Modifications and Extinguishments" to account for debt exchange. Jazz first, determined that the exchange was not considered troubled debt, mainly due to the fact that no concession was given by the creditor. Based on the provisions of ASC 470-50 Jazz determined that the exchange resulted in an extinguishment of the old debt and the issuance of a new debt. As described above, the Warrants J and New Notes were issued to settle the Old Notes. Jazz considered the transaction to be at arm's length (the transaction was made between willing unrelated parties) and therefore evidence of fair value. Since the new debt was not traded and no quotes were available, Jazz determined the fair value of the New Notes in a manner consistent with the manner used in the allocation of the purchase price of Jazz in September 2008 by using present value techniques. This, together with the fair value of the warrants, was used to determine the value of the Old Notes on the date of the exchange and resulted in an expense of approximately \$2,350, which has been recorded in the statement of operations for the year ended December 31, 2010. Since the Warrants J may be settled in cash in certain instances beyond Tower's control, the fair value of the Warrants J was recorded in liabilities and the corresponding entry was part of the overall expense of the debt exchange. The fair value of the warrants was calculated based on the Black-Scholes formula. This fair value was also confirmed by independent calculation made by the investors as evidenced by the contract. The following assumptions were used in the fair

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**NOTE 13 - DEBENTURES (cont.)**

**G. Notes Issued By Jazz in 2010 (cont.)**

value calculation: risk-free rate based on US treasury bills of 1.79% per annum, term of the warrants of five years, Tower's market share price immediately prior to closing date of \$1.36, the exercise price of the warrants as agreed with the investors of \$1.70 and the volatility of Tower ordinary shares of approximately 50%.

As of December 31, 2011 and 2010, \$93,556 in principal amount of the New Notes was outstanding.

**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. Interest Rate Derivatives**

A derivative is typically defined as an instrument whose value is derived from an underlying instrument, index or rate, has a notional amount, requires no or little initial investment and can be net settled.

ASC Topic 815 "Derivatives and Hedging" requires that all derivatives be recorded in the financial statements at their fair value at the date of the financial statements. The changes in the fair value of the derivatives are charged to the statement of operations unless designated as a hedging item in a cash flows hedge at which time changes are classified in other comprehensive income, to the extent effective.

Tower, from time to time, enters into agreements to hedge variable interest rate exposure on long-term loans. Tower uses interest rate collar agreements, some with knock-out and knock-in features to hedge its LIBOR-based variable debt cash flow exposure. The knock-out feature was set above the cap level and the knock-in feature was set below the floor level. The derivatives, although used as economic hedges, are not treated as hedges for accounting purposes. The changes in fair value are recorded immediately in earnings.

As of December 31, 2011 and 2010, Tower had outstanding agreements to economically hedge interest rate exposure on loans drawn down under the Facility Agreement, in the aggregate amounts of \$30,000 and \$90,000, respectively. These agreements resulted in a loss of \$111, \$1,396 and \$1,552 for the years ended December 31, 2011, 2010 and 2009, respectively.

The Company does not hold or issue derivative financial instruments for non-hedging purposes.

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
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**NOTE 14 - FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS (cont.)**

**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 agencies 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.

The Company generally does not require collateral for insurance of receivables, however, in certain circumstances the Company maintains a customer's credit insurance policy 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, see Note 18.

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, 2011 and 2010. The fair values of Tower and Jazz's debentures, based on quoted market prices or other valuation as of December 31, 2011 and 2010, were \$227,280 and \$393,356, respectively compared to carrying amounts of \$240,720 and \$339,777, for the above dates, respectively.

**D. Fair Value Measurements**

Fair values were determined, as follows:

- For Tower's loans from 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.
- For Embedded Derivatives and Warrants - the Company utilized the Black Scholes Merton formula.
- For Over the Counter derivatives - the Company used the market approach using quotations from independent brokers and dealers.
- For Tower's Series E - the market approach using quoted market prices was used.

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**NOTE 14 - FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS (cont.)**

**D. Fair Value Measurements (cont.)**

Recurring Fair Value Measurements Using the Indicated Inputs:

	December 31, 2011	Quoted prices in active market for identical liability (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Convertible debentures series E	\$ 27,157	\$ 27,157	\$ --	\$ --
Tower's loans (including current maturities)(*)	93,845	--	--	93,845
Derivatives	458	--	458	--
Warrants and previously bifurcated conversion option	2,268	--	--	2,268
	<u>\$ 123,728</u>	<u>\$ 27,157</u>	<u>\$ 458</u>	<u>\$ 96,113</u>

(\*) 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 debt (including current maturities)	Warrants and previously bifurcated conversion option
As of January 1, 2011 - at fair value	\$ 119,882	\$ 20,892
Settlement of an embedded derivative in shares	(12,087)	--
Warrants exercise	--	(521)
Loan repayment	(30,000)	--
Total losses (gains) unrealized in earnings	16,050	(18,103)
As of December 31, 2011 - at fair value	<u>\$ 93,845</u>	<u>\$ 2,268</u>
Unrealized losses (gains) recognized in earnings from liabilities held at period end	<u>\$ 16,050</u>	<u>\$ (18,103)</u>

Non Recurring Fair Value Measurements Using the Indicated Inputs:

	Jazz's New Notes as of Exchange Date (Note 13G)	Significant unobservable inputs (Level 3)
Jazz's New Notes	\$ 62,539	\$ 62,539
	<u>\$ 62,539</u>	<u>\$ 62,539</u>

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**NOTE 14 - FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS (cont.)**

**D. Fair Value Measurements (cont.)**

Recurring Fair Value Measurements Using the Indicated Inputs:

	December 31, 2010	Quoted prices in active market for identical liability (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Convertible debentures series E	\$ 39,811	\$ 39,811	\$ --	\$ --
Tower's loans (including current maturities)	119,882	--	--	119,882
Derivatives	774	--	774	--
Warrants and previously bifurcated conversion option	20,892	--	--	20,892
	<u>\$ 181,359</u>	<u>\$ 39,811</u>	<u>\$ 774</u>	<u>\$ 140,774</u>

Liabilities measured on a recurring basis using significant unobservable inputs (Level 3):

	Tower's debt (including current maturities)	Warrants and previously bifurcated conversion option
As of January 1, 2010 - at fair value	\$ 167,606	\$ 12,034
Warrants exercise	--	(3,790)
Decrease in bifurcated conversion option due to conversions	--	(6,346)
Issuance of warrants	--	13,247
Loan repayment	(49,065)	--
Total losses unrealized in earnings	1,341	5,747
As of December 31, 2010 - at fair value	<u>\$ 119,882</u>	<u>\$ 20,892</u>
Unrealized losses recognized in earnings from liabilities held at period end	<u>\$ 1,341</u>	<u>\$ 5,747</u>

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**NOTE 15 - EMPLOYEE RELATED LIABILITIES**

**A. Employee Termination Benefits**

Israeli law and labor agreements determine the obligations of Tower to make severance payments to dismissed employees and to 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 purchased 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 \$11,374 and \$12,586, respectively. 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 release it from any additional severance obligation to its employees and therefore Tower incurs no liability or asset, 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 approximately \$4,641, \$3,437 and \$2,496 for 2011, 2010 and 2009, respectively.

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. TJP does not cover the termination liability through deposits to benefit funds and the entire liability, in the amount of \$73,037, is reflected in the balance sheets in long-term employee related liabilities.

**B. Employee Benefit Plans**

The following information provided recognizes the changes in 2011, 2010 and 2009 periodic expenses and benefit obligations due to the bargaining agreement effective December 19, 2009 entered into by Jazz with its collective bargaining unit employees.



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**NOTE 15 - EMPLOYEE RELATED LIABILITIES (cont.)**

**B. 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 December 31, 2011	Year ended December 31, 2010	Year ended December 31, 2009
<b>Net periodic benefit cost</b>			
Service cost	\$ 193	\$ 177	\$ 178
Interest cost	573	512	463
Expected return on the plan's assets	--	--	--
Amortization of transition obligation (asset)	--	--	--
Amortization of prior service costs	114	--	--
Amortization of net (gain) or loss	109	48	57
Total net periodic benefit cost	<u>\$ 989</u>	<u>\$ 737</u>	<u>\$ 698</u>
<b>Other changes in plan assets and benefits obligations recognized in other comprehensive income</b>			
Prior service cost for the period	\$ (990)	\$ 376	\$ --
Net (gain) or loss for the period	(1,752)	643	19
Amortization of transition obligation (asset)	--	--	--
Amortization of prior service costs	(114)	--	--
Amortization of net (gain) or loss	(109)	(48)	(57)
Total recognized in other comprehensive income	<u>\$ (2,965)</u>	<u>\$ 971</u>	<u>\$ (38)</u>
Total recognized in net periodic benefit cost and other comprehensive income	<u>\$ (1,976)</u>	<u>\$ 1,708</u>	<u>\$ 660</u>
<b>Weighted average assumptions used:</b>			
Discount rate	5.90%	6.30%	6.10%
Expected return on plan assets	N/A	N/A	N/A
Rate of compensation increases	N/A	N/A	N/A
<b>Assumed health care cost trend rates:</b>			
Health care cost trend rate assumed for current year	10.00%/21.00%	10.00%	9.00%
Ultimate rate	5.00%/5.00%	5.00%	5.00%
Year the ultimate rate is reached	2021/2019	2017	2015
Measurement date	December 31, 2011	December 31, 2010	December 31, 2009

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**NOTE 15 - EMPLOYEE RELATED LIABILITIES (cont.)**

**B. Employee Benefit Plans (cont.)**

Impact of one-percentage point change in assumed health care cost trend rates as of December 31, 2011:

	Increase	Decrease
Effect on service cost and interest cost	\$ 133	\$ (107)
Effect on postretirement benefit obligation	\$ 1,182	\$ (958)

The components of the change in benefit obligation, change in plan assets and funded status for postretirement medical plan are as follows:

	Year ended December 31, 2011	Year ended December 31, 2010	Year ended December 31, 2009
<b>Change in benefit obligation:</b>			
Benefit obligation at beginning of period	\$ 9,811	\$ 8,232	\$ 7,688
Service cost	193	177	178
Interest cost	573	512	463
Benefits paid	(86)	(129)	(116)
Change in plan provisions	(990)	376	--
Actuarial loss	(1,752)	643	19
Benefit obligation end of period	<u>\$ 7,749</u>	<u>\$ 9,811</u>	<u>\$ 8,232</u>
<b>Change in plan assets:</b>			
Fair value of plan assets at beginning of period	\$ --	\$ --	\$ --
Actual return on plan assets	--	--	--
Employer contribution	86	129	116
Benefits paid	(86)	(129)	(116)
Fair value of plan assets at end of period	<u>--</u>	<u>--</u>	<u>--</u>
Funded status	<u>\$ (7,749)</u>	<u>\$ (9,811)</u>	<u>\$ (8,232)</u>

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
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**NOTE 15 - EMPLOYEE RELATED LIABILITIES (cont.)**

**B. Employee Benefit Plans (cont.)**

	As of December 31, 2011	As of December 31, 2010	As of December 31, 2009
Amounts recognized in statement of financial position:			
Non-current assets	\$ --	\$ --	\$ --
Current liabilities	(137)	(200)	(199)
Non-current liabilities	(7,612)	(9,611)	(8,033)
Net amount recognized	<u>\$ (7,749)</u>	<u>\$ (9,811)</u>	<u>\$ (8,232)</u>
Weighted average assumptions used:			
Discount rate	5.20%	5.90%	6.30%
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)	8.25%/57.0%	10.0%/21.0%	10.0%/10.0%
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)	2021/2019	2021/2019	2017/2017

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
2012	\$ 137
2013	192
2014	223
2015	262
2016	300
2017 - 2021	\$ 2,190

**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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**NOTE 15 - EMPLOYEE RELATED LIABILITIES (cont.)**

**B. Employee Benefit Plans (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 December 31, 2011	Year ended December 31, 2010	Year ended December 31, 2009
<b>Net periodic benefit cost</b>			
Service cost	\$ --	\$ 106	\$ 306
Interest cost	736	729	679
Expected return on plan assets	(810)	(693)	(537)
Amortization of transition obligation/(asset)	--	--	--
Amortization of prior service costs	--	--	--
Amortization of net (gain) or loss	--	--	192
Total net periodic benefit cost	<u>\$ (74)</u>	<u>\$ 142</u>	<u>\$ 640</u>
<b>Other changes in plan assets and benefits obligations recognized in other comprehensive income</b>			
Prior service cost for the period	\$ --	\$ --	\$ --
Net (gain) or loss for the period	2,468	(85)	(1,415)
Amortization of transition obligation (asset)	--	--	--
Amortization of prior service costs	--	--	--
Amortization of net (gain) or loss	--	--	(192)
Total recognized in other comprehensive income	<u>\$ 2,468</u>	<u>\$ (85)</u>	<u>\$ (1,607)</u>
Total recognized in net periodic benefit cost and other comprehensive income	<u>\$ 2,394</u>	<u>\$ 57</u>	<u>\$ (967)</u>
<b>Weighted average assumptions used:</b>			
Discount rate	5.70%	6.20%	6.20%
Expected return on plan assets	7.50%	7.50%	7.50%
Rate of compensation increases	N/A	N/A	N/A
	Year ended December 31, 2011	Year ended December 31, 2010	Year ended December 31, 2009
<b>Estimated amounts that will be amortized from accumulated other comprehensive income in the next fiscal year ending :</b>			
Transition obligation (asset)	\$ --	\$ --	\$ --
Prior service cost	--	--	--
Net actuarial (gain) or loss	\$ 70	\$ --	\$ --

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**NOTE 15 - EMPLOYEE RELATED LIABILITIES (cont.)**

**B. Employee Benefit Plans (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 December 31, 2011	Year ended December 31, 2010	Year ended December 31, 2009
<b>Change in benefit obligation:</b>			
Benefit obligation at beginning of period	\$ 13,105	\$ 11,939	\$ 11,101
Service cost	--	106	306
Interest cost	736	729	679
Benefits paid	(273)	(265)	(241)
Change in plan provisions	--	--	--
Actuarial loss (gain)	1,566	596	94
Benefit obligation end of period	<u>\$ 15,134</u>	<u>\$ 13,105</u>	<u>\$ 11,939</u>
<b>Change in plan assets</b>			
Fair value of plan assets at beginning of period	\$ 10,742	\$ 9,253	\$ 6,995
Actual return on plan assets	(92)	1,375	2,046
Employer contribution	465	379	453
Benefits paid	(273)	(265)	(241)
Fair value of plan assets at end of period	<u>\$ 10,842</u>	<u>\$ 10,742</u>	<u>\$ 9,253</u>
Funded status	<u>\$ (4,292)</u>	<u>\$ (2,363)</u>	<u>\$ (2,686)</u>
Accumulated benefit obligation	<u>\$ (15,134)</u>	<u>\$ (13,105)</u>	<u>\$ (11,939)</u>
<b>Amounts recognized in statement of financial position</b>			
Non-current assets	\$ --	\$ --	\$ --
Current liabilities	--	--	--
Non-current liabilities	(4,292)	(2,363)	(2,686)
Net amount recognized	<u>\$ (4,292)</u>	<u>\$ (2,363)</u>	<u>\$ (2,686)</u>
<b>Weighted average assumptions used</b>			
Discount rate	5.10%	5.70%	6.20%
Expected return on plan assets	7.50%	7.50%	7.50%
Rate of compensation increases	N/A	N/A	N/A

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
2012	\$ 434
2013	502
2014	572
2015	633
2016	684
2017 – 2021	\$ 4,222

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**NOTE 15 - EMPLOYEE RELATED LIABILITIES (cont.)**

**B. Employee Benefit Plans (cont.)**

Jazz has estimated the expected return on assets of the plan of 7.5% 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 Jazz's estimates are not consistent with actual investment performance.

Jazz's pension plan weighted average asset allocations on December 31, 2011 by asset category are as follows:

Asset Category:	December 31, 2011	Target allocation 2012
Equity securities	74%	65 – 75%
Debt securities	26%	25 – 35%
Real estate	0%	0%
Other	0%	0%
<b>Total</b>	<b>100%</b>	<b>100%</b>

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 25-35% debt, or fixed income securities, and 65-75% 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.

**NOTE 16 - COMMITMENTS AND CONTINGENCIES**

**A. Commitments and Contingencies Relating to Fab 2**

**(1) Overview**

In 2001, the Company's Board of Directors approved the establishment of a second wafer fabrication facility in Israel, designated as Fab 2. In connection with the establishment, equipping and financing of Fab 2, the Company entered into several related agreements and other arrangements and has completed several public and private financing transactions. The agreements and arrangements include those with technology partners, principal customers, TIC, the Israeli Banks, the Government of Israel through the Investment Center and others.

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**NOTE 16 - COMMITMENTS AND CONTINGENCIES (cont.)**

**A. Commitments and Contingencies Relating to Fab 2 (cont.)**

**(1) Overview (cont.)**

In the frame of the arrangements made with principal customers, the Company established long-term advances utilizable as credits against future wafer purchases. In 2009, the Company recorded a write-off of the liability in the amount of \$2,342 due to Low utilization of the wafer credits based on past history and future forecasts received from the customer.

As of December 31, 2011 and 2010, the outstanding long-term customer advances related to the principal customers, were \$7,485 and \$7,757, respectively.

**(2) Facility Agreement**

**Compliance with Financial Ratios and Covenants**

As of the balance sheet date, Tower was in full compliance with all of the financial ratios and covenants under the Facility Agreement, as amended to date. According to the Facility Agreement, satisfying the financial ratios and covenants is a material provision. The amended Facility Agreement provides that if, as a result of any default, the Israeli Banks were to accelerate Tower's obligations, Tower would be obligated, among other matters, to immediately repay all loans made by the Israeli Banks (which as of the approval date of the financial statements amounted to approximately \$131,000) plus penalties, and said 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.

**Liens**

Under the Facility Agreement, Tower agreed to register liens in favor of the Israeli Banks on substantially all its present and future assets.

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**NOTE 16 - COMMITMENTS AND CONTINGENCIES (cont.)**

**A. Commitments and Contingencies Relating to Fab 2 (cont.)**

**Offer by the Israeli Banks**

If one or more 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 60% 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, unless TIC and the principal customers agree to exercise in a rights offering rights applicable to their shareholdings and agree to purchase in a private placement enough shares to ensure that the full amount of the Offer is invested.

For further details in regard to the Facility Agreement, see Note 12B.

For interest rate derivatives agreements in connection with the loans under the Facility Agreement, see Note 14.

**(3) Approved Enterprise Status**

For details regarding Approved Enterprise Status relating to Fab 2, see Note 7B.

**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.

For the license agreement between TJP and Micron see Note 3.

**C. Leases**

Tower's offices and engineering and Fab 1 manufacturing operations are located in a building complex situated in an industrial park in Migdal Ha'emek, in the northern part of Israel. These premises are currently occupied 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 SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
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**NOTE 16 - COMMITMENTS AND CONTINGENCIES (cont.)**

**C. Leases (cont.)**

Tower occupies certain other premises under various operating leases. The obligations under such leases were not material as of December 31, 2011.

Since 2002, Jazz has leased its fabrication facilities, land and headquarters from Conexant under non-cancelable operating leases through 2017. In December 2010, Conexant sold Jazz's fabrication facilities, land and headquarters. In connection with the sale, Jazz negotiated amendments to its operating leases that confirm Jazz's ability to remain in the fabrication facilities through 2017 and Jazz's unilateral options to extend the terms of each of these leases for two consecutive five-year periods. Under the amended leases with the new owner, 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. Under the lease amendments, the landlord may terminate the lease for Jazz's headquarters building, but not Jazz's fabrication facility, no earlier than January 2014.

Aggregate rental expense under operating leases, including amounts paid to Conexant and the current owner, was approximately \$2,400 for each of the years ended December 31, 2011, 2010 and 2009.

Future minimum payments under non-cancelable operating leases are as follows:

**Payment Obligations by Year**

	2012	2013	2014	2015	2016	Thereafter	Total
Operating leases	\$ 2,260	\$ 2,376	\$ 2,376	\$ 2,338	\$ 2,222	\$ 432	\$ 12,004

TJP has entered into capital lease arrangements of certain facilities for the supply of gasses used in production, which expire through 2019. The remaining aggregate minimum lease commitment under such arrangements as of December 31, 2011 is \$8,013. Payments under these arrangements are denominated in JPY. The gases produced by such facilities are used exclusively by TJP.

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
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**NOTE 16 - COMMITMENTS AND CONTINGENCIES (cont.)**

**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.

**(1) Siliconix**

In 2004, Tower and Siliconix incorporated ("Siliconix"), a subsidiary of Vishay Intertechnology Inc., entered into a definitive long-term foundry agreement for semiconductor manufacturing. During recent years, the parties amended the agreement several times to revise the terms of the purchase of wafers and transfer additional product platforms to Tower for the manufacturing of new products.

**(2) An agreement with an Asian entity**

In November 2009, Tower entered into a definitive agreement with an Asian entity for the capacity ramp-up and upgrade of the entity's current installed and commissioned eight inch refurbished wafer fabrication facility with 0.18 micron Complementary Metal Oxide Semiconductor (CMOS) technology. Said facility has 0.25 micron and lower geometries.

Under said agreement, Tower provides, on a turn-key basis, 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 project is divided into several phases of implementation: (i) supply of documents of the offered 0.18 micron CMOS technology; (ii) project planning; (iii) supply process equipment; (iv) installation and acceptance of process equipment; (v) process set-up and integration; and (vi) technology qualification and production. The total agreement value is approximately \$130,000, of which approximately \$114,000 was paid as of December 31, 2011.

Payments are based on performance of milestones derived from the phases above and delivery of the deliverables. The following are the major payment milestones: shipment of process equipment; delivery of process flow document of the 0.18 micron technology; delivery of detailed working plans; design of clean room; delivery of process equipment; training and integration; and performance of qualification tests and analyses.

For revenue recognition policy for said agreement, see Note 2K. During the years ended December 31, 2011, 2010 and 2009, Tower recorded \$44,426, \$70,999 and \$8,079 revenues respectively relating to said agreement.

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
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**NOTE 16 - COMMITMENTS AND CONTINGENCIES (cont.)**

**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. International Trade Commission Action**

During 2008, an International Trade Commission ("ITC") action was filed by Agere/LSI Corporation ("LSI"), alleging infringement of U.S. patent No. 5,227,335 (the '335 patent) under Section 337 of the Tariff Act of 1930 (Section 337) by seventeen corporations. Following the initial filing, in October 2008, LSI amended the ITC complaint to add Tower, Jazz and three other corporations as additional respondents. In September 2009, the administrative law judge ("ALJ") ruled against LSI and in favor of the respondents, determining that the patent claims asserted by LSI are invalid. In November 2009, in response to a Petition for Review filed by LSI, the ITC determined that it would review the ALJ's determination on patent invalidity. In March 2010, the ITC issued a notice of final determination that there was no violation of Section 337, ruling that the LSI '335 patent claims were invalid, and terminated the ITC investigation.

LSI appealed the final determination to the U.S. Court of Appeals for the Federal Circuit ("Federal Circuit"). While that appeal was pending, the '335 patent expired. The ITC moved to dismiss LSI's appeal as moot, which LSI conceded. In November, 2010, the Federal Circuit issued an order vacating the ITC's final determination and remanded the investigation to the ITC with instructions to dismiss the Investigation as moot.

LSI also previously filed an action for patent infringement of the '335 patent against the Company and other corporations in the United States District Court for the Eastern District of Texas, which action was stayed pending the conclusion of the ITC Investigation. On June 16, 2011, the District Court granted a motion by LSI to dismiss the Texas action without prejudice. As a result of that dismissal, there is no longer any legal proceeding currently pending by LSI against the Company.

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
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**NOTE 16 - COMMITMENTS AND CONTINGENCIES (cont.)**

**G.** In connection with Jazz's aerospace and defense business, its facility security clearance and trusted foundry status, Tower and Jazz are working with the Defense Security Service of the United States Department of Defense ("DSS") to develop an appropriate structure to 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. In order to safeguard classified information, it is expected that the DSS will require adoption of a Special Security Agreement ("SSA"). The SSA may include certain security related restrictions, including restrictions on the composition of the board of directors, the separation of certain employees and operations, as well as restrictions on disclosure of classified information to Tower. The provisions contained in the SSA may also limit the synergies and other benefits realized from the merger with Jazz. There is no assurance when, if at all, an SSA will be reached.

**H. 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, 2011. In regard to Investment Center grants, see Note 7B.

**NOTE 17 - SHAREHOLDERS' EQUITY**

**A. Description of Ordinary Shares**

As of December 31, 2011 and 2010, Tower had 1.1 billion authorized ordinary shares, par value NIS 1.00 each, of which approximately 318 and 266 million, respectively, were issued and outstanding (net of 1.3 million ordinary shares held by Tower as of such dates). As of December 31, 2011, there were additional ordinary shares of Tower contingently issuable under various agreements according to their provisions, as detailed below: (i) the possible exercise of outstanding warrants, see Notes 13G and G below; (ii) the possible exercise of options granted to employees of the Company and non-employees, see B below; (iii) the possible conversion of outstanding convertible debentures, see Note 13; (iv) the possible exercise of equity equivalent capital notes, see C below; and (v) the possible exercise of Israeli Banks warrants, see B(5) below. 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.

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
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**NOTE 17 - SHAREHOLDERS' EQUITY (cont.)**

**B. Share Option Plans**

**(1) Employee, Chairman of the Board of Directors, Chief Executive Officer and Director Share Options**

**(a) General**

The Company has granted to its employees and directors options to purchase ordinary shares under several option plans adopted by the Company since 1995. The particular provisions of each plan and grant vary as to vesting period, exercise price, exercise period and other terms. Generally, the options are 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 four-year period according to various vesting schedules, and are not exercisable beyond ten years from the grant date.

**(b) Share Incentive Plan for the Chairman of Board**

In June 2009, the Audit Committee and the Board approved a grant of options to the Chairman of the Board to purchase 11.5 million Tower ordinary shares, which was further approved by Tower's shareholders in November 2009. The exercise price is \$0.29 (but not lower than the nominal value of Tower's ordinary shares), which was the closing price of Tower's ordinary shares on the NASDAQ Global Market on the trading day immediately prior to the date of approval of the grant by the Board. The options vest over three years as follows: 50% of the options shall vest on the second anniversary of the date of grant and an additional 50% on the third anniversary of the date of grant. The options are exercisable for a period of seven years from the date of grant. The compensation cost of the options granted was determined based on the fair value at the date of grant and amounted to \$9,711. Such amount is expensed over the vesting periods of the options.

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**NOTE 17 - SHAREHOLDERS' EQUITY (cont.)**

**B. Share Option Plans (cont.)**

**(1) Employee, Chairman of the Board of Directors, Chief Executive Officer and Director Share Options (cont.)**

**(c) Share Incentive Plan for the Company's Employees and CEO**

In November 2008, the Audit Committee and Board approved Tower's 2009 Employee Share Incentive Plan (the "Plan") to grant options and/or restricted share units to the Company's employees (including its CEO), which plan was approved by Tower's shareholders in April 2009. Up to approximately 28.3 million options are reserved for grant to the Company's employees (excluding its CEO), and approximately 28.3 million additional options under the Plan were reserved for grant to the CEO. However, the amount of available options for grant at any time will be reduced by the aggregate number of outstanding options under all employee option plans and under all CEO share option plans.

In June 2009, the Board approved a grant to the CEO under the Plan to purchase up to 8.5 million ordinary shares. These options are exercisable at an exercise price of \$0.29 (but not lower than the nominal value of Tower's ordinary shares), which was the closing price of Tower's ordinary shares on the NASDAQ Global Market on the trading day immediately prior to the date of approval of the grant by the Board. These options vest over a three-year period as follows: 50% of the options shall vest on the second anniversary of the date of grant and an additional 50% on the third anniversary of the date of grant. The options granted are exercisable for a period of seven years from the date of grant.

In July 2011, the Board approved a grant to the CEO under the Plan to purchase up to 3.9 million ordinary shares. These options are exercisable at an exercise price of \$1.15, which was the closing price of Tower's ordinary shares on the NASDAQ Global Market on the trading day immediately prior to the date of approval of the grant by the Board. Other terms of the options are identical to the terms of the June 2009 CEO grant described above.

As of the balance sheet date, a total of 27.3 million options were outstanding to the CEO under the CEO share option plans. The compensation cost of the total options granted to the CEO was determined based on the fair value on the respective grant dates and amounted to \$15,212. Such amount is expensed over the vesting periods of the options. As of the balance sheet date, approximately 1 million options are available for future grants of options to the CEO.

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**NOTE 17 - SHAREHOLDERS' EQUITY (cont.)**

**B. Share Option Plans (cont.)**

**(1) Employee, Chairman of the Board of Directors, Chief Executive Officer and Director Share Options (cont.)**

**(c) Share Incentive Plan for the Company's Employees and CEO (cont.)**

In June 2009, the Board approved a grant to the employees of the Company under the Plan to purchase up to 9 million ordinary shares. These options are exercisable at an exercise price of \$0.29 (but not lower than the nominal value of Tower's ordinary shares), which was the closing price of Tower's ordinary shares on the NASDAQ Global Market on the trading day immediately prior to the date of approval of the grant by the Board.

These options will vest over a three-year period as follows: 50% of the options shall vest on the second anniversary of the date of grant and an additional 50% on the third anniversary of the date of grant. The options granted are exercisable for a period of seven years from the date of grant.

In February 2011, the Board approved a grant to the employees of the Company under the Plan to purchase up to 6.9 million ordinary shares. These options are exercisable at an exercise price of \$1.42, which was the closing price of Tower's ordinary shares on the NASDAQ Global Market on the trading day immediately prior to the date of approval of the grant by the Board. Other terms of the options are identical to the terms of the June 2009 employees grant described above.

As of the balance sheet date, approximately 2.1 million options are available for future grants of options to Company employees.

**(d) Options Granted to Directors**

During 2001, the Audit Committee, the Board and the shareholders approved a stock option plan pursuant to which certain of Tower's directors will be granted options to purchase up to 400,000 Tower ordinary shares (40,000 to each eligible director appointed to the Board of Directors) at an exercise price equal to the closing market price of Tower's ordinary shares immediately prior to the date of grant. As of December 31, 2011, 110,000 options were outstanding under said plan with a weighted average exercise price of \$1.24.

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**NOTE 17 - SHAREHOLDERS' EQUITY (cont.)**

**B. Share Option Plans (cont.)**

**(1) Employee, Chairman of the Board of Directors, Chief Executive Officer and Director Share Options (cont.)**

**(d) Options Granted to Directors (cont.)**

Options granted under said plan vest over a four-year period according to various vesting schedules, and generally may not be exercised beyond five years from the date they first become exercisable. So long as the Independent Directors' Option Plan described below remains in effect, no new Independent Director, (as defined in (e) below) appointed after January 2007 will be entitled to receive options under the 2001 director options plan.

Further to the one-time grant of 75,000 options that were approved to be granted to the Company's Independent Directors as detailed in (e) below, the Audit Committee and Board approved a one-time grant of 75,000 options to each of the following directors, Nir Gilad and Yoav Doppelt, the grant is further subject to the approval of the shareholders.

These options shall vest over 3 years on a monthly basis following the date of approval by the shareholders. The exercise price per option shall be \$1.04 per share which was the closing price of the Company's Ordinary Shares on NASDAQ on the trading day immediately prior to the date the options grant was approved by the Board.

**(e) 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 employees of the Company ("Independent director") initial options to purchase Tower's ordinary shares that equal 150,000 less the number of unvested options to purchase Tower's ordinary shares held by such Independent Director as of the date of shareholders' approval. The initial options vest over 3 years: one third will vest on the first anniversary of the grant date, and thereafter, the remaining two thirds pro-rata on a monthly basis over the remaining two years until fully vested. Each new Independent Director appointed will be granted 150,000 options to purchase Tower's ordinary shares with the same vesting terms as the initial grants, at an exercise price equal to the closing price of Tower's ordinary shares on NASDAQ on the trading day immediately prior to the relevant date of appointment.



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**NOTE 17 - SHAREHOLDERS' EQUITY (cont.)**

**B. Share Option Plans (cont.)**

**(1) Employee, Chairman of the Board of Directors, Chief Executive Officer and Director Share Options (cont.)**

**(e) Independent Directors Option Plan (cont.)**

Upon each third anniversary of a previous grant of options to an Independent Director, each such Independent Director shall be granted an additional 150,000 options to purchase Tower's ordinary shares, which will vest over 3 years on a monthly basis until fully vested. The exercise price of each such option shall be the closing price of Tower's ordinary shares on the NASDAQ 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.

In August 2011, the Company's shareholders approved a one-time grant each Independent Directors of 75,000 options, after the same was approved by the Audit Committee and Board of Directors. Said options vest over 3 years on a monthly basis until fully vested. The exercise price per option is \$0.80 per share, which is the closing price of the Company's ordinary shares on the NASDAQ on the trading day immediately prior to the date of shareholders' approval.

As of December 31, 2011, 1.56 million options were outstanding under the Independent Directors' plan with a weighted average exercise price of \$0.75.

The compensation cost of the total options outstanding to the directors and to Independent Directors under the plans described in (d) and (e) above (excluding options not yet granted pending shareholders' approval) was determined based on the fair value on the respective grant dates and amounted to \$662. Such amount is expensed over the vesting periods of the options.

A summary of the status of all employee and director share option plans as of December 31, 2011, 2010 and 2009, as well as changes during each of the years then ended, is presented below (for options granted to the Israeli Banks, see B(5) below).

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**NOTE 17 - SHAREHOLDERS' EQUITY (cont.)**

**B. Share Option Plans (cont.)**

**(2) Summary of the Status of all the Company's Employee and Director Share Options**

	2011		2010		2009	
	Number of share options	Weighted average exercise price	Number of share options	Weighted average exercise price	Number of share options	Weighted average exercise price
Outstanding as of beginning of year	59,197,265	\$ 0.99	61,524,549	\$ 0.99	35,118,153	\$ 1.62
Granted	11,815,754	1.29	1,014,000	1.41	29,292,482	0.29
Exercised	(1,318,293)	0.38	(1,426,178)	0.79	(24,725)	0.85
Terminated	(221,061)	11.26	(14,700)	21.72	--	--
Forfeited	(2,216,739)	1.61	(1,900,406)	1.15	(2,861,361)	1.59
Outstanding as of end of year	<u>67,256,926</u>	1.00	<u>59,197,265</u>	0.99	<u>61,524,549</u>	0.99
Options exercisable as of end of year	<u>40,184,186</u>	\$ 1.15	<u>28,002,921</u>	\$ 1.66	<u>22,815,612</u>	\$ 1.74

**(3) Summary of Information about Employee Share Options Outstanding**

The following table summarizes information about employee share options outstanding as of December 31, 2011:

Range of exercise Prices	Outstanding as of December 31, 2011			Exercisable as of December 31, 2011		
	Number outstanding	Weighted average remaining contractual life (in years)	Weighted average exercise price	Number exercisable	Weighted average exercise price	
\$ 0.18-\$ 0.29	26,951,482	4.74	\$ 0.29	13,083,088	\$ 0.29	
0.32-0.69	1,054,479	6.73	0.55	1,012,479	0.55	
0.71-0.87	1,251,642	8.25	0.82	474,132	0.86	
1.06	2,202,075	6.10	1.06	1,580,975	1.06	
1.15-1.44	12,266,963	6.09	1.32	1,237,727	1.34	
1.45	7,049,948	4.41	1.45	6,875,948	1.45	
1.50-1.59	9,152,941	4.20	1.54	8,757,441	1.54	
1.6-1.78	2,378,453	5.12	1.72	2,213,453	1.73	
1.8-1.83	1,286,495	5.26	1.81	1,286,495	1.81	
1.88-1.96	1,347,084	4.64	1.88	1,347,084	1.88	
2.02-2.28	1,765,950	4.52	2.12	1,765,950	2.12	
\$3.25-\$6.00	549,414	4.11	\$ 4.06	549,414	\$ 4.06	
	<u>67,256,926</u>			<u>40,184,186</u>		

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**NOTE 17 - SHAREHOLDERS' EQUITY (cont.)**

**B. Share Option Plans (cont.)**

**(3) Summary of Information about Employee Share Options Outstanding (cont.)**

	Year Ended December 31,		
	2011	2010	2009
The intrinsic value of options exercised	\$ 845	\$ 1,103	\$ 11
The fair value of options exercised	\$ 512	\$ 433	\$ 8

The table below summarizes key information for the option plans as of December 31, 2011:

	Number of Shares Reserved for Grant	Number of Shares Outstanding	Number of Shares Available for Grant
Company Employees and CEO plans	55,499,262	52,392,842	3,106,420
Jazz Employees pre merger plan	1,699,084	1,699,084	--
Independent Directors' plan	2,000,000	1,555,000	445,000
Directors plan	350,000	110,000	240,000
Chairman plan	11,500,000	11,500,000	--
Total	<u>71,048,346</u>	<u>67,256,926</u>	<u>3,791,420</u>

Stock-based compensation expense was recognized in the following line items in the statement of operations as follows:

	Year Ended December 31,		
	2011	2010	2009
Component of income (loss) before provision for income taxes:			
Cost of revenue	\$ 1,120	\$ 731	\$ 545
Research and development, net	850	692	587
Selling, general and administrative	6,137	4,990	1,709
Stock-based compensation expense	<u>\$ 8,107</u>	<u>\$ 6,413</u>	<u>\$ 2,841</u>

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**NOTE 17 - SHAREHOLDERS' EQUITY (cont.)**

**B. Share Option Plans (cont.)**

**(4) Weighted Average Grant-Date Fair Value of Options Granted to Employees**

The weighted average grant-date fair value of the options granted during 2011, 2010 and 2009 to employees and directors amounted to \$0.58, \$0.73 and \$0.52 per option, respectively. The Company utilizes the Black-Scholes model. The Company estimated the fair value, utilizing the following assumptions for the years 2011, 2010 and 2009 (all in weighted averages):

	2011	2010	2009
Risk-free interest rate	0.94%-2.3%	1.14%-3.64%	2.51%-3.83%
Expected life of options	4.75 years	7 years	7 years
Expected annual volatility	49.42%-54.45%	50.97%-68.60%	63%-78.5%
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 Company's ordinary share prior to the options award for the term identical to expected life.

**(5) Non-Employee Warrants – Israeli Banks Warrants**

As of December 31, 2011, 4.6 million warrants to purchase ordinary shares of Tower, at terms described below, were outstanding and exercisable, at a weighted average exercise price of \$2.49 per share. All the warrants are exercisable until December 2015.

In August 2009, as part of the terms of the August 2009 amendment to the Facility Agreement, Tower agreed to issue the Israeli Banks new warrants in three annual tranches with an aggregate exercise price for all new warrants issued to each bank of \$1,500, exercisable at a price and for the purchase of a number of shares to be determined based on the future stock price (the first two tranches of which were issued for an exercise price of approximately \$0.89 and the last tranche issued for an exercise price of approximately \$0.79) totaling to 3.5 million warrants, as of December 31, 2011 1.3 million of such warrants were outstanding. See Note 12B for the accounting treatment of these warrants.

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
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**NOTE 17 - SHAREHOLDERS' EQUITY (cont.)**

**B. Share Option Plans (cont.)**

**(5) Non-Employee Warrants – Israeli Banks Warrants (cont.)**

In 2010, as part of the definitive agreements with the Israeli Banks, their warrants were extended to December 2015. The cost of the extension was determined based on the difference in fair value of the warrants prior to and following the extension and amounted to a total of \$2,478.

In lieu of paying the exercise price in cash, the Israeli Banks are entitled to exercise their warrants on a “cashless” basis, i.e. by forfeiting part of the warrants in exchange for ordinary shares equal to the aggregate fair market value of the ordinary shares underlying the warrants forfeited less the aggregate exercise price.

**C. Equity-Equivalent Capital Notes**

All issued equity equivalent capital notes described in these financial statements 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. In January 2007, at the request of the Israeli Banks and TIC (the holders of the capital notes) pursuant to their right to request registration, the Company filed a registration statement with the SEC on Form F-3 for the registration of the ordinary shares underlying the capital notes. The SEC, among other comments, required that the Israeli Banks and TIC be named as underwriters for purposes of this registration statement. The Israeli Banks and TIC did not agree to be named as underwriters and in 2008 asked the Company to withdraw the registration statement. The ordinary shares underlying the capital notes remain unregistered under the US Securities Act of 1933. The equity equivalent capital notes are classified in shareholders' equity. For further information regarding the equity equivalent capital notes, see Note 12B.

**D. Treasury Stock**

During 1998, the Board authorized, subject to certain conditions, the purchase of up to 1.4 million of Tower ordinary shares to facilitate the exercise of employee stock options under Tower's share option plans. During 1999 and 1998, the Company funded the purchase by a trustee of 0.1 million and 1.2 million, respectively, 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.

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
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**NOTE 17 - SHAREHOLDERS' EQUITY (cont.)**

**F. Private Placement in Israel - November 2006**

As part of a private placement in Israel in 2006, the Company issued to Israeli investors 11.6 million ordinary shares and 5.2 million warrants ("Series 5 Warrants"). Series 5 Warrants were exercisable through December 2010, at an exercise price of NIS 9.48 linked to the CPI. Series 5 Warrants were classified as liabilities due to the exercise price denominated in NIS which is not the Company's functional currency. Series 5 Warrants expired unexercised in December 2010.

**G. Private Placement in the US - March 2007**

In March 2007, Tower completed a private placement of ordinary shares and warrants for the purchase of ordinary shares, raising a total of approximately \$29,000 in gross proceeds. In the private placement, Tower issued approximately 18.8 million shares and warrants for approximately 9.4 million ordinary shares exercisable until March 2012 at an exercise price of \$2.04 ("Series I Warrants"). This exercise price is subject to an adjustment mechanism under certain limited circumstances during a five year period. Under such circumstances, the exercise price was adjusted during 2009 to be \$0.74.

Following exercises by several investors, the Series I Warrants outstanding was approximately 3.0 million as of December 31, 2011. Following the adoption of EITF 07-5 as codified in ASC 815-40, on January 1, 2009, Series I Warrants were classified from equity to liabilities. Since Series I Warrants are carried at fair value, the changes in fair value reflect the decreased exercise price. Series I Warrants will continue to be carried at fair value due to potential exercise price adjustments.

**H. Definitive Agreement with Yorkville**

In August 2009, Tower entered into a definitive agreement with YA Global Master SPV Ltd. ("Yorkville"), according to which Yorkville committed to invest in Tower, upon Tower's request, up to \$25,000 over a period of 24 months by way of a stand-by equity-line, in consideration for ordinary shares of Tower to be issued at a 3% discount on the market price of the ordinary shares as determined in accordance with said agreement. This agreement, was amended a few times (with the last amendment in November 2010) to increase the maximum amount which Yorkville is committed to invest at Tower's request, to a current aggregate of \$95,000 and to reduce the discount on market price at which the shares are issued to 2%. During 2011, Yorkville invested in Tower an aggregate total of \$20,000 for the issuance of approximately 16 million ordinary shares. As of December 31, 2011 \$7,000 remains available for drawdown by Tower.

No warrants or any debt or derivative instruments were issued by Tower under Yorkville agreement.

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
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**NOTE 17 - SHAREHOLDERS' EQUITY (cont.)**

**I. Investment by Israeli Institutional Investors**

In September 2009, Tower raised approximately \$21,000 of gross proceeds from certain Israeli institutional investors in consideration for 22 million ordinary shares and approximately 5.3 million warrants Series 6. Warrants Series 6 were exercisable through August 2011, traded on the Tel Aviv Stock Exchange, and classified as shareholders' equity. As of August 2011, 1.8 million Warrants Series 6 were exercised and the remainder expired unexercised.

**J. Universal Registration Statement on Form F-3**

In September 2010, Tower filed a shelf registration statement on Form F-3 with the U.S. Securities and Exchange Commission, registering the possible offer and sale from time to time of up to \$50,000 of securities which Tower may elect to so offer and sell during the three years following the effective date of the registration statement. The registration form was declared effective in September 2010. As of December 31, 2011, \$22,000 was available for future utilization.

**K. Securities Issuance Pursuant to the Acquisition of TJP**

For ordinary shares issued as part of the Acquisition of TJP, see Note 3.

**NOTE 18 - INFORMATION ON GEOGRAPHIC AREAS AND MAJOR CUSTOMERS**

**A. Revenues by Geographic Area - as percentage of total sales**

	Year ended December 31,		
	2011	2010	2009
USA	78%	69%	79%
India	7	14	3
Asia Pacific*	8	8	10
Europe*	5	7	5
Israel	2	2	3
Total	100%	100%	100%

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

The basis of attributing revenues from external customers to individual countries is based on the headquarters location of the customer issuing the purchase order.

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
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**NOTE 18 - INFORMATION ON GEOGRAPHIC AREAS AND MAJOR CUSTOMERS (cont.)**

- B.** 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 TJP's long-lived assets are located in Japan.

Property and equipment, net - by Geographic Area

	As of December 31,	
	2011	2010
Israel	\$ 251,506	\$ 283,287
United States	96,672	92,038
Japan	150,505	--
Total	<u>\$ 498,683</u>	<u>\$ 375,325</u>

**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, 2011 and 2010 consist of the following customers:

	As of December 31,	
	2011	2010
Customer 1	43%	--%
Customer 2	8%	10%
Customer 3	2%	16%

**D. Major Customers - as percentage of total sales**

	Year ended December 31,		
	2011	2010	2009
Customer A	32%	--%	--%
Customer B	7	14	3
Customer C	7	9	11
Customer D	4	16	17
Other customers (*)	8	12	7

- (\*) Represents sales to two different customers accounted for 3% and 5% of sales during 2011; to two different customers accounted for 5% and 7% of sales during 2010 and to one customer accounted for 7% of sales during 2009.



**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
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**NOTE 19 - FINANCING EXPENSE, NET**

	Year ended December 31, 2011	Year ended December 31, 2010	Year ended December 31, 2009
Interest and amortization on debt, net	\$ 45,277	\$ 37,838	\$ 34,522
Changes in fair value, (total level 3 changes in fair value as reported in Note 14D)	(2,053)	7,088	(15,714)
Changes in fair value on debentures, derivatives and warrants - other than level 3 as reported in Note 14D	(3,435)	12,727	17,374
Rate exchange difference (mainly due to the effect of the NIS/USD exchange rate changes on our NIS denominated debentures)	(1,327)	5,946	4,810
Loss from notes exchange	--	2,350	--
Others	1,840	6,976	4,718
Financing expense, net	<u>\$ 40,302</u>	<u>\$ 72,925</u>	<u>\$ 45,710</u>

**NOTE 20 - INCOME TAXES**

**A. Approved Enterprise Status**

Substantially all of Tower's existing facilities and other capital investments through December 31, 2005 have been granted approved enterprise status, as provided by the Investments Law and as a result of discussions held by Tower with the Israeli Investment Center toward approval of a new expansion program since January 1, 2006, in December 2010, the Company was notified by senior governmental officials that the Israeli Investment Center Committee has approved the Company's program according to which it will receive up to NIS 150 million related to investments in fixed assets entitled for grant. The Investment Center Committee approval was followed by an official approval received in February 2011 from the Israeli Investment Center ("ktav ishur") according to which Tower may receive up to NIS 150 million during the years 2011 through 2014, related to investments in fixed assets entitled for grants. See also Note 7B.

The tax benefits derived from approved enterprise status relate only to taxable income attributable to each approved enterprise investments program. Pursuant to the Investments Law and the approval certificates, Tower's income attributable to its various approved enterprise investments is taxed at a rate of up to 20% in 2012. Taxable income attributable to the Fab 2 approved program shall be tax-exempt for the first two profitable years for tax purposes. The portion of Tower's taxable income that is not attributable to approved enterprise investments is taxed at a rate of 24% in 2011 ("Regular Company Tax").

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**NOTE 20 - INCOME TAXES (cont.)**

**A. Approved Enterprise Status (cont.)**

The tax benefits are also conditioned upon fulfillment of the requirements stipulated by the 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 7B.

**B. Income Tax provision is as follows:**

	Year Ended		
	December 31, 2011	December 31, 2010	December 31, 2009
<b>Current tax expense:</b>			
Foreign	\$ 16,645	\$ 11,188	\$ 50
<b>Total current</b>	<b>16,645</b>	<b>11,188</b>	<b>50</b>
<b>Deferred tax expense:</b>			
Foreign	4,717	1,642	(5,072)
<b>Total deferred</b>	<b>4,717</b>	<b>1,642</b>	<b>(5,072)</b>
<b>Income tax provision(benefit)</b>	<b>\$ 21,362</b>	<b>\$ 12,830</b>	<b>\$ (5,022)</b>

	Year Ended		
	December 31, 2011	December 31, 2010	December 31, 2009
<b>Profit (loss) before taxes</b>			
Domestic	\$ (47,541)	\$ (70,068)	\$ (121,003)
Foreign	50,373	40,531	(4,478)
<b>Total income (loss) before taxes</b>	<b>\$ 2,832</b>	<b>\$ (29,537)</b>	<b>\$ (125,481)</b>

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
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**NOTE 20 - INCOME TAXES (cont.)**

**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,	
	2011	2010
Net deferred tax benefit – current		
Net operating loss carryforwards	\$ 758	\$ 758
Employees benefits and compensation	5,926	2,532
Accruals, reserves and others	5,174	2,620
	<u>11,858</u>	<u>5,910</u>
Valuation allowance	(1,369)	(1,182)
Total net current deferred tax benefit	<u>\$ 10,489</u>	<u>\$ 4,728</u>
	As of December 31,	
	2011	2010
Net deferred tax benefit - long-term		
Deferred tax assets -		
Net operating loss carryforwards	\$ 256,139	\$ 256,709
Employees benefits and compensation	5,699	5,524
Research and development	2,707	1,769
Others	1,684	--
	<u>266,229</u>	<u>264,002</u>
Valuation allowance	(222,568)	(220,306)
	<u>43,661</u>	<u>43,696</u>
Deferred tax liability - depreciation and amortization	(48,721)	(33,434)
Intangible assets	(12,785)	(14,495)
Investment basis difference	--	(2,916)
Debt discount	(1,209)	--
Others	(1,374)	(2,727)
Total net long-term deferred tax liability	<u>\$ (20,428)</u>	<u>\$ (9,876)</u>

Deferred tax asset in the amounts of \$10,489 and \$4,728 as of December 31, 2011 and 2010, respectively are presented in other current assets.

Deferred tax liability in the amounts of \$20,428 and \$9,876 as of December 31, 2011 and 2010, respectively are presented in deferred tax liability.

Jazz 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, Jazz evaluates both positive and negative evidence. The 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.

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**NOTE 20 - INCOME TAXES (cont.)**

**C. Components of Deferred Tax Asset/Liability (cont.)**

On December 31, 2011 and 2010, Jazz recorded a valuation allowance against its deferred tax assets in the amounts of \$3,830 and \$3,370, respectively. Tower recorded a valuation allowance of \$220,107 and \$218,118 as of December 31, 2011 and 2010 to offset the related net deferred tax assets as Tower 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 tax benefits
Balance at January 1, 2011	\$ 14,908
Additions for tax positions of current year	8,462
Additions for tax positions of prior year	9,730
Reductions for tax positions of prior year	(723)
Balance at December 31, 2011	\$ 32,377
	Unrecognized tax benefits
Balance at January 1, 2010	\$ 10,929
Additions for tax positions of current year	4,937
Additions for tax positions of prior year	249
Reductions for tax positions of prior year	(1,207)
Balance at December 31, 2010	\$ 14,908

Jazz accounts for its uncertain tax provisions in accordance with ASC 740. Jazz'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. On December 31, 2011, Jazz had unrecognized tax benefits of \$23,965. The amount of unrecognized tax benefit that, if recognized and realized, would affect the effective tax rate is \$19,300 as of December 31, 2011.

During the third quarter of 2011, Jazz completed an analysis on its ability to utilize net operating losses, under Section 382 of the Internal Revenue Code. The conclusion reached in the analysis was based on authority that did not meet recognition threshold as provided for in ASC 740. This position relates to net operating losses that were incurred prior to September 19, 2008. The \$9,730 increase in the gross unrecognized tax benefit has been recorded as a change to a prior year unrecognized tax benefit in the tabular rollforward above. Jazz does not anticipate a significant increase or decrease in its uncertain tax benefits within twelve months of the reporting date.

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARIES**  
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**NOTE 20 - INCOME TAXES (cont.)**

**D. Effective Income Tax Rates**

The reconciliation of the statutory tax rate to the effective tax rate is as follows:

	Year ended December 31,		
	2011	2010	2009
Tax expense (benefit) computed at statutory rates	\$ 680	\$ (7,384)	\$ (32,625)
Effect of different tax rates in different jurisdictions	10,683	7,552	6,825
Tax benefits for which deferred taxes were not recorded	7,300	17,467	23,617
State tax, net of federal benefit	96	(302)	(3,686)
Domestic Production Activities Deduction	--	(1,136)	--
Permanent differences and other, net	2,603	(3,367)	847
Income tax provision (benefit)	<u>\$ 21,362</u>	<u>\$ 12,830</u>	<u>\$ (5,022)</u>

Jazz's effective tax rate for the year ended December 31, 2011 was lower than the statutory rate primarily due to interest expense on unrecognized tax benefits and state taxes.

TJP's effective tax rate for the year ended December 31, 2011 is 42% which is similar to the relevant statutory rates in Japan as applicable to TJP.

**E. Net Operating Loss Carry forward**

On December 31, 2011, Tower had net operating loss carry forwards for tax purposes of approximately one billion USD which may be carried forward for an unlimited period of time.

The future utilization of the 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 our acquisition of Jazz Semiconductor. The second "change in ownership" event occurred on September 19, 2008, the date of the Merger with Tower. Jazz concluded that the net operating loss limitation for the change in ownership which occurred in September 2008 will be an annual utilization of \$2,100 for the use in its tax return. On December 31, 2011, Jazz had federal net operating loss carry forwards of approximately \$36,800 that will begin to expire in 2021, unless previously utilized.

On December 31, 2011, Jazz had state net operating loss carry forwards of approximately \$119,000. The state tax loss carry forwards will begin to expire in 2016, unless previously utilized.

At December 31, 2011, Jazz had combined federal and state alternative minimum tax credits of \$600. The alternative minimum tax credits do not expire.

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**NOTE 20 - INCOME TAXES (cont.)**

**F. Final Tax Assessments**

Tower possesses final tax assessments through the year 1998. In addition, the tax assessments for the years 1999-2007 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. With few exceptions, Jazz is no longer subject to U.S. federal income tax examinations for years before 2008; state and local income tax examinations before 2007; and foreign income tax examinations before 2008. 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 has not final assessments.

**NOTE 21 - RELATED PARTIES BALANCES AND TRANSACTIONS**

**A. Balances**

	<u>The nature of the relationships involved</u>	As of December 31,	
		2011	2010
Long-term investment	Equity investment in a limited partnership	\$ 20	\$ 234
Trade accounts payable	Trade accounts payable	\$ 97	\$ 33
Debentures	Debenture Series B held by TIC including interest accrued	\$ 3,303	\$ 3,123

**B. Transactions**

	<u>Description of the transactions</u>	Year Ended December 31,		
		2011	2010	2009
Cost of revenues	Purchase of services and goods from related parties of TIC	\$ 2,658	\$ 2,551	\$ 1,118
Financing expenses	Interest on Debentures Series B held by TIC	\$ 180	\$ 161	\$ 198
General and Administrative expenses	Mainly directors fees and reimbursement to directors	\$ 165	\$ 136	\$ 131
Other expense (income), net	Equity loss (profit) in a limited partnership	\$ 214	\$ (51)	\$ 23