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TOWER SEMICONDUCTOR LTD  
Form 6-K  
November 01, 2002

FORM 6-K

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

For the month of October 2002 (No. 2)

TOWER SEMICONDUCTOR LTD.  
(Translation of registrant's name into English)

P.O. BOX 619, MIGDAL HAEMEK, ISRAEL 10556  
(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports under cover Form 20-F or Form 40-F.

Form 20-F  Form 40-F   
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Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes  No   
-----

On October 30, 2002, the Registrant announced its financial results for the three months and nine months ended September 30, 2002. Attached hereto are the Registrant's unaudited condensed interim financial statements as of September 30, 2002 and for the three month and nine month periods then ended.

This Form 6-K is being incorporated by reference into all effective registration statements filed by us under the Securities Act of 1933.

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY

INDEX TO UNAUDITED CONDENSED INTERIM  
CONSOLIDATED FINANCIAL STATEMENTS

# Edgar Filing: TOWER SEMICONDUCTOR LTD - Form 6-K

AS OF SEPTEMBER 30, 2002

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The Board of Directors  
Tower Semiconductor Ltd.  
Migdal Ha'emek  
-----

Gentlemen:

Re: Review of Unaudited Condensed Interim  
Consolidated Financial Statements as of September 30, 2002  
-----

At your request, we have reviewed the condensed interim consolidated financial statements ("interim financial statements") of Tower Semiconductor Ltd. ("the Company") and its subsidiary, as follows:

- Balance sheet as of September 30, 2002.
- Statements of operations for the nine months and three months ended September 30, 2002.
- Statement of changes in shareholders' equity for the nine months ended September 30, 2002.
- Statement of cash flows for the nine months ended September 30, 2002.

Our review was conducted in accordance with procedures prescribed by the Institute of Certified Public Accountants in Israel. The procedures included, inter alia, reading the aforementioned interim financial statements, reading the minutes of the shareholders' meetings and meetings of the board of directors and its committees, and making inquiries with the persons responsible for financial and accounting affairs.

Since the review that was performed is limited in scope and does not constitute an audit in accordance with generally accepted auditing standards, we do not express an opinion on the aforementioned interim financial statements.

In performing our review, nothing came to our attention which indicates that material adjustments are required to the interim financial statements for them to be deemed financial statements prepared in conformity with accounting

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principles generally accepted in Israel.

Accounting principles generally accepted in Israel vary in certain significant respects from accounting principles generally accepted in the United States of America. The application of the latter would have affected the determination of shareholders' equity and financial position as of September 30, 2002 to the extent summarized in Note 6.

Respectfully submitted,

Brightman Almagor & Co.  
 Certified Public Accountants  
 A member of Deloitte Touche Tohmatsu

Tel Aviv, Israel  
 October 30, 2002

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

|  | September 30,<br>2002<br>(unaudited) | December<br>2001 |
|--|--------------------------------------|------------------|
| <b>ASSETS</b>  |                                      |                  |
| <b>CURRENT ASSETS</b>  |                                      |                  |
| Cash and cash equivalents  | \$ 7,046                             | \$ 19,61         |
| Short-term interest-bearing deposits   | 11,500                               | 10,04            |
| Cash and short-term interest-bearing deposits<br>designated for investments relating to Fab 2          | 34,743                               | 3,54             |
| Trade accounts receivable (net of allowance for<br>doubtful accounts of \$250 and \$215, respectively) | 5,082                                | 3,32             |
| Other receivables  | 21,338                               | 21,25            |
| Inventories  | 10,085                               | 8,42             |
| Other current assets   | 2,030                                | 1,21             |
| Total current assets   | 91,824                               | 67,42            |
| <b>LONG-TERM INVESTMENTS</b>   |                                      |                  |
| Long-term interest-bearing deposits<br>designated for investments relating to Fab 2                    | 11,544                               | --               |
| Other long-term investment   | 6,000                                | 6,00             |
|  | 17,544                               | 6,00             |
| PROPERTY AND EQUIPMENT, NET  | 435,485                              | 340,72           |
| OTHER ASSETS   | 84,913                               | 57,91            |

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|  |            |           |
|--|------------|-----------|
| TOTAL ASSETS   | \$ 629,766 | \$ 472,05 |
|  | =====      | =====     |
| LIABILITIES AND SHAREHOLDERS' EQUITY   |            |           |
| CURRENT LIABILITIES  |            |           |
| Short-term debt  | \$ 4,000   | \$ 14,00  |
| Trade accounts payable   | 54,559     | 64,48     |
| Other current liabilities  | 8,819      | 5,27      |
|  | -----      | -----     |
| Total current liabilities  | 67,378     | 83,75     |
| LONG-TERM DEBT   | 254,000    | 115,00    |
| CONVERTIBLE DEBENTURES   | 23,369     | --        |
| LONG-TERM LIABILITY IN RESPECT<br>OF CUSTOMERS' ADVANCES   | 32,578     | 17,91     |
| OTHER LONG-TERM LIABILITIES  | 5,332      | 2,58      |
|  | -----      | -----     |
| Total liabilities  | 382,657    | 219,24    |
|  | -----      | -----     |
| SHAREHOLDERS' EQUITY   |            |           |
| Ordinary shares, NIS 1 par value - authorized<br>70,000,000 shares; issued 31,511,228 and<br>26,297,102 shares, respectively | 8,537      | 7,44      |
| Additional paid-in capital   | 338,777    | 307,86    |
| Shareholder receivables and unearned compensation  | (74)       | (19)      |
| Accumulated deficit  | (91,059)   | (53,24)   |
|  | -----      | -----     |
| Treasury stock, at cost - 1,300,000 shares   | 256,181    | 261,87    |
|  | (9,072)    | (9,07)    |
|  | -----      | -----     |
| Total shareholders' equity   | 247,109    | 252,80    |
|  | -----      | -----     |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY   | \$ 629,766 | \$ 472,05 |
|  | =====      | =====     |

See notes to condensed interim consolidated financial statements.

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

|               | Nine months ended<br>September 30, |           | Three months ended<br>September 30, |          |
|---------------|------------------------------------|-----------|-------------------------------------|----------|
|               | 2002                               | 2001      | 2002                                | 2001     |
|               | ----                               | ----      | ----                                | ----     |
| SALES         | \$ 36,229                          | \$ 43,539 | \$ 16,187                           | \$ 9,913 |
| COST OF SALES | 49,956                             | 62,126    | 21,078                              | 18,124   |

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|  |             |             |             |             |
|--|-------------|-------------|-------------|-------------|
|  | -----       | -----       | -----       | -----       |
| GROSS LOSS   | (13,727)    | (18,587)    | (4,891)     | (8,211)     |
|  | -----       | -----       | -----       | -----       |
| OPERATING COSTS AND EXPENSES   |             |             |             |             |
| Research and development   | 10,184      | 6,843       | 3,642       | 2,419       |
| Marketing, general and administrative                                    | 11,807      | 11,263      | 4,680       | 3,464       |
|  | -----       | -----       | -----       | -----       |
|  | 21,991      | 18,106      | 8,322       | 5,883       |
|  | -----       | -----       | -----       | -----       |
| OPERATING LOSS   | (35,718)    | (36,693)    | (13,213)    | (14,094)    |
| FINANCING INCOME (EXPENSE), NET  | (2,100)     | 1,866       | (1,300)     | 136         |
| OTHER INCOME, NET  | --          | 5,576       | --          | 1,539       |
|  | -----       | -----       | -----       | -----       |
| LOSS FOR THE PERIOD  | \$ (37,818) | \$ (29,251) | \$ (14,513) | \$ (12,419) |
|  | =====       | =====       | =====       | =====       |
| <br>   |             |             |             |             |
| BASIC LOSS PER ORDINARY SHARE  |             |             |             |             |
| Loss per share   | \$ (1.34)   | \$ (1.53)   | \$ (0.48)   | \$ (0.60)   |
|  | =====       | =====       | =====       | =====       |
| Loss used to compute<br>basic loss per share                             | \$ (37,818) | \$ (29,155) | \$ (14,513) | \$ (12,419) |
|  | =====       | =====       | =====       | =====       |
| Weighted average number of ordinary<br>shares outstanding - in thousands | 28,129      | 19,099      | 30,211      | 20,783      |
|  | =====       | =====       | =====       | =====       |

See notes to condensed interim consolidated financial statements.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY  
(UNAUDITED)  
(dollars in thousands, except share data and per share data)

| Ordinary shares | Additional | Shareholder  |
|-----------------|------------|--------------|
| -----           | paid-in    | receivables  |
| Shares          | capital    | and          |
| Amount          | -----      | unearned     |
| -----           | -----      | compensation |
| -----           | -----      | -----        |

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|   |            |          |            |          |       |
|---|------------|----------|------------|----------|-------|
| BALANCE - JANUARY 1, 2002                   | 26,297,102 | \$ 7,448 | \$ 307,865 | \$ (195) | \$ (  |
| Issuance of shares,<br>net of related costs | 5,214,126  | 1,089    | 30,912     | --       |       |
| Amortization of unearned compensation       | --         | --       | --         | 121      |       |
| Loss for the period                         | --         | --       | --         | --       | (     |
|   | -----      | -----    | -----      | -----    | ----- |
| BALANCE - SEPTEMBER 30, 2002                | 31,511,228 | \$ 8,537 | \$ 338,777 | \$ (74)  | \$ (  |
|   | =====      | =====    | =====      | =====    | ===== |

See notes to condensed interim consolidated financial statements.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(UNAUDITED)

(dollars in thousands, except share data and per share data)

|  | Nine mo<br>Sept<br>-----<br>2002<br>---- |
|--|--|
| <b>CASH FLOWS - OPERATING ACTIVITIES</b>   |  |
| Loss for the period  | \$ (37,818)                              |
| Adjustments to reconcile loss for the period<br>to net cash provided by (used in) operating activities:              |  |
| Income and expense items not involving cash flows:   |  |
| Depreciation and amortization  | 14,402                                   |
| Other income, net  | --                                       |
| Changes in assets and liabilities:   |  |
| Decrease (increase) in trade accounts receivable   | (1,761)                                  |
| Decrease (increase) in other receivables and other current assets  | (1,852)                                  |
| Decrease (increase) in inventories   | (92)                                     |
| Increase (decrease) in trade accounts payable  | 4,453                                    |
| Increase (decrease) in other current liabilities   | 3,520                                    |
| Increase in other long-term liabilities  | 2,748                                    |
|  | -----                                    |
| Increase in long-term liability<br>in respect of customers' advances   | (16,400)<br>14,668                       |
|  | -----                                    |
| Net cash provided by (used in) operating activities  | (1,732)                                  |
|  | -----                                    |
| <b>CASH FLOWS - INVESTING ACTIVITIES</b>   |  |
| Increase in cash, short-term and long-term interest-bearing<br>deposits designated for investments relating to Fab 2 | (42,739)                                 |
| Investments in property and equipment  | (149,790)                                |
| Investment grants received   | 25,305                                   |

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|  |           |
|--|-----------|
| Proceeds from sale of equipment  | --        |
| Investments in other assets  | (24,356)  |
| Increase in deposits, net  | (1,456)   |
| Proceeds from sale of long-term investments                                  | --        |
|  | -----     |
| Net cash used in investing activities  | (193,036) |
|  | -----     |
| CASH FLOWS - FINANCING ACTIVITIES  |           |
| Proceeds from issuance of shares, net  | 31,664    |
| Proceeds from exercise of share options                                      | --        |
| Proceeds on account of share capital   | --        |
| Proceeds from exercise of a warrant  | --        |
| Increase (decrease) in short-term debt                                       | (10,000)  |
| Repayment of long-term debt  | (3,000)   |
| Proceeds from long-term debt   | 142,000   |
| Proceeds from sale of securities, net  | 21,540    |
|  | -----     |
| Net cash provided by financing activities                                    | 182,204   |
|  | -----     |
|  |           |
| INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS                             | (12,564)  |
| CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD                              | 19,610    |
|  | -----     |
|  |           |
| CASH AND CASH EQUIVALENTS - END OF PERIOD                                    | \$ 7,046  |
|  | =====     |
| NON-CASH ACTIVITIES  |           |
| Investments in property and equipment  | \$ 29,015 |
|  | =====     |
| Exercise of a warrant  |           |
| Stock-based compensation related to<br>the Facility Agreement with the Banks |           |
| Investments in other assets  | \$ 3,716  |
|  | =====     |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION                             |           |
| Cash paid during the period for interest                                     | \$ 8,296  |
|  | =====     |
| Cash paid during the period for income taxes                                 | \$ 91     |
|  | =====     |

See notes to condensed interim consolidated financial statements.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
NOTES TO UNAUDITED CONDENSED INTERIM CONSOLIDATED  
FINANCIAL STATEMENTS AS OF SEPTEMBER 30, 2002  
(dollars in thousands, except share data and per share data)

NOTE 1 - BASIS OF PRESENTATION

A. The unaudited condensed interim consolidated financial statements as

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of September 30, 2002 and for the nine months and three months then ended ("interim financial statements") of Tower Semiconductor Ltd. ("the Company") and subsidiary should be read in conjunction with the audited consolidated financial statements of the Company and subsidiary as of December 31, 2001 and for the year then ended, including the notes thereto. In the opinion of management, the interim financial statements include all adjustments necessary for a fair presentation of the results for the interim periods presented. The results of operations for the interim periods are not necessarily indicative of the results to be expected on a full-year basis.

- B. The interim financial statements have been prepared in conformity with generally accepted accounting principles ("GAAP") in Israel, which, as applicable to these interim financial statements, are identical in all material respects to GAAP in the United States of America ("U.S. GAAP"), except as indicated in Note 6.

The accounting principles applied in the preparation of these interim financial statements are consistent with those principles applied in the preparation of the most recent annual audited financial statements.

- C. Establishment of New Fabrication Facility

In January 2001, the Company's Board of Directors approved the establishment of a new wafer fabrication facility in Israel ("Fab 2"), at an expected cost of approximately \$1,500,000. The Company entered into several related agreements and arrangements in connection with Fab 2, including agreements and other arrangements with technology and Wafer Partners, Equity Investors, the Company's Banks and the government of Israel. The Fab 2 project is a complex undertaking, which entails substantial risks and uncertainties. For further details concerning such agreements, risks and uncertainties, see Note 4 below and Note 16A to the 2001 audited consolidated financial statements. For details concerning non-capitalizable expenses and cash flows used in operating activities relating to Fab 2, see Note 4F below.

- D. Certain amounts in prior periods' financial statements have been reclassified in order to conform to the 2002 presentation.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
NOTES TO UNAUDITED CONDENSED INTERIM CONSOLIDATED  
FINANCIAL STATEMENTS AS OF SEPTEMBER 30, 2002  
(dollars in thousands, except share data and per share data)

### NOTE 2 - INVENTORIES

Inventories consist of the following (\*):

|                          | September 30,<br>2002<br>---- | December 31,<br>2001<br>---- |
|--------------------------|-------------------------------|------------------------------|
|                          | (unaudited)                   |                              |
| Raw materials            | \$ 4,163                      | \$ 2,739                     |
| Spare parts and supplies | 3,475                         | 3,216                        |
| Work in process          | 2,260                         | 1,673                        |
| Finished goods           | 187                           | 800                          |



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|          |          |
|----------|----------|
| -----    | -----    |
| \$10,085 | \$ 8,428 |
| =====    | =====    |

(\*) Net of write-downs to net realizable value of \$317 and \$412 as of September 30, 2002 and December 31, 2001, respectively.

NOTE 3 - MAJOR CUSTOMERS

Sales to major customers as a percentage of total sales were as follows:

|                     | Nine months ended<br>September 30, |      |
|---------------------|------------------------------------|------|
|                     | 2002                               | 2001 |
|                     | ----                               | ---- |
|                     | (unaudited)                        |      |
| Customer A          | 31%                                | 29%  |
| Customer B          | 15                                 | 18   |
| Customer C          | 11                                 | --   |
| Other customers (*) | 18                                 | 29   |

(\*) Represents sales to four different customers each of whom accounted for between 2% and 8% of sales during the nine months ended September 30, 2002, and to five customers (3%-8%) during the nine months ended September 30, 2001.

NOTE 4 - RECENT DEVELOPMENTS RELATING TO FAB 2

A. Amendment to the Wafer Partner and Equity Investor Agreements

Through April 2002, the Company, its Fab 2 Wafer Partners and the Equity Investors entered into amendments to their agreements with the Company under terms described below, to provide for the acceleration of the Fab 2 Third Milestone and Fourth Milestone scheduled installment payments, each in the aggregate amount of \$44,736. Pursuant to these amendments the following investments were made:

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
 NOTES TO UNAUDITED CONDENSED INTERIM CONSOLIDATED  
 FINANCIAL STATEMENTS AS OF SEPTEMBER 30, 2002  
 (dollars in thousands, except share data and per share data)

NOTE 4 - RECENT DEVELOPMENTS RELATING TO FAB 2 (cont.)

A. Amendment to the Wafer Partner and Equity Investor Agreements (cont.)

(1) Towards the Third Milestone: During the second quarter of 2002, the Wafer Partners invested in the Company an aggregate of \$36,669, of which \$22,001 was credited as paid in capital in consideration for an aggregate of 3,571,657 Ordinary Shares of the Company, and \$14,668 was established as long-term customer advances; and the Equity Investors invested an aggregate of

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\$8,067 in consideration for the purchase of 1,309,524 Ordinary Shares of the Company.

- (2) Towards the Fourth Milestone: In October 2002, the Wafer Partners invested in the Company an aggregate of \$36,669, of which \$22,001 was credited as paid in capital in consideration for an aggregate of 4,482,763 Ordinary Shares of the Company, and \$14,668 was established as long-term customer advances; and the Equity Investors invested an aggregate of \$8,067 in consideration for the purchase of 1,643,577 Ordinary Shares of the Company.

According to the amendments, the Wafer Partners and the Equity Investors undertook to advance both their Third and Fourth Milestone installment payments, prior to their achievement. In consideration for their investment the Wafer Partners and the Equity Investors were issued fully-paid Ordinary Shares of the Company equivalent to 60% and 100%, respectively, of the aggregate amount invested by them. The remaining 40% of the advanced payments made by the Wafer Partners was established as long-term customer advances to be credited, in general, against future purchases by them. Under the amendments, Ordinary Shares issued in consideration for the accelerated installments are based on the lower of the average trading price for the Ordinary Shares during the 30 consecutive trading days preceding the date of any actual payment and \$12.50.

### B. Amendments to the Fab 2 Facility Agreement

According to the Facility Agreement with its banks, as amended during 2002, the Company is obligated to raise, by the end of 2003, \$144,000 from specified financial sources, other than the already committed funds by the Wafer Partners and Equity Investors, as follows: by October 31, 2002, an aggregate of \$76,000, which has been already raised to date; by the end of 2002, an aggregate of \$110,000; and by the end of 2003 an aggregate of \$144,000. According to the Facility Agreement, raising these amounts by the dates stated is a material provision.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
NOTES TO UNAUDITED CONDENSED INTERIM CONSOLIDATED  
FINANCIAL STATEMENTS AS OF SEPTEMBER 30, 2002  
(dollars in thousands, except share data and per share data)

### NOTE 4 - RECENT DEVELOPMENTS RELATING TO FAB 2 (cont.)

#### B. Amendments to the Fab 2 Facility Agreement (cont.)

Pursuant to the amendments made during 2002, the banks agreed that the Company may attribute up to \$40,000 to be invested by the existing Wafer Partners and Equity Investors by no later than July 31, 2002 on account of the Third Milestone, to the April and June 2002 funding milestones, provided that the Company raised \$35,000 from other specified financial sources by no later than October 31, 2002. Accordingly, the Company attributed \$40,000 out of the \$44,736 invested in the second quarter of 2002 by the Wafer Partners and Equity Investors (see paragraph A.(1) above) towards the April and

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June 2002 funding milestones from the other specified financial sources.

The Company achieved the October 2002 funding milestone in October 2002 through \$20,492 raised from a rights offering (see 5C below), \$4,950 from proceeds paid under a technology agreement and a \$15,000 investment made by OTPP (see D below).

### C. New Technology Agreements

- (1) 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. The agreement calls for certain amounts to be paid by the Japanese manufacturer to the Company following the signing of the agreement and subject to achievement of certain milestones, through a period ending 2005. Pursuant to the agreement, the Japanese manufacturer may allocate, subject to certain conditions stipulated in the agreement, part or all of the second half of the total amounts paid by it to the Company as long-term customer advances to be applied against future purchases made by the Japanese manufacturer through 2007.
- (2) In September 2002, the Company entered into a non-exclusive technology transfer, development and licensing agreement with Motorola Inc. ("Motorola"), a U.S. corporation. This agreement provides for the transfer by Motorola to the Company of existing and newly developed version of advanced semiconductor manufacturing process technologies to be installed in Fab 2, and for the provision by Motorola of related technology transfer assistance, all in exchange for certain fees for patent and other intellectual property licenses, technology transfer and development, technical assistance and ongoing royalties based on sales of products manufactured in Fab 2 with the transferred technology. Subject to prior termination for cause by Motorola, the licenses under the agreement are perpetual.

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
NOTES TO UNAUDITED CONDENSED INTERIM CONSOLIDATED  
FINANCIAL STATEMENTS AS OF SEPTEMBER 30, 2002  
(dollars in thousands, except share data and per share data)

### NOTE 4 - RECENT DEVELOPMENTS RELATING TO FAB 2 (cont.)

#### D. New Equity Investor

In July 2002, the Company entered into a definitive agreement with the Ontario Teachers' Pension Plan Board ("OTPP") for an investment, which was fully paid in October 2002, of \$15,000 in the Company's equity in consideration for 3,000,000 Ordinary Shares of the Company for \$5.00 per share (the same as the subscription price per right in the rights offering described in Note 5C below), and a warrant, exercisable for a

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four-year period, to purchase an additional 1,350,000 Ordinary Shares of the Company, at an exercise price of \$7.50 per share (subject to customary adjustments). Pursuant to the agreement, OTPP may not sell these securities for a period of nine months from the closing date of the agreement (October 2002).

### E. Other Agreements

Through September 30, 2002 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 as of such date amounted to \$153,788. Some of the agreements provide for cancellation fees, subject to certain provisions and cancellation schedules in such agreements.

### F. Non-Capitalizable Expenses and Operating Activities Cash Flows in Connection with Fab 2

In connection with establishing Fab 2, the Company incurred during the nine-month period ended September 30, 2002 non-capitalizable expenses in the amount of \$19,383, of which \$11,447 was included in cost of sales and \$7,936 was included in marketing, general and administrative (during the corresponding period - \$8,596, \$3,323 and \$5,273, respectively). During the three-month period ended September 30, 2002, non-capitalizable expenses amounted to \$11,169 of which \$7,821 was included in cost of sales and \$3,348 was included in marketing, general and administrative (during the corresponding period - \$3,320, \$1,479 and \$1,841, respectively).

Net cash used in operating activities during the nine-month period ended September 30, 2002 (excluding \$14,668 increase in connection with long-term liability in respect of customers' advances) was \$16,400. That amount includes net cash out flows in the amount of \$17,253 attributable to the establishing of Fab 2.

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TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY  
NOTES TO UNAUDITED CONDENSED INTERIM CONSOLIDATED  
FINANCIAL STATEMENTS AS OF SEPTEMBER 30, 2002  
(dollars in thousands, except share data and per share data)

### NOTE 5 - OTHER RECENT DEVELOPMENTS

#### A. Sale of Securities

On January 22, 2002, the Company issued, based on a prospectus published on January 15, 2002 in Israel, the following securities, which are listed on the Tel Aviv Stock Exchange, for initial proceeds of approximately \$23,200. Costs in relation to the prospectus and the issuance of the securities were approximately \$1,750.

(1) Convertible Debentures - 110,579,800 convertible debentures each of which is of NIS 1.00 in principal amount. The debentures were issued at discount of 96% of their par value. Each debenture is linked

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to the Israeli Consumer Price Index ("CPI") and bears annual interest at the rate of 4.7%, payable on January 20 of each year commencing on January 20, 2003. The principal on the debentures is payable in four installments on January 20 of each year between 2006 and 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 (\$8.41) amount of the debentures (subject to customary adjustments). The effective rate of interest on the convertible debentures, taking into account the initial proceeds net of the discount and the related issuance costs, is 7.26%. For US GAAP purposes, which requires taking into account, in addition to the discount and the related issuance costs, amounts attributed to the options described below, the effective rate of interest on the convertible debentures is 9.88%.

(2) Options (Series 1) - 2,211,596 options (Series 1) for no consideration. Each option (Series 1) is exercisable into one Ordinary Share of the Company until January 20, 2006 for an exercise price of NIS 39 (subject to customary adjustments), linked to the CPI (as of September 30, 2002 - NIS 41.57, \$8.53).

(3) Options (Series A) - 552,899 options (Series A) for no consideration, to purchase additional debentures. These options, none of which were exercised, expired in March 2002.

Subject to certain conditions, the Company may, commencing in July 2005, announce the early redemption of the debentures or part thereof, provided that the sum of the last payment on account of the principal shall be no less than approximately \$700.

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.

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### NOTE 5 - OTHER RECENT DEVELOPMENTS (cont.)

#### A. Sale of Securities (cont.)

Pursuant to a covenant in the Facility Agreement, the Company deposited 50% of the principal amount (net of discounts) of the unconverted convertible debentures (approximately \$11,600 as of the balance sheet date) in favor of the banks as security for payment of the amounts the Company owes the banks. The said amount may be released only as provided in the Facility Agreement, including payments of interest on account of the convertible debentures.

The debentures are unsecured and rank behind the Company's existing and future secured indebtedness to the banks under the Facility Agreement, as well as to the government of Israel in connection with grants the Company receives under the Fab 2 approved enterprise

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program.

See Note 6D for the effect of the accounting treatment under U.S. GAAP on this sale of securities.

### B. Share Option Plans

In the framework of the Company's Board of Directors resolution to increase the total number of options available for grant under all the Company's share option plans by an amount equal, in general, to 4% of the outstanding Ordinary Shares of the Company at the beginning of each year, 999,884 options were added to the Company's share option plans. Of that amount 812,974 options were granted to certain employees during the nine-month period ended September 30, 2002. The options were granted at an average exercise price of approximately \$5.89, the market price of the Company's shares on the dates of grant. Options granted may not be exercisable beyond ten years from their grant date, and become vested over a four-year period according to various vesting schedules.

### C. Rights Offering

In October 2002 the Company issued, based on a right offering prospectus for the distribution of transferable rights published in September 2002 in Israel and in the U.S., 4,098,365 Ordinary Shares of the Company and 1,844,262 warrants to purchase Ordinary Shares of the Company, in consideration for an aggregate of immediate proceeds of \$20,492. Of these amounts, 4,086,038 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 may be exercised for the purchase of one Ordinary Share at an exercise price of \$7.50 for a period ending on October 31, 2006. The securities issued are listed on the NASDAQ and the Tel Aviv Stock Exchange. Costs in relation to the prospectus and the issuance of the securities were approximately \$1,000.

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#### NOTE 5 - OTHER RECENT DEVELOPMENTS (cont.)

##### C. Rights Offering (cont.)

The rights were distributed to shareholders of the Company and employees, who held options entitling them to participate in the rights offering. Each recipient received one right for each 4.94 Ordinary Shares or employee options that he held on September 30, 2002 (the record date). Each full right entitled the recipient to purchase, at a subscription price of \$5.00, one Ordinary Share and 0.45 of a warrant

#### NOTE 6 - MATERIAL DIFFERENCES BETWEEN ISRAELI AND U.S. GAAP

With regard to the Company's interim financial statements, the material differences between GAAP in Israel and in the U.S. relate to the following.

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See E below for the presentation of the Company's unaudited balance sheet as of September 30, 2002 in accordance with U.S. GAAP.

A. Presentation of Cash and Short-Term Interest-Bearing Deposits Designated for Investments Relating to Fab 2

In accordance with U.S. GAAP, cash and short-term interest-bearing deposits designated for investments relating to Fab 2 should be excluded from current assets and presented separately as a non-current asset. Accordingly, \$34,743 and \$11,544 were reclassified, respectively, from current assets and long-term investments to a long-term asset.

B. Hedging Activities in accordance with U.S. GAAP (SFAS 133)

Complying with SFAS 133 and SFAS 138 and the related interpretations thereon with respect to the Company's hedging transactions as of September 30, 2002 would have resulted in: an increase in the Company's current liabilities in the amount of \$13,339, an increase in other comprehensive loss for the nine months ended September 30, 2002 in the net amount of \$11,261; and in a decrease of \$6,091 in property and equipment, net as of September 30, 2002.

C. Presentation of Net Long-Term Liabilities in Respect of Employees

Under U.S. GAAP, assets and liabilities relating to severance arrangements are to be presented separately and are not to be offset. Accordingly, an amount of \$11,374 was reclassified from other long-term liabilities to long-term investments.

D. Sale of Securities

Under Accounting Principles Board Opinion No. 14 ("APB 14"), the proceeds from the sale of the securities described in Note 5A are to be allocated to each of the securities issued based on their relative fair value, while according to Israeli GAAP such treatment is not required. Complying with APB 14, based on the average market value of each of the securities issued in the first three days following their issuance, would have resulted in an increase in shareholders' equity in the amount of \$2,363 (net of \$196 related issuance expenses), and a decrease in convertible debentures in the amount of \$2,559. The effect of the U.S. GAAP application on the convertible debentures' discount amortization for the nine-month period ended September 30, 2002 is immaterial.

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NOTE 6 - MATERIAL DIFFERENCES BETWEEN ISRAELI AND U.S. GAAP (cont.)

E. Balance Sheet in Accordance with U.S. GAAP

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Following are the condensed consolidated balance sheets in accordance with U.S. GAAP:

|   | September 30,<br>2002<br>-----<br>(unaudited) | December 31,<br>2001<br>----- |
|---|---|-------------------------------|
| Current assets  | \$ 57,081                                     | \$ 63,872                     |
| Long-term investments   | 17,374  | 16,334                        |
| Property and equipment, net   | 429,394                                       | 336,160                       |
| Other assets  | 84,717  | 57,910                        |
| Cash, short-term and long-term interest-bearing deposits designated for investments relating to Fab 2 | 46,287<br>-----                               | 3,548<br>-----                |
| Total assets  | 634,853<br>=====                              | 477,824<br>=====              |
| Current liabilities   | 80,717  | 87,360                        |
| Long-term debt  | 254,000                                       | 115,000                       |
| Convertible debentures  | 20,810  | --                            |
| Long-term liability in respect of customers' advances   | 32,578  | 17,910                        |
| Other long-term liabilities   | 16,706  | 12,918                        |
| Shareholders' equity (*)  | 230,042<br>-----                              | 244,636<br>-----              |
| Total liabilities and shareholders' equity  | \$634,853<br>=====                            | \$477,824<br>=====            |

(\*) The balance as of September 30, 2002 includes accumulated other comprehensive loss of \$19,460 and net proceeds on account of options (Series 1) in the amount of \$2,363 (see also D above); as of December 31, 2001 - accumulated other comprehensive loss of \$8,199.

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NOTE 6 - MATERIAL DIFFERENCES BETWEEN ISRAELI AND U.S. GAAP (cont.)



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F. Statements of Operations in Accordance with U.S. GAAP

Complying with SFAS 133 and SFAS 138 (B above) and APB 14 (D above) would not have resulted in a material change in the Company's loss for the nine-month period ended September 30, 2002.

G. Loss Per Share in Accordance with U.S. GAAP (SFAS 128)

In accordance with U.S. GAAP (SFAS 128), including the implementation of SFAS 133 and SFAS 138 and APB 14 as described in F above, the basic and diluted loss per share for the nine-month and three-month periods ended September 30, 2002 would be \$1.34 and \$0.48, respectively.

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### SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

TOWER SEMICONDUCTOR LTD.

Date: October 31, 2002

By: /S/RAFAEL LEVIN

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Name: Rafael Levin  
Title: Co-Chief Executive Officer