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TOWER SEMICONDUCTOR LTD  
Form 20-F  
June 18, 2008

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

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FORM 20-F  
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ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES  
EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2007      COMMISSION FILE NUMBER: 0-24790

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

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ISRAEL  
(Jurisdiction of incorporation or organization)

RAMAT GAVRIEL INDUSTRIAL PARK  
P.O. BOX 619, MIGDAL HAEMEK, ISRAEL 23105  
(Address of principal executive offices)

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SECURITIES REGISTERED OR TO BE REGISTERED PURSUANT TO SECTION 12(B) OF THE ACT:

TITLE OF EACH CLASS	NAME OF EACH EXCHANGE ON WHICH REGISTERED
Ordinary Shares, par value New Israeli Shekels 1.00 per share	NASDAQ Global Market
Convertible Debentures	NASDAQ Capital Market

SECURITIES REGISTERED OR TO BE REGISTERED PURSUANT TO SECTION 12(G) OF THE ACT:  
None

SECURITIES FOR WHICH THERE IS A REPORTING OBLIGATION PURSUANT TO SECTION 15(D)  
OF THE ACT: None

Indicate the number of outstanding shares of each of the issuer's classes  
of capital or common stock as of the close of the period covered by the annual  
report: 124,226,116 Ordinary Shares

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

Yes       No

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

Yes       No

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

Yes [X] No [ ]

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

Large accelerated filer [ ] Accelerated filer [ ] Non-accelerated filer [X]

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

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US GAAP [X]	International Financial Reporting Standards as issued by the International Accounting Standards Board [ ]	Other [ ]
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If "Other" has been checked in response to the previous question,

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 [ ] Item 18 [X]

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

Yes [ ] No [X]

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

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Beginning with the fourth quarter of 2007, we prepare our consolidated financial statements in United States dollars and in accordance with accounting principles generally accepted in the United States of America ("US GAAP"). We recast the comparative amounts included in our financial statements and in this report to US GAAP. Prior to the fourth quarter of 2007, we prepared our financial reports in United States dollars and in accordance with generally

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accepted accounting principles in Israel ("Israeli GAAP") and provided reconciliation to US GAAP in the notes to the financial statements.

The transition to US GAAP was made as a result of Israel Accounting Standard 29, which stipulates that Israeli public companies that previously reported their financial results based on Israeli GAAP must begin reporting their financial results in accordance with International Financial Reporting Standards ("IFRS") for periods beginning on or after January 1, 2008. However, Israeli public companies that are also listed on NASDAQ are allowed to report utilizing US GAAP rather than IFRS. We elected to use US GAAP to increase transparency and comparability of our financial reports and facilitate research and analysis by shareholders, analysts and other participants in the U.S. capital markets.

All references herein to "dollars" or "\$" are to United States dollars, and all references to "Shekels" or "NIS" are to New Israeli Shekels.

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

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MICROFLASH(R) is a registered trademark of Tower

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### PART I

- ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS

Not applicable.

- ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

- ITEM 3. KEY INFORMATION

#### SELECTED FINANCIAL DATA

This section presents our selected historical financial data. You should carefully read the financial statements included in this annual report, including the notes to the financial statements. The selected data in this section is not intended to replace the financial statements.

We derived the selected statement of operations data and other financial data for the years ended December 31, 2007, 2006 and 2005, and selected balance sheet data as of December 31, 2007 and 2006 from the audited financial statements in this annual report. Those financial statements were audited by Brightman Almagor & Co., a member firm of Deloitte Touche Tohmatsu, independent registered public accounting firm. We derived the selected statement of

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operations data and other financial data for the years ended December 31, 2004 and 2003 and the selected balance sheet data as of December 31, 2005, 2004 and 2003 from our audited financial statements that are not included in this annual report, which were recast to US GAAP. Our management believes that the financial statements contain all adjustments needed to present fairly the information included therein.

	YEAR ENDED DECEMBER 31,		
	2007	2006	2005
	(IN THOUSANDS, EXCEPT PER SHARE)		
<b>STATEMENT OF OPERATIONS:</b>			
Revenues	\$ 230,853	\$ 187,438	\$ 101,991
Cost of Sales	284,771	267,520	238,358
Gross loss	(53,918)	(80,082)	(136,367)
Research and development	13,790	15,048	16,029
Marketing, general and administrative	31,604	25,831	17,418
Operating loss	(99,312)	(120,961)	(169,814)
Financing expense, net	(34,976)	(47,563)	(35,651)
Other income (expense), net	92	597	2,383
Loss for the year	\$ (134,196)	\$ (167,927)	(203,082)
Basic loss per ordinary share	\$ (1.13)	\$ (2.03)	(3.06)
<b>OTHER FINANCIAL DATA:</b>			
Depreciation and amortization	\$ 154,343	\$ 171,743	153,189

	YEAR ENDED DECEMBER 31,			
	2007	2006	2005	2004
	(IN THOUSANDS)			
<b>SELECTED BALANCE SHEET:</b>				
Cash and cash equivalents, including short-term interest-bearing deposits and designated cash	\$ 44,536	\$ 40,940	\$ 38,998	\$ 86,591
Working capital	46,711	29,973	(40,725)	5,848
Total assets	686,782	714,132	690,624	859,043
Current maturities of long-term debt and other short-term debt	--	--	21,103	--
Current maturities of convertible debentures	7,887	6,902	5,813	--
Long-term debt from banks	379,314	432,430	497,000	497,000
Convertible debentures	117,460	83,863	42,932	24,092
Long-term liabilities in respect of customers' advances	27,983	46,042	59,621	64,428
Shareholders' equity (deficit)	44,709	39,516	(29,228)	163,318
Weighted average number of ordinary shares outstanding (*)	118,857	82,581	66,371	64,633
Number of shares issued and outstanding (*)	124,226	100,752	66,932	65,700

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(\* ) Net of 1,300,000 treasury shares.

RISK FACTORS

This annual report and statements that we may make from time to time may contain forward-looking information. There can be no assurance that actual results will not differ materially from our expectations, statements or projections. Factors that could cause actual results to differ from our expectations, statements or projections include the risks and uncertainties relating to our business described below.

RISKS AFFECTING OUR BUSINESS

IF THE INVESTMENT CENTER WILL NOT APPROVE OUR REQUEST FOR AN EXPANSION PROGRAM, WE WOULD BE REQUIRED TO SEEK ALTERNATIVE FINANCING SOURCES TO CONTINUE THE RAMP-UP OF FAB 2, WHICH MAY NOT BE AVAILABLE. OUR NOT COMPLETING INVESTMENTS IN THE AMOUNT OF \$1.25 BILLION BY THE END OF 2005 MAY RESULT IN THE INVESTMENT CENTER REQUIRING US TO REPAY ALL OR A PORTION OF THE GRANTS ALREADY RECEIVED AND IF WE ARE UNABLE TO REFUND SUCH GRANTS, WE WOULD LIKELY BE UNABLE TO FUND OUR ON-GOING OPERATIONS.

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In connection with Fab 2, we received approval for grants and tax benefits from the Investment Center of the Israeli Ministry of Industry, Trade and Labor (Investment Center) under its Approved Enterprise Program. Under the terms of the approval, we were eligible to receive grants equal to 20% of up to \$1.25 billion invested in Fab 2 plant and equipment, or an aggregate of up to \$250 million. As of May 31, 2008, we received a cumulative amount of approximately \$165 million in grants from the Investment Center in relation to Fab 2. Our eligibility to receive grants was with respect to investments in Fab 2 plant and equipment made by the end of 2005. Any failure by us to meet the conditions of our grants may result in the cancellation of all or a portion of the grants and tax benefits and in the Investment Center requiring us to repay all or a portion of grants already received. In 2007, we submitted the final report in relation to the investments made through 2005 totaling \$825 million out of the entire investment plan of \$1.25 billion. The investment plan has been spread over additional years and was not completed through 2005 primarily due to the external economic conditions of worldwide markets during 2001 through 2004 and the semiconductor industry in particular following the September 11, 2001 terrorist attack as well as the outbreak of the Second Intifada (Israeli-Palestinian conflict) in September 2000 which lasted until 2003. Under Israeli law, our not completing investments in an amount of \$1.25 billion by the end of 2005 could result in a request from the Investment Center to repay all or a portion of grants already received, which has not been made. Israeli law limits the ability of the Investment Center to extend this time limitation, unless approved through an expansion plan. We have therefore been holding discussions with the Investment Center to achieve satisfactory arrangements to approve an expansion plan to commence as of January 1, 2006. On numerous occasions, we have received assurances and commitments from governmental authorities that such an expansion plan will be approved pending positive recommendation of an economical audit by the Industrial Bank of the Investment Center. In 2005, at the Investment Center's request, we submitted a revised business plan to the Investment Center and its Industrial Bank for the period commencing January 1, 2006. While the Industrial Bank of the Investment Center gave a positive recommendation, the governmental approval process has been protracted and as a result, in May 2008, we filed a petition with the Israeli

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High Court of Justice asking the Court to order that our expansion plan be brought before the relevant Israeli governmental bodies for their respective approvals without delay. During the period from January 1, 2006 through May 31, 2008, we invested approximately \$230 million in Fab 2 plant and equipment. Currently, we cannot estimate when we will receive a formal response to our request for an expansion plan to commence as of January 1, 2006 or if the Investment Center will approve our request. If the Investment Center does not approve our request for an expansion plan, we would likely be required to obtain alternative financing sources, which may not be available, in order to successfully continue the ramp-up of Fab 2. While there can be no assurance that we will obtain the Investment Center's approval for the expansion plan, we believe that the likelihood that the Investment Center would demand that we repay all or a portion of grants already received due to our not completing investments in an amount of \$1.25 billion by the end of 2005 is remote. If we would have to repay the Investment Center all or a portion of the grants already received, we would need to seek financing sources to refund the grants we received and if we do not succeed in finding such financing sources, we would likely be unable to fund our on-going operations.

IF WE DO NOT OBTAIN INVESTMENT CENTER APPROVAL FOR OUR EXPANSION PLAN OR OUR FUTURE OPERATIONS DO NOT IMPROVE OR WE DO NOT GENERATE INCREASED LEVELS OF CASH FROM OPERATIONS OR WE DO NOT RAISE ADDITIONAL FUNDING OR WE DO NOT OBTAIN FUNDS FROM OTHER SOURCES OR MARKET CONDITIONS DO NOT IMPROVE SIGNIFICANTLY, WE WOULD LIKELY BE UNABLE TO FUND OUR ON-GOING OPERATIONS.

There is no assurance that we will obtain Investment Center approval for our expansion plan (see "Risk Factors" - "If the Investment Center will not approve our request for an expansion program, we would be required to seek alternative financing sources...") or that our future operations will improve significantly or that we will generate increased levels of cash from operations or that we will succeed in raising additional funding or that we will obtain funds from other sources (including, for example, funds from a sale and lease-back of a portion of our real estate assets and/or a sale of other assets) or that market conditions (including our product prices) will improve significantly. If a portion of the above does not occur sufficiently and in a timely manner, we would likely be unable to continue the ramp up of Fab 2, and/or fund our on-going operations and/or repay our short-term and long-term debt and other liabilities, which consist mainly of banks debt, debentures, trade accounts payable and other payables. Furthermore, we can not assure you that the mitigation actions we are taking, such as cost reductions, employee layoffs and price and payment term negotiations with suppliers, will be satisfactory to overcome this position.

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IF WE WILL NOT BE IN COMPLIANCE WITH THE REPAYMENT SCHEDULE UNDER THE AMENDED FACILITY AGREEMENT AND WE ARE UNSUCCESSFUL IN NEGOTIATING A REVISED REPAYMENT SCHEDULE, OR IF WE FAIL TO MEET ANY OF THE COVENANTS AND FINANCIAL RATIOS STIPULATED IN OUR AMENDED FACILITY AGREEMENT AND OUR BANKS DO NOT WAIVE OUR NONCOMPLIANCE, WE WOULD LIKELY BE UNABLE TO FUND OUR ON-GOING OPERATIONS.

Under our amended facility agreement with Bank Hapoalim B.M. and Bank Leumi Le-Israel B.M., our banks, in the event that we will not be in compliance with the repayment schedule and we are unsuccessful in negotiating a revised repayment schedule, or if we fail to meet any of the covenants and financial ratios stipulated in our amended facility agreement and our banks do not waive our noncompliance, our banks may require us to immediately repay all loans made by them to us, plus penalties, and they would be entitled to exercise the remedies available to them under our amended credit facility, including

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enforcement of their lien against our assets. There is no assurance that our future operations will improve significantly or that we will generate increased levels of cash from operations or that we will succeed in raising additional funding or that we will obtain funds from other sources (including, for example, funds from a sale and lease-back of a portion of our real estate assets and/or a sale of other assets) or that market conditions (including our product prices) will improve significantly. If a portion of the above does not occur sufficiently and in a timely manner, we would likely be unable to comply with the repayment schedule under the amended facility agreement and we would likely fail to meet covenants and financial ratios stipulated in it. This would have a material adverse effect on our company and we would likely be unable to fund our on-going operations unless the banks agree to a revised repayment schedule or to waive our non-compliance.

IF WE DO NOT FULLY EQUIP FAB 2 AND COMPLETE THE EQUIPMENT INSTALLATION, AND RAMP-UP OF PRODUCTION IN FAB 2 TO ITS FULL CAPACITY, WE WILL NOT FULLY UTILIZE THE SUBSTANTIAL INVESTMENT MADE IN THE CONSTRUCTION OF FAB 2.

Fab 2 production capacity as of December 31, 2007 was approximately 24,000 wafers per month. During 2008, we are implementing a capacity increase plan targeting to reach up to approximately 30,000 wafers per month, which has not yet been completed. Depending on the process technology and product mix, when fully ramped-up, we estimate that Fab 2 will be able to achieve capacity levels of approximately 44,000 wafers per month. Our determination as to the timing of the implementation of the ramp-up of Fab 2 and the increase in Fab 2's production levels is dependent on prevailing and forecasted market conditions and our ability to fund these increases. There can be no assurance as to the timing or our ability to achieve Fab 2 capacity levels of approximately 44,000 wafers per month. The ramp-up of Fab 2 is a substantial and complex project. If we cannot fund the further ramp-up of Fab 2 or otherwise successfully complete the ramp-up of Fab 2, we may be unable to meet our customers' production demands and as a result we may lose customers and may not attract new ones. In addition, if we do not acquire and install the equipment necessary to successfully complete the ramp-up of Fab 2, we will not fully utilize the substantial investment made in constructing Fab 2, which will adversely affect our financial results. In order to fully ramp-up Fab 2, we will need to continue to develop new process technologies in order to suit our customers' needs. In addition, we have and may in the future experience difficulties that are customary in the installation, functionality and operation of equipment during manufacturing. Failures or delays in obtaining and installing the necessary equipment, technology and other resources may delay the completion of the ramp-up of Fab 2, add to its cost and result in us not fully utilizing the substantial investment made in the construction of Fab 2, which would adversely affect our future financial results.

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THE CYCLICAL NATURE OF THE SEMICONDUCTOR INDUSTRY AND THE RESULTING PERIODIC OVERCAPACITY HAVE ADVERSELY AFFECTED OUR BUSINESS IN THE PAST, RESULTING IN A HISTORY OF LOSSES; DOWNWARD PRICE PRESSURE MAY SERIOUSLY HARM OUR BUSINESS.

The semiconductor industry has historically been highly cyclical. Historically, companies in the semiconductor industry have expanded aggressively during periods of increased demand. This expansion has frequently resulted in overcapacity and excess inventories, leading to rapid erosion of average sale prices. We expect this pattern to repeat itself in the future. The overcapacity and downward price pressure characteristic of a prolonged downturn in the semiconductor market may not allow us to operate at a profit, even at full utilization, and could seriously harm our financial results and business.



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OUR OPERATING RESULTS FLUCTUATE FROM QUARTER TO QUARTER WHICH MAKES IT DIFFICULT TO PREDICT OUR FUTURE PERFORMANCE.

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

- o The cyclical nature of both the semiconductor industry and the markets served by our customers;
  - o Changes in the economic conditions of geographical regions where our customers and their markets are located;
  - o Shifts by integrated device manufacturers (IDMs) and customers between internal and outsourced production;
  - o Inventory and supply chain management of our customers;
  - o The loss of a key customer, postponement of an order from a key customer. The rescheduling or cancellation of large orders
  - o The occurrence of accounts receivables write-offs, failure of a key customer to pay accounts receivables in a timely manner or the financial condition of our customers;
  - o The rescheduling or cancellation of planned capital expenditures;
  - o Our ability to satisfy our customers' demand for quality and timely production;
  - o The timing and volume of orders relative to our available production capacity;
  - o Our ability to obtain raw materials and equipment on a timely and cost-effective basis;
  - o Environmental events or industrial accidents such as fires or explosions;
  - o Our susceptibility to intellectual property rights disputes;
  - o Our ability to continue with existing and to enter into new partnerships and technology and supply alliances on mutually beneficial terms;
  - o Actual capital expenditures exceeding planned capital expenditures;
  - o Interest, price index and currency rate fluctuations that may not be adequately hedged;
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- o Technological changes and short product life cycles;
  - o Timing for designing and the qualification of new products; and
  - o New accounting rules affecting our results including the accounting

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treatment of our bank debt and convertible debentures.

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

THE LACK OF A SIGNIFICANT BACKLOG RESULTING FROM OUR CUSTOMERS NOT PLACING PURCHASE ORDERS FAR IN ADVANCE MAKES IT DIFFICULT FOR US TO FORECAST OUR REVENUES IN FUTURE PERIODS.

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

WE OCCASIONALLY MANUFACTURE WAFERS BASED ON FORECASTED DEMAND, RATHER THAN ACTUAL ORDERS FROM CUSTOMERS. IF OUR FORECASTED DEMAND EXCEEDS ACTUAL DEMAND IT WE MAY HAVE OBSOLETE INVENTORY, WHICH COULD HAVE A NEGATIVE IMPACT ON OUR RESULTS OF OPERATIONS

We initiate production of a majority of our wafers once we have received an order from a customer. We generally do not manufacture wafers unless we receive a customer purchase order. On occasion, we may produce wafers in excess of customer orders based on forecasted customer demand, because we may forecast future excess or because of future capacity constraints. If we manufacture more wafers than are actually ordered by customers, we may be left with excess inventory that may ultimately become obsolete and must be scrapped when it cannot be sold. Significant amounts of obsolete inventory could have a negative impact on our results of operations.

WE HAVE A HISTORY OF OPERATING LOSSES AND EXPECT TO OPERATE AT A LOSS FOR THE FORESEEABLE FUTURE; OUR FACILITIES MUST OPERATE AT HIGH UTILIZATION RATES AND WE MUST INCREASE OUR CAPACITY LEVELS IN ORDER TO REDUCE OUR LOSSES.

We have operated at a loss for the last number of years. Because fixed costs represent a substantial portion of the operating costs of semiconductor manufacturing operations, we must operate our facilities at high utilization rates for us to reduce our losses. In addition, to reduce our losses, we must increase our capacity levels. We began construction of Fab 2 in 2001 and Fab 2 operations began in 2003. Our losses since 2003 are due primarily to significant depreciation and amortization expenses related mainly to Fab 2, as well as financing and operating expenses that have not yet been offset by a sufficient increase in the level of our revenues. If we do not succeed in operating our facilities at high utilization rates and in increasing our capacity levels, we expect to continue to operate at a loss for the foreseeable future, which may adversely affect our business and company.

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OUR SALES CYCLES ARE TYPICALLY LONG AND ORDERS RECEIVED MAY NOT MEET OUR EXPECTATIONS, WHICH MAY ADVERSELY AFFECT OUR OPERATING RESULTS.

Our sales cycles, which we measure from first contact with a customer to first shipment of product ordered by the customer, vary substantially and may last as long as two years or more, particularly for new technologies. In addition, even after we make initial shipments of prototype products, it may take several more months to reach full production of the product. As a result of these long sales cycles, we may be required to invest substantial time and incur significant expenses in advance of the receipt of any product order and related revenue. If orders ultimately received differ from our expectations with respect to the product, volume, price or other items, our operating results, financial condition and ability to maintain our operations may be adversely affected.

DEMAND FOR OUR FOUNDRY SERVICES IS DEPENDENT ON THE DEMAND IN OUR CUSTOMERS' END MARKETS.

We are ramping-up Fab 2 based on our expectations of customer demand and our financial resources. In order for demand for our wafer fabrication services to increase, the markets for the end products using these services must develop and expand. For example, the success of our imaging process technologies will depend, in part, on the growth of markets for certain image sensor product applications. Because our services may be used in many new applications, it is difficult to forecast demand. If demand is lower than expected, we may have excess capacity, which may adversely affect our financial results. If demand is higher than expected, we may be unable to fill all of the orders we receive, which may result in the loss of customers and revenue.

IF WE DO NOT MAINTAIN OUR CURRENT CUSTOMERS AND ATTRACT ADDITIONAL CUSTOMERS, OUR BUSINESS MAY BE ADVERSELY AFFECTED.

During the three months ended March 31, 2008, approximately 66% of our business was generated by five significant customers that contributed 20%, 18%, 15%, 7% and 6% of our revenue, respectively. We expect to continue to receive a significant portion of our revenue from a limited number of customers for the foreseeable future. Loss or cancellation of business from, or decreases in the sales volume or sales prices to, our significant customers, could seriously harm our financial results, revenue and business. Since the sales cycle for our services typically exceeds one year, if our customers order significantly fewer wafers than forecasted, we will have excess capacity that we may not be able to sell in a short period of time, resulting in lower utilization of our facilities. We may have to reduce prices in order to try to sell the excess capacity. In addition to the revenue loss that could result from unused capacity or lower sales prices, we might have difficulty adjusting our costs to reflect the lower revenue in a timely manner, which could harm our financial results.

WE DEPEND ON A RELATIVELY SMALL NUMBER OF PRODUCTS FOR A SIGNIFICANT PORTION OF OUR REVENUES.

From time to time, a significant portion of our revenue is generated from a small number of very high volume products that are shipped to volatile consumer-oriented markets. The volume of orders of such products may adversely change or demand for such products may be abruptly discontinued. We expect that for the foreseeable future we will continue to be dependent upon a relatively limited number of products for a significant portion of our revenue due to the nature of our business. A decrease in the price of, or demand for, any of these products could negatively impact our financial results.

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IF WE DO NOT RECEIVE ORDERS FROM OUR CUSTOMERS WITH WHOM WE HAVE SIGNED LONG-TERM CONTRACTS, WE MAY HAVE EXCESS CAPACITY.

We have committed a portion of our capacity for future orders to our wafer partners and customers with whom we have signed long-term contracts. Parties to whom we have committed capacity are generally not obligated to utilize or pay for all or any portion of their allocated capacity, and generally provide and confirm their orders to us less than one month before the production start date. If these parties do not place orders with us in accordance with their contractual loading and purchase commitments, and if we are unable to fill such unutilized capacity, our financial results may be adversely affected.

IF WE DO NOT MAINTAIN AND DEVELOP OUR TECHNOLOGY PROCESSES AND SERVICES, WE WILL LOSE CUSTOMERS AND MAY NOT BE ABLE TO ATTRACT NEW ONES.

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

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

Our ability to maintain our current customer base and attract new customers is dependent in part on our ability to continuously develop and introduce to production advanced specialized manufacturing process technologies. Since the successful development and introduction to production of these processes may not be achieved in a timely manner or at all, we may not be able to maintain our current customer base and may not be able to attract new customers.

IF WE DO NOT COMPETE EFFECTIVELY, WE WILL LOSE BUSINESS TO OUR COMPETITORS.

The semiconductor foundry industry is highly competitive. We compete with more than ten independent dedicated foundries, the majority of which are located in Asia-Pacific, including foundries based in Taiwan, China, Korea and Malaysia, and with over 20 integrated semiconductor and end-product manufacturers that allocate a portion of their manufacturing capacity to foundry operations. The foundries with which we compete benefit from their close proximity to other companies involved in the design and manufacture of integrated circuits, or ICs. In addition, many of our competitors may have one or more of the following competitive advantages over us:

- o greater manufacturing capacity;
- o multiple and more advanced manufacturing facilities;
- o more advanced technological capabilities;

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- o a more diverse and established customer base;

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- o greater financial, marketing, distribution and other resources;
- o a better cost structure; and/or
- o better operational performance in cycle time and yields.

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

WE HAVE A LARGE AMOUNT OF DEBT WHICH COULD HAVE SIGNIFICANT NEGATIVE CONSEQUENCES.

We have a large amount of long-term debt and may incur additional indebtedness, which could have significant negative consequences. As of May 31, 2008, we had (i) approximately \$399 million of bank debt under our amended credit facility agreement and September 2007 credit lines with the banks, (ii) \$30 million outstanding under the September 2007 credit line with TIC and (iii) approximately \$180 million of debt in respect of outstanding convertible and non-convertible debentures, including approximately \$10 million short term convertible debt. Our current and future indebtedness could have significant negative consequences, including:

- o requiring the dedication of a substantial portion of our expected cash flow from operations to service our indebtedness;
- o increasing our vulnerability to general adverse economic and industry conditions;
- o limiting our ability to obtain additional financing;
- o limiting our flexibility in planning for, or reacting to, changes in our business and the industry in which we compete;
- o placing us at a competitive disadvantage to less leveraged competitors and competitors that have better access to capital resources; and/or
- o affecting our ability to make interest payments and other required debt service on our indebtedness.
- o enforcement by the banks of their lien against our assets (in the event of default).

WE MAY INCUR ADDITIONAL INDEBTEDNESS.

Although we are limited by the covenants in our amended credit facility agreement with our banks, we could enter into certain transactions that would increase the amount of our outstanding indebtedness. If new indebtedness is added to our current indebtedness levels, the related risks, including the negative consequences associated with our increased level of indebtedness, could intensify.

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ISRAELI BANKING LAWS MAY IMPOSE RESTRICTIONS ON THE TOTAL DEBT THAT WE MAY BORROW FROM OUR BANKS.

Pursuant to a directive published by the Israel Supervisor of Banks, effective March 31, 2004, we may be deemed part of a group of borrowers comprised of the Ofer Brothers Group, Israel Corp., and other companies which are also included in such group of borrowers pursuant to the directive,

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including companies under the control or deemed control of these entities. The directive imposes limitations on amounts that banks may lend to borrowers or groups of borrowers. Should our banks exceed these limitations, they may limit our ability to borrow other money in the future and may require us to return some or all of our outstanding borrowings (which, under our amended credit facility agreement and our September 2007 credit lines with our banks, were approximately \$399 million in the aggregate as of May 31, 2008), which may have a material adverse effect on our business, financial condition and results of operations.

IF WE EXPERIENCE DIFFICULTY IN ACHIEVING ACCEPTABLE DEVICE YIELDS, PRODUCT PERFORMANCE AND DELIVERY TIMES AS A RESULT OF MANUFACTURING PROBLEMS, OUR BUSINESS WILL BE ADVERSELY AFFECTED.

The process technology for the manufacture of semiconductor wafers is highly complex, requires advanced and costly equipment and is constantly being modified in an effort to improve device yields, product performance and delivery times. Microscopic impurities such as dust and other contaminants, difficulties in the production process, defects in the key materials and tools used to manufacture a wafer and other factors can cause wafers to be rejected or individual semiconductors on specific wafers to be non-functional. We have from time to time experienced production difficulties that have caused delivery delays or returns and lower than expected device yields. We may also experience difficulty achieving acceptable device yields, product performance and product delivery times in the future as a result of manufacturing problems. Any of these problems could seriously harm our operating results, financial condition and ability to maintain our operations.

IF WE ARE UNABLE TO PURCHASE EQUIPMENT AND RAW MATERIALS, WE MAY NOT BE ABLE TO MANUFACTURE OUR PRODUCTS IN A TIMELY FASHION, WHICH MAY RESULT IN A LOSS OF EXISTING AND POTENTIAL NEW CUSTOMERS.

To complete the ramp-up of our Fab 2 facility and to maintain the quality of production in our facilities, we must procure additional equipment. In periods of high market demand, the lead times from order to delivery of manufacturing equipment could be as long as 12 to 18 months. In addition, our manufacturing processes use many raw materials, including silicon wafers, chemicals, gases and various metals, and require large amounts of fresh water and electricity. Manufacturing equipment and raw materials generally are available from several suppliers. In many instances, however, we purchase equipment and raw materials from a single source. Shortages in supplies of manufacturing equipment and raw materials could occur due to an interruption of supply or increased industry demand. Any such shortages could result in production delays that could have a material adverse effect on our business and financial condition.

OUR EXPOSURE TO INFLATION AND CURRENCY EXCHANGE AND INTEREST RATE FLUCTUATIONS MAY INCREASE OUR COST OF OPERATIONS.

Almost all of our cash generated from operations and our financing and investing activities is denominated in US dollars and New Israeli Shekels, or NIS. Our expenses and costs are denominated in NIS, US dollars, Japanese Yen and Euros. We are, therefore, exposed to the risk of currency exchange rate fluctuations.

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The dollar amount of our operations, which is denominated in NIS, is influenced by the timing of any change in the rate of inflation in Israel and

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the extent to which such change is not offset by the change in valuation of the NIS in relation to the US dollar. Outstanding principal and interest on some of our debentures is linked to the Israeli consumer price index (CPI) and therefore, our dollar costs will increase if inflation in Israel exceeds the devaluation of the NIS against the US dollar, or if the timing of such devaluation lags behind inflation in Israel. The recent devaluation of the US dollar in relation to the NIS increased our dollar expenses related to our NIS denominated debentures and our NIS denominated expenses.

Our borrowings under our Fab 2 credit facilities [and our and our September 2007 credit lines] provide for interest based on a floating LIBOR rate, thereby exposing us to interest rate fluctuations. Furthermore, if our banks incur increased costs in financing our Fab 2 credit facility due to changes in law or the unavailability of foreign currency, our banks may exercise their right to increase the interest rate on our Fab 2 credit facilities as provided for in the credit facility agreement.

We regularly engage in various hedging strategies to reduce our exposure to some, but not all, of these risks and intend to continue to do so in the future. However, despite any such hedging activity, we are likely to remain exposed to interest rate and exchange rate fluctuations and inflation, which may increase the cost of our operating and financing activities.

WE DEPEND ON INTELLECTUAL PROPERTY RIGHTS OF THIRD PARTIES AND FAILURE TO MAINTAIN OR ACQUIRE LICENSES COULD HARM OUR BUSINESS.

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

FAILURE TO COMPLY WITH THE INTELLECTUAL PROPERTY RIGHTS OF THIRD PARTIES OR TO DEFEND OUR INTELLECTUAL PROPERTY RIGHTS COULD HARM OUR BUSINESS.

Our ability to compete successfully depends on our ability to operate without infringing on the proprietary rights of others and defending our intellectual property rights. Because of the complexity of the technologies used and the multitude of patents, copyrights and other overlapping intellectual property rights, it is often difficult for semiconductor companies to determine infringement. Therefore, the semiconductor industry is characterized by frequent litigation regarding patent, trade secret and other intellectual property rights. There are no lawsuits currently pending against us regarding the infringement of patents or intellectual property rights of others nor are we currently a plaintiff in any such action against other parties. However, we have been subject to such claims in the past, all of which have been resolved through license agreements, the terms of which have not had a material effect on our business.

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Because of the nature of the industry, we may continue to be a party to infringement claims in the future. In the event any third party were to assert

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infringement claims against us or our customers, we may have to consider alternatives including, but not limited to:

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

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

As of May 31, 2008, we held 67 patents worldwide. We intend to continue to file patent applications when appropriate. The process of seeking patent protection may take a long time and be expensive. We cannot assure you that patents will be issued from pending or future applications or that, if patents are issued, they will not be challenged, invalidated or circumvented or that the rights granted under the patents will provide us with meaningful protection or any commercial advantage. In addition, we cannot assure you that other countries in which we market our services and products will protect our intellectual property rights to the same extent as the United States. Further, we cannot assure you that we will at all times enforce our patents or other intellectual property rights or that courts will uphold our intellectual property rights, or enforce the contractual arrangements that we have entered into to protect our proprietary technology, which could reduce our opportunities to generate revenues.

WE COULD BE SERIOUSLY HARMED BY FAILURE TO COMPLY WITH ENVIRONMENTAL REGULATIONS.

Our business is subject to a variety of laws and governmental regulations in Israel relating to the use, discharge and disposal of toxic or otherwise hazardous materials used in our production processes. If we fail to use, discharge or dispose of hazardous materials appropriately, or if applicable environmental laws or regulations change in the future, we could be subject to substantial liability or could be required to suspend or adversely modify our manufacturing operations.

WE ARE SUBJECT TO THE RISK OF LOSS DUE TO FIRE BECAUSE THE MATERIALS WE USE IN OUR MANUFACTURING PROCESSES ARE HIGHLY FLAMMABLE.

We use highly flammable materials such as silane and hydrogen in our manufacturing processes and are therefore subject to the risk of loss arising from fires. The risk of fire associated with these materials cannot be completely eliminated. We maintain insurance policies to reduce losses caused by



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fire, including business interruption insurance. If any of our fabs were to be damaged or cease operations as a result of a fire, or if our insurance proves to be inadequate, it would reduce our manufacturing capacity and revenues.

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### POSSIBLE PRODUCT RETURNS COULD HARM OUR BUSINESS.

Products manufactured by us may be returned within specified periods if they are defective or otherwise fail to meet customers' prior agreed upon specifications. Product returns in excess of established provisions, if any, may have an adverse effect on our business and financial condition.

### WE MAY BE REQUIRED TO REPAY GRANTS TO THE INVESTMENT CENTER THAT WE RECEIVED IN CONNECTION WITH FAB 1.

We received grants and tax benefits for Fab 1 under the government of Israel Approved Enterprise program. As of December 31, 2001, we completed our investments under our Fab 1 program and are no longer entitled to any further investment grants for future capital investments in Fab 1. We have agreed with the Investment Center that if we do not achieve Fab 1 revenues of \$90 million for 2003 and \$100 million for 2004 and maintain at Fab 1 at least 600 employees for 2003 and 625 employees for 2004, subject to prevailing market conditions, we will, if demanded by the Investment Center, be required to repay the Investment Center up to approximately \$2.5 million. Since our actual level of Fab 1 revenues and employees for 2003 and 2004 were not in compliance with the above mentioned levels, we may be required to repay the Investment Center up to approximately \$2.5 million.

### WE ARE SUBJECT TO RISKS RELATED TO OUR INTERNATIONAL OPERATIONS.

We have made substantial sales to customers located in Asia-Pacific and in Europe. Because of our international operations, we are vulnerable to the following risks:

- o we price our products primarily in US dollars; if the Euro, Yen or other currencies weaken relative to the US dollar, our products may be relatively more expensive in these regions, which could result in a decrease in our revenue;
- o the need to comply with foreign government regulation;
- o general geopolitical risks such as political and economic instability, potential hostilities and changes in diplomatic and trade relationships;
- o natural disasters affecting the countries in which we conduct our business;
- o reduced sales to our customers in Asia Pacific that may arise from regional issues in Asia;
- o imposition of regulatory requirements, tariffs, import and export restrictions and other barriers and restrictions;
- o adverse tax rules and regulations;
- o weak protection of our intellectual property rights; and

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- o delays in product shipments due to local customs restrictions.

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OUR BUSINESS COULD SUFFER IF WE ARE UNABLE TO RETAIN AND RECRUIT QUALIFIED PERSONNEL.

We depend on the continued services of our executive officers, senior managers and skilled technical and other personnel. Our business could suffer if we lose the services of some of these personnel and we cannot find and adequately integrate replacement personnel into our operations in a timely manner. We seek to recruit highly qualified personnel and there is intense competition for the services of these personnel in the semiconductor industry. Competition for personnel may increase significantly in the future as new fabless semiconductor companies as well as new semiconductor manufacturing facilities are established. Our ability to retain existing personnel and attract new personnel is in part dependent on the compensation packages we offer. As demand for qualified personnel increases, we may be forced to increase the compensation levels and to adjust the cash, equity and other components of compensation we offer our personnel.

WE MAY NOT BE ABLE TO CONSUMMATE AND INTEGRATE THE JAZZ TECHNOLOGIES, INC. ACQUISITION.

We have entered into an agreement and plan of merger and reorganization to acquire Jazz Technologies, Inc. The merger is subject to a number of conditions, which are beyond our control and that may prevent, delay or otherwise materially adversely affect its completion. We cannot predict whether and when these conditions will be satisfied and we may fail to obtain the necessary approvals to consummate the acquisition. Further, the requirements for obtaining the required clearances and approvals could delay the completion of the merger for a significant period of time or prevent it from occurring. Any delay in completing the merger may significantly reduce the synergies and other benefits that Tower and Jazz expect to achieve if they successfully complete the merger within the expected time frame and integrate their respective businesses. In addition, the acquisition involves other known and unknown risks that could adversely affect our future revenues and operating results. For example:

- o The acquisition may divert management's attention away from our primary product offerings, resulting in the loss of key customers and/or personnel and exposing us to unanticipated liabilities.
- o We may fail to successfully integrate the acquisition in accordance with our business strategy.
- o We may not be able to retain the skilled employees and experienced management that may be necessary to operate the businesses we are acquiring and, if we cannot retain such personnel, we may not be able to attract new skilled employees and experienced management to replace them.
- o Jazz Technologies, Inc. may have undisclosed contingent liabilities, including, among others, known or unknown intellectual property infringement, environmental liabilities or product liability claims. Before the merger with Jazz technologies, Inc. we, our independent auditors and our legal counsel conducted due diligence on Jazz Technologies, Inc. customary and appropriate for a merger transaction. However, the due diligence process may not have revealed all material liabilities of Jazz technologies, Inc. currently existing or which may

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be asserted in the future against us relating to Jazz technologies, Inc. activities before the consummation of the merger.

### RISKS RELATED TO OUR SECURITIES

#### OUR STOCK PRICE MAY BE VOLATILE IN THE FUTURE.

The stock market, in general, has experienced extreme volatility that often has been unrelated to the operating performance of particular companies. In particular, the stock prices for many companies in the semiconductor industry have experienced wide fluctuations, which have often been unrelated to the operating performance of such companies. These broad market and industry fluctuations may adversely affect the market price of our ordinary shares, regardless of our actual operating performance.

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In addition, it is possible that in some future periods our operating results may be below the expectations of public market analysts and investors. In this event, the price of our securities may under perform or fall.

ISSUANCE OF ADDITIONAL SHARES PURSUANT TO OUR FAB 2 FINANCING PLANS AND ARRANGEMENTS AND THE TERMS OF OUTSTANDING SECURITIES WHICH ARE EXERCISABLE OR CONVERTIBLE INTO SHARES MAY DILUTE THE INTEREST OF OUR SHAREHOLDERS. WE MAY ALSO ISSUE IN THE FUTURE ADDITIONAL SHARES AND/OR SECURITIES WHICH ARE EXERCISABLE OR CONVERTIBLE INTO SHARES.

As of May 31, 2008, we had approximately 125.4 million ordinary shares outstanding and have outstanding securities convertible or exercisable into up to approximately 245.6 million ordinary shares including: (i) up to 25.3 million ordinary shares issuable upon the conversion of our 2005 outstanding convertible debentures held by some of our major shareholders and others at a conversion rate of \$1.10; (ii) 8.3 million warrants issued to our banks with an exercise price of \$1.21; (iii) up to 24.2 million ordinary shares issuable upon the conversion of our 2006 outstanding convertible debentures at a conversion rate of approximately \$2.5; (iv) 17.5 million warrants with an exercise price of \$2.04; (v) 5.2 million warrants with an exercise price of approximately \$2.8; (vi) 32.7 million employee and director options with a weighted average exercise price of \$1.72; (vii) 5.5 million warrants with an exercise price of approximately \$2.2; and (viii) 7.4 million ordinary shares issuable upon the conversion of our 2007 convertible debentures, at a conversion rate of approximately \$5.2. Additionally, in September 2006, we issued equity equivalent capital notes to our banks and to Israel Corp., which are convertible for no additional consideration, into approximately 52 million and 65.8 million of our ordinary shares, respectively.

In May 2008 we entered into a definitive agreement with Jazz Technologies, Inc. to acquire its shares in a stock-for-stock transaction in which we expect to issue approximately 34.3 million shares and reserve for future issuance upon the exercise or conversion of outstanding Jazz options, warrants and senior convertibles notes, an additional approximately 96.5 million shares.

In January 2008, we filed a shelf registration statement on Form F-3 with the U.S. Securities and Exchange Commission, which was declared effective in February 2008, registering the possible offer and sale from time to time of up to \$40 million of securities.

Following the reduction of the interest rate applicable to the quarterly actual interest payments on our outstanding loans to our banks following the

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closing of the September 2006 amendment to our facility agreement, we have agreed to issue shares or convertible securities to our banks in January 2011, calculated based on the amount of decreased interest payments as set forth in the amendment and our share price in the forth quarter of 2010.

We may undertake additional financings in the future and in connection therewith we may issue shares or securities convertible into shares, which may materially dilute the holdings of our current shareholders.

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MARKET SALES OF LARGE AMOUNTS OF OUR SHARES ELIGIBLE FOR FUTURE SALE, OR EVEN THE PERCEPTION THAT SUCH SALES MAY OCCUR, MAY LOWER THE PRICE OF OUR ORDINARY SHARES.

Of our approximately 125.4 million outstanding ordinary shares as of May 31, 2008, approximately 86.5 million are held by non-affiliates and are freely tradable under US securities laws. In addition, certain of our affiliates (Israel Corp., SanDisk Corporation and Macronix International) hold approximately 38.9 million of our outstanding shares, of which (i) approximately 3.3 million are registered for resale and are therefore freely tradable under US securities laws, and (ii) approximately 35.6 million are currently eligible for sale subject to the volume and manner of sale limitations of Rule 144 promulgated under the US Securities Act of 1933, as amended ("Rule 144"). As of May 31, 2008, up to approximately 25.3 million additional shares issuable upon the conversion of our 2005 convertible debentures beneficially owned by non-affiliates or are registered for sale and are freely tradable under US securities laws and approximately 5.4 million shares issuable upon exercise of warrants issued to Israel Corp. and our banks will become eligible for sale commencing six months after exercise of the warrants, subject, in the case of Israel Corp. and, if deemed "affiliates" of our company, the banks, to the volume and manner of sale limitations of Rule 144. Approximately 65.8 million shares underlying Israel Corp.'s equity equivalent convertible capital notes are freely tradable subject to volume and manner of sale requirements of Rule 144. In addition, (i) approximately 9.2 million shares issuable upon the exercise of warrants we granted to our banks and (ii) approximately 9.4 million shares issuable upon exercise of warrants issued in our March 2007 private placement, are registered for resale and are therefore freely tradable under US securities laws. Additionally, up to: (i) approximately 29.7 million shares issuable upon the conversion and/or exercise of the securities sold in our June 2006 public offering in Israel, (ii) approximately 5.2 million shares issuable upon exercise of warrants sold in private placements completed in November 2006 and (iii) the additional up to approximately 10.1 million ordinary shares which are issuable upon the conversion and/or exercise of warrants sold in our June 2007 private placement and September 2007 public offering in Israel, would be freely tradable in normal trading transactions in the United States. We have filed a registration statement covering the resale of an additional up to approximately 52 million shares issuable upon the conversion of equity equivalent convertible capital notes issued to our banks and if declared effective, such shares would be freely tradable under US securities laws. In January 2008, we filed a shelf registration statement, which was declared effective in February 2008, registering the possible offer and sale from time to time of up to \$40 million of securities which we may elect to offer and sell during the three years following February 2008. Furthermore, as part of the definitive merger agreement with Jazz Technologies, Inc., we undertook to file a registration statement in connection with the shares to be issued in the transaction and the shares that may be issued in the future upon the exercise of Jazz options, warrants and senior convertibles notes. The sales of large amounts of our ordinary shares (or the potential for those sales even if they do not actually occur) may depress

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the market price of our ordinary shares. This could also impair our ability to raise capital through the sale of our equity securities.

OUR PRINCIPAL SHAREHOLDERS COLLECTIVELY OWN A CONTROLLING INTEREST IN US AND WILL BE ABLE TO EXERCISE THEIR VOTING RIGHTS IN WAYS WHICH MAY BE ADVERSE TO THE INTERESTS OF OUR OTHER SHAREHOLDERS.

As of May 31, 2008, our major wafer partners and Israel Corp. collectively owned approximately 31% of our outstanding shares. In the event Israel Corp. were to convert its equity convertible capital notes, our major wafer partners and Israel Corp. would collectively own approximately 55% of our outstanding shares. Under our articles of association, two shareholders holding together 33% of our outstanding shares constitute a quorum for conducting a shareholders' meeting. If Israel Corp. were to convert its equity convertible capital notes, our wafer partners and Israel Corp. would constitute a quorum for purposes of conducting a shareholders' meeting. If only two large shareholders, owning collectively at least 33% of our shares, were to participate in one of our shareholders' meetings, these shareholders would determine the outcome of our shareholders' meeting without the benefit of the participation of our other shareholders. The interests of these shareholders may not be consistent with the interests of our other shareholders. As a result, these shareholders may exercise voting rights or otherwise influence corporate action in ways that are adverse to the interests of our other shareholders.

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THE PAYMENT OF THE REDEMPTION AMOUNT ON ACCOUNT OF OUR OUTSTANDING DEBENTURES IS SUBORDINATED TO OUR INDEBTEDNESS TO OUR BANKS AND OBLIGATIONS TO SECURED CREDITORS.

The payment of the redemption amount on account of our outstanding debentures is subordinated to the prior payment of approximately \$399 million in the aggregate payable by us to our banks under our amended credit facility agreement and our September 2007 credit lines with them, to any obligations to the Investment Center of the Israeli Ministry of Industry, Trade and Labor related to approximately \$165 million in grants received as of May 31, 2008 under the Investment Center's "Approved Enterprise" program in relation to Fab 2, and to a first ranking charge in favor of SanDisk Corporation, on approximately \$10 million of equipment purchased in connection with the performance of our obligations under our agreement with SanDisk Corporation. As a result, upon any distribution to our creditors in liquidation or reorganization or similar proceedings, these secured creditors will be entitled to be paid in full before any payment may be made with respect to our outstanding debentures. In any of these circumstances, we may not have sufficient assets remaining to pay amounts due on any or all of our debentures then outstanding. In addition, we are not permitted under the terms of our credit facility agreement to make a payment on account of the debentures if on the date of such payment an "Event of Default" exists under our credit facility agreement.

### RISKS RELATED TO OUR OPERATIONS IN ISRAEL

INSTABILITY IN ISRAEL MAY HARM OUR BUSINESS.

All of our manufacturing facilities and our corporate and some of our sales offices are located in Israel. Accordingly, political, economic and military conditions in Israel may directly affect our business.

Since the establishment of the State of Israel in 1948, a number of armed

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conflicts have taken place between Israel and its Arab neighbors, as well as incidents of civil unrest. In addition, Israel and companies doing business with Israel have, in the past, been the subject of an economic boycott. Although Israel has entered into various agreements with Egypt, Jordan and the Palestinian Authority, Israel has been and is subject to civil unrest and terrorist activity, with varying levels of severity. Parties with whom we do business have sometimes declined to travel to Israel during periods of heightened unrest or tension, forcing us to make alternative arrangements where necessary. In addition, the political and security situation in Israel may result in parties with whom we have agreements claiming that they are not obligated to perform their commitments under those agreements pursuant to force majeure provisions. We can give no assurance that security and political conditions will not adversely impact our business in the future. Any hostilities involving Israel or the interruption or curtailment of trade between Israel and its present trading partners could adversely affect our operations and could make it more difficult for us to raise capital. Furthermore, our manufacturing facilities are located exclusively in Israel, which has been experiencing civil unrest, terrorist activity and military action. We could experience serious disruption of our manufacturing if acts associated with this conflict result in any serious damage to our manufacturing facilities. In addition, our business interruption insurance may not adequately compensate us for losses that may occur, and any losses or damages incurred by us could have a material adverse effect on our business.

OUR OPERATIONS MAY BE NEGATIVELY AFFECTED BY THE OBLIGATIONS OF OUR PERSONNEL TO PERFORM MILITARY SERVICE.

In the event of severe unrest or other conflict, individuals could be required to serve in the military for extended periods of time. In response to increases in terrorist activity, there have been periods of significant call-ups of military reservists, and it is possible that there will be additional call-ups in the future. A large part of male Israeli citizens, including our employees, are subject to compulsory military reserve service through middle age. Our operations could be disrupted by the absence for a significant period of time of one or more of our key employees or a significant number of our other employees due to military service. Such disruption could harm our operations.

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OUR OPERATIONS MAY BE AFFECTED BY NEGATIVE ECONOMIC CONDITIONS IN ISRAEL.

Israel has experienced periods of recession in economic activity, resulting in low growth rates and growing unemployment. Our operations could be adversely affected if the economic conditions in Israel deteriorate. In addition, Israel has experienced several general strikes and other work stoppages, affecting banks, government offices, airports and ports. These strikes have had an adverse effect on the Israeli economy and on businesses, including our ability to deliver products to our customers or to receive raw materials from our suppliers in a timely manner. From time to time, the Israeli trade unions threaten strikes or work-stoppages, which may, if carried out, have a material adverse effect on the Israeli economy and our business.

IF THE EXEMPTION ALLOWING US TO OPERATE OUR MANUFACTURING FACILITIES SEVEN DAYS A WEEK IS NOT RENEWED, OUR BUSINESS WILL BE ADVERSELY AFFECTED.

We operate our manufacturing facilities seven days a week pursuant to an exemption from the law that requires businesses in Israel to be closed from sundown on Friday through sundown on Saturday. This exemption expires by its terms on December 31, 2008. If the exemption is not renewed and we are forced to

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close any or all of the facilities for this period each week, our financial results and business will be harmed.

IF WE ARE CONSIDERED TO BE A PASSIVE FOREIGN INVESTMENT COMPANY, EITHER PRESENTLY OR IN THE FUTURE, US HOLDERS WILL BE SUBJECT TO ADVERSE US TAX CONSEQUENCES.

We will be a passive foreign investment company, or PFIC, if 75% or more of our gross income in a taxable year, including our pro rata share of the gross income of any company, US or foreign, in which we are considered to own, directly or indirectly, 25% or more of the shares by value, is passive income. Alternatively, we will be considered to be a PFIC if at least 50% of our assets in a taxable year, averaged over the year and ordinarily determined based on fair market value, including our pro rata share of the assets of any company in which we are considered to own, directly or indirectly, 25% or more of the shares by value, are held for the production of, or produce, passive income. If we were to be a PFIC, and a US Holder does not make an election to treat us as a "qualified electing fund," or QEF, or a "mark to market" election, "excess distributions" to a US Holder, any gain recognized by a US Holder on a disposition of our ordinary shares would be taxed in an unfavorable way. Among other consequences, our dividends would be taxed at the regular rates applicable to ordinary income, rather than the 15% maximum rate applicable to certain dividends received by an individual from a qualified foreign corporation. The tests for determining PFIC status are applied annually and it is difficult to make accurate predictions of future income and assets, which are relevant to the determination of PFIC status. In addition, under the applicable statutory and regulatory provisions, it is unclear whether we would be permitted to use a gross loss from sales (sales less cost of goods sold) to offset our passive income in the calculation of gross income. In light of the uncertainties described above, we have not obtained an opinion of counsel with respect to our PFIC status and no assurance can be given that we will not be a PFIC in any year. If we determine that we have become a PFIC, we will then notify our US Holders and provide them with the information necessary to comply with the QEF rules. If the IRS determines that we are a PFIC for a year with respect to which we have determined that we were not a PFIC, however, it might be too late for a US Holder to make a timely QEF election, unless the US Holder qualifies under the applicable Treasury regulations to make a retroactive (late) election. US Holders who hold ordinary shares during a period when we are a PFIC will be subject to the foregoing rules, even if we cease to be a PFIC in subsequent years, subject to exceptions for US Holders who made a timely QEF or mark-to-market election.

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IT MAY BE DIFFICULT TO ENFORCE A US JUDGMENT AGAINST US, OUR OFFICERS, DIRECTORS AND ADVISORS OR TO ASSERT US SECURITIES LAW CLAIMS IN ISRAEL.

We are incorporated in Israel. Most of our executive officers and directors and our Israeli accountants and attorneys are nonresidents of the United States, and a majority of our assets and the assets of these persons are located outside the United States. Therefore, it may be difficult to enforce a judgment obtained in the United States, against us or any of these persons, in US or Israeli courts based on the civil liability provisions of the US Federal securities laws. Additionally, it may be difficult for you to enforce civil liabilities under US Federal securities laws in original actions instituted in Israel.

#### ITEM 4. INFORMATION ON THE COMPANY

##### A. HISTORY AND DEVELOPMENT OF THE COMPANY

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We are a pure-play independent specialty foundry dedicated to the manufacture of semiconductors. Typically, pure-play foundries do not offer products of their own, but focus on producing integrated circuits, or ICs, based on the design specifications of their customers. We manufacture semiconductors using advanced production processes for our customers primarily based on third party designs and our own proprietary designs. We currently offer the manufacture of ICs with geometries ranging from 1.0 to 0.13-micron. We also provide design services and complementary technical services. ICs manufactured by us are incorporated into a wide range of products in diverse markets, including consumer electronics, personal computers, communications, automotive, industrial and medical device products.

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

Our company was founded in 1993, when we acquired National Semiconductor's 150-mm wafer fabrication facility, or Fab 1, and commenced operations as an independent foundry with a production capacity of approximately 5,000 wafers per month. Since then, we have significantly modernized our Fab 1 facility and equipment, which has improved our process geometries to range from 1.0-micron to 0.35-micron and enhanced our process technologies to include CMOS image sensors, embedded flash and mixed-signal technologies. Production capacity in Fab 1 as of May 31, 2008 was approximately 16,000 wafers per month depending on process technology and product mix.

In January 2001, we commenced construction of a new, state-of-the-art wafer fabrication facility, which we refer to as Fab 2, located in Migdal Haemek, Israel and adjacent to our first facility, Fab 1. In 2003, we completed the infrastructure of Fab 2 and commenced production wafer shipments from this Fab. Fab 2 is designed to operate in geometries of 0.18-micron and below, using advanced materials and advanced CMOS technology licensed from Freescale and Toshiba and other technologies that we developed and will develop independently or with development partners. During 2008, we are implementing a capacity increase plan targeting to reach up to approximately 30,000 wafers per month, which has not yet been completed. Production capacity of Fab 2 as of December 31, 2007 was approximately 24,000 wafers per month. Depending on the process technology and product mix, when fully ramped-up we estimate that Fab 2 will be able to achieve capacity levels of up to approximately 44,000 wafers per month. We have not yet made a decision as to the timing of the commencement of any further ramp-up of Fab 2 capacity beyond approximately 30,000 wafer starts per month. The timing of that decision and its implementation will depend upon several factors, including, funding, and cost availability of equipment and market conditions.

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Our capital expenditures, net of Investment Center grants, for 2007, 2006



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and 2005 of approximately \$91 million, \$163 million and \$32 million, respectively, were made principally in connection with the construction of, and purchase of equipment and technology for, Fab 2.

Our legal and commercial name is Tower Semiconductor Ltd. We were incorporated under the laws of Israel. Our manufacturing facilities and executive offices are located in the Ramat Gavriel Industrial Park, Shaul Amor Street, Post Office Box 619, Migdal Haemek, 23105 Israel, and our telephone number is 972-4-650-6611. Our worldwide web site is <http://www.towersemi.com>. Information on our web site is not incorporated by reference in this annual report.

### RECENT DEVELOPMENTS

On May 19, 2008 we entered into a definitive merger agreement with Jazz Technologies, Inc., a leader in Analog-Intensive Mixed Signal (AIMS) foundry solutions, by which we will acquire all of the outstanding shares of Jazz Technologies, Inc. in a stock-for-stock transaction valuing Jazz at an equity value of approximately \$40 million, based on the closing price of our shares on the date of the agreement. The total value of the transaction, including net debt, is approximately \$169 million. The transaction is subject to closing conditions, which must all be met or waived (by the applicable party) in order for the transaction to be consummated. Under the terms of the agreement, upon the closing of the merger, Jazz will become our wholly-owned subsidiary and each outstanding share of Jazz common stock will be converted into the right to receive 1.8 Tower ordinary shares. We expect the transaction to close in the second half of 2008.

### B. BUSINESS OVERVIEW

#### INDUSTRY OVERVIEW

Semiconductor devices are responsible for the rapid growth of the electronics industry over the past fifty years. They are critical components in a variety of applications, from computers, consumer electronics and communications, to industrial, military, medical and automotive applications. The semiconductor industry is characterized by rapid changes in technology, frequently resulting in the obsolescence of recently introduced products. As performance has increased and size and cost have decreased, the use of semiconductors and the number of their applications have grown significantly.

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

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Semiconductor suppliers face increasing demands for new products that

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provide higher performance, greater functionality and smaller form factors at lower prices, which require increasingly complex ICs. In addition to the increased complexity of designs, there has also been a dramatic increase in the number of applications for semiconductors. To compete successfully, semiconductor suppliers must also minimize the time it takes to bring a product to market. As a result, fabless companies and IDMs are focusing more on their core competencies—design and intellectual property—and outsourcing manufacturing to foundries.

The consumer sector is expanding worldwide with new applications and multi-functional devices, including those that incorporate CMOS image sensors, embedded flash and mixed-signal ICs. Increasingly, emerging applications, such as camera-equipped cell phones, digital still cameras and flat panel displays, are enabled by ICs manufactured using advanced process technologies.

The enormous costs associated with modern fabs, combined with the increasing demand for complex ICs, has created an expanding market for outsourced manufacturing offered by foundries. Foundries can cost-effectively supply advanced ICs to even the smallest fabless companies by creating economies of scale through pooling the demand of numerous customers. In addition, customers whose IC designs require process technologies other than standard digital CMOS have created a market for independent foundries that focus on providing specialized process technologies, such as CMOS image sensors, embedded flash and mixed-signal technologies. Foundries also offer competitive customer service through design, testing, and other technical services, often at a level previously found only at an IDM's internal facilities.

These trends have led to the rapid growth in demand in recent years for advanced semiconductor manufacturing services provided by independent foundries.

### MANUFACTURING PROCESSES AND SPECIALIZED TECHNOLOGIES

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

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

We manufacture ICs using CMOS process technology. CMOS is currently the dominant semiconductor manufacturing process because it requires lower power than other technologies and allows dense placement of components onto a single IC. The low power consumption and high-density characteristics of the CMOS process allow the continued development of high performance ICs that are smaller and faster. We believe that our specialized process technology distinguishes our IC manufacturing services and attracts industry-leading customers.

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We believe that we are a trusted, customer-oriented service provider that has built a solid reputation in the foundry industry over the last fifteen

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years. We have built strong relationships with customers, who continue to use our services, even as their demands evolve to smaller form factors and new applications. Our consistent focus on providing high-quality, value added services, including engineering and design support, has allowed us to attract customers for both our Fab 1 and Fab 2 facilities who seek to work with a proven provider of foundry services. Our emphasis on working closely with customers and accelerating the time-to-market of our customers' next-generation products is also reflected in our corporate structure. As a result, we have a high customer retention rate and an increase in new customers and new products for production.

We derived approximately 48% of our revenues for the year ended December 31, 2007 from our target specialized markets: CMOS image sensors, embedded flash, mixed-signal, RF and power ICs. We are highly experienced in these markets, being an early entrant and having developed unique proprietary technologies, primarily through licensing and joint development efforts with our customers and other technology companies. The specific process technologies that we currently focus on include:

### CMOS IMAGE SENSORS

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

In addition, our innovative "stitching" technology enables semiconductor exposure tools to manufacture single ultra high-resolution CMOS image sensors containing millions of pixels at sizes far larger than their existing field. Our 0.5, 0.35-micron and 0.18-micron CMOS image sensor processes are designed to permit the customer to create high-quality solutions and integrate a product's CMOS analog and logic circuitry together with the sensor pixel array all on one chip, thereby facilitating miniaturization, reducing power consumption and increasing performance.

We are currently actively involved in this mass market as well as the high-end sensor and applications specific markets, which include applications such as industrial machine vision, medical X-Ray and automotive sensors. While CMOS image sensors for advanced optical applications are an emerging technology, we believe that they are becoming the preferred technology to traditional charge coupled devices, or CCDs. CCDs have historically provided superior image quality; however, advances in semiconductor manufacturing processes and design techniques have led to significant improvements in CMOS image sensor performance and image quality. These advances have resulted in smaller size circuits and better power control, making it possible to design CMOS image sensors that provide high image quality at a significantly lower cost.

As early as 1997, we recognized the market potential of using CMOS process technology for a digital camera-on-a-chip, which would integrate a CMOS image sensor, filters and digital circuitry. In entering the CMOS image sensor foundry business, we utilized research and development work that had been ongoing since 1993. Our services include a broad range of turnkey solutions and services, including pixel IP services, optical characterization of a CMOS process, innovative stitching manufacturing technique and optical testing and packaging. CMOS image sensors manufactured by us deliver outstanding image quality for a broad spectrum of digital imaging applications.

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During the last quarter of 2005, we commenced volume production of CMOS image sensors for the cellular phone camera market in 0.18 micron process and using a 3.6 micron pixel which we developed. In 2006, we commenced volume production with our developed 2.8 micron pixel and in parallel we developed a 2.2 micron pixel which serves as the foundation for products for several of our customers, and is being used in VGA, 1.3Mp, 2Mp and 3Mp and which we expect to be used in the future for 5Mp sensors for both the cellular phone and PC camera commodity market, and the low end DSC market.

During 2007, we ramped to production products with 2.8 micron, 3.2 micron and 3.6 micron pixels, all developed by us and supplied to our customers as pixel IP. In the end of 2006, we began prototyping of two image sensors in Fab 2 in 0.18 micron technology to be used in cellular phone and smart phone cameras. Our Advanced Photo Diode (APD) technology used in these CMOS image sensors enables improved optical and electrical performance of ultra-small pixels utilizing deep sub-micron process technologies, thus enabling the manufacturing of small, cost-effective camera module solutions. During 2007, four VGA products for cell phone applications, a 1/7" and a 1/8", based on 3.2 micron and 2.8 micron pixels respectively, ramped into mass production.

We developed a new 2.2-micron pixel for which prototyping began during 2007. In addition, in the beginning of 2007, we were selected by e2v as its supplier of choice for its CMOS image sensor devices. e2v's products target a broad range of industrial and medical applications. The CMOS sensors will be produced in Fab2, using the CIS 0.18 micron process and its advanced capabilities, including our patented stitching technology that was successfully developed for Fab 2 in 2006.

For the X-Ray market, we developed stitched technology in Fab2 on 0.18micron process and a variety of 20-micron pixels that are optimized for X-Ray applications. These pixels are used by our customers in dental and other medical X-Ray products.

The stitched technology that was developed for Fab 2 during 2006 provided us with the ability to manufacture large sensors (up to one die per wafer) on 8" wafers using state of the art, 0.18-micron CMOS image sensor technology. In 2007, we had several new orders from customers whose products are based on this technology. For example, in December 2007, we established a partnership with CMT Medical Technologies Ltd., a leading provider of advanced digital X-ray imaging systems for medical diagnosis, to develop, market and sell X-ray detectors for medical applications. The detectors' intended use is for radiography/fluoroscopy, cardiology, angiography, mammography and similar large-size X-ray modalities. Large size detectors require the manufacturing of up to one die per 8" wafer, at high yields. Delivery of the first flat panel detectors is expected to begin in 2009.

During the first quarter of 2008, Canesta Inc.'s revolutionary 3D image sensors went into the qualification stage at Tower. These CanestaVision(TM) sensors, now in final qualification stages for the automotive industry, are being manufactured at Tower's advanced Fab2 facility, using its state-of-the-art, CMOS Image Sensor (CIS) 0.18-micron technology process.

In March 2008, we ramped-up the production of N-trig's A-trig and D-trig - the newest digitizer chipset to be integrated in OEMs computer systems.

EMBEDDED FLASH

Flash memory is a constantly powered nonvolatile memory that can be erased and reprogrammed in units of memory called blocks. The IC of flash memory is organized so that a section of memory cells may be erased in a single action, or "flash". Applications for flash memory products range from most types of portable electronic equipment devices to high volume mass storage of data. Flash is particularly suitable for applications such as handheld devices, combining the need for portability, high density, ruggedness and lower power requirements. Flash memory products are also well-suited for audio products such as digital answering machines and MP3 players, as well as other applications including networking devices, digital cameras, personal computer motherboards and portable memory devices.

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Embedded flash is the combination of flash memory with other components, such as other memory, logic and analog, on a single IC to provide speed, functionality and form factor advantages and reduce system cost. Embedded flash memory products are used in communications, consumer, industrial, military and automotive applications. End products include networks, base stations, servers, microcontrollers, toys, set-top boxes, DVD players, cell phones and smart cards.

The relative simplicity of our microFLASH manufacturing process offers cost advantages over competing flash technologies for high density memories. Using our 0.5-micron technology, we have introduced the first of our microFLASH processes into production with the manufacture of a 2 megabit stand-alone memory device and embedded multi-time programming modules, with a limited number of rewrite cycles. Our 0.18-micron embedded flash technology was mutually developed with a Japanese semiconductor manufacturer during 2004, with multiple flash modules ranging in sizes from 0.5 megabit to 8 megabit, and is currently in different stages of prototyping and production with a few customers.

#### MIXED SIGNAL, RF CMOS, AND RFID

Mixed-signal ICs are an essential part of any electronic system that interacts with the real world. Analog ICs monitor and manipulate real world signals such as sound, light, pressure, motion, temperature and electrical current and are used in a wide variety of electronic products such as PCs, cell phones, DVD players, automotive electronics and medical imaging equipment. Digital ICs perform arithmetic functions on data represented by a series of ones and zeroes, provide critical processing power and have enabled many of the computing and communication advances of recent years. Mixed-signal ICs combine analog and digital semiconductor functionality on a single IC to enable digital systems to interface with the real world. As these digital systems proliferate, there is a growing need for analog functionality to enable them to interface with the real world. For 0.18-micron technology, we have developed design kits optimized for mixed-signal and RFCMOS design. These design kits contain a comprehensive characterization of a wide range of analog and RF devices to provide our customers with the ability to design mixed-signal and RF ICs for their specific needs.

In recent years, more and more designers opt to develop high frequency products based on RF CMOS technologies. The superior cost structure of CMOS technologies enables high volume, low cost production of such high frequency products. We use our mixed signal expertise to leverage and develop processes and provide services for customers utilizing CMOS technologies. We further enhanced our mixed signal 0.18-micron platform technology offering by developing RF CMOS product design kits. This allowed us to increase our customer base and obtain new products for production as well as develop special capabilities with

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RFID applications.

RFID. In 2004, we started a joint development program with Alien Technology Corporation that targets the RFID tag market and utilizes a platform technology of mixed signal, RF and non volatile memory function. Since 2006, we have been the manufacturing supplier for Alien Technology's internally-designed Gen 2 RFID ICs. Currently certain of Alien's products are in production at Fab 2 and the next generation technology developments are in process.

### CONVERGENCE OF TECHNOLOGIES

In response to the growing demand for a single chip to offer a wide array of functions, we are leveraging a combination of some of the abovementioned technologies by developing a single chip with multiple functions. The successful development of this chip will allow us to provide additional value to our customers and obtain a unique market position by offering our customers a unique technology platform. We engage in projects merging CMOS, NVM and CIS for unique solutions to customers' needs, as well as in a project targeting RFID tags applications merging RF CMOS, mixed signal and NVM technologies onto a single chip.

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### CUSTOMERS, MARKETING AND SALES

Our marketing and sales strategy seeks to aggressively expand our global customer base. We have marketing, sales and engineering support personnel in the United States, Taiwan and Israel. Our marketing and sales staff is supported by independent sales representatives, located throughout the world, who have been selected based on their understanding of the semiconductor marketplace. In November 2007, we opened a representative office in Taiwan to support our increasing presence throughout the Asia Pacific region. Our new representative office provides applications and logistical support to our existing customers. This representative office also performs marketing activities aimed at the local market to increase our customer base.

Our sales cycle is generally 12-24 months or longer for new customers and can be as short as 9-12 months for existing customers. The typical stages in the sales cycle process from initial contact until production are:

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

The primary customers of our foundry services are fabless semiconductor companies and IDMs. A substantial portion of our product sales are made pursuant to long-term contracts with our customers, under which we have agreed to reserve manufacturing capacity at our production facilities for such customers. Our

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customers include many industry leaders, some of our shareholders and a number of Taiwanese companies that preferred our solution to the solutions that were offered locally. During the year ended December 31, 2007, we had seven significant customers who contributed 29%, 13%, 11%, 7%, 5%, 5% and 5% of our revenues, respectively. In 2006, we had seven significant customers who contributed 23%, 11%, 10%, 9%, 6%, 5% and 5% of our revenues, respectively.

In addition to further developing our customer base, we have also made a concentrated effort to maintain the geographical diversity of our sales. The percentage of our sales from customers located outside the United States was 36%, 31 and 25% in the years ended December 31, 2005, 2006 and 2007, respectively. We believe that although most of our sales are from US-based customers a substantial portion of our sales will continue to come from customers located outside the United States. The following table sets forth the geographical distribution, by percentage, of our net sales for the periods indicated:

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	YEAR ENDED DECEMBER 31,		
	2007	2006	2005
United States	75%	69%	64%
Israel	7%	7%	7%
Asia-Pacific	10%	16%	20% (*)
Europe	8%	8%	9%
Total	100%	100%	100%

(\*) Including payments made to us in connection with our May 2002 joint development agreement for 0.18-micron embedded MICROFLASH technology.

### COMPETITION

The global semiconductor foundry industry is highly competitive. The major independent dedicated foundries include Taiwan Semiconductor Manufacturing Corporation, United Microelectronics Corporation, Chartered Semiconductor Manufacturing Ltd. and Semiconductor Manufacturing International Corp.; emerging and existing Chinese, Korean and Malaysian foundries, including DongBu, He Jien Technology, ASMC, MagnaChip, CSMC, Grace, HHNEC, and Silterra. In addition, there are IDMs and end-product manufacturers that produce ICs for their own use and/or allocate a portion of their manufacturing capacity to foundry operations. Most of the foundries with which we compete are located in Asia-Pacific and benefit from their close proximity to other companies involved in the design and manufacture of ICs. We believe that the principal elements of competition in the wafer foundry market are:

- o technical competence;
- o production quality;
- o time-to-market;
- o device and end-product price;
- o available capacity;

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- o device yields;
- o design and customer support services;
- o access to intellectual property; and
- o research and development capabilities.

Many of our competitors have greater manufacturing capacity, multiple manufacturing facilities, more advanced technological capabilities, a more diverse and established customer base, greater financial, marketing, distribution and other resources and a better cost structure than ours.

We seek to compete primarily on the basis of technology, production quality, device yields and services involving design, engineering support and manufacturing. We believe we have a differentiated service offering and track record in specialized markets, which enables us to effectively compete with larger IC manufacturers.

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### WAFER FABRICATION SERVICES

Wafer fabrication is an intricate process that consists of constructing layers of conducting and insulating materials on raw wafers in intricate patterns that give the IC its function. IC manufacturing requires hundreds of interrelated steps performed on different types of equipment, and each step must be completed with extreme accuracy for finished ICs to work properly. The process can be summarized as follows:

**CIRCUIT DESIGN.** IC production begins when a fabless IC company or IDM designs the layout of a device's components and designates the interconnections between each component. The result is a pattern of components and connections that defines the function of the IC. In highly complex circuits, there may be more than 35 layers of electronic patterns. After the IC design is complete, we provide these companies with IC manufacturing services.

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

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

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



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IC supplier or directly to its final destination.

### PROCUREMENT AND SOURCING

Our manufacturing processes use many raw materials, including silicon wafers, chemicals, gases and various metals. These raw materials generally are available from several suppliers. In many instances, we purchase raw materials from a single source. In connection with our technology advancement plans, we expect to continue to make purchases of semiconductor manufacturing equipment, mainly for Fab 2.

### RESEARCH AND DEVELOPMENT

Our future success depends, to a large degree, on our ability to continue to successfully develop and introduce to production advanced process technologies that meet our customers' needs. Our process development strategy relies on CMOS process technologies that we primarily license and transfer from third parties. We also develop these technologies on our own, at our own initiative, our customers' request or in cooperation with our customers.

From time to time, at a customer's request, we develop a specialty process module, which we use for such customer on an exclusive basis, and, if permitted under our agreements with such customer, we then add it to our process offering. Such developments are very common in all of our special process technologies noted above. In 2004, in response to market demand, we introduced a 0.16-micron optical shrink solution which represents a 10% linear shrink from our existing 0.18-micron offering while utilizing virtually the same 0.18-micron libraries and IP. The shrink allows a 15 to 20 percent die size reduction and a potentially higher wafer ASP and lower die cost. Applications include industry standard CMOS logic and some mixed-signal technologies. This 0.16-micron technology is currently in production.

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Our research and development activities have related primarily to our process development efforts and have been sponsored and funded by us with some participation by the Israeli Office of the Chief Scientist, or OCS. Accordingly, we are subject to restrictions set forth in Israeli law which limit the ability of a company to manufacture products or to transfer technologies outside of Israel, if such products or technologies were developed with OCS funding. Research and development expenses for the years ended December 31, 2005, 2006 and 2007 were \$16.0 million, \$15.0 million and \$13.8 million, net of government participation of \$1.0 million, \$1.9 million and \$2.61 million, respectively. As of May 31, 2008, we employed 146 professionals in our research and development department, 29 of whom have PhDs. In addition to our research and development department located at our facilities in Migdal Haemek, we maintain a design center in Netanya, Israel.

### PROPRIETARY RIGHTS

#### INTELLECTUAL PROPERTY AND LICENSING AGREEMENTS

Our success depends in part on our ability to obtain patents, licenses and other intellectual property rights covering our production processes. To that end, we have acquired certain patents and patent licenses and intend to continue to seek patents on our production processes. As of May 31, 2008, we held 67 patents. We have entered into various patent licenses and cross-licenses with technology companies including Toshiba, Freescale, Synopsys, ARM, Chipidea Microelectronics, Virage Logic, Impinj and others. We may choose to renew our

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present licenses or obtain additional technology licenses in the future. There can be no assurance that any such licenses could be obtained on commercially reasonable terms.

We constantly seek to strengthen our technological expertise through relationships with technology companies and silicon suppliers. We seek to expand our core strengths in CMOS image sensors, embedded flash and mixed-signal technologies by combining our proprietary technology with those of other technology companies. A main component of our process development strategy is to acquire licenses for standard CMOS technologies and cell libraries from leading designers, such as Freescale and Toshiba, and further develop specialized processes through our internal design teams. The licensing of these technologies has enormously reduced our internal development costs.

### CMOS PROCESS TECHNOLOGY PLATFORM

We have licensed an array of process technologies through the following arrangements:

TOSHIBA. In April 2000, we entered into a technology transfer agreement with Toshiba, pursuant to which Toshiba has transferred to us certain advanced CMOS technologies for use in Fab 2. In exchange for certain license and technology transfer fees and royalties, Toshiba has provided us with recipes, know-how and patent licenses and has trained a group of our engineers and managers. Subject to prior termination for cause by Toshiba, our licenses under the agreement with Toshiba are perpetual. Based on Toshiba's 0.18-micron CMOS process technology, we have internally developed an enhanced industry compatible version of the process technology.

MOTOROLA (NOW FREESCALE). In September 2002, we entered into a technology transfer and development agreement with Motorola, pursuant to which Motorola transferred to us its 0.13-micron HiP MOS7 CMOS process technology for Fab 2 as well as co-developed with us an industry-standard compatible version of the process technology. Subject to prior termination for cause by Motorola, our licenses under the technology transfer agreement with Motorola are perpetual. In August 2004, Motorola assigned all of its rights and obligations under the aforementioned agreement to Freescale.

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### FOUNDATION IP BLOCKS

To better serve our customers design needs using advanced CMOS processes and mixed-signal, we have entered into a series of agreements with leading providers of physical design libraries, mixed-signal and non volatile memory design components. These components are basic design building blocks, such as standard cells, interface input-output (I/O) cells, software compilers for the generation of on-chip embedded memories arrays, mixed-signal and non-volatile memory design blocks. To achieve optimal performance, all of these components must be customized to work with our manufacturing process. These components are used in most of our customers' chip designs. SYNOPSYS. In June 2001, we entered into an agreement with Synopsys (formerly, Avant!) under which Synopsys developed libraries for our 0.18-micron process technology. Multiple customers use the Synopsys libraries in producing their ICs at our company. In 2004, we entered into a set of comprehensive technology transfer and license agreements with Synopsys that provide us with broad rights to use Synopsys' library technology in multiple process technology generations including 0.18 micron and 0.13 micron. Under these agreements, we were given the right to develop, customize, validate and characterize libraries based on Synopsys' library

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technology and to distribute such libraries . These agreements place us in a superior position of having in-house capability to serve our customers' needs. Certain parts of the 2004 license agreements relating to support services provided by Synopsys were terminated according to an agreement signed between the parties in July 2007.

ARM LIMITED. In 2002 and subsequently in 2004 and 2006, we entered into license agreements with ARM Limited (formerly, Artisan Components and ARM Inc.) under which we received a license to a suite of library products for our 0.18-micron and 0.13-micron process technologies and ARM licenses its libraries to our customers free of charge. Multiple customers are using the ARM libraries in their chip design for manufacturing at our company. The ARM libraries include, among others, standard cells, general purpose and specialty input-output cells and memory generators.

VIRAGE LOGIC. In 2002 and subsequently in 2004 and in 2006, we entered into license agreements with Virage Logic under which we received a license to a suite of library products for our 0.18-micron and 0.13-micron process technologies, respectively. These library products are available for licensing by our customers, and with respect to most of the 0.13-micron library products, free of a license charge. Virage offers a variety of SRAM and ROM memory compilers on both process technologies, and also offers standard cells, general purpose and specialty input-output cells libraries in the 0.13-micron technology. Presently, multiple customers' products that use Virage Logic's memory products are in production at Fab 2. In addition, our license agreements with Virage Logic from 2002 and 2006 has also introduced Virage Logic's patented Nonvolatile Electrically Alterable embedded memories for production on our 0.18-micron CMOS logic process. Currently, customers' products that use Virage Logic's non-volatile memory products are in production at Fab 2. We have selected and qualified these memories for our process to help our customers meet their application requirements for cost-effective embedded non-volatile memory for security, encryption, unique device identification, analog trimming, silicon repair and flexible program store.

CHIPIDEA MICROELECTRONICS. (TODAY MIPS TECHNOLOGIES, INC). In 2003 and subsequently in 2005 and 2006, we entered into a non-exclusive, perpetual, royalty-free license and design agreement with Chipidea Microelectronics. Further to this agreement, Chipidea has customized several of its mixed-signal design blocks for manufacturing on our 0.18-micron and 0.13-micron process technologies, such as USB 2.0 (Universal Serial Bus 2.0) and USB2.0 OTG (On The Go), which are currently being utilized by several of our customers.

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IMPINJ INC. In 2005, we entered into a development and license agreement with Impinj Inc. under which Impinj is developing its AEON(R) non-volatile memory (NVM), in parallel architecture, based on its patented Self-Adaptive Silicon(R) technology, for production on our 0.13-micron CMOS logic process. We chose Impinj's cost-effective NVM to help our customers' products meet their application requirements for embedded non-volatile memories. Primary applications for Impinj's AEON parallel architecture include analog trimming, digital rights management and wireless controllers. In 2007, Impinj's AEON(R)/MTP Parallel Architecture NVM cores became available in our 0.13-micron logic process.

### IMAGE SENSOR TECHNOLOGIES

We developed, both independently and together with our customers, basic pixel intellectual property to be used by those customers in the manufacturing

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of our CMOS image sensor products.

### C. ORGANIZATIONAL STRUCTURE

The legal and commercial name of our company is Tower Semiconductor Ltd. We were incorporated under the laws of the State of Israel in 1993. Tower Semiconductor USA, Inc. is a wholly-owned subsidiary incorporated in the United States.

On May 19, 2008 we entered into a definitive merger agreement with Jazz Technologies, Inc., a leader in Analog-Intensive Mixed Signal (AIMS) foundry solutions. The transaction is subject to closing conditions, which must all be met or waived (by the applicable party) in order for the transaction to be consummated. Under the terms of the agreement, upon the closing of the merger, Jazz will become our wholly-owned subsidiary and each outstanding share of Jazz common stock will be converted into the right to receive 1.8 Tower ordinary shares. We expect the transaction to close in the second half of 2008. See also - "item 4-information on the Company - A, history and development of the Company - recent development."

### D. PROPERTY, PLANTS AND EQUIPMENT

#### MANUFACTURING FACILITIES

##### FAB 1

We acquired our Fab 1 facility from National Semiconductor in 1993, which had operated the facility since 1986. We occupy the facility pursuant to a long-term lease from the Israel Lands Authority that expires in 2032.

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

Since we commenced manufacturing at Fab 1, we increased its manufacturing capacity from 5,000 wafers per month, using 1.25-micron and 1.0-micron processes, to approximately 16,000 wafers per month as of May 31, 2008, depending on process technology and product mix, using our 1.0 micron to 0.35-micron processes, including specialized processes. Fab 1 is also manufacturing products for Siliconix Incorporated and Siliconix Technology C.V under a long term foundry agreement that we entered into in May 2004 using process technology that Siliconix transferred to us. During the first quarter of 2008, the parties amended the foundry agreement to revise the terms of the purchase of trench products as well as transfer additional differentiated product platforms to Tower for manufacturing.

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Our exact capacity is variable and depends on the combination of the processes being used and the product mix hence, it may be significantly lower at certain times as a result of certain of our combinations. In general, our ability to increase our manufacturing capacity has been achieved through the addition of equipment, improvement in equipment utilization, the reconfiguration and expansion of the existing clean room area and the construction of an additional clean room area within the building shell of Fab 1.

##### FAB 2

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In January 2001, we commenced construction of Fab 2, our advanced wafer fab adjacent to Fab 1 in Migdal Haemek. The land on which Fab 2 is located is subject to a long-term lease from the Israel Lands Authority that expires in 2049.

Fab 2 offers integrated circuits manufacturing services utilizing advanced materials and a 0.18-micron process technology we licensed from Toshiba, as well as 0.13-micron process technology we licensed from Freescale. Fab 2 is also manufacturing products in 0.35-micron process technology that International Rectifier Corporation ("IR") transferred to us under a long term foundry agreement that we entered into in September 2006. During the fourth quarter of 2007, we began volume production of products for IR.

The overall clean room area in Fab 2 is approximately 100,000 square feet. We began volume production at Fab 2 during the third quarter of 2003. Production capacity as of December 31, 2007 was approximately 24,000 wafers per month. Depending on the process technology and product mix, when fully ramped-up, we estimate that Fab 2 will be able to achieve capacity levels of approximately 44,000 wafers per month.

Since 2000, we have invested significantly in the purchase of fixed assets, primarily in connection with the construction of Fab 2, technology advancement and capacity expansion. Capital expenditures in 2007, 2006 and 2005 were approximately \$91 million, \$163 million and \$38 million, respectively, before related Investment Center grants of \$0 million, \$0 million and \$6 million, respectively.

We have registered liens in favor of the State of Israel and our banks on substantially all of our present and future assets, including Fab 1 and Fab 2 (see "Item 5 - Operating and Financial Review and Prospects - B. Liquidity and Capital Resources - Fab 2 Agreements - Credit Facility").

### ENVIRONMENTAL, QUALITY MATTERS AND CERTIFICATIONS

Our operations are subject to a variety of laws and governmental regulations relating to the use, discharge and disposal of toxic or otherwise hazardous materials used in our production processes. Failure to comply with these laws and regulations could subject us to material costs and liabilities, including costs to clean up contamination caused by our operations.

We believe that we are currently in compliance in all material respects with applicable environmental laws and regulations.

In November 2004, we received ISO 14001 certification from The Standards Institution of Israel. A series of international standards on environmental management, ISO 14000 provides a framework for the development of an environmental management system and the supporting audit program. ISO 14001 is the cornerstone standard of the ISO 14000 series. It specifies a framework of control for an environmental management system pursuant to which an organization can be certified by a third party. The ISO 14001 certification applies to all of our manufacturing facilities. Our authorized design center in Netanya, Israel also received certification.

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In December 2004, we received the OHSAS 18001 certification from the Standard Institution of Israel, which provides the framework of control for Safety and Health. This certification covers all of our activities and departments.

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In November 2005, we achieved ISO/TS 16949 certification from the UK-based National Quality Association pertaining to the manufacturing processes, work procedures and product performance meeting the requirements of the automotive industry. This quality management system standard certification covers all our departments and activities.

In March 2006, we achieved ISO 17799 certification from The Standards Institution of Israel for the high quality of our security technology and implementations, covering all of our departments and activities.

In 2004, we achieved ISO 9000:2001 certification from The Standards Institution of Israel for all quality systems and processes, covering all our departments and activities. This certification is renewed annually pursuant to extensive audits performed by the SII.

### ITEM 4A. UNRESOLVED STAFF COMMENTS

Not Applicable.

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

#### A. OPERATING RESULTS

#### MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

THE INFORMATION CONTAINED IN THIS SECTION SHOULD BE READ IN CONJUNCTION WITH OUR CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2007 AND RELATED NOTES AND THE INFORMATION CONTAINED ELSEWHERE IN THIS ANNUAL REPORT. OUR FINANCIAL STATEMENTS HAVE BEEN PREPARED IN ACCORDANCE WITH U.S. GENERALLY ACCEPTED ACCOUNTING PRINCIPLES ("US GAAP"). WE RECAST THE COMPARATIVE PRIOR YEAR AMOUNTS INCLUDED IN OUR FINANCIAL STATEMENTS AND IN THIS REPORT TO US GAAP. PRIOR TO THE FOURTH QUARTER OF 2007, WE PREPARED OUR FINANCIAL REPORTS IN ACCORDANCE WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES IN ISRAEL. AND PROVIDED RECONCILIATION TO US GAAP IN THE NOTES TO THE FINANCIAL STATEMENTS.

#### OVERVIEW

We are a pure-play independent specialty foundry dedicated to the manufacture of semiconductors. Pure-play foundries do not offer any products of their own, but focus on producing integrated circuits based on the design specifications of their customers. We manufacture semiconductors using advanced production processes for our customers primarily based on third party designs and our own proprietary designs. We currently offer the manufacture of ICs with geometries ranging from 1.0 to 0.13-micron.

Our primary source of our revenue is from the fabrication of ICs using CMOS process technology. We are currently focused on the emerging opportunities involving CMOS image sensors, mixed-signal, RFCMOS and RFID technologies. ICs manufactured by us are incorporated into a wide range of products in diverse markets, including consumer electronics, personal computer and office equipment, communications, automotive, professional photography and medical device products.

The primary customers for our products are fabless IC companies and IDMs. A substantial portion of our product sales are made pursuant to long-term contracts with our customers, under which we have agreed to reserve manufacturing capacity at our production facilities. Our sales cycle is generally 12-24 months for new customers and can be as short as 9-12 months for existing customers. The typical stages in the sales process, from initial contact until production are: technical evaluation; photomask design

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specification; silicon prototyping; assembly and testing; validation and qualification; and production.

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During the year ended December 31, 2007, we had seven significant customers who contributed between 5% to 29% of our revenues. In 2006, we had seven significant customers who contributed between 5% to 23% of our revenues. In 2005, we had five significant customers who contributed between 5% to 22% of our revenues. In these years SanDisk was a significant customer of FAB 2. During 2007 additional large customers increased their orders following the qualification of their products in Fab 2.

In addition to further developing our customer base, we have also made a concentrated effort to maintain the geographical diversity of our sales. The percentage of our sales from customers located outside the United States was 25%, 31% and 36% in the years ended December 31, 2007, 2006 and 2005, respectively. We believe that a substantial portion of our sales will continue to come from customers located outside the United States.

Our company was founded in 1993, when we acquired National Semiconductor's 150-mm wafer fabrication facility, or Fab 1, and commenced operations as an independent foundry. Since then, we have significantly modernized our Fab 1 facility, which has improved its process geometries from 1.0-micron to 0.35-micron and enhanced its process technologies to include CMOS image sensors, embedded flash and mixed-signal technologies. We have also expanded our production capacity in Fab 1 to approximately 16,000 wafers per month as of May 31, 2008, depending on process technology and product mix, to meet additional customer demand. Fab 1 has been cash flow positive from operations since the second quarter of 2002.

During the third quarter of 2003, we completed the construction of the building and infrastructure of our second manufacturing facility Fab 2, and commenced volume production at that facility. Fab 2 is designed to operate in geometries of 0.18-micron and below, using advanced materials and advanced CMOS technology licensed from Freescale and Toshiba, as well as other technologies that we might acquire or develop independently. Production capacity of Fab 2 as of December 31, 2007 was approximately 24,000 wafers per month. During 2008, we are implementing a capacity increase plan targeting to reach up to approximately 30,000 wafers per month, which has not yet been completed.

### CRITICAL ACCOUNTING POLICIES

**REVENUE RECOGNITION.** In accordance with generally accepted accounting principles, our revenues are recognized when persuasive evidence of an agreement exists with fixed or determinable prices, shipment has occurred or as services are rendered when title has been transferred, collectibility is reasonably assured and acceptance provisions criteria are satisfied, based on tests performed prior to customer on-site testing. Prior to commencement of our production, both our customers and our personnel test and pre-approve the prototype, on the basis of which specifications and features the ordered products will be produced. Electronic, functional and quality tests are performed on the products prior to shipment and customer on-site testing. Such testing reliably demonstrates that the products meet all of the specified criteria prior to formal customer acceptance and that product performance upon customer on-site testing can reasonably be expected to conform to the specified acceptance provisions. Our revenue recognition policy is significant because our revenues are a key component of our results of operations. We follow very specific and detailed guidelines in measuring revenue; however an accrual for

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estimated returns, which is computed primarily on the basis of historical experience, is recorded. Any changes in assumptions for determining the accrual for returns and other factors affecting revenue recognition may affect mainly the timing of our revenue recognition and cause our operating results to vary from quarter to quarter. Accordingly, our financial position and results of operations may be affected.

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DEPRECIATION AND AMORTIZATION. We are heavily capital oriented and the amount of depreciation is a significant amount of our yearly expenses. Changes to the useful lives assumption and hence the depreciation can have material impact on our results of operations. Depreciation and amortization expenses in 2007 amounted to \$154.3 million. During the third quarter of 2003, we commenced depreciating the Fab 2 property and equipment and amortizing the 0.18-micron technology, based on the straight-line method. During the second quarter of 2007, we reassessed the estimated useful lives of our machinery and equipment and as a result, effective as of April 1, 2007, machinery and equipment is to be depreciated over estimated useful lives of 7 years rather than 5 years as estimated prior to such date. The change reflects our best estimate of the useful lives of our equipment and is also based on experience accumulated from Fab 1 and on recent trends in industry practices. We believe that the change better reflects the economics associated with the ownership of the equipment. This change has been accounted for as a change in estimate and has been applied prospectively. Currently, we estimate that the expected economic life of our assets will be as follows: (i) buildings (including facility infrastructure) - 14 to 25 years; (ii) machinery and equipment - seven years; and (iii) the 0.18-micron and 0.13 micron technology - four years, with each amortization phases commencing on the date on which such Fab 2 manufacturing line became ready for its intended use. We expect that depreciation and amortization expenses relating to Fab 2 facilities will be approximately \$120 million in 2008. Changes in our estimates regarding the expected economic life of Fab 2 assets, or a change in the dates on which each of the Fab 2 manufacturing lines is ready for its intended use, might affect our depreciation and amortization expenses.

IMPAIRMENT OF ASSETS. Management reviews long-lived assets on a periodic basis, as well as when such a review is required based upon relevant circumstances to ensure that assets are not presented in amounts exceeding their recoverable value. The review of possible impairment charges was performed based on our business plan, as was approved by our board of directors. The business plan is based, among other things, on the future completion of the ramp up of Fab 2. Application of SFAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144") resulted in no impairment charges.

According to SFAS 144 and SFAS 142 for those intangible assets that have definite useful lives, recoverability tests are performed based on undiscounted expected cash flows, SFAS 144 requires that when the asset is not recoverable an impairment loss should be computed based on the difference between the carrying amount of the assets (or asset group) and the fair value. The fair value in most instances will be determined using present value techniques applied to expected cash flows. While applying the provisions of SFAS 144 had no effect on our financial position and results of operations, the use of different assumptions with respect to the expected cash flows from our assets and with respect to other economic variables, primarily the discount rate, may lead to different conclusions regarding the recoverability of our assets' carrying values and to the potential need to record an impairment loss for our long-lived assets.

CONVERTIBLE DEBENTURES. According to Accounting Principles Board Opinion



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No. 14 ("APB 14"), we are to allocate the proceeds from the sale of the securities to each security issued based on their relative fair value. We are required, according to SFAS 133, to determine whether the conversion option embedded in the convertible debt should be bifurcated and accounted for separately. Such determination is based on the determination whether on a stand alone such conversion option would be classified in equity. If the option can be classified as equity no bifurcation is required.

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DEBT RESTRUCTURING. During the first quarter of 2007 we early adopted the provisions of SFAS No. 159 "The Fair Value Option for Financial Assets and Financial Liabilities". As required by the standard we concurrently adopted the provisions of SFAS 157 Fair Value Measurements. The adoption of the standard is effective January 1, 2007. According to the standard we can choose to carry at fair value eligible items as defined in the standard, from the date of early adoption and accordingly we decided to apply the fair value option to the facility agreement. The effect of applying the fair value option to the facility agreement as of January 1, 2007 has been recorded as a cumulative effect adjustment to retained earnings (no tax effects have been recorded).

In 2006, prior to the fair value election, the debt modification under the September 2006 Amendment was considered troubled debt restructuring within the scope of SFAS No. 15 "Accounting by Debtors and Creditors for Troubled Debt Restructurings" which requires the following: (i) the amount considered settled for shares and classified in equity is based on the price per share as quoted at the closing date; (ii) the remaining balance after deduction of the amount used as proceeds for the share issuance in the first bullet above, will remain outstanding; (iii) a new, lower effective interest rate will be calculated as the interest rate that equates future payments to the outstanding balance; and (iv) no gains or losses are recognized in the current period.

FAIR VALUE MEASUREMENTS. We decided to early adopt the provisions of SFAS No. 157 effective January 1, 2007, concurrent with the adoption of FASB 159 "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS No. 159):

- o The income approach was applied using a present value technique.
- o For Loans - The cash flows used in that technique reflect the income stream expected to be used to satisfy the obligation over its economic life.
- o For Embedded Derivatives - we utilized the Black Scholes Merton formula.
- o For Over the Counter derivatives - we used the market approach using quotation from dealer markets.
- o For convertible debentures series E - The market approach was applied using quoted prices for the same debentures.

### RECENT ACCOUNTING PRONOUNCEMENTS AS THEY APPLY TO US

SFAS NO. 141 (REVISED 2007 ) "BUSINESS COMBINATIONS" - In December 2007, the FASB issued FASB 141(R), "Business Combinations" of which the objective is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects. The new standard requires the acquiring

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entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. In December 2007, the FASB issued FASB 160 "Non-controlling Interests in Consolidated Financial Statements - an amendment of ARB No.51" of which the objective is to improve the relevance, comparability, and transparency of the financial information that a reporting entity provides in its consolidated financial statements by establishing accounting and reporting standards by requiring all entities to report non controlling (minority) interests in subsidiaries in the same way - as equity in the consolidated financial statements. Moreover, Statement 160 eliminates the diversity that currently exists in accounting for transactions between an entity and non-controlling interests by requiring they be treated as equity transactions. Both FASB 141(R) and FASB 160 are effective for fiscal years beginning after December 15, 2008. The Company is currently examining this new standard; however, at this stage, it is unable to estimate the standard's effect, if any, on its financial position and results of operations. Initial Adoption of New Standards

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SFAS NO. 159, "THE FAIR VALUE OPTION FOR FINANCIAL ASSETS AND FINANCIAL LIABILITIES" - In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS No. 159). SFAS No. 159 permits companies to choose to measure certain financial instruments and certain other items at fair value. The standard requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. We adopted the provisions of this standard, together with the adoption of FASB No. 157 FAIR VALUE MEASUREMENTS, starting with the first quarter of 2007.

### RESULTS OF OPERATIONS

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

	YEAR ENDED DECEMBER 31,		
	2007	2006	2005
	-----	-----	-----
STATEMENT OF OPERATIONS DATA:			
Total revenues	100.0%	100.0%	100.0%
Cost of total revenues	123.4	142.7	233.7
	-----	-----	-----
Gross loss	(23.4)	(42.7)	(133.7)
Research and development	6.0	8.0	15.7
Marketing, general and administrative	13.7	13.8	17.1
	-----	-----	-----
Operating loss	(43.0)	(64.5)	(166.5)
Financing expense, net	(15.2)	(25.4)	(35.0)
	-----	-----	-----
Other income (expense), net	0.0	0.3	2.3
	-----	-----	-----

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Loss	(58.1)% =====	(89.6)% =====	(199.1)% =====
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YEAR ENDED DECEMBER 31, 2007 COMPARED TO YEAR ENDED DECEMBER 31, 2006

REVENUES. Revenues for the year ended December 31, 2007 increased by 23.2% to \$230.9 million from \$187.4 million for the year ended December 31, 2006. This \$43.4 million increase was mainly attributable to a higher volume of wafer shipments.

COST OF TOTAL SALES. Cost of total sales for the year ended December 31, 2007 amounted to \$284.8 million, compared with \$267.5 million for the year ended December 31, 2006. This increase of 6.4% in cost of sales, which is relatively low in relation to the 23.2% increase in sales, which is mainly attributable to the Company's cost structure of high level of fixed costs according to which with an increased volume of sales the Company can benefit and achieve reasonable margins for each incremental dollar of revenue. In addition we had a reduction in depreciation and amortization expenses as result of our reassessment of the estimated useful lives of our machinery and equipment, as described above. This change has been accounted for as a change in estimate and is applied prospectively. Total depreciation and amortization expenses included in Cost of Total Sales was approximately \$137 million for the year ended December 31, 2007, as compared to approximately \$155 million for the year ended December 31, 2006. Said reduction was mainly attributed to the aforementioned change.

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GROSS LOSS. Gross loss for the year ended December 31, 2007 was \$53.9 million compared to a gross loss of \$80.1 million for the year ended December 31, 2006. The decrease in gross loss was mainly attributable to the 23.2% increase in sales as compared to a 6.4% increase in Cost of Total Sales as described above.

RESEARCH AND DEVELOPMENT. Research and development expenses for the year ended December 31, 2007 decreased to \$13.8 million from \$15.0 million for the year ended December 31, 2006 mainly attributed to decreased depreciation.

MARKETING, GENERAL AND ADMINISTRATIVE EXPENSES. Marketing, general and administrative expenses for the year ended December 31, 2007 increased to \$31.6 million from \$25.8 million for the year ended December 31, 2006. The increase is primarily due to stock based compensation expenses and increased sales expenses deriving directly from the higher revenues mentioned above.

OPERATING LOSS. Operating loss for the year ended December 31, 2007 was \$99.3 million, compared to \$121.0 million for the year ended December 31, 2006. The decrease in the operating loss is attributable mainly to the decrease in the gross loss described above.

FINANCING EXPENSES, NET. Financing expenses, net for the year ended December 31, 2007 were \$35.0 million compared to financing expenses, net of \$47.6 million for the year ended December 31, 2006. This decrease is mainly due to the consummation of the debt restructuring with our banks which was closed in the third quarter of 2006, pursuant to which, approximately 30% of our then outstanding loans were converted into capital notes and the interest rate applicable to the interest payments was reduced from the three month LIBOR rate plus 2.5% to the three month LIBOR rate plus 1.1%. OTHER INCOME, NET. Other income, net, for the year ended December 31, 2007 was \$0.09 million compared to \$0.6 million for the year ended December 31, 2006.

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LOSS. Loss for the year ended December 31, 2007 was \$134.2 million, compared to \$167.9 million for the year ended December 31, 2006. This decrease is primarily attributable to the decrease of \$21.6 million in the operating loss and to the \$12.6 million decrease in financing expenses described above.

YEAR ENDED DECEMBER 31, 2006 COMPARED TO YEAR ENDED DECEMBER 31, 2005

REVENUES. Revenues for the year ended December 31, 2006 increased by 83.8% to \$187.4 million from \$102 million for the year ended December 31, 2005. This \$85.4 million increase was mainly attributable to an increase in our customer base and higher volume of wafer shipments offset by \$8 million recorded for the year ended December 31, 2005 from a previously announced technology-related agreement.

COST OF TOTAL REVENUES. Cost of total revenues for the year ended December 31, 2006 amounted to \$267.5 million, compared with \$238.4 million for the year ended December 31, 2005. This 12.2% modest increase in cost of revenues, despite the 83.8% increase in revenues, was achieved mainly due to previously announced cost reductions and efficiency measures taken by the Company and the Company's cost structure, according to which, the Company has high net margins for each marginal additional sum of revenue.

GROSS LOSS. Gross loss for the year ended December 31, 2006 was \$80.1 million compared to a gross loss of \$136.4 million for the year ended December 31, 2005. The decrease in gross loss was mainly attributable to the increase in revenues and previously announced cost reductions and efficiency measures taken by the Company and the Company's cost structure, according to which, the Company has high net margins for each marginal additional sum of revenue.

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RESEARCH AND DEVELOPMENT. Research and development expenses for the year ended December 31, 2006 decreased to \$15.0 million from \$16.0 million for the year ended December 31, 2005. The decrease was mainly attributable to previously announced cost reductions and efficiency measures taken by the Company. Research and development expenses are reflected net of participation grants received from the Israeli government.

MARKETING, GENERAL AND ADMINISTRATIVE EXPENSES. Marketing, general and administrative expenses for the year ended December 31, 2006 increased to \$25.8 million from \$17.4 million for the year ended December 31, 2005, primarily due to stock based compensation expenses recorded for the first time and increased sales commissions attributable to the higher revenues mentioned above.

OPERATING LOSS. Operating loss for the year ended December 31, 2006 was \$121.0 million, compared to \$169.8 million for the year ended December 31, 2005. The decrease in the operating loss is attributable mainly to the decrease in the gross loss described above and the Company's cost structure, according to which, the Company has high net margins for each marginal additional sum of revenue.

FINANCING EXPENSES, NET. Financing expenses, net for the year ended December 31, 2006 were \$47.6 million compared to financing expenses, net of \$35.7 million for the year ended December 31, 2005. This increase is mainly due to an increase in costs related to our convertible debentures resulting mainly from the issuance of two new series of convertible debentures (in December 2005 and June 2006) and the weakening in 2006 of the NIS/dollar exchange rate which caused an increase in the dollar amount of the NIS denominated outstanding convertible debt.

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OTHER INCOME, NET. Other income, net, for the year ended December 31, 2006 was \$0.6 million compared to \$2.4 million for the year ended December 31, 2005, mainly due to a lower capital gain, net, from sale and disposal of equipment.

LOSS. Our loss for the year ended December 31, 2006 was \$167.9 million, compared to \$203.1 million for the year ended December 31, 2005. This decrease is primarily attributable to the decrease of \$48.8 million in the operating loss described above, offset by the \$11.9 million increase in financing expenses described above.

### IMPACT OF INFLATION AND CURRENCY FLUCTUATIONS

The dollar cost of our operations in Israel is influenced by the timing of any change in the rate of inflation in Israel and the extent to which such change is not offset by the change in valuation of the NIS in relation to the dollar. During the year ended December 31, 2007, the exchange rate of the dollar in relation to the NIS decreased by 9.0%, and the Israeli Consumer Price Index, or CPI, increased by 3.4% resulting in an increase in our dollar costs, including our dollar expenses related to our NIS dominated debts (during the year ended December 31, 2006 there was a decrease of 8.2% in the exchange rate of the dollar in relation to the NIS and a decrease of 0.1% in the CPI).

We believe that the rate of inflation in Israel has not had a material effect on our business to date. However, our dollar costs will increase if inflation in Israel exceeds the devaluation of the NIS against the dollar, or if the timing of such devaluation lags behind inflation in Israel. Our dollar costs will continue to increase if the exchange rate of the dollar in relation to the NIS will continue decreasing,

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Almost all of the cash generated from our operations and from our financing and investing activities is denominated in U.S. dollars and NIS. Our expenses and costs are denominated in NIS, U.S. dollars, Japanese Yen and Euros. We are, therefore, exposed to the risk of currency exchange rate fluctuations. The devaluation of the US dollar in relation to the NIS since 2007 increased mainly our dollar expenses related to our NIS denominated debentures and the dollar amount of our NIS denominated expenses.

Our borrowings under our Fab 2 credit facility, which comprise the majority of our long-term liabilities and our borrowings under the September 2007 credit lines, provide for interest based on a floating LIBOR rate, and we are therefore exposed to interest rate fluctuations. From time to time, we engage in various hedging strategies to reduce our exposure to some, but not all, of these risks and intend to continue to do so in the future. However, despite any such hedging activity, we are likely to remain exposed to interest rate fluctuations, which may increase the cost of our business activities, particularly our financing expenses.

Our 2002, 2006 and 2007 debentures are denominated in NIS linked to the Israeli CPI and therefore we are exposed to fluctuation in the NIS/dollar exchange rate. The dollar amount of our financing costs (interest and currency adjustments) related to these debentures will increase if the rate of inflation in Israel is not offset (or is offset on a lagging basis) by the devaluation of the NIS in relation to the dollar. In addition, the dollar amount of any repayment on account of the principal of these debentures will also increase. The recent devaluation of the US dollar in relation to the NIS increased our dollar expenses related to our NIS denominated debentures.

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

### B. LIQUIDITY AND CAPITAL RESOURCES

As of December 31, 2007, we had an aggregate of \$44.5 million in cash and cash equivalents. This compares to \$40.9 million we had as of December 31, 2006 in cash, cash equivalents, and short-term interest-bearing deposits. During the year ended December 31, 2007, we raised \$77.2 million in net proceeds from the issuance of debentures, ordinary shares and warrants, \$28 million as long-term loans, \$1.7 million from Investment Center grants and generated a net amount of \$16.7 million from our operating activities. These liquidity resources financed the capital expenditure investments we made during the year ended December 31, 2007, which aggregated \$109.0 million, mainly in connection with the purchase and installation of equipment and other assets for the ramp up of Fab 2, repayment of convertible debentures in the amount of \$7.1 million and repayment of long-term debt in the amount of \$3.2 million.

As of December 31, 2007, we had long-term loans from banks, in the amount of \$379.3 million, most of which are recorded at fair value, which we obtained mainly in connection with the establishment of Fab 2. As of such date, we had \$125.3 million in debentures, of which \$7.9 million are presented as current maturities.

In recent years, the Company has experienced significant recurring losses, recurring negative cash flows from operating activities and an increasing accumulated deficit. The Company is working in various ways to mitigate its financial difficulties. Since the second half of 2005, the Company has increased its customer base, mainly in Fab 2, modified its organizational structure to better address its customers and its market positioning, increased its sales, recorded ten consecutive quarters of positive EBITDA commencing the fourth quarter of 2005 and six consecutive quarters of positive cash flow from operations commencing the fourth quarter of 2006, reduced its losses, increased its capacity level and utilization rates, raised funds and restructured its bank debt.

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In 2006, the board of directors of the Company approved a plan to ramp up Fab 2's capacity to approximately 24,000 wafers per month in order to help meet customer needs and product qualification needs, based on its customer pipeline and reinforced by forecasted market conditions. This plan was completed during 2007. During 2008, we are implementing a capacity increase plan targeting to reach up to approximately 30,000 wafers per month, which has not yet been completed.

For details regarding the September 2007 Credit Line Agreements with each of the Banks and TIC and the September 2007 Amendment to the facility agreement with the banks, see - "Fab 2 Agreements" below. .

For details regarding the long term debentures issued in Israel in the second half of 2007 see - "Fab 2 Agreements" below.

For implications on us if we do not obtain Investment Center approval or generate increased levels of cash from operations or do not raise additional funding and if we will not be in compliance with the repayment schedule under the amended facility agreement and are unsuccessful in negotiating a revised repayment schedule, see Item 3. Key Information - Risk Factors - Risks Affecting Our Business - Risk Factors - "If we do not obtain Investment Center

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approval for our expansion plan..." and "If we will not be in compliance with the repayment schedule...".

In May 2008, we announced the commencement of a \$40 million per annum cost reduction plan pending synergies expected to occur following the Jazz acquisition and including the reduction in workforce of approximately 170 employees and announced the filing of a petition with the Israeli High Court of Justice targeting an approval for the receipt of grants under our requested Investment Center expansion plan.

We continue to examine alternatives for additional funding sources in order to fund our Fab 2 ramp-up, support our growth plans, including the Jazz acquisition, and improve our shareholders' equity.

### FAB 2 AGREEMENTS

#### WAFER PARTNER AGREEMENT.

During the years 2000 and 2001, we entered into various shares purchase agreements ("Wafer Partner Agreements") with Wafer Partners to partially finance the construction and equipping of Fab 2. Pursuant to the Wafer Partner Agreements, the Wafer Partners agreed to invest an aggregate of \$250 million to purchase Ordinary Shares of the Company. According to the Wafer Partner Agreements, we agreed, subject to certain conditions, to reserve for each Wafer Partner a certain portion, and collectively approximately 50%, of Fab 2 wafer manufacturing capacity for a period of 10 years ending January 2011.

In August 2006, we signed agreements with SanDisk in connection with the expansion of our 0.13 micron manufacturing capacity. SanDisk committed to purchase, upon such expansion, volume quantities of 0.13 micron wafers during 2007 and 2008 and has a right of first refusal on the use of this extra capacity in 2009. We also borrowed approximately \$10 million from SanDisk for the purpose of financing the purchase of the equipment needed for the expansion. The loan bears interest on the amounts outstanding at three-month USD LIBOR plus 1.1%. We granted SanDisk a first ranking charge on the equipment purchased with the amounts borrowed. In April 2008 we signed on an amendment, which postpones the repayment schedule of the loan.

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WAFER CREDITS. In connection with their investments in Fab 2, we issued to our wafer partners non-transferable credits that may be used to reduce the cash amounts to be paid by them when paying for wafers manufactured in Fab 2. These credits could generally be used at a rate of 7.5% for purchases made through June 2005 and 15% for purchases made thereafter. Our wafer partners, SanDisk, Alliance and Macronix, agreed that they will not utilize any of their credits, for purchase orders of our wafer products until December 31, 2006. For orders placed from January 1, 2004 to December 31, 2006, each major wafer partner was entitled, every quarter, to convert into our ordinary shares its wafer credits that could have been utilized by such wafer partner against the actual payment of wafers manufactured at Fab 2 during such quarter; otherwise, these credits will bear interest payable every quarter at three-month LIBOR plus 2.5%. As of May 31, 2008, approximately \$16 million of wafer credits had been converted into an aggregate of 10.4 million ordinary shares.

In 2006, we and one of the primary wafer partners, entered into an agreement to defer to December 31, 2009 the repayment of certain outstanding wafer credits that were not converted into ordinary shares. According to the agreement, with respect to certain orders placed before July 2006, and all

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orders placed thereafter through December 2009, such wafer credits that could have offset from payment by such wafer partner prior to the agreement, will bear interest at an annual rate equal to three-month LIBOR plus 1.1%, payable at the end of each quarter, through December 31, 2009.

In 2007 we decided to write-off the balance of wafer credits outstanding on behalf of one of our wafer partners, due to changes in its operations and the recent cessation of its semiconductor activities, we believe that no future utilization is expected and determined that a full write-down of its outstanding amount was appropriate.

All of the ordinary shares issued to our wafer partners and Israel Corp. in connection with their committed investments are subject to registration rights and pursuant to a shareholders agreement applicable to shares held by SanDisk, Israel Corp. and Macronix.

### CREDIT FACILITY

In January 2001, we entered into a credit facility with two leading Israeli banks, Bank Hapoalim and Bank Leumi, pursuant to which the banks committed to make available to us up to \$550 million in loans for Fab 2. As a result of our reduction of the total project cost of Fab 2 through the renegotiation of equipment prices and a change of equipment suppliers, in January 2002, we and our banks agreed to amend the credit facility such that the total amount of loans committed by the banks was reduced to \$500 million. Of that amount, we withdrew an aggregate of \$497 million. Under the original terms of the Facility Agreement the loans bore interest at a rate of LIBOR plus 1.55% per annum payable at the end of each quarter, which was later increased to LIBOR plus 2.5% per annum. In July 2005, we entered into a definitive amendment to our facility agreement with our banks which provided, among other things, for our banks to provide additional financing of up to approximately \$30 million. We borrowed such additional \$30 million pursuant to the July 2005 amendment.

**2006 AMENDMENT TO OUR FACILITY AGREEMENT.** As part of the financing efforts for the ramp-up plan to increase Fab 2's capacity to 24,000 wafers per month, in September 2006, we closed a definitive amendment to the credit facility with our banks for the refinancing of the approximately \$527 million of long-term debt outstanding thereunder. Pursuant to the amendment, among other things: (i) \$158 million, representing 30% of such debt, was converted into capital notes, with a face amount of \$79 million, that are convertible into 51,973,684 of our ordinary shares, at a conversion price per share of \$1.52; (ii) the interest rate applicable to the quarterly actual interest payment on the loans was reduced by 1.4%, from LIBOR plus 2.5% per annum to LIBOR plus 1.1% per annum, effective May 2006; (iii) the commencement date for the repayment of the outstanding loans, which following the conversion are approximately \$369 million, was postponed from July 2007 to September 2009, such that the loans shall be repaid in 12 quarterly installments between September 2009 and June 2012; (iv) the exercise periods of the warrants held by the banks immediately prior to the signing of the September 2006 amendment, were extended such that they are exercisable until September 2011, five years from the closing of the September 2006 amendment; and (v) the financial ratios and covenants that we are to satisfy were revised to be inline with our working plan as of the time of the amendment.

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To compensate the banks for the reduction in interest payments, we agreed to issue to the banks an additional number of shares (or equity equivalent capital notes or convertible debentures) on or about December 31, 2010, calculated based on the amount of decreased interest payments as set forth in



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the amendment. The amounts payable in securities of the Company may be payable in cash under certain circumstances and may be reduced in the event the Company prepays any part of the outstanding loans.

In connection with the amendment to the facility agreement, as part of the financing efforts for the ramp-up plan to increase Fab 2's capacity to 24,000 wafers per month, Israel Corp. invested \$100 million in consideration for a capital note, convertible into 65,789,474 of our ordinary shares, at a price per share of \$1.52; See below.

SEPTEMBER 2007 CREDIT LINE AGREEMENTS WITH EACH OF THE BANKS AND TIC AND SEPTEMBER 2007 AMENDMENT TO THE FACILITY AGREEMENT. In September 2007, we signed and closed definitive agreements with the Banks and with TIC, providing for credit lines totaling up to \$60 million, 15 million from each bank and \$30 million from TIC, to be used for the funding of equipment required for a ramp up plan in Fab 2 to increase its capacity to beyond 24,000 wafers per month. As of May 31, 2008 the entire amount had been borrowed under these credit lines. Loans under the credit lines bear interest at an annual rate of three-month USD LIBOR plus 3% and are repayable two years from the date any loan was borrowed(commencing October 2009). We paid the banks and TIC customary fees in connection with the credit line. Further, in September 2007 we signed and closed a definitive amendment to the Facility Agreement to mainly reflect the credit line agreements and to revise, based on the Company's operating plan at the time, the financial ratios and covenants with which we are required to comply (see below).

### COMPLIANCE WITH FINANCIAL RATIOS AND COVENANTS.

Under the terms of the amended facility agreement, we must meet certain financial ratios, including mainly financial covenants relating to our quarterly sales, our quarterly earnings before interest, taxes, depreciation and amortization (quarterly EBITDA), our "life of loan coverage ratio" (which is the ratio of our Fab 2 net cash flow to our total debt related to Fab 2 in any quarter), our ratio of debt to EBITDA and our ratio of equity to assets. Under the terms of the amended facility agreement, satisfying these financial ratios and covenants is a material provision.

As of May 31, 2008, the Company was in full compliance with all of the financial ratios and covenants under the amended Facility Agreement.

The amended Facility Agreement provides that if, as a result of any default, the Banks were to accelerate the Company's obligations, the Company would be obligated, among other matters, to immediately repay all loans made by the banks (which as of May 31, 2008 amounted to approximately \$399 million) plus penalties, and the banks would be entitled to exercise the remedies available to them under the amended Facility Agreement, including enforcement of their liens against all of the Company's assets.

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Under the terms of the amended facility agreement, (i) there are limitations on changes of ownership which generally require that, (a) until such time that more than 50% of our current outstanding loans have been repaid, Israel Corp. hold approximately 32.2 million of our ordinary shares (including shares issuable upon conversion of our convertible debentures) and thereafter hold approximately 14 million of our ordinary shares, and (b) our three largest wafer partners together hold approximately 60% of the shares held by them in January 2006 (with such amount being reduced under certain circumstances); (ii) TIC and our three largest wafer partners nominate a majority of our board of

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directors, subject to exceptions; and (iii) additional conditions and covenants, including restrictions on incurring debt and a prohibition on the distribution of dividends.

Our amended credit facility further provides that upon certain triggering events (such as the commencement of bankruptcy or receivership, proceedings against us ordered by a court of competent jurisdiction or the prior determination of an arbitrator that bankruptcy or receivership proceedings would be issued by a court against us were a petition to be filed with a court seeking reorganization or arrangement under applicable bankruptcy law or our requesting creditor protection), our banks will be able to bring a firm offer made by a potential investor to purchase our shares at the price provided in the offer. In such case, we shall be required thereafter to procure a rights offering to invest up to 60% of the amount of this offer on the same terms. If the offeror intends to purchase a majority of our outstanding share capital, the rights offering will be limited to allow for this, unless Israel Corp. and the wafer partners (excluding QuickLogic) 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.

**BANK'S WARRANTS-** In January 2001, we issued the banks warrants to purchase an aggregate of 400,000 ordinary shares at a purchase price of \$6.20 per share, which expired in January 2006. In December 2003, pursuant to the November 11, 2003 amendment to the credit facility, we issued our banks additional five year warrants to purchase an aggregate of 896,596 ordinary shares at a purchase price of \$6.17 per share, exercisable until December 2008. In connection with the July 2005 amendment to the credit facility, we issued our banks five year warrants to purchase an aggregate of 8,264,464 ordinary shares at a purchase price of \$1.21 per share. As described above, under the terms of the September 2006 amendment to our facility agreement, the warrants issued to the banks in 2003 and 2005 were extended to be exercisable until September 2011. In connection with the September 2007 credit lines we issued each of our banks and TIC warrants to purchase an aggregate of 5,411,764 ordinary shares at an exercise price of \$2.04 exercisable until March 2010.

### INVESTMENT BY ISRAEL CORPORATION.

In order to implement the ramp-up plan to increase Fab 2's capacity to 24,000 wafers per MONTH in a timely manner, in May 2006, we entered into an Equipment Purchase Agreement with Israel Corporation Ltd. ("TIC" or "Israel Corporation") according to which TIC would order up to approximately \$100 million worth of equipment for Fab 2. Under the terms of the Equipment Purchase Agreement: (i) TIC had the right to sell to us the equipment at cost, plus related expenses; (ii) we had the right to purchase the equipment from TIC at cost, plus related expenses, subject to our having raised \$100 million; and (iii) upon the purchase of the equipment from TIC we would assume TIC's obligations to the equipment suppliers.

In regard to our financing efforts for such ramp-up plan to increase Fab 2's capacity to 24,000 wafers per month and in connection with the September 2006 amendment to the Facility Agreement, in August 2006, we entered into a securities purchase agreement with TIC. The principal terms of the Securities Purchase Agreement were: (i) in consideration for its \$100 million investment, we issued to TIC capital notes convertible, for no additional consideration, into 65,789,474 of our Ordinary Shares at a conversion price per share of \$1.52; (ii) we would be deemed to have exercised the call option under the Equipment Purchase Agreement described above; and (iii) we and TIC would settle the amounts payable by TIC under the Securities Purchase Agreement with the amounts payable by us under the Equipment Purchase Agreement. The Securities Purchase Agreement closed contemporaneously with the closing of the September 2006 amendment to our facility agreement.

Upon the closing of the September 2006 amendment to our facility agreement and the Securities Purchase Agreement, TIC transferred ownership of the purchased equipment to us and we assumed TIC's obligations to the equipment suppliers.

#### INVESTMENT CENTER GRANTS

In December 2000, the Israeli government's Investment Center approved an investment program in connection with Fab 2. The approval certificate provides for government grants equal to 20% of qualified investments up to \$1.25 billion (i.e., up to \$250 million), subject to customary conditions and other conditions, including a requirement that approximately 30% of our Fab 2 funding consist of paid-in-capital and that \$550 million of our Fab 2 funding be obtained by way of a credit facility from commercial banks (which amount was subsequently reduced to \$500 million with the consent of the Investment Center). We have registered a lien on our assets for the benefit of the Investment Center which ranks subordinate to that of our banks. The approval certificate also provides for a tax holiday on all taxable income related to Fab 2 for the first two years of undistributed profitable operations. As of May 31, 2008, we had received \$165 million in grants from the Investment Center, and satisfied in full the 30% requirement described above. As long as we comply with the terms of our approval certificate, we are not required to make royalty payments or any other payments under the terms of our Investment Center grants.

To be eligible to receive grants, we were required to invest minimum amounts on an annual basis. We notified the Investment Center of our reduced rate of annual investments and in July 2004, we received approval of our revised investment schedule from the Investment Center. Under Israeli law, our not completing investments in an amount of \$1.25 billion by the end of 2005 could result in a request from the Investment Center to repay all or a portion of grants already received, which has not been made. Israeli law limits the ability of the Investment Center to extend this time limitation, unless approved through an expansion plan. In 2007, we submitted the final report in relation to the investments made through 2005 totaling \$825 million out of the entire investment plan of \$1.25 billion. The investment plan has been spread over additional years and was not completed through 2005 primarily due to the external economic conditions of the worldwide markets during 2001 through 2004 and the semiconductor industry in particular following the September 11, 2001 terrorist attack, as well as the outbreak of the Second Intifada (Israeli-Palestinian conflict) in September 2000, which lasted until 2003. We have been holding discussions with the Investment Center to achieve satisfactory arrangements to approve an expansion program to commence as of January 1, 2006. On numerous occasions we have received assurances and commitments from governmental authorities that such an expansion plan will be approved pending positive recommendation of an economical audit by the Industrial Bank of the Investment Center. In 2005, at the Investment Center's request, we submitted a revised business plan to the Investment Center and its Industrial Bank for the period commencing January 1, 2006. While the Industrial Bank of the Investment Center gave a positive recommendation, the governmental approval process has been protracted and as a result, in May 2008, we filed a petition with the Israeli High Court of Justice targeting an approval certificate from the Investment Center for the expansion plan. During the period from January 1, 2006 through May 31, 2008, we invested approximately \$230 million in Fab 2 plant and equipment. Currently, we cannot estimate when, if at all, we will receive approval of its request for an expansion plan to commence as of January 1, 2006 or if the Investment Center will approve our request. While there can be no assurance that we will obtain the Investment Center's approval for the expansion

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plan, we believe that the likelihood that the Investment Center would demand that we repay all or a portion of grants already received due to our not completing investments in an amount of \$1.25 billion by the end of 2005 is remote. See Item 3. Key Information - Risk Factors - Risks Affecting Our Business "Risk Factors - If the Investment Center will not approve our request for an expansion program . . ."

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### PUBLIC OFFERINGS AND PRIVATE PLACEMENTS

Set forth below is a description of public and private offerings of securities completed by us since inception of our financing activity for Feb 2.

**PUBLIC OFFERING IN ISRAEL.** January 2002. In January 2002, we completed a sale of units in Israel, composed of NIS 110,579,800 principal amount of convertible unsecured subordinated debentures and 2,211,596 options, resulting in net proceeds of approximately \$21.5 million. Each debenture is NIS 1 in principal amount, and is adjusted to reflect increases in the Israeli Consumer Price Index and bears interest at a rate of 4.7% per annum, payable yearly commencing January 20, 2003. Principal is payable in four installments beginning in January of 2006 through 2009. Prior to December 31, 2008, the debentures are convertible into ordinary shares at a conversion rate of one ordinary share per NIS 41 principal amount of debentures linked to the Israel Consumer Price Index. Each option was exercisable into one ordinary share until January 20, 2006 at an exercise price of NIS 39, linked to the Israel Consumer Price Index. All options expired and none have been exercised.

As of May 31, 2008 the outstanding principal amount of the convertible debentures was approximately, \$10 million.

**RIGHTS OFFERING 2002.** In September 2002, we distributed to our shareholders and certain of our employees in Israel and the United States rights to purchase ordinary shares and warrants to purchase our ordinary shares. Substantially all of the rights exercised in connection with the rights offering were exercised by Israel Corp. and our major wafer partners. The rights offering resulted in net proceeds of approximately \$19.7 million.

**PUBLIC OFFERING- JANUARY 2004.** In January 2004, we completed an underwritten public offering in the United States of 11.44 million of our ordinary shares at a price to the public of \$7.00 per share. The underwritten public offering resulted in net proceeds of approximately \$75.1 million.

**RIGHTS OFFERING 2005.** In December 2005, we distributed in the United States and Israel transferable rights to purchase up to \$50 million US dollar denominated debentures that are convertible into up to approximately 45.5 million of our ordinary shares. In connection with the exercise of these rights, through January 2006, we issued, in the aggregate, 48.2 million convertible debentures, with each debenture of \$1.00 in principal amount, or a total of \$48.2 million principal amount of debentures, which bear annual interest at the rate of 5%. The principal of the debentures, together with accrued interest, is payable in one installment on January 12, 2012. The debentures are convertible into our ordinary shares at a rate of one ordinary share per \$1.10 aggregate principal amount of debentures. The debentures contained a price protection anti-dilution provision, which expired in December 2006 without having been triggered. Subject to the terms of our facility agreement, we may at our option announce the early redemption of the debentures, provided that the outstanding aggregate balance of principal on account of the debentures is equal to or less than \$500,000. The debentures and interest thereon are unsecured and rank behind

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our existing and future secured indebtedness. As of May 31, 2008 the outstanding principal amount of the convertible debentures was \$27.9 million.

PUBLIC OFFERING IN ISRAEL 2006. In June 2006, we completed an underwritten public offering of our securities on the TASE in Israel resulting in gross proceeds of approximately NIS 140 million (approximately \$31 million). In the offering the following securities were issued, in the aggregate, (i) convertible debentures in the face amount of NIS 163,800,000 (approximately \$36.7 million), (ii) 390,000 options each exercisable for three months ended September 27, 2006 for NIS 100 principal amount of convertible debentures at an exercise price equal to 85% of their face amount linked to the Israeli Consumer Price Index ("CPI"), (iii) 10,920,000 warrants each exercisable for three months ended September 27, 2006 for one ordinary share at a price of NIS 6.75 linked to the CPI and (iv) 5,460,000 warrants each exercisable for three years ending June 30, 2009 for one ordinary share at a price of NIS 7.40 (approximately \$2.2), linked to the CPI. In addition, the Company sold the same securities through a private placement to its market maker in connection with the offering in consideration for NIS 526,000.

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The options and warrants described in (ii) and (iii) above expired in September 2006 and the warrants described in (iv) above expire on June 28, 2009. The convertible debentures are convertible into ordinary shares at a conversion rate of one ordinary share per NIS 8.40 (approximately \$2.5) principal amount of convertible debentures. The convertible debentures carry a zero coupon with principal payable at maturity in December 2011, at a premium of 37% over face value, linked to the Israeli Consumer Price Index (CPI). Under the terms of the convertible debentures, to the extent that the weighted average of the closing price of our shares on the Tel-Aviv Stock Exchange during the thirty trading days preceding June 27, 2008 is below NIS 6.60, the conversion rate will be decreased by the difference, expressed as a percentage, between NIS 6.60 and such weighted average. As of May 31, 2008 the outstanding principal amount of the convertible debentures was approximately \$65.1 million.

PRIVATE PLACEMENT IN ISRAEL 2006. In the fourth quarter of 2006, we received and accepted orders from Israeli investors in private placements for 11,615,000 Ordinary Shares and 5,227,500 warrants ("Series 5 Warrants") in the aggregate. The price of the Ordinary Shares was equal to the closing price of our shares on the Tel-Aviv Stock Exchange prior to the relevant private placements and the warrants were issued for no consideration. Total immediate gross proceeds amounted to approximately \$22 million.

Each of the Series 5 Warrants is exercisable at any time during a period of four years ending in December 2010 at a price per share equal to NIS 9.48 (approximately \$2.9) linked to the CPI, reflecting a 25% premium to the market price of the Company's shares at the date the prospectus was published.

PRIVATE PLACEMENT IN THE US - MARCH 2007. In March 2007, we completed a private placement of our securities in which we sold ordinary shares and warrants for the purchase of ordinary shares, raising a total of approximately \$29 million in gross proceeds. In the private placement, the Company issued approximately 18.8 million shares, warrants exercisable for approximately 9.4 million shares at an exercise price of \$2.04 (subject to downward adjustments), exercisable until March 15, 2012 ("Series I Warrants"), and short-term warrants exercisable for approximately 18.8 million shares at an exercise price of \$1.70, which was identical to the closing price of the Company's ordinary shares on the NASDAQ on the trading day immediately prior to the closing of the private placement ("Series II Warrants"), exercisable until December 31, 2007. All of

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the Series II Warrants have expired by their terms without exercise.

LONG TERM DEBENTURES ISSUED IN ISRAEL - 2007. In the second half of 2007, in a private placement with Israeli investors, we accepted orders for 342 units, resulting in gross proceeds of approximately NIS 167 million (approximately \$40 million). Each unit was comprised of: (i) long-term non-convertible bonds, repayable in six equal annual installments between the dates of December 2011 and December 2016, with a face amount of NIS 250,000 (approximately \$59,700) and carrying an annual interest rate of 8 percent; (ii) long-term convertible bonds repayable in December 2012 with a 17.2 NIS conversion price (approximately \$5.2) and with a face amount of NIS 262,500 (approximately \$62,700), carrying an annual interest rate of 8 percent, and (iii) 5,800 warrants, each exercisable for four years from the date the below mentioned prospectus is published, for one ordinary share at a price of \$2.04). Principal and interest on the bonds, including the convertible bonds, are linked to the Israeli consumer price index, or CPI, and were issued at 95.5% of par value. The conversion and exercise prices are subject to reduction in certain limited circumstances.

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In September 2007, we expanded our series of long-term debentures and warrants, by selling 12,118 units, each comprised of long-term non-convertible debentures, with a face amount of NIS 2,500 (approximately \$620), long-term convertible debentures, with a face amount of NIS 2,625 (approximately \$650), and 58 warrants. The debentures were issued at 90% of par value and with the same terms as the debentures and the warrants issued in the private placement. In this expansion, we raised gross proceeds of approximately \$14 million.

On January 4, 2008 we expanded our series of long-term convertible debentures which were issued at 85% of par value in consideration for gross proceeds of approximately \$1.4 million. As of May 31, 2008 the outstanding principal amount of the long-term convertible bonds amount was approximately \$40.9million and the amount of long-term non-convertible bonds was (approximately \$37million).

REGISTRATION STATEMENT In January 2008, we 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 \$40 million of securities which we may elect to offer and sell during the three years following the effective date of the registration statement. The registration form was declared effective in February 2008.

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

Our research and development activities have related primarily to our process development, and have been sponsored and funded by us with some participation by the Israeli government. Research and development expenses for the years ended December 31, 2007, 2006 and 2005 were \$13.8 million, \$15.0 million and \$16.0 million net of government participation of \$2.6 million, \$1.9 million and \$1.0 million, respectively We have also incurred costs in connection with the transfer of Toshiba and Freescale technology for use in Fab 2, some of which have been amortized over the estimated economic life of the technology following the commencement of production in Fab 2 during the third quarter of 2003 (see also in this Item "Critical Accounting Policies - Depreciation and Amortization"). For a description of our research & development policies and our patents and licenses, see "Item 4. Information on the Company-4.B. Business Overview".

### D. TREND INFORMATION

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The semiconductor industry has historically been highly cyclical on a seasonal and long-term basis. On a long-term basis, the market has fluctuated, cycling through periods of weak demand, production overcapacity, excess inventory and lower sales prices and periods of strong demand, full capacity utilization, product shortages and higher sales prices.

There is a trend within the semiconductor industry toward ever-smaller features and ever-growing wafer sizes. State-of-the-art fabs are currently using process geometries of 90-nanometer and below and wafer sizes of 300-mm. As demand for smaller geometries increases, there is downward pressure on the pricing of larger geometry products and increasing underutilization of fabs that are limited to manufacturing larger geometry products, which results in less profitability for manufacturers of larger geometry products. Fab 1 is limited to geometries of 0.35-micron and above on 150-mm wafers and Fab 2 currently offers process geometries of 0.18 and 0.13-micron and produces 200-mm wafers.

### E. OFF-BALANCE SHEET ARRANGEMENTS

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

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### F. TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS

The following table summarizes our contractual obligations and commercial commitments as of December 31, 2007:

	PAYMENT DUE				
TOTAL	LESS THAN 1 YEAR	2 YEARS	3 YEARS	4 Y	---
			(IN THOUSANDS)		
<b>CONTRACTUAL OBLIGATIONS</b>					
Short Term Debt(1)	49,025	49,025			
Other current liabilities(1)	10,797	10,797			
Long term debt(2)	483,479	32,600	116,456	139,709	131
Convertible Debenture(3)	214,577	18,417	18,041	9,674	68
Operating leases	4,211	2,544	1,248	419	
Construction & equipment purchase agreements(4)	45,606	45,606			
Other long-term liabilities	36,103	8,297	10,738	5,307	2
Purchase obligations	25,370	2,716	2,668	2,702	2
Total contractual obligations	869,168	170,002	149,151	157,811	205
	=====	=====	=====	=====	=====

(1) Short-term debt and Other current liabilities include our trade accounts payable for equipment and services that have already been supplied.

(2) Long-term debt includes principal and interest payments in accordance with the terms of the credit facility, as amended in September 2006, as well as the impact of our hedging transactions.

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- (3) Total amounts include expected principal and interest payments for the presented periods.
- (4) These amounts primarily consist of ordered equipment that has not yet been received. In addition to these contractual obligations, we have committed approximately \$7.4 million in standby letters of credit and guarantees to secure our Fab 2 equipment obligations.

The above table does not include other contractual obligations or commitments we have, such as undertakings pursuant to royalty agreements, commissions and service agreements. We are unable to reasonably estimate the total amounts or the time table for such payments to be paid under the terms of these agreements, as the royalties, commissions and required services are a function of future sales revenues, the volume of business and hourly-based fees. In addition, the above table does not include our liability with respect to our customers, which as of December 31, 2007, amounted to approximately \$29.9 million that may be utilized by them against future purchases of products. We are unable to reasonably estimate the total amounts that may be utilized by our customers since we can not reasonably estimate their future orders in the periods set forth in the above chart.

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### ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

#### A. DIRECTORS AND SENIOR MANAGEMENT

Set forth below is information regarding the members of our administrative, supervisory or management bodies and our directors.

SENIOR MANAGEMENT	AGE	TITLE
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Russell C. Ellwanger	53	Chief Executive Officer
Oren Shirazi	38	Acting Chief Financial Officer
Dr. Itzhak Edrei	48	Senior Vice President of Product Lines and Sales
Rafi Nave	58	Chief Technology Officer and Vice President of QA and Reliability
Ephie Koltin	46	Vice President and Fab 1, Test and Facility Manager
Dalit Dahan	40	Vice President of Human Resources and IT
Shimon Dahan	45	Vice President and Fab 2 and Supply Chain and Procurement Manager
Nati Somekh Gilboa	33	Corporate Secretary and General Counsel
Rafi Mor	44	Vice President of Business Development
DIRECTORS	AGE	TITLE
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Dov Moran	52	Chairman of the Board
Russell C. Ellwanger	53	Director
Miin Wu	59	Director
Ron Moskovitz	45	Director
Nir Gilad	51	Director
Kalman Kaufman	63	Independent Director
Miri Katz	57	Independent and External Director

RUSSELL C. ELLWANGER has served as our Chief Executive Officer since May 2005. From 1998 to 2005, Mr. Ellwanger served in various executive positions for Applied Materials Corporation, including Group Vice President, General Manager



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of the Applied Global Services (AGS), from 2004 to 2005, Group Vice President, General Manager of the CMP and Electroplating Business Group, from 2002 to 2004. Mr. Ellwanger also served as Corporate Vice President, General Manager of the Metrology and Inspection Business Group, from 2000 to 2002, during which he was based in Israel. From 1998 to 2000, Mr. Ellwanger served as Vice President of Applied Materials' 300-mm Program Office, USA. Mr. Ellwanger served as General Manager of Applied Materials' Metal CVD Division from 1997 to 1998 and from 1996 to 1997, Mr. Ellwanger served as Managing Director of CVD Business Development, during which he was based in Singapore. In addition, Mr. Ellwanger held various managerial positions in Novellus System from 1992 to 1996 and in Philips Semiconductors from 1980 to 1992.

OREN SHIRAZI was appointed as our acting Chief Financial Officer in November 2004. Mr. Shirazi joined us in October 1998 and served as our controller since July 2000, after serving as vice controller since October 1998. Prior to joining us, Mr. Shirazi was employed as an Audit Manager in the accounting firm of Ratzkovski-Fried & Co., which merged into Ernst & Young (Israel). Mr. Shirazi is a Certified Public Accountant in Israel (CPA). He has an MBA from the Graduate School of Business of Haifa University with honors and a BA in economics and accounting from the Haifa University.

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DR. ITZHAK EDREI was appointed Senior Vice President of Product Lines and Sales in August 2005 after serving as Vice President of Research and Development since August 2001, having served as Director of Research and Development since 1996. From 1994 to 1996, Dr. Edrei served as our Device and Yield Department Manager. Prior to joining Tower, Dr. Edrei was employed by National Semiconductor as Device Section Head. Dr. Edrei earned his Ph.D. in physics from Bar Ilan University and his post-doctorate from Rutgers University.

RAFI NAVE has served as our Chief Technology Officer since August 2005 and was appointed as Vice President of QA and Reliability in January 2008, after serving as a Vice President of Customer Services since August 2003. From 1996 to 2003, Mr. Nave served as Vice President of Research and Development for NDS Group. From 1974 to 1995, Mr. Nave was employed by Intel Corporation in a variety of positions of increasing responsibility, among them chip design engineer and General Manager of Intel's design center in Israel. Mr. Nave earned master and bachelor degrees in electrical engineering from the Technion - Israel Institute of Technology.

EPHIE KOLTIN has served as Vice President Fab 1 since April 2007, and has served as Test and Facility Manager since January 2008, after serving as Vice President of Business Development since August 2005, as Vice President, General Foundry and Mixed Signal Technology since 2003 and as Senior Director, FAB 2 Process Engineering since 2000. From 1996-1999, Mr. Koltin served in several senior positions as Director, NVM Technology, CIS technology and ERS manager, Fab 1. Prior to joining Tower, Mr. Koltin was employed at National Semiconductor and the Technion - Israel Institute of Technology. Mr. Koltin holds a B.Sc. in Mechanical Engineering and M.Sc. in Materials Engineering from the Technion - Israel Institute of Technology.

DALIT DAHAN serves as Vice President of Human Resources and was appointed IT Manager in January 2008, after serving as Vice President of Human Resources since April 2004. Ms. Dahan joined us in November 1993 and served as Personnel Manager since April 2000, after having served as Compensation & Benefits Manager and in various other positions in the Human Resources Department. Prior to joining us, Ms. Dahan served as Manager of the North Branch of O.R.S - Manpower Company for 3 years. Ms. Dahan holds a bachelor's degree in social science from

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Haifa University and an MBA from the University of Derby.

SHIMON DAHAN serves as Vice President and Supply Chain and Procurement Manager as was appointed as Fab 2 Manager in January 2008, after serving as Vice President of Manufacturing Services since January 2006, having served previously as Test & MTG manager since August 2005 and prior to that as Research and Development Operation Manager from November 2000. Prior to that, Mr. Dahan was employed by National Semiconductor in various capacities. Mr. Dahan holds a bachelors degree in Political Science from Haifa University, and an MBA from the University of Derby.

NATI SOMEKH GILBOA was appointed as Corporate Secretary and General Counsel in March 2005, has served as our Associate General Counsel since May 2004. From 2001 to 2004, Ms. Somekh Gilboa was employed by Goldsobel & Kirshen, Adv. Ms. Somekh Gilboa holds an LL.M. and J.D. from Boston University and a B.A. from Johns Hopkins University. She is a member of the Israeli Bar Association and the New York bar.

RAFI MOR was appointed Vice President of Business Development since April 2007, having served previously as Vice President and Fab 2 Manager since August 2005, as Fab 1 Manager since August 2003 and Senior Director and Fab 1 Manager since March 2003. From November 2000 to March 2003, Mr. Mor served as Senior Director of Process Device & Yield of Fab 1. From 1998 to 2000, Mr. Mor served as Director of Equipment Reliability & Support of Fab 1. Previously, Mr. Mor was employed by National Semiconductor in various engineering and management capacities. Mr. Mor earned master and bachelor degrees in chemical engineering from Ben Gurion University.

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DOV MORAN has served as Chairman of the Board since December 2006. Mr. Moran was a founder of M-Systems and served as a director, President, Chief Executive Officer and Chairman of the Board of Directors of M-Systems from 1989 until September 2006. From 1984 to 1989, Mr. Moran was an independent consultant in the computer industry. Mr. Moran holds a B.Sc. in Computers and Electronic Engineering from the Technion Israel Institute of Technology.

RON MOSKOWITZ has served as a director since October 2007. From July 2002 until November 2007, Mr. Moskovitz served as Senior Vice President and Chief Financial Officer of Amdocs Limited. From 1998 until July 2002, Mr. Moskovitz served as Vice President of Finance of Amdocs Limited. Between 1994 and 1998, Mr. Moskovitz served in various senior financial positions in Tower Semiconductor Ltd. Mr. Moskovitz is a certified public accountant in Israel. He holds a B.A. in accounting and economics from Haifa University and an MBA from Tel-Aviv University.

MIIN WU has served as a director since January 2001. Mr. Wu serves as Chairman and Chief Executive Officer of Macronix International and has been an executive officer of Macronix since its formation in 1989. Mr. Wu received both a B.S. and an M.S. in Electrical Engineering from National Cheng-Kung University in Taiwan as well as an M.S. in Material Science & Engineering from Stanford University.

KALMAN KAUFMAN has served as a director and as a member of our Audit Committee since August 2005 and as a members of our Stock Option and Compensation Committee since May 2008. Mr. Kaufman also served as Corporate Vice President at Applied Materials from 1994 to 2005. Between 1985 and 1994, Mr. Kaufman served as President of KLA Instruments Israel, a company he founded, and General Manager of Kulicke and Soffa Israel. Mr. Kaufman is currently the

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Chairman of Solgel Nanotechnology and is a member of several boards of directors. He holds engineering degrees from the Technion - Israel Institute of Technology.

MIRI KATZ has served as a director and member of the Audit Committee and the Stock Option and Compensation Committee since January 2007. Ms. Katz has been a member of the board of directors of bank Leumi Le-Israel since June 2008. Ms. Katz has been a member of the board of directors of Itamar Medical Ltd. since 2007. Ms. Katz has been a member of the board of trustees of The Hebrew University of Jerusalem and a member of its Committee for Academic Policy, the Audit Committee and the Constitution Committee since 2004. Ms. Katz has been of counsel at Ophir Katz & Co. and has served as a director of The Caesarea Foundation and The Caesarea Edmond Benjamin de Rothschild Development Corporation Ltd. since 2003. From 1997-2002, Ms. Katz served as the chairperson of the Israel Securities Authority. Ms. Katz holds an LL.B. from The Hebrew University of Jerusalem.

NIR GILAD has served as a director since May 2007. Mr. Gilad has served as Chief Executive Officer of Israel Corp. since June 2007; he previously served as Vice-Chief Executive Officer of the Israel Corporation from May 2006 to May 2007. From 2004-2006, Mr. Gilad served as vice-Chief Executive Officer of Migdal Holdings Insurance and Financings Ltd., Chief Executive Officer of Migdal Investment Management 2001 Ltd. and chairman of Migdal Capital Markets Ltd. In addition, from 1999-2003, Mr. Gilad served as General Comptroller of the Treasury Office of the State of Israel. Throughout the years, Mr. Gilad was a member and chairman of several boards of directors. Mr. Gilad holds a B.A. in Economics and Agricultural Management in Natural Sciences from the Hebrew University of Jerusalem and an M.A. in business administration from Bar Ilan University.

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Pursuant to a shareholders agreement dated January 18, 2001, SanDisk, Alliance Semiconductor, Israel Corp. and Macronix have agreed to vote all their respective shares for nominees designated by each shareholder and for the election of a nominee of Israel Corp. as Chairman of the Board, unless agreed to otherwise.

### B. COMPENSATION

For the year ended December 31, 2007, we paid to all our directors and senior management, as a group, an aggregate of \$2.7 million, in salaries, fees and bonuses, excluding management fees paid to Israel Corp. The total amount set aside or accrued in the year ended December 31, 2007 to provide for severance, retirement and similar benefits for such persons was \$0.3 million.

During 2001, the Audit Committee, Board of Directors and shareholders approved a stock option plan which provides for the grant to our Board members of options to purchase up to 400,000 ordinary shares. During 2007, we granted 80,000 options to our directors under this plan at a weighted average exercise price of \$1.74. As of December 31, 2007, 190,000 options to purchase ordinary shares were outstanding under this plan, with a weighted average exercise price of \$3.68. These options vest over a four-year period, according to various vesting schedules and are generally not exercisable following the fifth anniversary of their vesting date.

Since October 2001, our directors have foregone their directors' fees, except for fees required by law to be paid to our independent directors. The aggregate amount payable to each of our external directors with respect to the

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year ended December 31, 2007 was approximately \$26,000. Each of these directors also receives a per meeting fee.

On January 31, 2007, our shareholders approved, following our Board of Directors' and Audit Committee approvals, the grant to each independent director of the Company who is not affiliated with our major shareholders, and is not an employee of the Company, initial options to purchase Ordinary Shares that equal 150,000 less the number of unvested options to purchase Ordinary Shares held by such independent director as of the date of the shareholders' meeting. These initial options vest over three years, one third on the first month anniversary of the date the shareholders approved the grant, and thereafter, the remaining two-thirds pro-rata on a monthly basis over the remaining two years until fully vested. The exercise price per initial option is \$1.88, which was the closing price of our shares on the NASDAQ on the trading day immediately prior to the date the shareholders approved the grant. On January 31, 2007, our shareholders approved (i) the payment of annual fees and participation fees (per meeting) to the Independent Directors; and (ii) the reimbursement of out-of-pocket expenses of the independent directors, in both cases, to the maximum extent permitted under applicable Israeli law and regulations.

Each new independent director appointed will be granted 150,000 options to purchase Ordinary Shares, exercisable at the closing price of our shares on the NASDAQ on the trading day immediately prior to the relevant date of appointment, with the same vesting terms as the initial grants.

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 Ordinary Shares, which will vest over 3 years on a monthly basis until fully vested. The exercise price per each such option shall be the closing price of our 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. So long as this option plan remains in effect, no future grants will be made to independent directors under the 2001 plan mentioned above. During 2007, we granted 430,000 options to our independent directors under this plan at a weighted average exercise price of \$1.91. As of December 31, 2007, all such options were outstanding.

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On January 31, 2007, our shareholders approved the appointment of Dov Moran as Chairman of the Board of Directors and approved the grant to him of options to purchase 3,158,090 Ordinary Shares, which represented 1.0% of our issued and outstanding share capital on a fully diluted basis. The exercise price of these options is \$1.88, which was the closing price of our shares on the NASDAQ on the trading day immediately prior to the date of the shareholder approval. These options vest over four years as follows: 25% will vest on the 12 month anniversary of the shareholders approval date and 6.25% will vest each three months thereafter until fully vested.

In April 2005, our Board of Directors approved the grant of options to purchase up to 1,325,724 of our ordinary shares (which represented 1.6% of our issued and outstanding shares as of June 30, 2006) to Russell Ellwanger, our then newly-appointed Chief Executive Officer, who was also appointed as a director, which was further approved by our shareholders in October 2005. These options are exercisable at an exercise price of \$1.56, which was the closing market price of our shares on the last trading day prior to the board approval of the grant. These options vest over a four-year period, with 25% vesting over

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each year of employment. The options granted are exercisable for a period of ten years from the date of grant.

In addition, in May 2006, our Audit Committee and Board of Directors approved the grant of options to Mr. Ellwanger in addition to the options granted to him in April 2005, such that in total, he will hold options to purchase shares that represent 4% of our issued and outstanding shares on a fully diluted basis during the two-year period beginning May 16, 2006 (the date of the approval of the Audit Committee). This was further approved by our shareholders on September 28, 2006. The exercise price of the initial grant of approximately 4.3 million additional options was \$1.45, the 90 day average closing price of our shares prior to May 17, 2006 (the date of the Board of Directors' approval). In future dilutive events following May 2006, additional options were granted to the CEO with an exercise price equal to the price per share of the newly issued securities. The vesting period of the new options will be identical to the vesting period of the existing options. Any decrease in the Company's shares on a fully diluted basis during the two-year period from the approval of the Audit Committee will be followed by the cancellation of the corresponding options granted to the CEO. No additional options will be granted to the CEO under the April 2005 option grant. As of May 31, 2008, a total of 14,861,812 options were outstanding to our CEO at a weighted average exercise price of \$1.65.

On January 31, 2007, our shareholders approved: (i) an eight percent (8%) increase in Mr. Ellwanger's annual base salary from \$350,000 to \$378,000, effective January 1, 2007; and (ii) a performance-based bonus of up to \$525,000 for the year ending December 31, 2006.

In December 2007 our shareholders approved: (i) the procurement of a life insurance policy for Mr. Ellwanger; (ii) the payment to Mr. Ellwanger of an annual salary (together with social benefits) of approximately \$505,950, effective as of April 1, 2007; (iii) the reimbursement of Mr. Ellwanger for the difference, if any, between: (a) payments made by him, or on his behalf, to the Israeli tax authorities in respect of his aggregate base salary and performance-based bonuses from the Company, and (b) the amount that he would have been required to pay to the United States tax authorities had he been subject to United States taxation in respect of such amounts; (iv) the re-imbursment of Mr. Ellwanger for expenses associated with his relocation to Israel of up to approximately \$280,000 on an annual basis; and (v) a performance-based bonus of up to \$408,240 for the year ended December 31, 2007.

In May 2006, our board of directors approved a plan to offer each of our current employees, including senior management, the opportunity to exchange their existing options to purchase our ordinary shares for new options with an exercise price of \$1.45, which was the average closing price of our shares on the NASDAQ during the 90 consecutive trading days prior to the board of directors' approval in May 2006. The new options were granted based on terms similar to our existing employee option plan with new vesting periods.

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In May 2006, our board of directors further approved the allocation of additional options to be made available for grant to our employees if the total number of employee options, including the options to our CEO and senior management, during the 24 months period ended May 2008, will represent less than 8% of our shares on a fully diluted basis

During 2007, we granted a total of 995,000 options to purchase ordinary shares to our senior managers as a group (excluding the options granted to our

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CEO described above). These options have a weighted average exercise price of \$1.71 per share with vesting periods over four years and expire in 2017.

As of May 31, 2008, options to purchase approximately 14,073,953 ordinary shares held by our employees (excluding the options granted to our CEO and directors described above), with exercise prices ranging from \$1.06 to \$25, with weighted average exercise price of \$1.72 were outstanding under employees share options plans. Also as of such date, 787,000 options were available for future grants under our share options plans.

### C. BOARD PRACTICES

Our Articles of Association provide that the Board of Directors shall consist of at least five and no more than 11 members. All directors, except for external directors, hold office until their successors are elected at the next annual general meeting of shareholders. Our officers are appointed by the Board of Directors and (subject, in certain cases, to employment agreement provisions that require 270 days notice of termination) continue to serve at the discretion of the Board of Directors. The Board of Directors may grant the CEO the power to appoint officers.

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

None of the members of the Board are entitled to receive any severance or similar benefits upon termination of service with the Board of Directors.

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

- o an employment relationship;
- o a business or professional relationship maintained on a regular basis;
- o control; and
- o service as an office holder.

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A person shall be qualified to serve as an external director only if he or she possesses accounting and financial expertise or professional qualifications. At least one external director must possess accounting and financial expertise. The conditions and criteria for possessing accounting and financial expertise or professional qualifications were determined in regulations promulgated by the Israeli Minister of Justice in consultation with the Israeli Securities Authority. The regulations mandate that a person is deemed to have "expertise in

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finance and accounting" if his or her education, experience and qualifications provide him or her with expertise and understanding in business matters - accounting and financial statements, in a way that allows him or her to understand, in depth, the company's financial statements and to encourage discussion about the manner in which the financial data is presented.

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

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

The declaration required by law to be signed by a candidate to serve as an external director must include a statement by such candidate concerning his or her education and experience, if relevant, in order that the board of directors may properly evaluate whether such candidate meets the requirements set forth in the regulations. Additionally, the candidate should submit documents and certificates that support the statements set forth in the declaration.

No person may serve as an external director if the person's position or other business activities create, or may create, a conflict of interest with the person's responsibilities as an external director or may otherwise interfere with the person's ability to serve as an external director. If, at the time external directors are to be appointed, all current members of the board of directors are of the same gender, then at least one external director must be of the other gender.

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

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

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The initial term of an external director is three years and may be extended for additional three year terms, subject to certain conditions. External

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directors may be removed only by the same percentage of shareholders as is required for their election, or by a court, and then only if the external directors cease to meet the statutory qualifications for their appointment or if they violate their duty of loyalty to the company. Each committee of a company's board of directors must include at least one external director.

Ms. Miri Katz currently serves as our external director. Ms. Katz was appointed for an initial three-year term expiring in January 2010. Mr. Hans Rohrer's term serving as an external director expired in April 2008 and we will promptly call a shareholders' meeting to appoint an external director in his place.

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

The Companies Law requires public companies to appoint an audit committee. The responsibilities of the audit committee include reviewing the company's financial statements, monitoring the company's independent auditors, identifying irregularities in the management of the company's business and approving related party transactions as required by law. An audit committee must consist of at least three directors, including the external directors of the company. The chairman of the board of directors, any director employed by or otherwise providing services to the company, and a controlling shareholder or any relative of a controlling shareholder, may not be a member of the audit committee. An employee, executive officer or director of a controlling shareholder of an Israeli company may serve as a member of an audit committee under Israeli law, unless such individual controls more than 50% of the controlling shareholder. Each of our external directors are members of our audit committee.

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

Mr. Moran, Mr. Kalman and Ms. Katz serve on the stock option and compensation committee. The committee meets at least once a year. The primary function of this committee is to approve our employee compensation policy and determine remuneration and other terms of employment for our officers. In setting our remuneration policy, the committee considers a number of factors including:

- o the overall employment market environment;
- o the basic salaries and benefits available to comparable officers at comparable companies;
- o the need to attract and retain officers of an appropriate caliber;
- o the need to ensure such executives' commitment to the future success of our company by means of incentive schemes;
- o the performance of the officer; and
- o financial and operating results of our company.

#### D. EMPLOYEES



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

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	AS OF DECEMBER 31,		
	2007	2006	2005
Process and product engineering, R&D, design	308	343	293
Manufacturing, operations	904	879	734
Manufacturing support	82	113	115
Administration, marketing, finance	135	111	96
Total	1,429	1,446	1,238

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Except for an arrangement regarding pension contributions, we have no collective bargaining agreements with any of our employees. However, by administrative order, certain provisions of the collective bargaining agreements between the Histadrut (General Federation of Labor in Israel) and the Coordination Bureau of Economic Organizations, relating primarily to the length of the work day, minimum wages, pension contributions, insurance for work-related accidents, procedures for dismissing employees, determination of severance pay and other conditions of employment are applicable to our employees. In accordance with these provisions, the salaries of our employees are partially indexed to the Consumer Price Index in Israel.

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

### E. SHARE OWNERSHIP

All of the persons listed above under the caption "Directors and Senior Management" own ordinary shares and/or options to purchase ordinary shares. Except as described below, none of such persons own shares and/or options amounting to 1% or more of the outstanding ordinary shares. Information regarding our share option plans and warrants presented in Note 14B to our consolidated financial statements is incorporated herein by reference.

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### ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

#### D. MAJOR SHAREHOLDERS

The following table and notes thereto set forth information, as of May 31, 2008, concerning the beneficial ownership (as defined in Rule 13d-3 under the Securities Exchange Act of 1934, as amended), and on a diluted basis, of ordinary shares by any person who is known to own at least 5% of our issued and outstanding ordinary shares. As of such date, 125,364,021 ordinary shares were issued and outstanding. The voting rights of our major shareholders do not differ from the voting rights of other holders of our ordinary shares. However, certain of our shareholders have entered into a shareholders agreement pursuant to which they may be able to exercise control over matters requiring shareholder approval, including the election of directors and approval of significant corporate transactions.

IDENTITY OF PERSON OR GROUP -----	AMOUNT OWNED (1) -----	PERCENT OF CLASS (1) -----	PERCENT OF CLASS (DILUTED) (2) -----
Israel Corporation Ltd. (3)	101,231,883 (4)	47.68%	27.29%
SanDisk Corporation (3)	19,060,790 (5)	14.83%	5.14%
Macronix International Co. Ltd. (3)	9,682,485 (6)	7.67%	2.61%
Bank Leumi Le-Israel, B.M	31,567,372 (7)	20.12%	8.51%
Bank Hapoalim, B.M	32,037,960 (8)	20.35%	8.64%
Prisma Investment House Ltd.	10,055,527 (9)	7.81%	2.71%

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- (1) Assumes the holder's beneficial ownership of all ordinary shares and all securities that the holder has a right to purchase within 60 days.
  - (2) Assumes that all currently outstanding securities to purchase ordinary shares, other than those which cannot be calculated as of the date of this registration statement, have been exercised by all holders.
  - (3) Pursuant to a shareholders agreement among Israel Corp., SanDisk Corporation and Macronix Co. Ltd., each of Israel Corp., SanDisk Corporation and Macronix Co. Ltd. may be said to have shared voting and dispositive control over approximately 31% of the outstanding shares of Tower.
  - (4) Based on information provided by Israel Corp., represents 14,260,504 shares currently owned by Israel Corp., 18,181,823 shares issuable upon conversion of debentures, 65,789,474 shares issuable upon conversion of capital notes, 2,941,176 shares issuable upon the exercise of warrants at an exercise price per share of \$2.04 and 58,906 shares issuable upon the exercise of warrants at an exercise price per share of \$6.17.
  - (5) Based on information provided by SanDisk, represents 15,878,972 shares currently owned by SanDisk and 3,181,818 shares issuable upon conversion of debentures.
  - (6) Based on information provided by Macronix, represents 8,773,395 shares currently owned by Macronix and 909,090 shares issuable upon conversion of debentures.
  - (7) Based on information provided by Bank Leumi, represents 25,986,842 shares issuable upon conversion of capital notes, 4,132,232 shares issuable upon the exercise of warrants at an exercise price per share of \$1.21, 1,000,000

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shares issuable upon exercise of warrants at an exercise price per share of \$2.04 and 448,298 ordinary shares issuable upon exercise of warrants at an exercise price per share of \$6.17.

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- (8) Based on information provided by Bank Hapoalim represents 25,986,842 shares issuable upon conversion of capital notes, 4,132,232 shares issuable upon the exercise of warrants at an exercise price per share of \$1.21, 1,470,588 shares issuable upon exercise of warrants at an exercise price per share of \$2.04 and 448,298 ordinary shares issuable upon exercise of warrants issued to Tarshish Hahzakot Vehashkaot Hapoalim Ltd at an exercise price per share of \$6.17.
- (9) Based on information provided by Prisma represents 6,596,526 shares currently owned by Prisma and 3,459,001 shares issuable upon conversion of debentures.

Pursuant to a shareholders agreement dated January 18, 2001, among Israel Corp., Alliance Semiconductor, SanDisk and Macronix, such parties have agreed, among other things, to vote or cause to be voted all their respective shares for the election to the Board of Directors of nominees designated by each party, nominees recommended by the Board, the election of a designee of the Israel Corp. to serve as Chairman of the Board, unless agreed to otherwise (as was agreed in December 2006 with the appointment of Dov Moran as Chairman of the Board of Directors), and against the election of any other persons to the Board of Directors. In addition, subject to certain exceptions, each shareholder agreed to restrictions on the transfer of its shares, including certain rights of first refusal.

As of June 4, 2008, there were a total of 34 holders of record of our ordinary shares, of which 21 were registered with addresses in the United States. Such United States record holders were, as of such date, the holders of record of approximately 63% of our outstanding ordinary shares. The number of record holders in the United States is not representative of the number of beneficial holders nor is it representative of where such beneficial holders are resident since many of these ordinary shares were held of record by brokers or other nominees (including one U.S. nominee company, CEDE & Co., which held approximately 50% of our outstanding ordinary shares as of said date).

### B. RELATED PARTY TRANSACTIONS

EXEMPTION AND INDEMNIFICATION AGREEMENTS WITH DIRECTORS. In December 2001, we entered into exemption and indemnification agreements with the members of our Board of Directors, pursuant to which, subject to the limitations set forth in the Israeli Companies Law and our Articles of Association, they will be exempt from liability for breaches of the duty of care owed by them to the Company or indemnified for certain costs, expenses and liabilities with respect to events specified in the exemption and indemnification agreements. In September 2005, we entered into amended exemption and indemnification agreements with the members of our Board of Directors to reflect certain amendments to the Companies Law that came into effect in March 2005. Our shareholders approved these amended exemption and indemnification agreements in October 2005.

AGREEMENTS WITH CERTAIN OF OUR WAFER PARTNERS AND ISRAEL CORP. We are party to several agreements with our wafer partners, including SanDisk and Alliance, and Israel Corp related to the financing of Fab 2 and manufacture of products as described under the caption "Fab 2 Agreements" in "Item 5. Operating and Financial Review and Prospects Reference" of this annual report and Note 11A to

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the consolidated financial statements included in this annual report, which discussions are incorporated by reference herein.

AGREEMENTS WITH ISRAEL CORP. Discussed under "Item 4. Information on the Company -A. History and Development of the Company - Recent Developments" which discussion is incorporated by reference herein.

GRANT OF OPTIONS TO OUR CEO AND DIRECTOR. Discussed under "Item 6 - Directors, Senior Management and Employees - E. Share Ownership", which discussion is incorporated by reference herein.

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### C. INTERESTS OF EXPERTS AND COUNSEL

Not applicable.

## ITEM 8. FINANCIAL INFORMATION

### A. CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION

Our consolidated financial statements are incorporated herein by reference to pages following the signature page of this Annual Report.

### LEGAL PROCEEDINGS

In May 2008, we filed a petition with the Israeli High Court of Justice in which we asked the Court to order that our expansion plan be brought before the relevant Israeli governmental bodies for their respective approvals without delay. This petition was filed after making repeated requests over an extended period of time and after we sent letters in March, April and May of 2008 to the Israeli Ministry of Finance, the Israeli Ministry for Industry, Trade and Labor and the Investment Center, in which we noted among other things, that absent the expansion program being brought before the relevant governmental bodies within a specified period of time, a petition would be filed with the Court to compel the same. On May 29, 2008 the Court ordered that the respondents (the Israeli Ministry of Finance, the Israeli Ministry for Industry, Trade and Labor and the Investment Center) respond to our petition within 21 days of service of the petition. See also Item 3. Key Information - Risk Factors - Risks Affecting Our Business "Risk Factors - If the Investment Center will not approve our request for an expansion program . . ."

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

### B. SIGNIFICANT CHANGES

Not applicable.

## ITEM 9. THE OFFER AND LISTING

Our ordinary shares are listed and traded on the NASDAQ Global Market under the symbol "TSEM". In addition, in January 2001, our ordinary shares commenced trading on the Tel Aviv Stock Exchange (TASE) under the symbol "TSEM".

The following table sets forth, for the periods indicated, the high and low

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reported sales prices of the ordinary shares on the NASDAQ Global Market and Tel Aviv Stock Exchange:

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PERIOD	NASDAQ GLOBAL MARKET		TEL AVIV STOCK EXCHANGE	
	HIGH (\$)	LOW (\$)	HIGH (NIS)	LOW (NIS)
May 2008	1.25	0.84	4.13	2.90
April 2008	1.07	0.83	3.89	2.93
March 2008	1.06	0.79	3.69	2.63
February 2008	1.19	1.00	4.28	3.65
January 2008	1.45	0.74	5.50	3.29
December 2007	1.58	1.35	6.17	5.25
First quarter 2008	1.45	0.74	5.50	2.63
Fourth quarter 2007	1.80	1.35	7.25	5.25
Third quarter 2007	1.87	1.20	7.97	5.38
Second quarter 2007	1.94	1.42	7.63	6.20
First quarter 2007	2.08	1.64	8.88	7.00
Fourth quarter 2006	2.18	1.41	9.14	6.16
Third quarter 2006	1.51	1.24	6.69	5.11
Second quarter 2006	1.75	1.22	7.91	6.00
First quarter 2006	1.93	1.22	8.54	6.03
2007	2.08	1.20	8.88	5.25
2006	2.18	1.22	9.14	5.11
2005	2.38	0.92	10.30	5.10
2004	10.80	1.62	46.39	7.70
2003	7.90	2.16	35.00	10.25

### ITEM 10. ADDITIONAL INFORMATION

ARTICLES OF ASSOCIATION; ISRAELI COMPANIES LAW

ARTICLES OF ASSOCIATION

Our Articles of Association ("Articles") were adopted in November 2000, and

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as amended most recently on September 26, 2006, provide for an authorized capital of NIS 800 million divided into 800 million ordinary shares. The objective stated in the Articles is to engage in any lawful activity.

We have currently outstanding only one class of equity securities, our ordinary shares, par value NIS 1.00 per share. Holders of ordinary shares have one vote per share, and are entitled to participate equally in the payment of dividends and share distributions and, in the event of liquidation of the Company, in the distribution of assets after satisfaction of liabilities to creditors. No preferred shares are currently authorized.

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

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

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

### EXEMPTION AND INDEMNIFICATION AGREEMENTS WITH DIRECTORS

In December 2001, we entered into exemption and indemnification agreements with the members of our Board of Directors, pursuant to which, subject to the limitations set forth in the Israeli Companies Law and our Articles of Association, they will be exempt from liability for breaches of the duty of care

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owed by them to the Company or indemnified for certain costs, expenses and liabilities with respect to events specified in the exemption and indemnification agreements. In September 2005, we entered into amended exemption and indemnification agreements with the members of our Board of Directors to reflect certain amendments to the Companies Law that came into effect in March 2005. Our shareholders approved these amended exemption and indemnification agreements in October 2005.

### THE COMPANIES LAW

We are subject to the provisions of the Companies. The Companies Law codifies the fiduciary duties that "office holders," including directors and executive officers, owe to a company. An office holder, as defined in the Companies Law, is a director, general manager, chief business manager, deputy general manager, vice general manager, executive vice president, vice president, another manager directly subordinate to the managing director or any other person assuming the responsibilities of any of the foregoing positions without regard to such person's title. Each person listed in the table in "Item 6. Directors, Senior Management and Employees" above is an office holder. Under the Companies Law, all arrangements as to compensation of office holders who are not directors require approval of the board of directors. With the exception of compensation of external directors in an amount specified in the regulations adopted under the Companies Law, arrangements regarding the compensation of directors also require audit committee and shareholder approval.

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

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

The Companies Law applies the same disclosure requirements to a controlling shareholder of a public company, which is defined as a shareholder who has the ability to direct the activities of a company, other than if this power derives solely from the shareholder's position on the board of directors or any other

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position with the company and includes a shareholder that holds 25% or more of the voting rights if no other shareholder owns more than 50% of the voting rights in the company. Extraordinary transactions with a controlling shareholder or in which a controlling shareholder has a personal interest, and agreements relating to employment and compensation terms of controlling shareholders require the approval of the audit committee, the board of directors and the shareholders of the company. The shareholder approval must either include at least one-third of the shares held by disinterested shareholders who are present, in person or by proxy, at the meeting, or, alternatively, the total shareholdings of the disinterested shareholders who vote against the transaction must not represent more than one percent of the voting rights in the company.

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

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

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- o All or part of the consideration for the offering is not cash or registered securities, or the private placement is not being offered at market terms.
- o A private placement which results in anyone becoming a controlling shareholder.

The above transactions must not be adverse to the company's interest.

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

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

In addition, any controlling shareholder, any shareholder who knows that it possesses power to determine the outcome of a shareholder vote and any shareholder who has the power to appoint or prevent the appointment of an office holder in the company is under a duty to act with fairness towards the company. The Companies Law does not describe the substance of this duty.



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TENDER OFFER. A person wishing to acquire shares or any class of shares of a publicly traded Israeli company and who would as a result hold over 90% of the company's issued and outstanding share capital or of a class of shares, is required by the Companies Law to make a tender offer to all of the company's shareholders for the purchase of all of the issued and outstanding shares of the company. If the shares represented by the shareholders who did not tender their shares in the tender offer constitute less than 5% of the issued and outstanding share capital of the company, all of the shares that the acquirer offered to purchase will be transferred to the acquirer by operation of law. If the dissenting shareholders hold more than 5% of the issued and outstanding share capital of the company, the acquirer may not acquire additional shares of the company from shareholders who accepted the tender offer to the extent that following such acquisition the acquirer would then own over 90% of the company's issued and outstanding share capital. The Companies Law provides for an exception regarding this threshold requirement for a shareholder that on February 1, 2000 held over 90% of the public Israeli company's issued and outstanding share capital. Shareholders may petition the court to alter the consideration for the acquisition.

The Companies Law provides that, subject to certain exceptions, an acquisition of shares of an Israeli public company must be made by means of a tender offer if as a result of the acquisition the purchaser would become a holder of 25% or more of the voting rights in the company. This rule does not apply if there is already another shareholder of the company that holds 25% or more of the voting rights in the company. Similarly, the Companies Law provides that, subject to certain exceptions, an acquisition of shares in a public company must be made by means of a tender offer if as a result of the acquisition the purchaser would become a holder of more than 45% of the voting rights in the company, if there is no shareholder that holds more than 45% of the voting rights in the company.

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

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### NASDAQ MARKETPLACE RULES AND HOME COUNTRY PRACTICES

NASDAQ's Marketplace Rule 4350 ("Rule 4350") was amended to permit foreign private issuers to follow certain home country corporate governance practices without the need to seek an individual exemption from NASDAQ. Instead, a foreign private issuer must provide NASDAQ with a letter from outside counsel in its home country certifying that the issuer's corporate governance practices are not prohibited by home country law.

In July 2005, pursuant to this new exception, we provided a notice to NASDAQ required by Rule 4350, with a letter from our outside Israeli counsel informing it that in keeping with Rule 4350(a)(1) we had elected to follow the practices of our home country in lieu of those set forth in Rule 4350, to the extent permitted thereby, and provided a letter from our outside Israeli counsel certifying that our the practices being followed of amending employee share option plans that do not permit the grant of options to directors upon the approval of our board of directors, and without seeking shareholder approval (which approval is required for NASDAQ-listed companies under Marketplace Rule 4350(i)), is in place thereof were not prohibited by Israeli law.

As provided by Rule 4350(a)(1), in lieu of the requirements of Rule 4350 we have chosen to follow the practices of our home country with respect to the following:

- o We do not supply an annual report as required by Rule 4350(b)(1)(A), but makes our audited financial statements available to our shareholders prior to our annual general meeting.
- o The majority of our Board of Directors is not comprised of directors who meet the definition of independence contained in NASDAQ Marketplace Rule 4200(a)(15), as required by Rule 4350(c)(1). Under the Companies Law a majority of the Board of Directors is not required to be comprised of independent directors. In keeping with the requirements of the Companies Law two of the members of our Board of Directors are external directors, and are independent as defined under Rule 10A-3 of the Securities Act.
- o Our Board has not adopted a policy of conducting regularly scheduled meetings at which only our independent directors are present, as required by Rule 4350(c)(2). The Companies Law does not require our external directors to conduct regularly scheduled meetings at which only they are present.

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- o The compensation of our chief executive officer and all other executive officers is not determined, or recommended to the Board for determination, in the manner required by Rule 4350(c)(3). In accord with the Companies Law the compensation of the chief executive officer and all other officers requires the approval of our Board of Directors, however the compensation of our chief executive officer, who also serves as a director, requires also the approval of our shareholders.
- o Director nominees are not selected, or recommended for the Board's selection, as required by Rules 4350(c)(4)(A) and 4350(c)(4)(C).
- o Our Board of Directors has not adopted a formal written charter or

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board resolution addressing the nomination process and such related matters as may be required under United States federal securities laws, as required by Rule 4350(c)(4)(B).

- o Although we have adopted a formal written audit committee charter, there is no requirement under the Companies Law to do so and the charter as adopted may not specify all the items enumerated in Rule 4350(d)(1).
- o Our audit committee does not meet with all of the requirements of Rules 4350(d)(2)(A)(i), 4350(d)(2)(A)(iii) and 4350(d)(2)(A)(iv). Though all members are independent as such term is defined under Rule 10A-3 of the Exchange Act, the audit committee does not comply with the foregoing Rule 4350 requirements, as permitted by the Companies Law.
- o Our articles of association do not provide for a quorum of not less than 33 1/3% of the outstanding shares of our voting ordinary shares for meetings of our ordinary shareholders, as required by Rule 4350(f). Our articles of association presently require a quorum consisting of two shareholders holding a combined 33% of our ordinary shares. Under the Companies Law a quorum consisting of two shareholders holding a combined 25% of the company's voting shares is required.
- o We review and approve all related party transactions in accordance with the requirements and procedures for approval of interested party acts and transactions, set forth in the Companies Law, which do not fully reflect the requirements of Rule 4350(h).
- o We seek shareholder approval for all corporate action requiring such approval, in accordance with the requirements of the Companies Law, which does not fully reflect the requirements of Rule 4350(i).

We may in the future provide NASDAQ with an additional such letter or letters notifying NASDAQ that we are following our own practices, consistent with the Companies Law and practices in Israel in lieu of other requirements of Marketplace Rule 4350.

**MATERIAL CONTRACTS.** Discussions of these agreements are incorporated herein by reference to the discussion under the caption "Intellectual Property and Licensing Agreements" in "Item 4. Information on the Company" and under the caption "Fab 2 Agreements" in "Item 5. Operating and Financial Review and Prospects" of this annual report.

**FAB 2 AGREEMENTS.** Since 2000, we have entered into several important Fab 2 agreements and arrangements with a key technology partner, wafer and equity financing partners, the Israeli Investment Center and two leading Israeli banks. Discussions of these agreements are incorporated herein by reference to the discussion under the caption "Fab 2 Agreements" in "Item 5. Operating and Financial Review and Prospects" of this annual report and to Note 11A to the consolidated financial statements included in this annual report.

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**INTELLECTUAL PROPERTY AND LICENSING AGREEMENTS.** Discussions of these agreements are incorporated herein by reference to the discussion under the caption "Intellectual Property and Licensing Agreements" in "Item 4. Information on the Company" of this annual report.

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### EXCHANGE CONTROLS

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

Under Israeli law and our company's Articles, both residents and non-residents of Israel may freely hold, vote and trade our ordinary shares.

### TAXATION

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

#### ISRAELI CAPITAL GAINS TAX

Until the end of the year 2002 and provided we maintained our status as an "Industrial Corporation", capital gains from the sale of our securities were generally exempt from Israeli Capital Gains Tax. This exemption did not apply to a shareholder whose taxable income was determined pursuant to the Israeli Income Tax Law (Inflationary Adjustments) 1985, or to a person whose gains from selling or otherwise disposing of our securities were deemed to be business income.

On January 1, 2006 an amendment to the Israeli tax regime became effective (the "2006 Tax Reform"). The 2006 Tax Reform significantly changed the tax rates applicable to income derived from shares.

According to the 2006 Tax Reform, an individual is subject to a 20% tax rate on real capital gains derived from the sale of shares, as long as the individual is not a "substantial shareholder" (generally a shareholder with 10% or more of the right to profits, right to nominate a director or voting rights) in the company issuing the shares. The rate on the gains from publicly traded shares applicable to gains that were realized between January 1, 2003 and January 1, 2006 was 15%.

A substantial shareholder will be subject to tax at a rate of 25% in respect of real capital gains derived from the sale of shares issued by the company in which he or she is a substantial shareholder. The determination of whether the individual is a substantial shareholder will be made on the date that the securities are sold. In addition, the individual will be deemed to be a substantial shareholder if at any time during the 12 months preceding this date he or she had been a substantial shareholder.

Corporations will be subject to corporate tax rates in respect of total income, including capital gains, with the corporate tax rate reduced gradually from 29% in 2007 to 25% in 2010. However, between 2006 and 2009, corporations whose taxable income was not determined, immediately before the 2006 Tax Reform was published, pursuant to part B of the Israeli Income Tax Law (Inflationary Adjustments), 1985 or pursuant to the Income Tax Regulations (Rules on

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Bookkeeping by Foreign Invested Companies and Certain Partnership and Determination of their Chargeable Income), 1984 will generally be taxed at a rate of 25% on their capital gains from the sale of their securities.

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

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

Pursuant to the treaty between the Governments of the United States and Israel with respect to taxes on income, or the US-Israel tax treaty, the sale, exchange or disposition of our ordinary shares by a person who qualifies as a resident of the United States under the treaty and who is entitled to claim the benefits afforded to him by the treaty, will generally not be subject to Israeli capital gains tax. This exemption shall not apply to a person who held, directly or indirectly, shares representing 10% or more of the voting power in our company during any part of the 12-month period preceding the sale, exchange or disposition, subject to certain conditions. A sale, exchange or disposition of our shares by a US resident qualified under the treaty, who held, directly or indirectly, shares representing 10% or more of the voting power in our company at any time during the preceding 12-month period would be subject to Israeli tax, to the extent applicable; however, under the treaty, this US resident would be permitted to claim a credit for these taxes against the US income tax with respect to the sale, exchange or disposition, subject to the limitations in US laws applicable to foreign tax credits.

### ISRAELI TAX ON INTEREST INCOME AND ON ORIGINAL ISSUANCE DISCOUNT

Interest and Original Issuance Discount (OID) on our convertible debentures will, in general, be subject to Israeli tax of up to 20% if received by an individual. This reduced rate of tax will not apply if the interest and OID are business income in the hands of the recipient, if the interest is recorded or should be recorded in the individual's accounting books, if the recipient is a substantial shareholder of our company, if financing expenses related to the purchase of the debentures were deducted by the individual in the calculation of the individual's Israeli taxable income, or if the individual is an employee, supplier, or service provider of the company and the tax authorities have not been persuaded that the payment of interest was not affected by the relationship between the parties. In such cases the regular rate of tax on Interest and OID of up to 47% will apply to the individual. Interest and OID paid to corporations will be subject to corporate tax at the regular rates of 29% in 2007, 27% in 2008, 26% in 2009 and 25% in 2010 and thereafter. As a result of the provisions related to tax withholding, as explained below, foreign resident individuals and corporations will be subject to tax of 25% or less, according to the relevant treaty relating to their domicile country.

Under regulations promulgated as part of the 2006 Tax Reform, withholding

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tax at source from debenture interest and OID paid to resident individuals will, in general, be at a rate of 20%. However, if the individual receiving the interest and OID is a substantial shareholder, an employee, supplier or service provider of the company, tax will be withheld at the marginal rates applicable to individuals. Corporations will be subject to withholding tax at the applicable rate of corporate tax as set out above. Withholding tax at source from debenture interest and OID paid to non-resident individuals or corporations will be at a rate of 25% or less, according to the relevant treaty relating to their domicile country. In any event, under the US-Israel Tax Treaty, the maximum Israeli tax withheld on interest and OID paid on our convertible debentures due 2006 to a US treaty resident (other than a US bank, savings institution or company) is 17.5%.

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### ISRAELI TAX ON DIVIDEND INCOME

On distributions of dividends other than bonus shares, or stock dividends, to Israeli individuals and foreign resident individuals and corporations we would be required to withhold income tax at the rate of 20%. If the income out of which the dividend is being paid is attributable to an Approved Enterprise under the Law for the Encouragement of Capital Investments, 1959, the rate is 15%. A different rate may be provided for in a treaty between Israel and the shareholder's country of residence.

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

### PFIC RULES

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

We do not believe that we satisfied either of the tests for PFIC status in 2006 or in any prior year. However, there can be no assurance that we will not be a PFIC in 2007 or a later year. If, for example, the "passive income" earned by us exceeds 75% or more of our "gross income", we will be a PFIC under the "income test". Passive income for PFIC purposes includes, among other things, gross interest, dividends, royalties, rent and annuities. For manufacturing businesses, gross income for PFIC purposes should be determined by reducing total sales by the cost of goods sold. Although not free from doubt, if our cost of goods sold exceeds our total sales by an amount greater than our passive income, such that we are treated as if we had no gross income for PFIC purposes, we believe that we would not be a PFIC as a result of the income test. However, the tests for determining PFIC status are applied annually and it is difficult to make accurate predictions of future income and assets, which are relevant to the determination of PFIC status.

If we were to be a PFIC at any time during a US holder's holding period, such US holder would be required to either: (i) pay an interest charge together

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

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### DOCUMENTS ON DISPLAY

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

You may review and copy our filings with the SEC, including any exhibits and schedules, at the SEC's public reference room at 100 F Street N.E., Washington, D.C. 20549. You may call the SEC at 1-800-SEC-0330 for further information on this public reference room. As a foreign private issuer, all documents which were filed after November 4, 2002 on the SEC's EDGAR system will be available for retrieval on the SEC's website at [www.sec.gov](http://www.sec.gov). These SEC filings are also available to the public on the Israel Securities Authority's Magna website at [www.magna.isa.gov.il](http://www.magna.isa.gov.il) and from commercial document retrieval services. We also generally make available on our own web site ([www.towersemi.com](http://www.towersemi.com)) our quarterly and year-end financial statements as well as other information.

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

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

Market risk is the risk of loss related to changes in market prices, including interest rates and foreign exchange rates, of financial instruments and derivatives that may adversely impact our consolidated financial position, results of operations or cash flows.

Our primary market risk exposures relate to interest rate movements on borrowings, fluctuations of the exchange rate of the US dollar, which is the primary currency in which we conduct our operations, against the NIS, the Japanese Yen and the Euro. To manage those risks and mitigate our exposure to them, we from time to time use financial instruments, primarily, interest rate

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collar agreements (with a knock-out and knock-in features for certain agreements), and foreign currency forward contracts and options (including zero-cost cylinders).

All financial instruments are managed and controlled under a program of risk management in accordance with established policies. These policies are reviewed and approved by our board of directors. Our treasury operations are subject to an internal audit on a regular basis. We do not hold derivative financial instruments for speculative purposes, and we do not issue any derivative financial instruments for trading or speculative purposes.

### RISK OF INTEREST RATE FLUCTUATION

We have market risk exposure to changes in interest rates on our long-term debt obligations with floating interest rates. We have entered into debt obligations to support our capital expenditures and needs. From time to time we enter into interest rate collar agreements to modify our exposure to interest rate movements and to reduce our borrowing costs. These agreements limit our exposure to the risks of fluctuating interest rates by allowing us to convert a portion of the interest on our borrowings from a variable rate to a limited variable rate.

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We are subject to interest rate exposure in connection with \$369 million long-term debt outstanding as of December 31, 2007 under the Fab 2 facility agreement, as such debt bears interest at a rate of LIBOR plus 1.1% per annum (as amended in the September 2006 amendment to the Facility Agreement, as described above) and with \$28 million long-term debt outstanding as of December 31, 2007 under the September 2007 credit lines with each of the banks and TIC as such debt bears interest at a rate of LIBOR plus 3% per annum. The interest rate as of December 31, 2007 on \$317 million of the Fab 2 loans, not subject to the results of our collar agreements, was as follows: \$289 million - 5.98% and \$28 million - 7.88%. Our remaining loans of \$80 million, were covered by the collar agreements as of December 31, 2007, and bore annual interest rate as of such date of 5.1% including the results of our hedging activities described below. Following the September 2006 amendment to the Facility Agreement, the loans are repayable in 12 equal consecutive quarterly installments commencing September 30, 2009 and the \$28 million loans under the September 2007 credit lines with each of the banks and TIC are repayable two years from the date any loan was borrowed (commencing October 2009).

As of December 31, 2007, we had collar agreements in the amount of \$80 million which expire in 2009.

Our collar agreements resulted in a gain of \$1.1 million in the year ended December 31, 2007. As of December 31, 2007, the fair value of these agreements was a \$0.3 million gain.

During the first quarter of 2008 we entered into new collar agreements in the amount of \$290 million, effective June and September 2008. The terms of these collar agreements are as follows: if the LIBOR is below the floor level of 2% we will pay total interest at the fixed rate of 3.1% (the 2.0% floor rate plus 1.1% under the amended facility agreement); if the LIBOR is between 2.0% and 3.74% (or 3.94% for part of the agreements), we will pay total interest at the actual LIBOR plus 1.1%; if the LIBOR is higher than 3.74% (or 3.94%) we will pay total interest at a fixed rate of 4.84% and 5.04% (the cap level plus 1.1%).

Assuming a 10% upward shift in the LIBOR rate at December 31, 2007 (from



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4.88% to 5.37%), will increase our yearly interest payments. Such an increase in the LIBOR rate will not affect our interest payments on our \$80 million loans hedged by the collar with a CAP level of 4% since the interest payments will remain based on the CAP level + 1.1% and will not affect our interest payments on our \$290 million loans hedged by our new collar agreements effective throughout 2008 with a CAP level of 3.74 and 3.94%, since the interest payments will remain based on the CAP level + 1.1%. Giving effect to all the above, assuming a 10% upward shift in the LIBOR rate at December 31, 2007 (from 4.88% to 5.37%), will increase our yearly interest payments in 2008 by \$1.2 million.

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

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### FOREIGN EXCHANGE RISK

We are exposed to the risk of fluctuation in the NIS/dollar exchange rate with respect to our 2002, 2006 and 2007 debentures. As of December 31, 2007 the adjusted outstanding principal amount of these debentures was \$132.8 million. The dollar amount of our finance costs (interest and currency adjustments) related to these debentures will be increased if the rate of inflation in Israel is not offset (or is offset on a lagging basis) by the devaluation of the NIS in relation to the dollar. In addition, the dollar amount of any repayment on account of the principal of these debentures will be increased as well. If the devaluation of the NIS against the dollar is greater than the rate of inflation in Israel, the dollar amounts we may raise on the date of exercising our NIS denominated options linked to the CPI will be decreased. The recent devaluation of the US dollar in relation to the NIS increased our dollar expenses related to our NIS denominated debentures.

From the date of the issuance of the 2002 convertible debentures in January 2002 until December 31, 2007, the Israel consumer price index increased by 11.8% while the US dollar/NIS exchange rate decreased by 16.1%. From the date of the issuance of the 2006 convertible debentures in June 2006 until December 31, 2007, the Israel consumer price index increased by 1.8% while the US dollar/NIS exchange rate decreased by 14.1%. From the date of the issuance of the 2007 debentures in the second half of 2007 until December 31, 2007, the Israel consumer price index increased by 2.9% while the US dollar/NIS exchange rate decreased by approximately 8%.

The 2002 convertible debentures bear annual interest at a fixed rate of 4.7%. The debentures are payable in four annual installments commencing in January 2006. The 2005 convertible debentures are denominated in USD and bear annual interest at the rate of 5%. The principle of the debentures, together with accrued interest, will be payable in one installment on January 12, 2012. The 2006 convertible debentures carry a zero coupon with principal payable at maturity in December 2011, at a premium of 37% over face value. The 2007 debentures bear annual interest at a fixed rate of 8.0% and repayable starting 2011. Therefore, we are not subject to exposure to interest rate fluctuations with respect to the debentures. However, in case the actual market interest rates are lower than the interest rate provided on the debentures, our actual finance costs would be higher than in case our debentures bear floating interest rate.

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Our main foreign currency exposures other than debentures are associated with exchange rate movements of the US dollar, our functional and reporting currency, against the NIS, Japanese Yen and the Euro. To protect against reductions in value and the volatility of future cash flows caused by changes in foreign exchange rates, we utilize foreign currency forward contracts and options (including zero-cost cylinder options) in order to minimize part of the impact of foreign currency fluctuations on our financial position and results of operations. A cylinder option is a combination of a purchased call option and a written put option. The exercise prices of the options may not be identical and this effectively creates a synthetic range forward. The maturity dates of the options coincide with the scheduled payments.

In order to mitigate our exposure to the risk of fluctuations in the NIS/dollar exchange rate with respect to our NIS denominated expenses, mainly payroll, we entered in 2008 into \$15.8 million new option transactions, which will expire throughout 2008.

We are exposed to currency risk in the event of default by the other parties of the exchange transaction. We estimate the likelihood of such default to occur is remote, as the other parties are widely recognized and reputable Israeli banks.

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Assuming a 10% revaluation of the NIS against the US dollar on December 31, 2007 (from 3.846 to 3.46), the effective fair value of our liabilities net of assets denominated in NIS (mainly vendors, debentures and liabilities in regard to employees ) would have increased in approximately \$13 million.

### IMPACT OF INFLATION

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

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

Not applicable.

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## PART II

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

None.

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

Not applicable.

### ITEM 15. CONTROLS AND PROCEDURES

#### EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

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

### INTERNAL CONTROL OVER FINANCIAL REPORTING

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Under the supervision and with the participation of our management, including our Chief Executive Officer and acting Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the criteria in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation, management has concluded that our internal control over financial reporting was effective as of December 31, 2007.

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

ATTESTATION REPORT OF THE REGISTERED PUBLIC ACCOUNTING FIRM. The attestation report of our registered public accounting firm is included in page F-1 of our audited consolidated financial statements set forth in "Item 18. Financial Statements," and is incorporated herein by reference.

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ITEM 16. [RESERVED]

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our board of directors has determined that a member of our audit committee, Ms. Miri Katz, is an audit committee financial expert and is independent as defined by NASDAQ Marketplace Rule 4350.

ITEM 16B. CODE OF ETHICS

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

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### ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

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

	2007	2006
	-----	-----
	(US DOLLARS IN THOUSANDS)	
	-----	-----
Audit fees (1)	217	235
Audit-related fees (2)	29	20
Tax fees (3)	-	9
	-----	-----
	246	264
	=====	=====

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- (1) Audit fees consist of fees for professional services rendered for the audit of our consolidated financial statements, services in connection with statutory and regulatory filings and engagements (including review of Forms 20-F, F-1, F-3 and S-8), and reviews of our unaudited interim consolidated financial statements included in our quarterly reports.
- (2) Audit related fees consist of accounting consultation and consultation on financial accounting standards, not arising as part of the audit.
- (3) Tax fees consist of fees for tax compliance services, tax planning and tax advice.

Our audit committee's charter states that the audit committee is responsible for receiving specific information on the independent auditor's proposed services and for pre-approving all audit services annually and separately approving any other permitted non-audit related services. All of the non-audit services provided in 2006 and 2007 were pre-approved without reliance on the Waiver Provisions in paragraph (c) (7) (i) (C) of Regulation S-X.

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

Not Applicable.

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

Not Applicable.

## PART III

### ITEM 17. FINANCIAL STATEMENTS

Not applicable.

### ITEM 18. FINANCIAL STATEMENTS

See Index to Financial Statements following the signature page.

### ITEM 19. EXHIBITS

1.1 Articles of Association of the Registrant, approved by shareholders on

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

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

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

2.1 Bank Warrants, dated January 18, 2001, between the Registrant and Bank Hapoalim B.M. and Bank Leumi Le-Israel B.M. (incorporated by reference to exhibit 2.2 to the Registrant's Annual Report on Form 20-F for the year ended December 31, 2000 (the "2000 Form 20-F")).

2.2 Registration Rights Agreement, dated January 18, 2001, by and between SanDisk Corporation, Israel Corporation, Alliance Semiconductor Ltd. and Macronix International Co., Ltd. (incorporated by reference to exhibit 2.2 to the 2000 Form 20-F).

2.3 Terms of the Registrant's Convertible Debentures issued under an Indenture, dated January 22, 2002, (incorporated by reference to the summary of terms included under the caption "Description of the Debentures" in Exhibit C to the Registrant's Report on Form 6-K for January 2002 (No. 2), filed January 16, 2002 ("January 2002 Form 6-K")).

2.4 Terms of the Registrant's Options (Series 1) (incorporated by reference to the summary of terms included under the caption "Description of the Options" in Exhibit C to the January 2002 Form 6-K).

2.5 Form of Indenture (incorporated by reference to exhibit 4.2 to the Registrant's Amendment No. 6 to the Registration Statement on Form F-1/A No. 333-126909 (the "Form F-1 No. 333-126909")).

2.6 Form of Note for the Debentures (incorporated herein by reference to Exhibit A to the Indenture filed as exhibit 4.2 to Form F-1 No. 333-126909).

2.7 First Amendment to a Warrant Issued on December 11, 2003 to Tarshish Hahzakot Vehashkaot Hapoalim Ltd., dated September 28, 2006 (incorporated by reference to exhibit 99.14 of the November 2006 Form 6-K).

2.8 First Amendment to a Warrant Issued on December 11, 2003 to Bank Leumi Le-Israel, dated September 28, 2006 (incorporated by reference to exhibit 99.15 of the November 2006 Form 6-K).

2.9 First Amendment to a Warrant Issued on August 4, 2005 to Bank Hapoalim B.M., dated September 28, 2006 (incorporated by reference to exhibit 99.16 of the November 2006 Form 6-K).

2.10 First Amendment to a Warrant Issued on August 4, 2005 to Bank Leumi Le-Israel B.M., dated September 28, 2006 (incorporated by reference to exhibit 99.17 of the November 2006 Form 6-K).

2.11 Form of Series I Warrant (incorporated by reference to exhibit 99.6 of

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the March 2007 Form 6-K).

2.12 Form of Series II Warrant (incorporated by reference to exhibit 99.7 of the March 2007 Form 6-K).

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3.1 Consolidated Shareholders Agreement, dated January 18, 2001, by and between SanDisk Corporation, Israel Corporation, Alliance Semiconductor Ltd. and Macronix International Co., Ltd. (incorporated by reference to the correspondingly-numbered exhibit to the 2000 Form 20-F).

4.1 Share Purchase Agreement, dated July 4, 2000, by and between SanDisk Corporation and the Registrant (incorporated by reference to the correspondingly-numbered exhibit to the 2000 Form 20-F).

4.2 Additional Purchase Obligation Agreement, dated July 4, 2000, by and between SanDisk Corporation ("SanDisk") and the Registrant (incorporated by reference to the correspondingly-numbered exhibit to the 2000 Form 20-F).

4.3 Share Purchase Agreement, dated August 29, 2000, by and between Alliance Semiconductor Corporation ("Alliance") and the Registrant (incorporated by reference to the correspondingly-numbered exhibit to the 2000 Form 20-F).

4.4 Share Purchase Agreement, dated December 11, 2000, by and between QuickLogic Corporation ("QuickLogic") and the Registrant (incorporated by reference to the correspondingly-numbered exhibit to the 2000 Form 20-F).

4.5 Share Purchase Agreement, dated December 12, 2000, by and between Macronix International Co., Ltd. ("Macronix") and the Registrant (incorporated by reference to the correspondingly-numbered exhibit to the 2000 Form 20-F).

4.6 Share Purchase Agreement, dated December 12, 2000, between Israel Corporation and the Registrant (incorporated by reference to the correspondingly-numbered exhibit to the 2000 Form 20-F).

4.7 Additional Purchase Obligation Agreement, dated December 12, 2000, between Israel Corporation and the Registrant (incorporated by reference to the correspondingly-numbered exhibit to the 2000 Form 20-F).

4.8 Share Purchase Agreement, dated February 11, 2001, between The Challenge Fund - Etgar II and the Registrant (incorporated by reference to the correspondingly-numbered exhibit to the 2000 Form 20-F).

4.9 Facility Agreement, dated January 18, 2001, among the Registrant, Bank Hapoalim B.M. and Bank Leumi Le-Israel B.M. (the "Facility Agreement") (incorporated by reference to the correspondingly-numbered exhibit to the 2000 Form 20-F).

4.10 Design and Construction/Turn-Key Contract, dated August 20, 2000, among the Registrant, M+W Zander Holding GmbH, Meissner-Baran Ltd. and Baran Group Ltd. (incorporated by reference to the correspondingly-numbered exhibit to the 2000 Form 20-F).

4.11 Approval, dated December 31, 2000, of the Israeli Investment Center (Hebrew language document; a summary of the terms is included in the 2000 Form 20-F under the caption "Fab 2 Agreements" in "Item 5. Operating and Financial Review and Prospects") (incorporated by reference to the correspondingly-numbered exhibit to the 2000 Form 20-F).

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4.12 Agreement between the Registrant and Saifun, dated October 9, 1997 (incorporated by reference to exhibit 1.1 to the Registrant's Annual Report on Form 20-F for the year ended December 31, 1997).

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4.13 Registrant's Non-Employee Director Share Option Plan 2000/3 (incorporated by reference to exhibit 4.5 to the Registrant's Registration Statement on Form S-8 No. 333-83204 ("Form S-8 No. 333-83204")).

4.14 Form of Grant Letter for Non-Employee Directors Share Option Plan 2001/4 (incorporated by reference to exhibit 4.9 to the Form S-8 No. 333-83204).

4.15 Form of Grant Letter for Non-Employee Directors Share Option Plan 2001/5 (incorporated by reference to exhibit 4.10 to the Form S-8 No. 333-83204).

4.16 Wafer Partner Conversion Agreements, dated September 2001, between the Registrant and each of SanDisk, Alliance and Macronix (incorporated by reference to exhibit 4.17 to the Registrant's Annual Report on Form 20-F for the year ended December 31, 2001 (the "2001 Form 20-F)).

4.17 Letter Agreement, dated November 29, 2001, among SanDisk, Alliance, Macronix, QuickLogic and the Registrant regarding the Utilization of Prepayments (incorporated by reference to exhibit 4.18 to the 2001 Form 20-F).

4.18 Letter Agreements among Alliance, Macronix, QuickLogic, Israel Corp. and the Registrant and between SanDisk and the Registrant regarding Additional Wafer Partner Financing Date (incorporated by reference to exhibit 4.19 to the 2001 Form 20-F).

4.19 Letter Agreement, dated November 15, 2001, among SanDisk, Alliance, Macronix, QuickLogic, ICTech and the Registrant regarding Amendment to Financing Plan (incorporated by reference to exhibit 4.20 to the 2001 Form 20-F).

4.20 First Amendment, dated January 29, 2001, to the Facility Agreement (incorporated by reference to exhibit 4.21 to the 2001 Form 20-F).

4.21 Second Amendment, dated January 10, 2002, to Facility Agreement (incorporated by reference to exhibit 4.22 to the 2001 Form 20-F).

4.22 Third Amendment, dated March 7, 2002, to the Facility Agreement (incorporated by reference to exhibit 4.23 to the 2001 Form 20-F).

4.23 Joint Development and Transfer and Cross License Agreement, dated May 2002, between the Registrant and a Japanese manufacturer (incorporated by reference to exhibit 10.3 to the Registrant's Registration Statement on Form F-2, No. 333-97043).

4.24 Technology License Agreement, dated April 7, 2000, between the Registrant and Toshiba Corporation (incorporated by reference to exhibit 10.4 to the Registrant's Registration Statement on Form F-2, No. 333-97043). (Portions of this exhibit have been omitted pursuant to a request for confidential treatment.)

4.25 Technology Transfer License Agreement, dated September 2002, between Registrant and Motorola, Inc. (incorporated by reference to exhibit 10.5 to the Registrant's Registration Statement on Form F-2, No. 333-97043). (Portions of

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this exhibit have been omitted pursuant to a request for confidential treatment.)

4.26 Fourth Amendment, dated April 29, 2002, to the Facility Agreement (incorporated by reference to exhibit 4.27 to the Registrant's Annual Report on Form 20-F for the year ended December 31, 2002 (the "2002 Form 20-F)).

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4.27 Fifth Amendment dated September 18, 2002 to the Facility Agreement (incorporated by reference to exhibit 4.28 to the 2002 Form 20-F).

4.28 Amendment to Fifth Amendment to the Facility Agreement, dated October 22, 2002, to the Facility Agreement (incorporated by reference to exhibit 4.29 to the 2002 Form 20-F).

4.29 Letter Agreement, dated March 2002, among SanDisk, Alliance, Macronix, ICTech and Challenge Fund to advance Third and Fourth Milestone Payments (incorporated by reference to exhibit 4.30 to the 2002 Form 20-F).

4.30 Letter Agreement, dated July 2002, among SanDisk, Alliance, Macronix, and ICTech to exercise rights distributed in rights offering (incorporated by reference to exhibit 4.31 to the 2002 Form 20-F).

4.31 Letter Agreement, dated March 2003, among SanDisk, Alliance, Macronix, ICTech, and the Registrant (incorporated by reference to exhibit 4.32 to the 2002 Form 20-F).

4.32 Form of Rights Agent Agreement between the Registrant and American Stock Transfer & Trust Company (including form of Rights Certificate) (incorporated by reference to exhibit 4.1 to the Registrant's Registration Statement on Form F-2, No. 333-97043).

4.33 Form of Warrant Agreement between the Registrant and American Stock Transfer & Trust Company (including form of Warrant Certificate) (incorporated by reference to exhibit 4.2 to the Registrant's Registration Statement on Form F-2, No. 333-97043).

4.34 Reserved.

4.35 Investment Center Agreement related to Fab 1, dated November 13, 2001 (English translation of Hebrew original) (incorporated by reference to exhibit 10.2 to the Registrant's Registration Statement on Form F-2, No. 333-97043).

4.36 Development and License Agreement, dated March 31, 2002, between Virage Logic Corporation and the Registrant (incorporated by reference to exhibit 4.37 to the 2002 Form 20-F). (Portions of this exhibit have been omitted pursuant to a request for confidential treatment.)

4.37 Master Services and License Agreement, dated June 2002, between Artisan Components, Inc. and the Registrant (incorporated by reference to exhibit 4.38 to the 2002 Form 20-F).

4.38 Seventh Amendment to the Facility Agreement, dated November 11, 2003, (incorporated by reference to Exhibit 99.1 of the Registrant's Report on Form 6-K filed on December 17, 2003).

4.39 Undertaking of the Registrant, dated November 11, 2003 (incorporated by reference to Exhibit 99.3 of the Registrant's Report on Form 6-K filed on



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December 17, 2003).

4.40 Letter Agreement, dated November 11, 2003, by and among the Registrant, Israel Corporation Technologies, SanDisk Corporation, Alliance Semiconductor Corporation and Macronix International Co., Ltd. (incorporated by reference to Exhibit 99.4 of the Registrant's Report on Form 6-K filed on December 17, 2003).

4.41 Foundry Agreement, dated May 12, 2004, between the Registrant and Siliconix incorporated (incorporated by reference to exhibit 4.42 to the Registrant's Annual Report on Form 20-F for the year ended December 31, 2004 (the "2004 Form 20-F")). (Portions of this exhibit have been omitted pursuant to a request for confidential treatment.)

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4.42 Share Purchase Agreement, dated December 8, 2004, between the Registrant and the Purchasers named therein (incorporated by reference to exhibit 4.43 to the 2004 Form 20-F).

4.43 Agreement, dated December 31, 2004, by and among the Registrant and the Purchasers named therein (incorporated by reference to exhibit 4.44 to the 2004 Form 20-F).

4.44 Employee Share Option Plan 2004 (incorporated by reference to Exhibit 4.3 to the Registrant's Registration Statement on Form S-8 No. 333-117565 ("Form S-8 No. 333-117565")).

4.45 Form of Grant Letter to Israeli Employees (incorporated by reference to Exhibit 4.4 to Form S-8 No. 333-117565).

4.46 Form of Grant Letter to US Employees (incorporated by reference to Exhibit 4.5 to Form S-8 No. 333-117565).

4.47 Bank Warrants, dated August 2005, between the Registrant and Bank Hapoalim B.M. and Bank Leumi Le-Israel B.M (incorporated by reference to correspondingly-numbered exhibit to the Registrant's Annual Report on Form 20-F for the year ended December 31, 2005 (the "2005 Form 20-F")).

4.48 Ninth Amendment to the Facility Agreement, dated July 2005, dated July 24, 2005 (incorporated by reference to exhibit 4.5 to the Form F-1 No. 333-126909 ("Form F-1 No. 333-126909")).

4.49 Tenth Amendment to the Facility Agreement, dated September 2005 (incorporated by reference to Exhibit 4.4 to Form F-1 No. 333-126909).

4.50 Eleventh Amendment to the Facility Agreement, dated October 2005 (incorporated by reference to Exhibit 4.3 to Form F-1 No. 333-126909).

4.51 Twelfth Amendment to the Facility Agreement, dated November 2005 (incorporated by reference to Exhibit 4.6 to Form F-1 No. 333-126909).

4.52 Thirteenth Amendment to the Facility Agreement, dated May 2006 (incorporated by reference to correspondingly-numbered exhibit to the Registrant's Annual Report on Form 20-F for the year ended December 31, 2006"2006 Form 20-F").

4.53 Fourteenth Amendment to the Facility Agreement, dated May 2006 (incorporated by reference to correspondingly-numbered exhibit to the 2006 Form

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20-F).

4.54 Fifteenth Amendment to the Facility Agreement, dated June 2006 (incorporated by reference to correspondingly-numbered exhibit to the 2006 Form 20-F).

4.55 Reserved.

4.56 Form of Rights Agent Agreement with Rights Certificate Attached (incorporated by reference to Exhibit 4.1 to Form F-1 No. 333-126909).

4.57 Development and License Agreement, dated July 2005, between Impinj, Inc. and the Registrant (incorporated by reference to correspondingly-numbered exhibit to the 2005 Form 20-F). (Portions of this exhibit have been omitted pursuant to a request for confidential treatment.)

4.58 License and Design Agreement, dated January 10, 2003 between Chipidea Microelectronics S.A. and the Registrant (incorporated by reference to correspondingly-numbered exhibit to the 2005 Form 20-F). (Portions of this exhibit have been omitted pursuant to a request for confidential treatment.)

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4.59 Amendment to Design Agreement of January 2003 between Chipidea Microelectronics S.A. and the Registrant, dated June 2005 (incorporated by reference to correspondingly-numbered exhibit to the 2005 Form 20-F). (Portions of this exhibit have been omitted pursuant to a request for confidential treatment.)

4.60 License Agreement, dated April 29, 2004, between Synopsys, Inc. and the Registrant (incorporated by reference to correspondingly-numbered exhibit to the 2005 Form 20-F). (Portions of this exhibit have been omitted pursuant to a request for confidential treatment.)

4.62 Employee Share Option Plan 2005 (incorporated by reference to Exhibit 4.3 of the 2006 Form S-8).

4.63 Form of Grant Letter to Israeli Employees (incorporated by reference to Exhibit 4.4 of the 2006 Form S-8).

4.64 Form of Grant Letter to US Employees (incorporated by reference to Exhibit 4.5 of the 2006 Form S-8).

4.65 CEO Share Option Plan 2005 (incorporated by reference to Exhibit 4.6 of the 2006 Form S-8).

4.66 Option Grant Letter Agreement - CEO Share Option Plan 2005 from the Registrant to Russell Ellwanger, dated July 15, 2005 (incorporated by reference to Exhibit 4.7 of the 2006 Form S-8).

4.67 Option Grant Letter Agreement - CEO Share Option Plan 2005 from the Registrant to Russell Ellwanger, dated September 28, 2006 (incorporated by reference to Exhibit 4.8 of the 2006 Form S-8).

4.68 Option Grant Letter Agreement - CEO Share Option Plan 2005 from Tower Semiconductor USA, Inc. to Russell Ellwanger, dated July 15, 2005 (incorporated by reference to Exhibit 4.9 of the 2006 Form S-8).

4.69 Equity Convertible Capital Note, dated September 28, 2006, issued to

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Israel Corporation Ltd. (incorporated by reference to Exhibit 99.4 of the Form 6-K for the month of November 2006 No. 6 filed on November 7, 2006 (the "November 2006 Form 6-K"))).

4.70 Registration Rights Agreement, dated September 28, 2006, with Israel Corporation Ltd. (incorporated by reference to Exhibit 99.5 of the November 2006 Form 6-K).

4.71 Amending Agreement, dated August 24, 2006, with Bank Hapoalim B.M. and Bank Leumi Le-Israel B.M., to the Facility Agreement (incorporated by reference to Exhibit 99.6 of the November 2006 Form 6-K).

4.72 Facility Agreement, as amended and restated by the parties through August 24, 2006 (incorporated by reference to Exhibit 99.7 of the November 2006 Form 6-K).

4.73 Conversion Agreement, dated September 28, 2006, with Bank Hapoalim B.M. (incorporated by reference to Exhibit 99.8 of the November 2006 Form 6-K).

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4.74 Conversion Agreement, dated September 28, 2006, with Bank Leumi Le-Israel B.M. (incorporated by reference to Exhibit 99.9 of the November 2006 Form 6-K).

4.75 Registration Rights Agreement, dated September 28, 2006, with Bank Hapoalim B.M. (incorporated by reference to Exhibit 99.10 of the November 2006 Form 6-K).

4.76 Registration Rights Agreement, dated September 28, 2006, with Bank Leumi Le-Israel B.M. (incorporated by reference to Exhibit 99.11 of the November 2006 Form 6-K).

4.77 Equity Convertible Capital Note, dated September 28, 2006, issued to Bank Hapoalim B.M. (incorporated by reference to Exhibit 99.12 of the November 2006 Form 6-K).

4.78 Equity Convertible Capital Note, dated September 28, 2006, issued to Bank Leumi Le-Israel B.M. (incorporated by reference to Exhibit 99.13 of the November 2006 Form 6-K).

4.79 Form of Securities Purchase Agreement (incorporated by reference to Exhibit 99.2 of the Form 6-K for the month of March 2007 No.1 filed on March 15, 2007 (the "March 2007 Form 6-K"))).

4.80 Form of Registration Rights Agreement (incorporated by reference to Exhibit 99.4 of the March 2007 Form 6-K).

4.81 Loan Agreement, dated August 2006, between the Registrant and SanDisk Corporation (incorporated by reference to correspondingly-numbered exhibit to the 2006 Form 20-F).

4.82 Credit Line Agreement, dated September 10, 2007, between the Registrant and Bank Hapoalim, B.M.

4.83 Credit Line Agreement, dated September 10, 2007, between the Registrant and Bank Leumi Le-Israel, B.M.

4.84 Credit Line Agreement, dated September 10, 2007, between the

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Registrant and the Israel Corporation Ltd.

4.85 Amendment No. 1 to amended and restated Facility Agreement, dated September 10, 2007.

4.86 Agreement and Plan of Merger and Reorganization, dated May 19, 2008, between the Registrant, Jazz Technologies, Inc. and Armstrong Acquisition Corp. (incorporated by reference to Exhibit 2.1 of the May 20, 2008 Form 6-K)

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

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

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

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

14.1 Consent of Brightman Almagor & Co.

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### SIGNATURES

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the registrant certifies that it meets all the requirements for filing on Form 20-F and has duly caused this Annual Report to be signed on its behalf by the undersigned, thereunto duly authorized on this 18th day of June, 2008.

TOWER SEMICONDUCTOR LTD.

By: /s/ Russell C. Ellwanger

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Russell C. Ellwanger  
Chief Executive Officer

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TOWER SEMICONDUCTOR LTD.  
AND SUBSIDIARY  
CONSOLIDATED FINANCIAL STATEMENTS  
AS OF DECEMBER 31, 2007

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

TO BOARD OF DIRECTORS AND THE SHAREHOLDERS OF  
TOWER SEMICONDUCTOR LTD.

We have audited the accompanying consolidated balance sheets of Tower Semiconductor Ltd. and subsidiary ("the Company") as of December 31, 2007 and 2006, and the related consolidated statements of operations, changes in shareholders' equity and comprehensive income, and cash flows for each of the three years in the period ended December 31, 2007. These financial statements are the responsibility of the Company's Board of Directors and management. Our responsibility is to express an opinion on these 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 also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and subsidiary as of December 31, 2007 and 2006, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2007, in accordance with accounting principles generally accepted in United States.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company and subsidiary's internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 6, 2008 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

BRIGHTMAN ALMAGOR & CO.  
CERTIFIED PUBLIC ACCOUNTANTS  
A MEMBER FIRM OF DELOITTE TOUCHE TOHMATSU

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Tel Aviv, Israel  
February 6, 2008

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### REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

TO BOARD OF DIRECTORS AND THE SHAREHOLDERS OF  
TOWER SEMICONDUCTOR LTD.

We have audited the internal control over financial reporting of Tower Semiconductors Ltd. and subsidiaries (the "Company") as of December 31, 2007, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in ITEM 15 CONTROLS AND PROCEDURES - INTERNAL CONTROL OVER FINANCIAL REPORTING. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

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

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

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

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procedures may deteriorate.

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In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2007 of the Company and our report February 6, 2008 expressed an unqualified opinion on those financial statements.

BRIGHTMAN ALMAGOR & CO.  
 CERTIFIED PUBLIC ACCOUNTANTS  
 A MEMBER FIRM OF DELOITTE TOUCHE TOHMATSU

Tel Aviv, Israel  
 February 6, 2008

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
 CONSOLIDATED BALANCE SHEETS  
 (dollars in thousands, except share data and per share data)

	NOTE	AS OF DECEMBER 2007
	-----	-----
<b>A S S E T S</b>		
CURRENT ASSETS		
CASH AND CASH EQUIVALENTS		\$ 44,536
SHORT-TERM INTEREST-BEARING DEPOSITS		--
TRADE ACCOUNTS RECEIVABLE:	15	
RELATED PARTIES		12,823
OTHERS		32,154
OTHER RECEIVABLES	3	4,748
INVENTORIES	4	27,806
OTHER CURRENT ASSETS		1,580
		-----
TOTAL CURRENT ASSETS		123,647
		-----
LONG-TERM INVESTMENTS	5	15,093
		-----
PROPERTY AND EQUIPMENT, NET	6	502,287
		-----
INTANGIBLE ASSETS, NET	13A (2)	34,711

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OTHER ASSETS , NET	7	11,044
		=====
TOTAL ASSETS		\$ 686,782
		=====
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
CURRENT MATURITIES OF CONVERTIBLE DEBENTURES	10	\$ 7,887
TRADE ACCOUNTS PAYABLE		49,025
OTHER CURRENT LIABILITIES	8	20,024
		-----
TOTAL CURRENT LIABILITIES		76,936
LONG-TERM DEBT FROM BANKS (*)	9, 11	379,314
DEBENTURES (**)	10, 11	117,460
LONG-TERM CUSTOMERS' ADVANCES	13A	27,983
OTHER LONG-TERM LIABILITIES	12	40,380
		-----
TOTAL LIABILITIES		642,073
		-----
SHAREHOLDERS' EQUITY	10, 13A, 14	44,709
		=====
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		\$ 686,782
		=====

(\*) OF WHICH \$365,563 AT FAIR VALUE AS OF DECEMBER 31, 2007

(\*\*) OF WHICH \$28,484 AT FAIR VALUE AS OF DECEMBER 31, 2007

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

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

	Note	2007
	-----	-----
REVENUES		
SALES	15	\$ 230,85
REVENUES RELATED TO A JOINT DEVELOPMENT AGREEMENT	13B	-
		-----
		230,85
COST OF SALES		284,77



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GROSS LOSS		(53,91)
OPERATING COSTS AND EXPENSES		
RESEARCH AND DEVELOPMENT		13,79
MARKETING, GENERAL AND ADMINISTRATIVE		31,60
		45,39
OPERATING LOSS		(99,31)
FINANCING EXPENSE, NET	11, 16	(34,97)
OTHER INCOME, NET		9
LOSS FOR THE YEAR		\$(134,19)
BASIC LOSS PER ORDINARY SHARE		
LOSS PER SHARE		\$ (1.1)
WEIGHTED AVERAGE NUMBER OF ORDINARY SHARES OUTSTANDING - IN THOUSANDS		
		118,85
SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.		

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TOWER SEMICONDUCTOR LTD.  
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (DEFICIT)  
(dollars in thousands, except share data and per share data)

	Ordinary shares		Additional paid-in capital
	Shares	Amount	
BALANCE - JANUARY 1, 2005	66,999,796	\$ 16,274	\$ 519,839
ISSUANCE OF SHARES	1,232,260	274	1,520
STOCK-BASED COMPENSATION RELATED TO THE FACILITY AGREEMENT WITH THE BANKS, NOTE 14B(5)			2,793
STOCK-BASED COMPENSATION RELATED TO RIGHTS OFFERED TO EMPLOYEES, NOTE 14I			448
OTHER COMPREHENSIVE GAIN			
LOSS FOR THE YEAR			
COMPREHENSIVE INCOME (LOSS)			

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BALANCE - DECEMBER 31, 2005	68,232,056	\$ 16,548	\$ 524,600	\$
ISSUANCE OF SHARES AND WARRANTS	16,729,145	3,860	26,126	
CONVERSION OF CONVERTIBLE DEBENTURES TO SHARES	16,734,316	3,696	15,634	
EMPLOYEE STOCK-BASED COMPENSATION				
EXERCISE OF OPTIONS	7,250	2	9	
EXERCISE OF WARRANTS	350,000	81	469	
STOCK-BASED COMPENSATION RELATED TO THE FACILITY AGREEMENT WITH THE BANKS, NOTE 14B(5)			4,146	
CAPITAL NOTES				
OTHER COMPREHENSIVE GAIN				
LOSS FOR THE YEAR				
COMPREHENSIVE INCOME (LOSS)				
BALANCE - DECEMBER 31, 2006	102,052,767	\$ 24,187	\$ 570,984	\$
ISSUANCE OF SHARES AND WARRANTS	22,705,598	5,398	29,469	
CONVERSION OF CONVERTIBLE DEBENTURES TO SHARES	591,520	142	674	
EMPLOYEE STOCK-BASED COMPENSATION				
EXERCISE OF OPTIONS	176,231	44	183	
RECLASSIFICATION OF BIFURCATED CONVERSION OPTION TO SHAREHOLDERS' EQUITY			28,377	
STOCK-BASED COMPENSATION, NOTE 14B(5)			1,331	
OTHER COMPREHENSIVE LOSS				
CUMULATIVE EFFECT ADJUSTMENT OF THE FACILITY AGREEMENT TO RETAINED EARNINGS				
LOSS FOR THE YEAR				
COMPREHENSIVE INCOME (LOSS)				
BALANCE - DECEMBER 31, 2007	125,526,116	\$ 29,771	\$ 631,018	\$

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(dollars in thousands, except share data and per share data)

	YEAR END
	2007
CASH FLOWS - OPERATING ACTIVITIES	
LOSS FOR THE YEAR	\$ (134,196)
Adjustments to reconcile loss for the year	
TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES:	
INCOME AND EXPENSE ITEMS NOT INVOLVING CASH FLOWS:	
DEPRECIATION AND AMORTIZATION	154,343
EFFECT OF INDEXATION AND TRANSLATION ON DEBENTURES	6,227

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WRITE DOWN OF CUSTOMER ADVANCE		(9,747)
OTHER INCOME, NET		(92)
CHANGES IN ASSETS AND LIABILITIES:		
DECREASE (INCREASE) IN TRADE ACCOUNTS RECEIVABLE		(13,479)
DECREASE (INCREASE) IN OTHER RECEIVABLES AND OTHER CURRENT ASSETS		333
DECREASE (INCREASE) IN INVENTORIES		459
INCREASE (DECREASE) IN TRADE ACCOUNTS PAYABLE		15,435
INCREASE (DECREASE) IN OTHER CURRENT LIABILITIES		(1,363)
INCREASE (DECREASE) IN OTHER LONG-TERM LIABILITIES		935
		-----
		18,855
DECREASE IN LONG-TERM CUSTOMERS' ADVANCES, NET		(2,172)
		-----
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES		16,683
		-----
CASH FLOWS - INVESTING ACTIVITIES		
DECREASE IN DESIGNATED CASH, SHORT-TERM AND LONG-TERM INTEREST-BEARING DEPOSITS, NET		
		--
INVESTMENTS IN PROPERTY AND EQUIPMENT		(107,485)
INVESTMENT GRANTS RECEIVED		1,654
PROCEEDS RELATED TO SALE AND DISPOSAL OF PROPERTY AND EQUIPMENT		108
INVESTMENTS IN OTHER ASSETS AND INTANGIBLE ASSETS		(1,547)
DECREASE (INCREASE) IN SHORT-TERM INTEREST-BEARING DEPOSITS		1,230
LONG-TERM INVESTMENTS		(950)
		-----
NET CASH USED IN INVESTING ACTIVITIES		(106,990)
		-----
CASH FLOWS - FINANCING ACTIVITIES		
PROCEEDS FROM ISSUANCE OF DEBENTURES AND WARRANTS, NET		50,690
PROCEEDS FROM LONG-TERM LOANS		28,000
PROCEEDS FROM ISSUANCE OF ORDINARY SHARES AND WARRANTS, NET		26,534
PROCEEDS FROM EXERCISE OF WARRANTS		--
PROCEEDS ON ACCOUNT OF CAPITAL NOTES		--
REPAYMENT OF DEBENTURE		(7,088)
PROCEEDS FROM EXERCISE OF SHARE OPTIONS		227
DEBTS REPAYMENT		(3,230)
		-----
NET CASH PROVIDED BY FINANCING ACTIVITIES		95,133
		=====
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		4,826
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR		39,710
		-----
CASH AND CASH EQUIVALENTS - END OF YEAR		\$ 44,536
		=====
NON-CASH ACTIVITIES		
INVESTMENTS IN PROPERTY AND EQUIPMENT		\$ 17,982
		=====
STOCK-BASED COMPENSATION RELATED TO THE FACILITY AGREEMENT WITH THE BANKS		\$ --
		=====
STOCK-BASED COMPENSATION (SEE NOTE 14B(5))		\$ 1,331
		=====
STOCK-BASED COMPENSATION RELATED TO RIGHTS OFFERED TO EMPLOYEES, (SEE NOTE 14I)		\$ --
		\$ --

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INVESTMENTS IN OTHER ASSETS	\$	--	\$
CONVERSION OF LONG-TERM CUSTOMERS' ADVANCES TO SHARE CAPITAL	\$	6,414	\$
CONVERSION OF CONVERTIBLE DEBENTURES TO SHARES CAPITAL	\$	816	\$
CUMULATIVE EFFECT ADJUSTMENT OF THE FACILITY AGREEMENT TO RETAINED EARNINGS	\$	65,207	\$
RECLASSIFICATION OF BIFURCATED CONVERSION OPTION TO SHAREHOLDERS' EQUITY	\$	28,377	\$
CONVERSION OF LONG TERM DEBT TO CAPITAL NOTES	\$	--	\$
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION			
CASH PAID DURING THE YEAR FOR INTEREST	\$	28,831	\$
CASH PAID DURING THE YEAR FOR INCOME TAXES	\$	55	\$
SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.			

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

NOTE 1 - DESCRIPTION OF BUSINESS AND GENERAL

Tower Semiconductor Ltd. ("the Company"), incorporated in Israel, commenced operations in 1993. The Company is an independent wafer foundry that delivers customized solutions in a variety of advanced complementary metal oxide semiconductor (CMOS) technologies, including digital CMOS, mixed-signal and RF (radio frequency) CMOS, CMOS image sensors and power management devices. The Company manufactures integrated circuits in geometries ranging between 1.0 and 0.35 microns at its 150-millimeter fabrication facility ("Fab 1"), and in geometries ranging between 0.18 and 0.13 microns at its 200-millimeter fabrication facility ("Fab 2"). As a foundry, the Company manufactures wafers using its advanced technological capabilities and the proprietary integrated circuit designs of its customers.

The industry in which the Company operates is characterized by wide fluctuations in supply and demand. Such industry is also characterized by the complexity and sensitivity of the manufacturing process, by high levels of fixed costs, and by the need for constant advancements in production technology.

The Company's Ordinary Shares are traded on the NASDAQ Global Market and on the Tel-Aviv Stock Exchange.

In recent years, the Company has experienced significant recurring losses, recurring negative cash flows from operating activities and an increasing accumulated deficit. The Company is working in various ways to mitigate its financial difficulties. Since the second half of 2005, the Company increased its customer base, mainly in Fab 2, modified its organizational

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structure to better address its customers and its market positioning, increased its sales and its EBITDA, reduced its losses, increased its capacity level, utilization rates, raised funds and restructured its bank debt. See also Note 9B and Notes 14I-M.

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

### 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"). The Company recasted the comparative amounts included in this financial statements to US GAAP. In prior years the Company prepared its financial reports in accordance with generally accepted accounting principles in Israel. ("IL GAAP") and provided reconciliation to US GAAP in the notes to the financial statements.

#### A. USE OF ESTIMATES IN PREPARATION OF FINANCIAL STATEMENTS

The preparation of financial statements in conformity with generally accepted accounting principles requires management 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 the Company and its wholly-owned marketing subsidiary in the United States, after elimination of material inter-company transactions and balances. The effect of the subsidiary's operations on the Company's revenues, net loss and total assets was immaterial for the dates and periods presented.

#### 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 on the specific identification basis for accounts whose collectibility, in management's estimation, is uncertain.

#### E. INVENTORIES

Inventories are stated at the lower of cost or market. Cost is determined for raw materials and supplies 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.

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

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

F. PROPERTY AND EQUIPMENT

- (1) Property and equipment are presented at cost, including financing expenses and other 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 (whether performed by others or by the Company), and costs directly related to preproduction test runs of property and equipment that are necessary to get it ready for its intended use. Those costs include payroll and payroll-related costs of employees who devote time and are dedicated to the acquiring, constructing, establishing and installing of property and equipment. Allocation, when appropriate, of capitalizable incremental direct costs is based on management's estimates and methodologies including time sheet inputs.

Cost is presented net of investment grants received or receivable, and less accumulated depreciation and amortization. The accrual for grants receivable is determined based on qualified investments made during the reporting period, provided that the primary criteria for entitlement have been met.

During the second quarter of 2007, the Company reassessed the estimated useful lives of its machinery and equipment and as a result, effective as of April 1, 2007, machinery and equipment is to be depreciated over estimated useful lives of 7 years rather than 5 years as estimated prior to such date. The change reflects the Company's best estimate of the useful lives of its equipment and is also based on experience accumulated from Fab 1 and on recent trends in industry practices. The Company believes that the change better reflects the economics associated with the ownership of the equipment. This change has been accounted for as a change in estimate and was applied prospectively. For the effect of this change, see Note 6A.

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:

Building (including facility infrastructure)	14-25 years
Machinery and equipment	7 years (*)
Transportation vehicles	7 years

(\*) 5 years through March 31, 2007.

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

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

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

G. INTANGIBLE ASSETS

TECHNOLOGY - The cost of Fab 2 technologies includes the technology process cost and incremental direct costs associated with implementing the technologies until the technologies are ready for their intended use. The costs in relation to Fab 2 technologies are amortized over the expected estimated economic life of the technologies, commonly used in the industry. Amortization phases commence on the dates on which each of the Fab 2 manufacturing lines is ready for its intended use. The technologies are presented net of accumulated amortization as of December 31, 2007 and 2006 in the amounts of \$63,911 and \$53,741.

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

H. OTHER ASSETS

DEFERRED FINANCING CHARGES

Deferred financing charges in relation to funding the ramp-up of Fab 2 are amortized over the lives of the borrowings as an adjustment to the yield using the effective interest method. During the ramp up period of Fab 2, amortized deferred financing charges are capitalized to property and equipment.

PREPAID LONG-TERM LAND LEASE

Prepaid lease payments to the Israel Land Administration ("ILA") as detailed in Notes 13A(8) and 13C are amortized during the lease period.

I. CONVERTIBLE DEBENTURES

Under Accounting Principles Board Opinion No. 14 ("APB 14"), the proceeds from the sale of the securities are allocated to each security issued based on their relative fair value.

SFAS 133 generally provides three criteria that, if met, require companies to bifurcate conversion options from their host instruments and account for them as free standing derivative financial instruments. These three criteria are (a) 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, (b) the hybrid instrument that embodies both the embedded derivative instrument and the host contract is not remeasured at fair value under otherwise applicable generally accepted accounting principles with changes in fair value reported in earnings and (c) a separate instrument with the same terms as the embedded derivative instrument would be considered a derivative instrument subject to the requirements of SFAS 133. One scope exception provided by SFAS 133 and relevant to convertibles is when the embedded conversion feature is

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both indexed to and classified in the Company's equity based on the criteria established in EITF 00-19 and other EITF's. Financing costs are generally expensed as incurred unless directly related to the new ramp-up of equipment. In such case the costs are capitalized to property and equipment during the installation period until the equipment ready for its intended use.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
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 SFAS No. 109, "Accounting for Income Taxes" ("SFAS No. 109"). This Statement 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.

Deferred tax assets are recognized, if it is probable that such assets would be realized, for temporary differences, which will result in deductible amounts in future years and for carryforwards. An allowance against such deferred tax asset is recognized if it is probable that some portion or all of the deferred tax assets will not be realized. Due to the material loss carryforward of the Company as of December 31, 2007 and uncertainties with regard to its utilization in the future, no deferred taxes were recorded in the Company's results of operations.

K. REVENUE RECOGNITION

Revenues are recognized when persuasive evidence of an agreement exists with fixed or determinable prices, shipment has occurred or as services are rendered, when title has been transferred, collectibility is reasonably assured and acceptance provisions criteria are satisfied, based on performing electronic, functional and quality tests on the products prior to shipment and customer on-site testing. Such testing reliably demonstrates that the products meet all of the specified criteria prior to formal customer acceptance, and that product performance upon customer on-site testing can reasonably be expected to conform to the specified acceptance provisions. An accrual for estimated returns, computed primarily on the basis of historical experience, is recorded at the time when revenues are recognized.

L. RESEARCH AND DEVELOPMENT

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



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

M. LOSS PER ORDINARY SHARE

Basic earnings per share is calculated, in accordance with SFAS No. 128, "Earnings Per Share" ("SFAS No. 128"), by dividing profit or loss attributable to ordinary equity holders of the entity (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 the entity, and the weighted average number of shares outstanding, for the effects of all dilutive potential Ordinary Shares.

N. COMPREHENSIVE INCOME (LOSS)

In Accordance with SFAS 130, Comprehensive income (loss) represents the change in shareholder's 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 TRANSACTION GAINS AND LOSSES

The currency of the primary economic environment in which the Company conducts its operations is the U.S. dollar ("dollar"). Accordingly, the Company uses the dollar as its functional and reporting currency. Financing expenses, net in 2007 and 2006 include net foreign currency transaction losses of \$3,526, and \$3,659, respectively. Financing expenses, net in 2005 include net foreign currency transaction gains of \$1,398.

P. STOCK-BASED COMPENSATION

In January 1, 2006, the Company adopted the provisions of SFAS No. 123 (revised 2004), "Share-Based Payment" (SFAS No. 123(R)), under which employee share-based equity awards 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 elected the modified prospective method as its transition method. Under the modified prospective method the compensation cost recognized by the Company beginning in 2006 includes (a) compensation cost for all equity incentive awards granted prior to, but not yet vested as of January 1, 2006, based on the grant-date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation cost for all stock-based compensations granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R). The Company uses the straight-line attribution method

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to recognize stock-based compensation costs over the service period of the award.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
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 (dollars in thousands, except share data and per share data)

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

P. STOCK-BASED COMPENSATION (CONT.)

As for the periods before the adoption of the Standard, the Company accounted for employee and director stock-based compensation in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") and authoritative interpretations thereof. Accordingly, the Company accounted for share options granted to employees and directors based on the intrinsic value of the options on the measurement date.

PRO FORMA LOSS PER SHARE ACCORDING TO SFAS 123 AND SFAS 148

Had compensation cost for the Company's share option plans been determined based on the fair value at the grant dates for all awards made through December 31, 2005 in accordance with SFAS 123, as amended by SFAS 148, the Company's pro forma loss per share would have been as follows:

	For the year ended December 31, 2005 -----
PRO FORMA LOSS	
Loss for the year, as reported	\$(203,082)
Less - stock-based compensation determined under APB 25	--
Add - stock-based compensation determined under SFAS 123	(4,229)
	-----
Pro forma loss	\$(207,311) =====
BASIC LOSS PER SHARE	
As reported	\$ (3.06) =====
Pro forma	\$ (3.12) =====

STOCK-BASED COMPENSATION IN FINANCING TRANSACTIONS

The Company calculates the fair value of stock-based compensation included in its financing transactions. That fair value is recognized in equity. The amount of fair value of the warrants is considered a discount on the debt issued and adjust the yield on the financing transaction.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
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### NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT.)

#### Q. IMPAIRMENT OF LONG-LIVED ASSETS

Management reviews long-lived 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. Management's review of possible impairment charges for the periods presented was performed based on management's business plan and approved by the board of directors of the Company. The business plan is based, among other things, on the future completion of the ramp-up of Fab 2. Application of SFAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144") resulted in no impairment charges for the periods presented.

#### R. DERIVATIVES

The Company issues from time to time derivatives, whether embedded or freestanding, that are denominated in currency other than its functional currency (generally the NIS in which its shares are also traded). The Company consider those instruments to be indexed only to its own stock and not dual indexed. The Company considered the various guidance on that issue and decided that pending the final consensus in EITF 07-5 it will continue to consider such instruments as indexed solely to its own shares.

#### S. INITIAL ADOPTION OF NEW STANDARDS

SFAS NO. 159, "THE FAIR VALUE OPTION FOR FINANCIAL ASSETS AND FINANCIAL LIABILITIES" - In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS No. 159). SFAS No. 159 permits companies to choose to measure certain financial instruments and certain other items at fair value. The standard requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. The Company adopted the provisions of this standard, together with the adoption of FASB No. 157 FAIR VALUE MEASUREMENTS, starting with the first quarter of 2007.

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

### NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT.)

#### T. RECENTLY ISSUED ACCOUNTING STANDARDS

SFAS NO. 141 (REVISED 2007 ) "BUSINESS COMBINATIONS" - In December 2007, the FASB issued FASB 141(R), "Business Combinations" of which the objective is to improve the relevance, representational

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faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects. The new standard requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. In December 2007, the FASB issued FASB 160 "Non-controlling Interests in Consolidated Financial Statements - an amendment of ARB No.51" of which the objective is to improve the relevance, comparability, and transparency of the financial information that a reporting entity provides in its consolidated financial statements by establishing accounting and reporting standards by requiring all entities to report non controlling (minority) interests in subsidiaries in the same way - as equity in the consolidated financial statements. Moreover, Statement 160 eliminates the diversity that currently exists in accounting for transactions between an entity and non-controlling interests by requiring they be treated as equity transactions. Both FASB 141(R) and FASB 160 are effective for fiscal years beginning after December 15, 2008. The Company is currently examining this new standard; however, at this stage, it is unable to estimate the standard's effect, if any, on its financial position and results of operations.

### U. RECLASSIFICATION

Certain amounts in prior years' financial statements have been reclassified in order to conform to the 2007 presentation.

### NOTE 3 - OTHER RECEIVABLES

Other receivables consist of the following:

	As of December 31,	
	2007	2006
Government of Israel - investment grants receivable	\$ 24	\$ 1,530
Other government agencies	4,661	3,847
Others	63	48
	\$ 4,748	\$ 5,425
	=====	=====

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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### NOTE 4 - INVENTORIES

Inventories consist of the following (\*):

As of December 31,  
 -----

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	2007 -----	2006 -----
Raw materials	\$ 12,351	\$ 11,234
Work in process	14,964	22,884
Finished goods	491	645
	-----	-----
	\$ 27,806	\$ 34,763
	=====	=====

(\*) Net of aggregate write-downs to net realizable value of \$6,497 and \$5,948 as of December 31, 2007 and 2006, respectively.

NOTE 5 - LONG-TERM INVESTMENTS

Long-term investments consist of the following:

	As of December 31,	
	2007 -----	2006 -----
Severance pay funds, see Note 12B	\$ 13,848	\$ 13,535
Investment in Limited partnership, see below	950	--
Others	295	1,790
	-----	-----
	\$ 15,093	\$ 15,325
	=====	=====

INVESTMENT IN LIMITED PARTNERSHIP:

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

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
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(dollars in thousands, except share data and per share data)

NOTE 6 - PROPERTY AND EQUIPMENT, NET

A. Composition:

	As of December 31,	
	2007 -----	2006 -----
COST:		
Buildings (including facility infrastructure)	\$ 235,960	\$ 233,781
Machinery and equipment	985,608	895,725
Transportation vehicles	304	307
	-----	-----
	1,221,872	1,129,813
	-----	-----

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### ACCUMULATED DEPRECIATION AND AMORTIZATION

Buildings (including facility infrastructure)	75,227	61,200
Machinery and equipment	644,111	535,548
Transportation vehicles	247	267
	-----	-----
	719,585	597,015
	=====	=====
	\$ 502,287	\$ 532,798
	=====	=====

Supplemental disclosure relating to cost of property and equipment:

- (1) As of December 31, 2007 and 2006, the cost of property and equipment included costs relating to Fab 2 in the amount of \$966,164 and \$879,413, respectively. Said amounts are net of investment grants of \$164,675 and \$164,587, respectively.
- (2) As of December 31, 2007, the cost of buildings, machinery and equipment was reflected net of investment grants in the aggregate of \$267,922 (as of December 31, 2006 - \$267,866).
- (3) Cost of property and equipment as of December 31, 2007 and 2006 includes capitalized financing costs in the aggregate of \$19,625 and \$11,839, respectively.
- (4) Depreciation expenses, in relation to Fab 2 property and equipment were \$113,393, \$123,422 and \$114,141 in 2007, 2006 and 2005 respectively.
- (5) Had depreciation been calculated using five years of useful life depreciation method (see Note 2F(1)), depreciation expenses for 2007 would have been \$167,356 as compared to \$122,647 recognized in this financial statements.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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NOTE 6 - PROPERTY AND EQUIPMENT, NET (CONT.)

B. INVESTMENT GRANTS

In January 1996, an investment program ("1996 program") for expansion of Fab 1 in the aggregate amount (as amended in December 1999 and 2001) of \$228,680, entitling the Company to investment grants, was approved by the Investment Center. The Company completed its investments under the 1996 program in December 2001 and invested through such date approximately \$207,000. In May 2002, the Company submitted the final report in relation to the 1996 program. As of December 31, 2007, the report has not yet received final approval from the Investment Center.

See Note 13A(7) with respect to the Fab 2 program approved by the Investment Center in December 2000.

Entitlement to the above grants and other tax benefits is subject to

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various conditions stipulated by the Israeli Law for the Encouragement of Capital Investments - 1959 ("Investments Law") and the regulations promulgated thereunder, as well as the criteria set forth in the certificates of approval. In the event the Company fails to comply with such conditions, the Company 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 the Company's assets, see also Note 17A.

C. For liens, see Note 13A(7) Notes 13D(1) and (2) and 9D.

### NOTE 7 - OTHER ASSETS, NET

Other assets, net consist of the following:

	As of December 31,	
	2007	2006
	-----	-----
Prepaid expenses - long-term	\$ 1,270	\$ 1,346
Deferred Financing Charges, net	1,734	--
Debentures issuance expenses, net (see Note 14)	3,418	834
Prepaid long-term Land Lease, net (see Note 13C)	4,622	4,749
	-----	-----
	\$11,044	\$ 6,929
	=====	=====

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

### NOTE 8 - OTHER CURRENT LIABILITIES

Other current liabilities consist of the following:

	As of December 31,	
	2007	2006
	-----	-----
Accrued salaries	\$ 6,138	\$ 8,730
Vacation accrual	3,574	3,385
Interest payable (primarily in relation to convertible debentures)	742	1,089
Due to related parties	7,459	5,895
Other	2,111	2,997
	-----	-----
	\$ 20,024	\$ 22,096
	=====	=====

### NOTE 9 - LONG-TERM DEBT FROM BANKS

A. Composition:

As of December 31, 2007

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	Effective interest rate (*)	
In U.S. Dollar	5.98%	\$ 288,693
In U.S. Dollar	5.10%	80,000
In U.S. Dollar	7.88%	14,000
		-----
Total long-term debt from Banks- principle amount		382,693
Fair value adjustments		(3,379)
		-----
Total long-term debt from Banks		\$ 379,314
		=====

	Effective interest rate (*)		As of December 31, 2006
In U.S. Dollar	6.48%	\$288,693	-----
In U.S. Dollar	5.10%	80,000	-----
In U.S. Dollar		--	-----
Total long-term debt from Banks- principle amount		368,693	-----
Deferred gain on debt restructuring in accordance with SFAS No. 15		53,622	-----
Total carrying amount		422,315	-----
Embedded feature		10,115	-----
Total long-term debt from Banks		\$432,430	=====

(\*) See E below

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
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NOTE 9 - LONG-TERM DEBT FROM BANKS (CONT.)

B. FACILITY AGREEMENT

In January 2001, the Company entered into a Facility Agreement, as amended to date, with two leading Israeli banks ("Banks") entitling the Company to borrow an aggregate, of \$500,000 to finance the construction and equipping of Fab 2 ("Facility Agreement"). Of that amount, the Company withdrew an aggregate of \$497,000. Under the original terms of the Facility Agreement the loans bore interest at a rate of three-month USD LIBOR plus 1.55% per annum payable at the end of each quarter. The loans were originally to be paid in 12 quarterly installments 3 years from date of each loan drawn down. The loans were subject to certain prepayment provisions. The Facility Agreement was since amended in various instances. Prior to the closing of the September 2006 Amendment, the loans bore interest based on the three-month USD LIBOR rate plus 2.5%. For interest rates following



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September 2006 Amendment, see below.

JULY 2005 AMENDMENT - In July 2005, the Company and its Banks entered into a definitive amendment to the Facility Agreement, which closed in August 2005. The Amendment provided, among other things, for the Banks to provide additional financing of up to approximately \$30,000, subject to the Company raising through the issuance of shares or convertible debentures \$30,000 by March 31, 2006. In connection with the Amendment, The Israel Corporation Ltd ("TIC" or "Equity Investor") and SanDisk Corporation, Alliance Semiconductor Corporation and Macronix International Co. Ltd. (collectively, the "primary Wafer Partners") committed to invest an aggregate of \$23,500 towards such funding in the context of a rights offering. Following the satisfaction of all the Company's commitments under the July 2005 Amendment, the Banks provided the Company with \$29,693 in additional loans.

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NOTE 9 - LONG-TERM DEBT FROM BANKS (CONT.)

B. FACILITY AGREEMENT (CONT.)

SEPTEMBER 2006 AMENDMENT - As part of the financing for the ramp-up plan, in September 2006, the Company closed a definitive amendment to the Facility Agreement to refinance the approximately \$527,000 of long-term debt under its Facility Agreement. Pursuant to the Amendment, among other things: (i) \$158,000 of the debt under the Facility Agreement was converted into capital notes of the Company, which notes are convertible into 51,973,684 of the Company's Ordinary Shares, representing twice the average closing price per share during the ten days prior to signing on the Memorandum of Understanding ("MOU") that preceded the final Amendment; (ii) the interest rate 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 (the "Decreased Amount"). As compensation for the Decreased Amount and subject to adjustment, in January 2011, the Banks will be issued such number of shares (or equity equivalent capital notes or convertible debentures) that equals the Decreased Amount divided by the average closing price of the Company's Ordinary Shares during the fourth quarter of 2010 (the "Fourth Quarter 2010 Price"). If during the second half of 2010, the closing price of Company's Ordinary Shares on every trading day during this period exceeds \$3.49, then the Banks will only be granted such number of shares (or equity equivalent capital notes or convertible debentures) that equals half of the Decreased Amount divided by the Fourth Quarter 2010 Price. If during the period ending December 31, 2010, the Banks sell a portion of the capital notes or shares issuable upon the conversion of the capital notes described in (i) above, at a price per share in excess of \$3.49, then the consideration payable for the interest rate reduction will be reduced proportionately. The amounts payable in securities of the Company may be payable in cash under certain circumstances and the Decreased Amount may be reduced in the event the Company prepays any part of the outstanding loans; (iii) the commencement date for the

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repayment of the outstanding loans, which following the conversion are approximately \$369,000, was postponed from July 2007 to September 2009, such that the outstanding loans shall be repaid in 12 quarterly installments between September 2009 and June 2012; (iv) the exercise periods of the warrants held by the Banks immediately prior to the signing of the September 2006 Amendment, were extended such that they are exercisable until September 2011, see also Note 14B(5)(a); and (v) the financial ratios and covenants that the Company is to satisfy were revised to be inline with the Company's working plan as of the time of the Amendment.

SEPTEMBER 2007 CREDIT LINE AGREEMENTS WITH THE BANKS AND TIC AND SEPTEMBER 2007 AMENDMENT - In September 2007, the Company signed and closed definitive agreements with the Banks and with TIC, providing for credit lines totaling up to \$60,000, 25% of which from each Bank and 50% from TIC, to be used for the funding of equipment required for a ramp up plan in Fab 2 to increase its capacity to beyond 24,000 wafers per month. As of December 31, 2007, \$28,000 had been borrowed under these credit lines and an additional \$32,000 was borrowed during January 2008, each drawdown comprised of 25% from each bank and 50% from TIC. Loans under the credit lines are bearing interest at an annual rate of three-month USD LIBOR plus 3% and are repayable 2 years from the date any loan was borrowed. The Company paid the Banks and TIC customary fees. For details regarding 5,411,764 warrants granted to the Banks and TIC in connection with this agreement, see Note 14B(5). Further, in September 2007, the Company signed and closed a definitive amendment to the Facility Agreement to mainly reflect into it the Credit Line Agreements described above and to revise the financial ratios and covenants that the Company is to satisfy to be inline with the Company's working plan as of the time of the Amendment.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
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NOTE 9 - LONG-TERM DEBT FROM BANKS (CONT.)

B. FACILITY AGREEMENT (CONT.)

ACCOUNTING FOR THE LOANS UNDER THE FACILITY AGREEMENT

Loans received under the Facility Agreement, as amended to date, are presented commencing January 1, 2007 at fair value, with changes in value reflected on the statement of operations, following an election under FASB No. 159 "The Fair Value Option for Financial Assets and Financial Liabilities". Such loans bear interest based on the three-month USD LIBOR rate plus 1.1%, effective from May 17, 2006. Prior to the fair value election, in 2006, the loans under the Amendment of September 2006 was treated as a troubled debt restructuring within the scope of FASB No. 15 which required the following: (i) the amount considered settled for shares and classified in equity is based on the price per share as quoted at the closing date; (ii) the remaining balance after deduction of the amount used as proceeds for the shares issuance in (i) above, will remain outstanding; (iii) a new, lower effective interest rate will be calculated as the interest rate that equates future payments to the

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outstanding balance; and (iv) no gains or losses are recognized in the current period.

The obligation to issue additional securities of the Company in January 2011 under the restructuring in September 2006 Amendment as compensation to the Decreased Amount, is considered to include an embedded derivative that should be separately accounted for. The Company considered the obligation to issue shares as agreed with the Banks and determined that it contains two components: (i) a contingent component and (ii) an uncontingent component. The contingent component is the obligation to issue shares equal to half of the amount of the Decreased Amount if the Fourth Quarter 2010 Price is less than \$3.49. The uncontingent component is the obligation to issue shares equal to half of the Decreased Amount regardless of the Fourth Quarter 2010 Price. The Company accounted for the uncontingent component as an additional interest expense and calculated the effective interest rate to include such expense. The Company treated the uncontingent component as an embedded derivative that needs to be bifurcated and separately accounted for based on fair value. Initial separation of the embedded derivative will be done using the "with and without" method described in DIG Issue B6. Changes in the fair value of the embedded derivative will be included in financing expenses.

In the first quarter of 2007, the Company adopted the provisions of SFAS No. 159. As required by such Standard the Company also adopted the provisions of FASB 157 FAIR VALUE MEASUREMENTS. The adoption of the Standard is effective January 1, 2007. According to the Standard the Company can choose to carry at fair value eligible items as defined in the Standard, from the date of early adoption and accordingly the Company decided to apply the fair value option to the Facility Agreement.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
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NOTE 9 - LONG-TERM DEBT FROM BANKS (CONT.)

B. FACILITY AGREEMENT (CONT.)

ACCOUNTING FOR THE LOANS UNDER THE FACILITY AGREEMENT (CONT.)

The effect of the election of fair value option to the Facility Agreement as of January 1, 2007 was a gain of \$65,207 which has been recorded as a cumulative effect adjustment to retained loss (no tax effects have been recorded). The carrying amount of the Facility Agreement prior to the adoption was \$432,430 and immediately after was \$367,223. The Company reasoned its election of the fair value option for the Facility Agreement on the fact that the application of previous GAAP prescribed in FASB 15 Accounting by Debtors and Creditors for Troubled Debt Restructurings to the Facility Agreement did not reflect the economic benefits that were achieved with the consummation of the Amendment to the Facility Agreement and that the application of the fair value better reflects such benefits. For fair value measurement, see Note 11D below.

C. REPAYMENT SCHEDULE

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The principle amount of the long-term debt as of December 31, 2007 is repayable as follows:

2009	\$ 75,449
2010	122,898
2011 and thereafter	184,346
	-----
	\$382,693
	=====

- D. The Facility Agreement with the Banks restricts the Company's ability to place liens on its assets (other than to the State of Israel in respect of investment grants - see Note 13A(7), to Siliconix - see Note 13D(1) and to SanDisk - see Note 13D(2)), without the prior consent of the Banks. Furthermore, the agreements contain certain restrictive financial ratios and covenants. For further details concerning the Facility Agreement and its amendments, see Note 13A(6).
- E. The effective interest rate as of December 31, 2007 and 2006 of loans, the amount of which as of such dates was \$80,000 and \$207,000, includes the terms of the collar agreements with knock-out and knock-in features described in Note 11A. Interest is payable at the end of each quarter.

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

NOTE 10 - DEBENTURES

A. Composition:

		As of December 31, 2007		
	Interest rate	Carrying amount	Bifurcated embedded feature	Fair value
		-----	-----	-----
2002 Convertible debentures series A	4.7%	\$ 15,774	\$ --	\$ --
2005 Convertible debentures series B	5%	9,547	--	--
2006 Convertible debentures series C	-- (*)	36,602	7,313	--
2007 Non-convertible debentures series D	8%	27,627	--	--
2007 Convertible debentures series E, see Note 11	8%	--	--	28,484
		-----	-----	-----
		89,550	7,313	28,484
Less - current maturities		7,887	--	--
		-----	-----	-----
		\$ 81,663	\$ 7,313	\$ 28,484
		=====	=====	=====

As of December 31, 2006

	Interest	Carrying	Bifurcated embedded
--	----------	----------	---------------------

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	rate	amount	feature	Total
		-----	-----	-----
2002 Convertible debentures series A	4.7%	\$ 20,704	\$ --	\$ 20,704
2005 Convertible debentures series B	5%	4,790	28,377	33,167
2006 Convertible debentures series C	--(*)	25,381	11,513	36,894
		-----	-----	-----
		50,875	39,890	90,765
Less - current maturities		6,902	--	6,902
		-----	-----	-----
		\$ 43,973	\$ 39,890	\$ 83,863
		=====	=====	=====

(\*) See D below

If on a payment date of the principal or interest on the debentures there exists an infringement of certain covenants and conditions under the Facility Agreement, the dates for payment of interest and principal on the debentures may be postponed, depending on various scenarios under the Facility Agreement until such covenant or condition is settled. The debentures and interest thereon are unsecured and subordinated to the Company's existing and future secured indebtedness, including indebtedness to the Banks under the Facility Agreement - see Note 13A(6), to Siliconix - see Note 13D(1), to SanDisk- see Note 13D(2) and to the government of Israel - see Note 6B.

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

NOTE 10 - DEBENTURES (CONT.)

B. 2002 CONVERTIBLE DEBENTURES SERIES A

In January 2002, the Company issued on the Tel-Aviv Stock Exchange, NIS 110,579,800 (approximately \$24,300) principal amount of convertible debentures, linked to the Israeli Consumer Price Index ("CPI"). The debentures were issued at 96% of their par value, and bear annual interest at the rate of 4.7%, payable in January of each year commencing in January 2003. The principal amount is payable in four equal installments in January of each year between 2006 and 2009. The outstanding principal amount of convertible debentures as of December 31, 2007, adjusted to the CPI was \$15,984, half of which was paid on January 2008 and the other half is due on January 2009. The debentures may be converted until December 31, 2008 into Ordinary Shares, at a conversion rate of one Ordinary Share per each NIS 41.00 principal amount of the debentures.

C. 2005 CONVERTIBLE DEBENTURES SERIES B

The Company issued \$48,169 principal amount of convertible debentures by way of rights offering based on a prospectus which became effective on December 2005. The debentures are listed for trade on the Tel-Aviv Stock Exchange and on the NASDAQ Capital Market ("Series B"). The debentures accrue annual interest at the rate of 5% which will be payable, together with the principal of the debentures, in one installment on January 2012.

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The debentures are convertible into the Company's Ordinary Shares at a conversion price of \$1.10 per share. The conversion price was subject to downward adjustment under certain circumstances if the Company had sold securities in future financings at a price per share which was lower than the conversion price, provided that such financings closed, or agreements for such financings were signed, through December 2006. No such adjustment was or will be required and the downward adjustment mechanism has expired.

The Equity Investors and the primary Wafer Partners, which were considered related parties, invested \$27,811 in the framework of the rights offering.

Through December 31, 2007, \$19,055 in aggregate principal amount of debentures were converted into 17,322,575 Ordinary Shares of the Company, hence the outstanding principal amount of convertible debentures as of December 31, 2007 was \$29,114.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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NOTE 10 - CONVERTIBLE DEBENTURES (CONT.)

D. 2006 CONVERTIBLE DEBENTURES SERIES C

In a public offering the Company issued NIS 164,430,000 principal amount of convertible debentures linked to the CPI, for gross proceeds of NIS 139,765,500 (approximately \$31,219), and 391,500 options each exercisable for three months ending on September 27, 2006 for NIS 100 principal amount of convertible debentures at an exercise price equal to 85% of their face amount, linked to the CPI. The convertible debentures are convertible into the Company's Ordinary Shares at a conversion rate of one ordinary share per NIS 8.40 principal amount of convertible debentures. The convertible debentures carry a zero coupon with principal payable at maturity in December 2011, at a premium of 37% over principal value, linked to the CPI. The conversion price is subject to reduction in certain limited circumstances. The outstanding principal amount of convertible debentures as of December 31, 2007 was \$53,570.

E. 2007 NON-CONVERTIBLE DEBENTURES SERIES D AND CONVERTIBLE DEBENTURES E

In the second half of 2007, the Company consummated a private placement with Israeli institutions of long-term convertible and non-convertible debentures and warrants, by which the Company raised a gross proceeds of approximately \$40,000. In the funding, 342 units were sold, each comprised of: (i) long-term non-convertible-debentures, repayable in six equal annual installments between the dates of December 2011 and December 2016, with a face amount of NIS 250,000 (approximately \$59.7) and carrying an annual interest rate of 8 percent ("series D"); (ii) long-term convertible-debentures repayable in December 2012 with a 17.2 NIS conversion price, with a face amount of NIS 262,500 (approximately \$62.7), carrying an annual interest of 8 percent ("series E"), and (iii) 5,800 warrants, each exercisable until 2011, for one Tower

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ordinary share at a price of \$2.04. The debentures are linked to the CPI and were issued at 95.5% of par value. The conversion and exercise prices are subject to reduction in certain limited circumstances.

In September 2007, the Company expanded its series of long-term debentures and warrants, by selling 12,118 units, each comprised of long-term non-convertible debentures, with a face amount of NIS 2,500 (approximately \$0.62), long-term convertible debentures, with a face amount of NIS 2,625 (approximately \$0.65), and 58 warrants. The debentures were issued at 90% of par value and with the other same terms as the debentures and the warrants issued in the private placement. In this expansion, the Company raised gross proceeds of approximately \$14,000.

The outstanding principal amount of series D and E as of December 31, 2007 was \$30,865 and \$32,408, respectively. The Company elected to carry series E at fair value in accordance with provisions of SFAS No. 155.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
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### NOTE 11 - 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. HEDGING ACTIVITIES

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.

SFAS 133 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 hedging item in a cash flows hedge at which time changes are classified in other comprehensive income, to the extent effective.

The Company, from time to time, enters into agreements to hedge variable interest rate exposure on long-term loans. The Company uses interest rate collar agreements with a knock-out and knock-in features to hedge its LIBOR-based variable long-term 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 Company determined that the probability that the cap will be knocked-out is remote and thus expected that the hedge will be highly effective. The Company assessed and measured the effectiveness of the hedge, at inception and throughout the hedge, based on total changes in cash flows of the collar, and reported changes in fair value in other comprehensive income. Amounts presented in other comprehensive income are

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reclassified to operations or capitalized to property and equipment, as applicable, as interest payment become due.

As of December 31, 2007 and 2006, the Company had outstanding agreements to hedge interest rate exposure on loans drawn down under the Facility Agreement, the aggregate amount of which was \$80,000 and \$207,000 respectively, all of which is attributable to Fab 2. These agreements resulted in 2007 and 2006 in a gain of \$1,074 and \$880, respectively and in 2005 in a loss of \$1,756

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

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, cash equivalents are maintained with high-quality banks, and the composition and maturities of investments are regularly monitored by management. Generally, these securities may be redeemed upon demand and bear minimal risk.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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NOTE 11 - FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS (CONT.)

B. CONCENTRATION OF CREDIT RISKS

The Company generally does not require collateral; however, in certain circumstances, the Company maintains a credit insurance policy or may require letters of credit. An allowance for doubtful accounts is determined with respect to those amounts that the Company has determined to be doubtful of collection. The Company performs ongoing credit evaluations of its customers.

The Company is exposed to credit-related losses in respect of derivative financial instruments in a manner similar to the credit risk involved in the realization or collection of other types of assets. In management's estimation, due to the fact that derivative financial instrument transactions are entered into solely with financial institution counterparties, it is not expected that such counterparties will fail to meet their obligations.

C. FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair values of the Company's financial instruments, excluding the Company's long-term debentures do not materially differ from their respective carrying amounts as of December 31, 2007 and 2006. The fair value of the interest rate hedging transactions as of December 31, 2007, 2006 and 2005 would have resulted in an unrealized capitalizable gain of \$295, \$1,790 and \$1,767, respectively. The fair values of debentures as of December 31, 2007, 2006 and 2005 were \$157,683, \$126,048 and \$22,750, respectively, based on quoted market prices for the respective dates.



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### D. FAIR VALUE MEASUREMENTS

The Company decided to early adopt the provisions of SFAS No. 157 effective January 1, 2007, concurrent with the adoption of FASB 159 "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS No. 159)

The income approach was applied using a present value technique.

For Loans - The cash flows used in that technique reflect the income stream expected to be used to satisfy the obligation over its economic life.

For Embedded Derivatives - the Company utilized the Black Scholes Merton formula.

For Over the Counter derivatives - the Company used the market approach using quotation from dealer markets.

For convertible debentures series E - The market approach was applied using quoted prices for the same debentures.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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#### NOTE 11 - FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS (CONT.)

##### D. FAIR VALUE MEASUREMENTS (CONT.)

Recurring Fair Value Measurements Using:

	December 31, 2007 -----	Quoted prices in active market for identical liability (Level 1) -----	Significant other observable Inputs (Level 2) -----	Significant Unobservable Inputs (Level 3) -----
Trading securities - convertible debentures series E	\$ 28,484	\$ 28,484	\$ --	\$ --
Long-term debt	365,563	--	--	365,563
Derivatives	7,018	--	(295)	7,313
	-----	-----	-----	-----
	\$ 401,065	\$ 28,484	\$ (295)	\$ 372,876
	=====	=====	=====	=====

Asset Measurement on a Recurring Basis Using Significant Unobservable Inputs (Level 3):

	Long-term debt -----	Deriva -----
As of January 1, 2007- at fair value	\$ 367,223	\$ 11
Total gains unrealized in earnings	(1,660)	(4)
	-----	-----

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As of December 31, 2007 - at fair value	\$ 365,563	\$ 7
	=====	=====
Unrealized gain in earnings from liabilities still held at period end	\$ (1,660)	\$ (4)
	=====	=====

NOTE 12 - OTHER LONG-TERM LIABILITIES

A. Composition:

	As of December 31,	
	2007	2006
	-----	-----
Accrued Severance pay, see B below:	\$ 18,374	\$ 16,816
Long-term liabilities in respect of license agreements	--	1,804
LONG-TERM LOANS FROM RELATED PARTIES, NET OF CURRENT MATURITY, SEE NOTES 9B,13A(5) AND 13D(2)	19,073	8,096
Other (*)	2,933	1,439
	-----	-----
	\$ 40,380	\$ 28,155
	=====	=====

(\*) Includes \$2,468 and \$1,183 as of December 31, 2007 and 2006, respectively, of interest payable to related parties in regard to Series B, see also Note 10C.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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NOTE 12 - OTHER LONG-TERM LIABILITIES (CONT.)

B. EMPLOYEE TERMINATION BENEFITS

Israeli law and labor agreements determine the obligations of the Company 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 the Company into recognized severance and pension funds and by insurance policies purchased by the Company, 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 Other Long-term Liabilities, respectively. Commencing January 1, 2005 the Company is implementing a labor agreement according to which, monthly deposits into recognized severance and pension funds or insurance policies releases it from any additional severance obligation to its employees and therefore incur no liability or asset, since that date. Any net severance pay amount as of such date will be released thereafter, as fixed amount on employee termination date. Payments relating to employee termination benefits were approximately \$3,323, \$2,807 and \$2,631 for 2007, 2006 and 2005, respectively.

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### NOTE 13 - 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 the Company's second wafer fabrication facility in Israel ("Fab 2"). In Fab 2, the Company manufactures semiconductor integrated circuits on silicon wafers in geometries of 0.18 to 0.13 micron on 200-millimeter wafers. In connection with the establishment, equipping and financing of Fab 2, the Company has 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, with SanDisk Corporation, Alliance Semiconductor Corporation, Macronix International Co., Ltd. and QuickLogic Corporation (collectively, the "Wafer Partners"), Equity Investors, Banks, the Government of Israel through the Investment Center and others. The Company has also entered into agreements for the design and construction of Fab 2, for equipping Fab 2 and for the transfer to the Company of process technologies to produce wafers in Fab 2.

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

### NOTE 13 - COMMITMENTS AND CONTINGENCIES (CONT.)

#### A. COMMITMENTS AND CONTINGENCIES RELATING TO FAB 2 (CONT.)

##### (1) OVERVIEW (CONT.)

In 2006, the board of directors of the Company approved a plan to ramp up Fab 2's capacity to approximately 24,000 wafers per month in order to help meet customer needs and product qualification needs, based on its customer pipeline and reinforced by forecasted market conditions. This plan was completed during 2007. During 2007, the Company announced an additional plan to further ramp up to reach capacity beyond 24,000 wafers per month.

For details regarding the financing efforts of the ramp-up plans to reach capacity of 24,000 wafers per month and beyond, see Note 13A(4) for TIC investment of \$100,000; Note 9B for Facility Agreement amendments with the Banks and for credit lines from TIC and the Banks; Notes 14J-M for public and private fund raisings.

The Company continues to examine alternatives for additional funding sources in order to fund its Fab2 ramp-up.

##### (2) TECHNOLOGY TRANSFER AGREEMENTS

TOSHIBA - In 2000, the Company entered into a technology transfer agreement with Toshiba Corporation ("Toshiba"), a Japanese corporation. This agreement provided for the transfer by Toshiba

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to the Company of advanced semiconductor manufacturing process technologies to be installed in Fab 2 including related technology transfer assistance in exchange for certain fees for patent licenses, technology transfer and technical assistance. The transfer of the technology was substantially completed during 2003. The Company's commitment under the Toshiba agreement to reserve for Toshiba a certain portion of Fab 2 wafer manufacturing capacity expired in December 2005.

FREESCALE - In 2002, the Company entered into a non-exclusive technology transfer, development and licensing agreement with Freescale. This agreement provides for the transfer by Freescale to the Company of existing and newly developed versions of advanced semiconductor manufacturing process technologies to be installed in Fab 2, and for the provision by Freescale of related technology transfer assistance, in exchange for certain fees for patent and other licenses, technology transfer and development, and technical assistance. Subject to prior termination for cause by Freescale, the licenses under the agreement are perpetual.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
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NOTE 13 - COMMITMENTS AND CONTINGENCIES (CONT.)

A. COMMITMENTS AND CONTINGENCIES RELATING TO FAB 2 (CONT.)

(3) WAFER PARTNER AGREEMENTS

During the years 2000 and 2001, the Company entered into various shares purchase agreements ("Wafer Partner Agreements") with Wafer Partners to partially finance the construction and equipping of Fab 2. Pursuant to the Wafer Partner Agreements, the Wafer Partners agreed to invest an aggregate of \$250,000 to purchase Ordinary Shares of the Company. According to the Wafer Partner Agreements, the Company agreed, subject to certain conditions, to reserve for each Wafer Partner a certain portion, and collectively approximately 50%, of Fab 2 wafer manufacturing capacity for a period of 10 years ending January 2011.

Through December 31, 2004, the Wafer Partners invested under the Wafer Partner Agreements an aggregate of \$246,823. Of such amount, \$201,059, was credited as paid in capital and \$45,764, was established as long-term customers' advances which may be, subject to the terms and conditions stipulated in the Wafer Partner Agreements, as amended to date, utilized as credit against purchases to be made by the Wafer Partners, primarily through December 2010, or converted into paid-in-capital for limited term. Through December 31, 2007, the Wafer Partners were issued an aggregate of 36,489,681 Ordinary Shares at an average price per share of \$6.94, which was determined based on the average closing sale price of the Company's Ordinary Shares for the 15-30 trading days prior to making any capital investment: see also (5) below.

Due to recent changes in one of the Company's primary Wafer

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Partner's operations and its recent exit of its semiconductor activities, the Company believes that no future utilization is expected and determined that a full write-down of the its outstanding amount is appropriate.

For additional investments made by the primary Wafer Partners in the aggregate amount of \$19,089 in connection with the 2002 and 2005 rights offerings, see Notes 14G and 14I, respectively.

In August 2006, the Company signed an agreement with SanDisk, one of the Wafer Partners, to invest in the expansion of its 0.13 micron manufacturing capacity, see Note 13D(2).

For amendments to the Wafer Partner agreements, see (5) below.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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NOTE 13 - COMMITMENTS AND CONTINGENCIES (CONT.)

A. COMMITMENTS AND CONTINGENCIES RELATING TO FAB 2 (CONT.)

(4) EQUITY INVESTOR AGREEMENTS

During the years 2001-2004, TIC has invested in the Company \$50,000 for the purchase of an aggregate of 6,749,669 Ordinary Shares of the Company at an average price per share of \$7.41, which was determined based on the average closing sale price of the Company's Ordinary Shares for the 15-30 trading days prior to making any investment. The investment of TIC was made in accordance with shares purchase agreement the Company entered into in January 2001. For a description of an undertaking and additional investments made by TIC in the aggregate amount of \$29,152 in connection with the 2002 and 2005 rights offerings, see Notes 14G and 14I, respectively.

In regard to the Company's financing efforts for the ramp-up plan to reach capacity of 24,000 wafers per month and in connection with the September 2006 Amendment to the Facility Agreement, following TIC's commitment to invest \$100,000, the Company entered into a securities purchase agreement with TIC (the "Securities Purchase Agreement"). The Securities Purchase Agreement was approved by the Company's Audit Committee, Board of Directors and the Company's shareholders. The principal terms of the Securities Purchase Agreement were: (i) in consideration for its \$100,000 investment, the Company agreed to issue to TIC capital notes convertible into 65,789,474 of the Company's Ordinary Shares at a conversion price per share of \$1.52 (which equals the average closing price during the 10 consecutive trading days prior to signing the May 2006 Memorandum of Understanding with the Banks and TIC which was the basis of this agreement); (ii) the Company would be deemed to have exercised the Call Option under the Equipment Purchase Agreement described below; and (iii) the Company and TIC would settle the amounts payable by TIC under the Securities Purchase Agreement with the amounts payable by the Company under the Equipment Purchase

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Agreement. The Securities Purchase Agreement closed contemporaneously with the closing of the September 2006 Amendment.

In order to implement the ramp-up plan in a timely manner, in May 2006, the Company entered into an Equipment Purchase Agreement with TIC according to which TIC will order up to approximately \$100,000 worth of equipment for Fab 2. Under the terms of the Equipment Purchase Agreement: (i) TIC had the right to sell to the Company the equipment at cost, plus related expenses; (ii) the Company had the right to purchase the equipment from TIC at cost, plus related expenses, subject to the Company having raised \$100,000; and (iii) upon the purchase of the equipment from TIC the Company would assume TIC's obligations to the equipment suppliers.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
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NOTE 13 - COMMITMENTS AND CONTINGENCIES (CONT.)

A. COMMITMENTS AND CONTINGENCIES RELATING TO FAB 2 (CONT.)

(4) EQUITY INVESTOR AGREEMENTS (CONT.)

Upon the closing of the September 2006 Amendment and the Securities Purchase Agreement, TIC transferred ownership over the purchased equipment to the Company and the Company assumed TIC's obligations to the equipment suppliers.

For a credit line agreement signed with TIC in September 2007, see Note 9B.

(5) AMENDMENTS TO THE PRIMARY WAFER PARTNER AGREEMENTS

Pursuant to the primary Wafer Partner Agreements, as amended to date, each of the primary Wafer Partners had an option to convert, at the end of each calendar quarter commencing 2004, that portion of the long-term customers' advances which it is entitled to utilize, based upon payments made by such primary Wafer Partner and purchase orders received from the Wafer Partners through December 31, 2006, (subject to the below amendment with one of the Wafer Partners), into fully-paid Ordinary Shares of the Company. The number of shares has been determined based on the average closing sale price of the Company's Ordinary Shares for the 15 trading days preceding the end of the relevant quarter. Accordingly, through December 31, 2007, two of the primary Wafer Partners had elected to convert an aggregate of \$12,487 of long-term customer advances into 7,908,063 fully-paid Ordinary Shares of the Company, at an average share price of \$1.58 per share. Any quarterly amount, which the primary Wafer Partners had elected not to so convert, was utilized against purchases and was to be repaid on December 2007 ("December 2007 Date"). The amounts bear interest, payable at the end of each quarter, at an annual rate equal to three-month USD LIBOR plus 2.5% through December 31, 2007,

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subject to the below amendment with one of the Wafer Partners.

In 2006, the Company and one of the primary Wafer Partners, entered into an agreement to defer the December 2007 Date to be December 2009. Further, according to the agreement, with respect to certain orders placed until July 2006, and all orders placed thereafter through December 2009, such unutilized advances will bear interest at an annual rate equal to three-month USD LIBOR plus 1.1%, payable at the end of each quarter, through December 2009.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
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NOTE 13 - COMMITMENTS AND CONTINGENCIES (CONT.)

A. COMMITMENTS AND CONTINGENCIES RELATING TO FAB 2 (CONT.)

(6) FACILITY AGREEMENT

COMPLIANCE WITH FINANCIAL RATIOS AND COVENANTS - As of the balance sheet date, the Company 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 Banks were to accelerate the Company's obligations, the Company would be obligated, among other matters, to immediately repay all loans made by the Banks (which as of the approval date of the financial statements amounted to approximately \$400,000) plus penalties, and the Banks would be entitled to exercise the remedies available to them under the Facility Agreement, including enforcement of their liens against all of the Company's assets.

LIENS - Under the Facility Agreement, the Company agreed to register liens in favor of the Banks on substantially all its present and future assets. If, as a result of any default under the Facility Agreement, the Banks were to accelerate the Company's obligations, the Company would be obligated to immediately repay all loans made by the Banks (which as of the approval date of the financial statements amounted to approximately \$400,000), plus penalties, and the Banks would be entitled to exercise the remedies available to them under the Facility Agreement, including enforcement of the liens against the Company's assets.

OFFEROR BY THE BANKS - If one or more certain bankruptcy related events occur, the Banks are entitled to bring a firm offer made by a potential investor to purchase the Company's Ordinary Shares ("the Offer") at a price provided in the Offer. In such case, the Company 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 the Company's outstanding share capital, the rights offering will be limited to allow for this, unless TIC and the primary

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Wafer Partners 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 9B.

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NOTE 13 - COMMITMENTS AND CONTINGENCIES (CONT.)

A. COMMITMENTS AND CONTINGENCIES RELATING TO FAB 2 (CONT.)

(7) APPROVED ENTERPRISE STATUS

In December 2000, the Investment Center approved an investment program in connection with Fab 2 for expansion of the Company's plant. The approval certificate for the program provided for a benefit track entitling the Company to investment grants at a rate of 20% of qualified investments of up to \$1,250,000, or an aggregate of up to \$250,000, of which as of the balance sheet date, an aggregate of approximately \$165,000 has been received from the Investment Center. Under the terms of the program, investments in respect of Fab 2 were to be 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, the Company completed approximately 72% of the investments under the approved enterprise program. In December 2007, the Company submitted the final report in relation to the program. The Company has been holding discussions with the Investment Center to achieve satisfactory arrangements to approve a new expansion program commencing as of January 1, 2006. As of the approval date of the financial statements, the Company's management cannot estimate when, if at all, the Company will receive approval of its request for a new expansion program.

Any failure by the Company to meet the conditions of the 2000 approval certificate may result in the cancellation of all or a portion of the grants to be received and tax benefits and in the Investment Center requiring the Company to repay all or a portion of grants already received. Under Israeli law, the Company's non-completion of investments in an amount of \$1,250,000 by December 31, 2005 may permit the Investment Center to require the Company to repay all or a portion of grants already received. Management believes that it is improbable that the Investment Center would demand the Company to repay all or a portion of grants already received, or deny investment grants receivable as of December 31, 2005, due to its non-completion of investments in the amount of \$1,250,000 by December 31, 2005 - see also Note 17A

(8) AGREEMENT WITH THE ILA

In November 2000, the Company entered into a development



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agreement with the Israel Land Administration ("ILA") with respect to a parcel of land on which Fab 2 was constructed. Following the completion of the construction of Fab 2 on the land, in June 2003, the Company entered into a long-term lease agreement with the ILA 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.

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

NOTE 13 - COMMITMENTS AND CONTINGENCIES (CONT.)

A. COMMITMENTS AND CONTINGENCIES RELATING TO FAB 2 (CONT.)

(9) HEDGING ACTIVITIES

For hedging transactions and agreements of the Company, see Note 11A.

(10) OTHER AGREEMENTS

Through December 31, 2007, the Company had entered into several additional agreements related mainly to the construction, equipping and transfer of technology for Fab 2. The Company's aggregate commitment in connection with these agreements which were not supplied or rendered as of such date amounted to approximately \$45,000.

B. LICENSE AGREEMENTS

- (1) In June 2000, the Company entered into a cross license agreement with a major technology company. According to the agreement, each party acquired a non-exclusive license to certain of the other's patents. The Company agreed to pay an annual license fee through July 2005. In July 2006, the Company extended its cross license agreement with the major technology company until December 2010. According to terms of the new agreement, each party acquired a non-exclusive license to certain of the other's patents, and the Company agreed to pay an annual license fee through 2010.
- (2) In May 2002, the Company entered into a joint development and royalty-free, non-exclusive cross-license agreement with a Japanese semiconductor manufacturer corporation, for the joint development of certain technology to be used by the Company in its Fab 2 and by the Japanese manufacturer in its facilities. In April 2005, the Japanese semiconductor manufacturer corporation elected, and the Company agreed, to cease the joint development of certain technology and to terminate the agreement. However, the license rights granted to the parties continue pursuant to the terms of the May 2002 agreement. According to the terms of the termination agreement, the Japanese manufacturer paid the Company an amount of \$2,500 in 2005. In addition, each party expressly released the other party from any obligations or liabilities of any nature in connection with the original agreement. Revenues for 2005 include \$8,000 in relation to this

agreement.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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NOTE 13 - COMMITMENTS AND CONTINGENCIES (CONT.)

B. LICENSE AGREEMENTS (CONT.)

- (3) In October 1997 the Company and Saifun Semiconductors Ltd ("Saifun") entered into an agreement for certain exclusive semiconductor manufacturing rights on certain licensed technology. The agreement set certain limitations on Saifun regarding future licensing of such technology. Pursuant to certain provisions of the agreement, the Company and Saifun were obligated to pay each other royalties. The agreement was terminated in 2006, with the signing of a new agreement, according to which, among other things, Saifun extended the term of the license granted to the Company for certain licensed technology.
- (4) The Company from time to time enters into intellectual property and licensing agreements with third parties. 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, see also Note 12A.

C. LEASES

- (1) The Company's offices and engineering and 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. The Company has no obligation for lease payments related to this lease through the year 2032.
- (2) With respect to a long-term lease agreement of land on which Fab 2 was constructed, see A(8) above.
- (3) The Company occupies certain other premises under various operating leases. The obligations under such leases were not material as of December 31, 2007.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
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NOTE 13 - COMMITMENTS AND CONTINGENCIES (CONT.)

D. OTHER PRINCIPAL AGREEMENTS

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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 by both the other entities and the Company.

- (1) SILICONIX - In 2004, the Company and chip maker Siliconix incorporated ("Siliconix"), a wholly-owned subsidiary of Vishay Intertechnology Inc., entered into a definitive long-term foundry agreement for semiconductor manufacturing. Pursuant to the agreement, Siliconix will place with the Company orders for the purchase of wafers to be manufactured in the Company's Fab 1. According to the agreement, in 2004 Siliconix provided the Company \$20,000 to be used primarily for the purchase of additional equipment required to satisfy Siliconix's production wafer requests. The advanced amount is credited towards the purchase price of wafers. Under the agreement, Siliconix is entitled to register liens over the equipment purchased in connection with the transaction.
- (2) SANDISK CORPORATION - In 2006, in connection with Fab2 0.13 micron capacity expansion, the Company signed an agreement with SanDisk Corporation ("SanDisk"), one of its wafer partners, according to which, SanDisk is committed to purchase volume quantities of 0.13 micron wafers during 2007 and 2008 and will have a right of first refusal for a portion of the Company's 0.13 micron capacity in 2009. The Company and SanDisk also signed a Loan Agreement under which the Company borrowed approximately \$10,000 from SanDisk for the purpose of financing the purchase of a portion of the equipment needed for said expansion. The loan bears interest on the amounts outstanding at three-month USD LIBOR plus 1.1%. Pursuant to the agreement, SanDisk has been granted a first ranking charge on the equipment purchased therewith.

### E. ENVIRONMENTAL AFFAIRS

The Company's operations are subject to a variety of laws and governmental regulations in Israel 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 operations 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 was in compliance with the terms of the permits and licenses.

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

### NOTE 13 - COMMITMENTS AND CONTINGENCIES (CONT.)

#### F. CLASS ACTION

In June 2006, the United States Court of Appeals for the Second

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Circuit affirmed the August 2004 decision of the United States District Court for the Southern District of New York to dismiss the class action suit filed in July 2003 against the Company and certain of its directors, Wafer Partners and Equity Investors (the "Defendants"). The plaintiffs had asserted claims arising under the Securities Exchange Act of 1934, alleging misstatements and omissions made by the Defendants in materials sent to the Company's shareholders in April 2002 with respect to the approval of an amendment to the Company's investment agreements with its Fab 2 investors. The District Court accepted the motion to dismiss filed on behalf of the defendants and noted that the Company's status as a foreign private issuer exempts the Company, its directors and controlling shareholders, from liability under the proxy rules of Section 14(a) of the Securities Exchange Act.

### G. AMENDMENT TO ISRAELI BANKING REGULATIONS

Pursuant to an amendment to a directive published by the Israel Supervisor of Banks, effective March 31, 2004, the Company may be deemed part of a group of borrowers comprised of the Ofer Brothers Group, TIC, and other companies which are also included in such group of borrowers pursuant to the directive, including companies under the control or deemed control of these entities. The directive provides for limits on amounts that banks may lend to borrowers or groups of borrowers. Should the Banks exceed these limitations, they may limit the Company's ability to borrow other money in the future and may require the Company to return some or all of the outstanding borrowings (which were approximately \$400,000 as of the approval date of the financial statements). As of the approval date of the financial statements, the Company had received no such request.

### H. OTHER COMMITMENTS

Receipt of certain research and development grants from the government of Israel is subject to various conditions. In the event the Company fails to comply with such conditions, the Company may be required to repay all or a portion of the grants received. In management's opinion, the Company has been in full compliance with the conditions through December 31, 2007. In regard to investment center grants, see A(7) above.

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

### NOTE 14 - SHAREHOLDERS' EQUITY

#### A. DESCRIPTION OF ORDINARY SHARES

As of December 31, 2007 and 2006, the Company had 800,000,000 authorized Ordinary Shares, par value NIS 1.00 each, of which 124,226,116 and 100,752,767, respectively, were issued and outstanding (net of 1,300,000 Ordinary Shares held by the Company as of such dates). As of the balance sheet date, there were 243,905,535 Ordinary Shares of the Company contingently issuable. This amount includes Ordinary Shares to be issued under various agreements according to their provisions: (i) Equity Investor warrants, see B(5)(b) below;

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(ii) the exercise of outstanding warrants, see J,K,L and M below;  
(iii) options granted to employees and non-employees, see B(1) below;  
(iv) the conversion of all outstanding convertible debentures, see Note 10 above; and (v) the exercise of all capital notes, see C 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 the Company, 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.

### 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 options to purchase its 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 market value of the Ordinary Shares at the date of grant; vest over a three to four-year period according to various vesting schedules; and are not exercisable beyond ten years from the grant date.

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

#### NOTE 14 - SHAREHOLDERS' EQUITY (CONT.)

### B. SHARE OPTION PLANS (CONT.)

#### (1) EMPLOYEE, CHAIRMAN OF THE BOARD OF DIRECTORS, CHIEF EXECUTIVE OFFICER AND DIRECTOR SHARE OPTIONS (CONT.)

(B) OPTIONS TO THE CHAIRMAN OF THE COMPANY'S BOARD OF DIRECTORS - In December 2006, the Audit Committee and Board of Directors of the Company approved the appointment of a new Chairman to the Board of Directors of the Company and approved to grant him options to purchase 3,158,090 Ordinary Shares of the Company, which constituted 1% of the Company's issued and outstanding share capital on a fully diluted basis as of December 2006, the date the Board of Directors approved the grant. The exercise price is \$1.88, which was the closing price of the Company's Ordinary Shares on the NASDAQ Global Market on the trading day immediately prior to the date of approval of the grant by the Shareholders of the Company. The options vest over 4 years, 25% on the 12 month anniversary of the shareholders approval date and 6.25% on each 3 month anniversary of the first vesting date until fully vested. The options grant to the chairman of the Board of Directors was approved by the shareholders of the Company in January 2007. The compensation cost of the options granted was determined based on the fair value at the grant

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dates and amounted to \$3,568. Such amount is expensed on an accelerated basis over the vesting periods of the options.

- (C) OPTIONS TO THE COMPANY'S CHIEF EXECUTIVE OFFICER AND DIRECTOR - In April 2005, the Company's Board of Directors approved the grant of options to purchase up to 1,325,724 Ordinary Shares to the Company's Chief Executive Officer ("CEO"), who also serves as a director, which was further approved by the Company's shareholders in October 2005. These options are exercisable at an exercise price of \$1.56, which was the closing market price of the Company's shares on the last trading day prior to the board approval of the grant. These options will vest over a four-year period, with 25% vesting over each year of employment. The options granted are exercisable for a period of ten years from the date of grant.

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

### NOTE 14 - 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) OPTIONS TO THE COMPANY'S CHIEF EXECUTIVE OFFICER AND DIRECTOR (CONT.)

In May 2006, the Company's Audit Committee and Board of Directors approved the grant of options to the CEO, in addition to the options granted to him in 2005, such that in total, the CEO will hold options to purchase shares that represent 4% of the Company's shares on a fully diluted basis during the two-year period from the approval of the Audit Committee. The exercise price of the initial grant of the additional options was \$1.45, the 90-day average closing price of the Company's shares prior to the Board of Directors' approval. Future dilutive events following May 2006 and until May 2008 also entitles him for additional options grants with an exercise price equal to the price per share of the newly issued securities. Under certain circumstances, the exercise price will equal the 30-day average closing price of the Company's shares prior to the dilutive event. The additional options granted during the two-year period, will vest in equal amounts over 4 years of employment commencing from May 2006. Any decrease in the Company's shares on a fully diluted basis during the two-year period from the approval of the Audit Committee will be followed by the cancellation of the corresponding options granted to the CEO. The options are exercisable for a period of 10 years from the date of grant. No additional options will be granted under the CEO's 2005 option arrangement, which was approved by the Company's shareholders in October 2005. The new grant of options and

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its terms were approved by the Company's shareholders in September 2006.

As of the balance sheet date, a total of 14,872,087 options were outstanding to the CEO. The compensation cost of the total options granted to the CEO was determined based on the fair value at the grant dates and amounted to \$11,723. Such amount is expensed on an accelerated basis over the vesting periods of the options.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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NOTE 14 - 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) EMPLOYEE OPTIONS - In May 2006, the Company's board of directors approved a plan to offer each of the Company's employees the opportunity to exchange their existing options to purchase Ordinary Shares for new options with an exercise price of \$1.45, which is the average closing price of the Company's shares on the NASDAQ during the 90 consecutive trading days prior to the board of directors' approval. Accordingly, 4,299,250 options were exchanged. The new options were granted based on terms similar to the existing employee option plan with new vesting periods, starting May 2006. The cost of the new options was determined based on the fair value at the grant dates in and amounted to \$1,726. Such amount is amortized as an expense on an accelerated basis over the vesting periods of the new options. The Board of Directors further approved that if the total number of employee options, including the options to the CEO, during the two-year period from May 2006 will represent less than 8% of the Company's shares on a fully diluted basis, additional options will be allocated for grants to the Company's employees. As of the balance sheet date, approximately 3,938,000 options are reserved for future grant of options to employees.

(E) OPTIONS GRANTED TO DIRECTORS - During 2001, the Audit Committee, the Board of Directors of the Company and the shareholders of the Company approved a stock option plan pursuant to which certain of the Company's directors will be granted options to purchase up to 400,000 Ordinary Shares of the Company (40,000 to each eligible director appointed to the Board of Directors) at an exercise price equal to the market price of the Company's shares on the grant dates. In accordance with this option plan, 80,000 options were granted in 2007 to two director who were appointed in 2007 at an average exercise prices of \$1.74, which equals the market price of the Company's shares on the grant date. As of December 31, 2007, 190,000 options were outstanding under

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the plan with a weighted average exercise price of \$3.68.

Options granted under the 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, following January 2007, will be entitled to receive options under the 2001 director options plan.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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### NOTE 14 - SHAREHOLDERS' EQUITY (CONT.)

#### B. SHARE OPTION PLANS (CONT.)

(1) EMPLOYEE, CHAIRMAN OF THE BOARD OF DIRECTORS, CHIEF EXECUTIVE OFFICER AND DIRECTOR SHARE OPTIONS (CONT.)

(F) INDEPENDENT DIRECTORS OPTION PLAN - In November 2006, the Company's Board of Directors approved, following the approval by the Audit Committee, the grant to each independent director options to purchase Ordinary Shares ("Initial Options") that shall equal 150,000 less the number of options to purchase Ordinary Shares held by such independent director as of January 31, 2007, the date the shareholders approved the grant (the "Initial Grant Date") and which, as of the Initial Grant Date, have not vested. The Initial Options shall vest over 3 years, one third will vest on the 12 month anniversary of the Initial Grant Date, and thereafter, the remaining two thirds will vest on a monthly basis until fully vested. The exercise price of the Initial Options was \$1.88, which was the closing price of the Company's Ordinary Shares on the NASDAQ on the trading day immediately prior to the Initial Grant Date. Each new independent director appointed after the Initial Grant Date shall be granted 150,000 options to purchase Ordinary Shares ("Subsequent Options"), which, shall vest over 3 years, one third on the 12 month anniversary of the date on which such independent director shall have served on the Board of Directors of the Company, the remaining two thirds will vest on a monthly basis until fully vested. The exercise price per Subsequent Option shall be the closing price of the Company's Ordinary Shares on the NASDAQ on the trading day immediately prior to the relevant date of appointment.

Upon each 36 month anniversary of a previous grant of options to an independent director (each a "Tenure Grant Date"), each such independent director shall be granted an additional 150,000 options to purchase Ordinary Shares ("Tenure Options"), which will vest over 3 years on a monthly basis until fully vested. The exercise price per Tenure Option shall be the closing price of the Company's Ordinary Shares on the NASDAQ on the trading day immediately



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prior to the relevant Tenure Grant Date. Subject to certain conditions, the Initial Options, Subsequent Options and Tenure Options that have vested shall be exercisable by an Independent Director for a period of ten years following the date on which the Initial Options, Subsequent Options or Tenure Options, as the case may be, first vested. So long as this option plan remains in effect, no future grants will be made to independent directors under the plan described in (1)(e) above. The independent directors' option plan was approved by the shareholders of the Company in January 2007.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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NOTE 14 - SHAREHOLDERS' EQUITY (CONT.)

B. SHARE OPTION PLANS (CONT.)

(1) EMPLOYEE, CHAIRMAN OF THE BOARD OF DIRECTORS, CHIEF EXECUTIVE OFFICER AND DIRECTOR SHARE OPTIONS (CONT.)

(F) INDEPENDENT DIRECTORS OPTION PLAN (CONT.)

The compensation cost of the total options granted to the directors under the plan described in (1)(e) above and to the independent directors under the plan described in this section was determined based on the fair value at the grant dates and amounted to \$594. Such amount is expensed on an accelerated basis over the vesting periods of the options.

(2) SUMMARY OF THE STATUS OF ALL THE COMPANY'S EMPLOYEE AND DIRECTOR SHARE OPTIONS

A summary of the status of all the Company's employee and director share option plans as of December 31, 2007, 2006 and 2005, as well as changes during each of the years then ended, is presented below (for options granted to the Banks, a related party and a consultant, see B(5) below):

	2007		2006		Number of share options
	Number of share options	Weighted average exercise price	Number of share options	Weighted average exercise price	
Outstanding as of beginning of year	23,514,042	\$ 1.87	13,011,575	\$ 4.19	10,212,92
Granted	9,127,384	1.88	17,414,268	1.52	5,000,22
Exercised	(176,231)	1.30	(7,250)	1.58	-
Terminated	(525,000)	7.07	(132,176)	10.95	(77,21
Forfeited	(2,344,660)	1.81	(6,772,375)	5.23	(2,124,35
Outstanding as of end of year	29,595,535	1.79	23,514,042	1.87	13,011,57

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Options exercisable as of end of year	7,827,743	\$	2.15	2,849,132	\$	4.25	4,602,44
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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 (dollars in thousands, except share data and per share data)

NOTE 14 - SHAREHOLDERS' EQUITY (CONT.)

B. SHARE OPTION PLANS (CONT.)

(3) SUMMARY OF INFORMATION ABOUT EMPLOYEE SHARE OPTIONS OUTSTANDING

The following table summarizes information about employee share options outstanding as of December 31, 2007:

Outstanding as of December 31, 2007			Exercisable as of December 31, 2007		
Range of exercise PRICES	Number outstanding	Weighted average remaining contractual life (in years)	Weighted average exercise price	Number exercisable	Weighted average exercise price
\$ 1.16-\$1.30	401,203	7.35	\$ 1.26	197,501	\$ 1.26
1.37-1.40	922,332	8.52	1.40	232,333	1.40
1.45	7,990,416	8.37	1.45	2,010,515	1.45
1.46-1.58	9,355,391	8.11	1.54	3,168,731	1.55
1.60-1.98	7,817,044	9.05	1.83	479,952	1.82
2.02-2.28	2,071,492	8.28	2.13	971,921	2.17
3.25-3.70	239,687	6.47	3.26	199,328	3.26
4.11-4.56	416,269	8.40	4.23	185,761	4.33
5.00-10.75	158,601	2.89	7.18	158,601	7.18
11.81	200,000	3.41	11.81	200,000	11.81
\$16.50-\$25.00	23,100	2.62	\$ 22.23	23,100	\$ 22.23
	29,595,535			7,827,743	

(4) WEIGHTED AVERAGE GRANT-DATE FAIR VALUE OF OPTIONS GRANTED TO EMPLOYEES

The weighted average grant-date fair value of the options granted during 2007, 2006 and 2005 to employees and directors amounted to \$0.87, \$0.81 and \$0.83 per option, respectively. The Company utilized the Binomial lattice model since 2006 and the Black-Scholes option-pricing model in 2005. The Company estimated the fair value, utilizing the following assumptions for the years 2007, 2006 and 2005 (all in weighted averages):

2007	2006	2005
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Risk-free interest rate	3.61%-6.09%	4.44%-4.81%	3.69%-4.34%
Expected life of options	10 years	10 years	4.49 years
Expected annual volatility	55%-65%	65%-67%	54%-69%
Expected dividend yield	None	None	None

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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NOTE 14 - SHAREHOLDERS' EQUITY (CONT.)

B. SHARE OPTION PLANS (CONT.)

(5) NON-EMPLOYEE WARRANTS

(A) BANKS WARRANTS - As of December 31, 2007, 11,631,648 warrants to purchase Ordinary Shares of the Company, at terms described below, were outstanding and exercisable, at a weighted average exercise price of \$1.77 per share. 9,161,060 of the warrants are exercisable until September 2011 and 2,470,588 exercisable through March 2010

The cost of the 9,161,060 warrants issued to the Banks, determined based on the fair value at the grant and amendment dates in accordance with SFAS 123, amounted to a total of \$10,886. Such amount was amortized as deferred financing charges over the terms of the loans under the Facility Agreement.

In September 2007, as part of as part of the Company's credit line agreement with the Banks described in Note 9B, the Banks received an aggregate of 2,470,588 warrants to purchase Ordinary Shares of the Company at an exercise price of \$2.04 per share. All the warrants are exercisable until March 2010. The cost of the warrants, determined based on the fair value at the grant and amendment dates in accordance with SFAS 123, amounted to a total of \$608. Such amount was amortized as deferred financing charges over the term of the loans under the Facility Agreement.

In lieu of paying the exercise price in cash, the 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 shares underlying the warrants forfeited less the aggregate exercise price.

(B) WARRANTS GRANTED TO TIC - The Company issued TIC warrants for the purchase of 58,906 of the Company's Ordinary Shares. The exercise price for the warrants is \$6.17 per share, the 15-day average closing price of the Company's Ordinary Shares prior to the date the November 2003 Amendment with the Banks was signed. All the warrants are fully vested and none of them was exercised. The warrants are exercisable for a five-year period ending December 2008. The cost of the

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warrants award granted to TIC, determined based on the fair value at the grant date in accordance with SFAS 123, amounted to a total of \$259. Such amount was allocated to other assets as deferred financing charges and was amortized as financing expense over the terms of the loans under the Facility Agreement with the Banks.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
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NOTE 14 - SHAREHOLDERS' EQUITY (CONT.)

B. SHARE OPTION PLANS (CONT.)

(5) NON-EMPLOYEE WARRANTS (CONT.)

WARRANTS ISSUED IN SEPTEMBER 2007 - In September 2007, as part of the Company's credit line agreement with TIC described in Note 9B, TIC received an aggregate of 2,941,176 warrants to purchase Ordinary Shares of the Company at an exercise price of \$2.04 per share. All the warrants are exercisable until March 2010. The cost of the warrants, determined based on the fair value at the grant and amendment dates in accordance with SFAS 123, amounted to a total of \$723. Such amount was amortized as deferred financing charges over the term of the loans under the Facility Agreement.

C. CAPITAL NOTES

(1) BANKS' CAPITAL NOTES

As part of the September 2006 Amendment to the Facility Agreement, an amount of \$158,000 of debt was converted into capital notes of the Company, convertible into 51,973,684 of the Company's Ordinary Shares, representing twice the average closing price per share during the ten consecutive trading days prior to signing the MOU underlying the September 2006 Amendment to the Facility Agreement. The capital notes are instruments of equity and not debt. The capital notes' holders may convert the face amount of the capital notes, in whole or in part, without additional consideration, into Ordinary Shares of the Company, however, prior to such conversion, if at all, the capital notes (i) do not grant their holders with any of the rights of the Company's shareholders; (ii) have no maturity date, do not carry interest, are not linked to any index and are not redeemable; and (iii) are not registered. For additional information regarding the capital notes to the Banks, see Note 9B.

(2) TIC'S CAPITAL NOTES

Contemporaneous with the closing of the September 2006 Amendment and as part of the Securities Purchase Agreement between the Company and TIC, the Company issued TIC in consideration of its \$100,000 investment, capital notes convertible into 65,789,474 of the Company's Ordinary Shares, at a price per share of \$1.52 (which equals the average closing price during the 10 consecutive

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trading days prior to signing the MOU). The capital notes terms are the same as in (1) above. For additional information regarding the capital notes to TIC see Note 9B.

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

#### NOTE 14 - SHAREHOLDERS' EQUITY (CONT.)

##### D. TREASURY STOCK

During 1998, the Board of Directors of the Company authorized, subject to certain conditions, the purchase of up to 1,400,000 Ordinary Shares of the Company to facilitate the exercise of employee stock options under the Company's share option plans. During 1999 and 1998, the Company funded the purchase by a trustee of 142,500 and 1,157,500, respectively, of the Company's Ordinary Shares.

##### E. DIVIDEND DISTRIBUTIONS

According to the Facility Agreement, as amended to date, the Company undertook not to distribute any dividends prior to the date that all amounts payable under the Facility Agreement have been paid in full.

##### F. PUBLIC OFFERING IN ISRAEL - JANUARY 2002

In January 2002, the Company issued on the Tel Aviv Stock Exchange, NIS 110,579,800 principal amount of convertible debentures Series A, under terms described in Note 10B. Together with the convertible debentures the Company issued for no consideration an aggregate of 552,899 options exercisable into debentures and 2,211,596 Options (Series 1). As of the date of the financial statements, all said options expired and none were exercised. The total initial proceeds raised were \$23,200, and costs related to the issuance of the securities and the prospectus were approximately \$1,750.

##### G. RIGHTS OFFERING - OCTOBER 2002

In October 2002, the Company issued in connection with a rights offering done on the NASDAQ and on the Tel-Aviv Stock Exchange 4,097,964 Ordinary Shares of the Company and 1,844,070 warrants to purchase Ordinary Shares of the Company, in consideration for aggregate gross proceeds of \$20,490. Of these amounts, 4,086,037 Ordinary Shares and 1,838,715 warrants were issued to Wafer Partners and Equity Investors in consideration for an aggregate of \$20,430. Each warrant was exercisable for the purchase of one Ordinary Share at an exercise price of \$7.50 for a period ending on October 31, 2006. None of the warrants were exercised. Costs in relation to the prospectus and the issuance of the securities were approximately \$800.

##### H. PUBLIC OFFERING - JANUARY 2004

In January 2004, the Company completed a public offering of its Ordinary Shares in the U.S. at a price of \$7.00 per share. Following the offering, and including the partial exercise in February 2004 of an over-allotment option the Company granted the underwriters, the

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Company issued 11,444,500 of its Ordinary Shares, in consideration for gross proceeds of \$80,112 (net of related costs - \$75,086).

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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NOTE 14 - SHAREHOLDERS' EQUITY (CONT.)

I. RIGHTS OFFERING - DECEMBER 2005

In December 2005, the Company filed in Israel and the U.S. a prospectus for the distribution of transferable rights to purchase up to \$50,000 U.S. dollar denominated debentures Series B that are convertible into up to 45,454,545 of the Company's Ordinary Shares. The rights were distributed to the shareholders of record of the Company on December 20, 2005 (the record date), and to certain employees who on the record date held options to purchase the Company's Ordinary Shares under share options plans that entitle the options holders to participate in a rights offering. Each 138.98 Ordinary Shares and/or eligible employee options held on the record date entitled their holder to one right. The rights were exercisable until January 12, 2006. Each right entitled its holder to purchase, at a subscription price of \$0.1, 100 U.S. dollar denominated convertible debentures.

In connection with the exercise of the rights, the Company issued 48,169,300 convertible debentures under terms described in Note 10C.

For investment by primary Wafer Partners and Equity Investor see also Note 10C.

J. PUBLIC OFFERING IN ISRAEL - JUNE 2006

In June 2006 the Company completed an underwritten public offering of the Company's securities on the Tel-Aviv Stock Exchange resulting in immediate gross proceeds of approximately NIS 140,000,000 (approximately \$31,000). The units sold consisted of (i) convertible debentures Series C in the face amount of NIS 163,800,000 (approximately \$36,661), (ii) 390,000 options each exercisable for the three months ended September 27, 2006 for NIS 100 principal amount of convertible debentures at an exercise price equal to 85% of their face amount, (iii) 10,920,000 warrants each exercisable for the three months ended September 27, 2006 for one Ordinary Share of the Company at a price of NIS 6.75 (approximately \$0.00157, and (iv) 5,460,000 warrants each exercisable for three years ending on June 28, 2009 for one Ordinary Share of the Company at a price of NIS 7.40 (approximately \$0.00175). The convertible debentures are convertible into the Company's Ordinary Shares at a conversion rate of one Ordinary Share per NIS 8.40 (approximately \$0.00199) principal amount of convertible debentures. The convertible debentures carry a zero coupon with principal payable at maturity in December 2011, at a premium of 37% over face value, linked to the CPI. The conversion price is subject to reduction in certain limited circumstances.

In addition, the Company issued similar units including principle value of NIS 630,000 convertible debentures in consideration for NIS

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526,000 through a private placement to its market maker in connection with said offering.

Through September 2006, 391,500 options to purchase convertible debentures described in (ii) above were exercised and 350,000 short term warrants described in (iii) above were exercised into Ordinary Shares, totaling in proceeds of approximately \$8,000.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
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NOTE 14 - SHAREHOLDERS' EQUITY (CONT.)

K. PRIVATE PLACEMENT IN ISRAEL - NOVEMBER 2006

In the fourth quarter of 2006, the Company received and accepted orders from Israeli investors in private placements for 11,615,000 Ordinary Shares and 5,227,500 warrants ("Series 5 Warrants"). The price of the Ordinary Shares was equal to the closing price of the Company's shares on the Tel-Aviv Stock Exchange prior to the relevant private placements and the warrants were issued for no consideration. Total immediate gross proceeds amounted to approximately \$22,000. Each of the Series 5 Warrants is exercisable at any time during a period of four years ending in December 2010 at a price per share equal to a 25% premium to the market price of the Company's shares at the date the prospectus is published. As of December 28, 2006, following the publication of the prospectus, the exercise price was finalized and determined to be NIS 9.48 (approximately \$0.0022) linked to the CPI. Series 5 Warrants have been classified to equity.

L. PRIVATE PLACEMENT IN THE US - MARCH 2007

In March 2007, the Company completed a private placement of its securities in which it sold Ordinary Shares and warrants for the purchase of Ordinary Shares, raising a total of approximately \$29,000 in gross proceeds. In the private placement, the Company issued approximately 18.8 million shares and warrants exercisable into approximately 9.4 million shares at an exercise price of \$2.04 (subject to possible adjustments under certain circumstances) exercisable until March 15, 2012 ("Series I Warrants"). The Company also issued short-term warrants at an exercise price of \$1.70 ("Series II Warrants"), however all Series II Warrants were not exercised and were fully expired as of December 31, 2007.

M. LONG-TERM DEBENTURES ISSUED IN ISRAEL - 2007

In the second half of 2007, the Company consummated two private placements with Israeli institutions of long-term convertible and non-convertible debentures and warrants, see Note 10E.

N. U.S SHELF PROSPECTUS

In January 2008, the Company filed a shelf registration statement on Form F-3 with the US Securities and Exchange Commission to allow for the registration of a possible offer and sale of up to \$30,000 of

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securities of the Company, it may elect to execute during the three years following the effective date of the registration statement. As of the approval date of the financials statements, the registration statement has not yet been declared effective. The Company has made no decisions as to when, if at all, it will actually raise funds under the shelf registration.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
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NOTE 15 - INFORMATION ON GEOGRAPHIC AREAS AND MAJOR CUSTOMERS

A. REVENUES BY GEOGRAPHIC AREA (as percentage of total sales)

	Year ended December 31,		
	2007	2006	2005
United States	75%	69%	64%
Israel	7	7	7
Asia Pacific	10	16	20
Europe	8	8	9
Total	100%	100%	100%

B. LONG-LIVED ASSETS BY GEOGRAPHIC AREA - Substantially all of the Company's long-lived assets are located in Israel.

C. MAJOR CUSTOMERS (as percentage of total sales)

	Year ended December 31,		
	2007	2006	2005
Customer A (*)	29%	23%	22%
Customer B	13	9	5
Customer C	11	2	1
Customer D	7	10	14
Customer E (*) (**)	5	11	8
Other customers (***)	11	21	20

(\*) Related party

(\*\*) Including its affiliates

(\*\*\*) Represents sales to two different customers each of whom accounted for between 5% and 6% of sales during 2007; to five different customers each of whom accounted for between 2% and 6% of sales during 2006 and to five customers accounted for between 2% and 8% of sales during 2005.

As of December 31, 2007 and 2006, the above major customers



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constituted the majority of the trade accounts receivable reflected on the balance sheets.

### NOTE 16 - FINANCING EXPENSES, NET

Financing expenses, net consist mainly of Bank loans payable interest- see Note 9, and interest and other financing expenses in relation to our debentures- see Note 10.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
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### NOTE 17 - INCOME TAXES

#### A. APPROVED ENTERPRISE STATUS

Substantially all of the Company's existing facilities and other capital investments through December 31, 2005 have been granted approved enterprise status, as provided by the Israeli Law for the Encouragement of Capital Investments - 1959 ("Investments Law") see Note 6B.

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, the Company's income attributable to its various approved enterprise investments is taxed at a rate of up to 25% through 2012. Taxable income attributable to the Fab 2 approved program shall be tax-exempt for the first two years it arises. The portion of the Company's taxable income that is not attributable to approved enterprise investments is taxed at a rate of 29% in 2007 (regular "Company Tax"). The regular Company Tax rate is to be gradually reduced to 25% until 2010.

The tax benefits are also conditioned upon fulfillment of the requirements stipulated 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 the Company to comply with these conditions, the tax benefits could be canceled, in whole or in part, and the Company would be required to refund the amount of the canceled benefits, plus interest and certain inflation adjustments. In management's opinion, the Company has been in compliance with the conditions through the approval date of the financial statements. See also Notes 6B and 13A(7).

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
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### NOTE 17 - INCOME TAXES (CONT.)

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### B. 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,	
	2007	2006
	-----	-----
DEFERRED TAX BENEFIT - CURRENT		
Amounts relating to employees benefits	\$ 797	\$ 1,717
Other	438	115
	-----	-----
	1,235	1,832
Valuation allowance	(1,235)	(1,832)
	-----	-----
Total current deferred tax benefit	\$ --	\$ --
	=====	=====
NET DEFERRED TAX BENEFIT - LONG-TERM		
Deferred tax assets -		
Net operating loss carryforwards	\$ 200,000	\$ 174,000
Research and development	1,851	2,063
Liability for employee rights upon severance	905	656
	-----	-----
	202,756	176,719
Valuation allowance	(151,844)	(128,707)
	-----	-----
	50,912	48,012
Deferred tax liability - depreciation and amortization	(50,912)	(48,012)
	-----	-----
Total net long-term deferred tax benefit	\$ --	\$ --
	=====	=====

### C. EFFECTIVE INCOME TAX RATES

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

	Year ended December 31,		
	2007	2006	2005
	-----	-----	-----
Israeli statutory rate	(29)%	(31)%	(34)%
Reduced tax rate for approved enterprise	9	11	14
Tax benefits for which deferred taxes were not recorded	17	13	21
Permanent differences and other, net	3	7	(1)
	-----	-----	-----
	--%	--%	--%
	=====	=====	=====

### D. NET OPERATING LOSS CARRYFORWARD

As of December 31, 2007, the Company had net operating loss carryforwards for tax purposes of approximately \$1,000,000, which may be carried forward for an unlimited period of time.

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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NOTE 17 - INCOME TAXES (CONT.)

E. FINAL TAX ASSESSMENTS

The Company possesses final tax assessments through the year 1998. In addition, the tax assessments for the years 1999-2003 are deemed final.

NOTE 18 - RELATED PARTIES BALANCES AND TRANSACTIONS

A. BALANCES

	As of December 31,	
	2007	2006
Trade accounts receivable	\$ 12,823	\$ 13,625
Long-term investment	\$ 950	\$ --
Current liabilities, including current maturity of long-term loans	\$ 7,459	\$ 5,895
Convertible debentures	\$ 24,500	\$ 24,500
Long-term liability in respect of customers' advances	\$ 9,922	\$ 27,340
Other long-term liabilities, including long-term loans from related parties, net of current maturity	\$ 21,541	\$ 9,279
Capital note	\$100,000	\$100,000

B. TRANSACTION

	As of December 31,		
	2007	2006	2005
Revenue	\$ 78,870	\$ 64,055	\$ 33,456
Interest on loans and debentures	\$ 2,252	\$ 1,632	\$ 60
Expenses paid	\$ 289	\$ 46	\$ 47
Equity conversion of customer advances - see Note 13A(5)	\$ 6,414	\$ 7,621	\$ 1,794
Conversion of customer advances into Long-term loans - see Note 13A(5)	\$ 1,258	\$ 2,823	\$ 936

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Long-term loan received	\$ 14,000	\$ 9,705	\$ --
	=====	=====	=====
Loans repayment	\$ 2,974	\$ --	\$ --
	=====	=====	=====
Stock-based compensation - see Note 14B(5)	\$ 723	\$ --	\$ --
	=====	=====	=====

- C. For commitments, contingencies and other transaction relating to Fab 2 Wafer Partner and Equity Investor agreements, see Note 13A.