

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY
UNAUDITED CONDENSED INTERIM
CONSOLIDATED FINANCIAL STATEMENTS
AS OF JUNE 30, 2004**

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY

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CONSOLIDATED FINANCIAL STATEMENTS
AS OF JUNE 30, 2004**

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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 June 30, 2004**

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 June 30, 2004.
- Statements of operations for the six months and three months ended June 30, 2004.
- Statements of changes in shareholders' equity for the six months and three months ended June 30, 2004.
- Statements of cash flows for the six months and three months ended June 30, 2004.

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 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 effect of the application of the latter on the financial position and results of operations as of the date and for the periods presented is summarized in Note 5.

Respectfully submitted,

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

Tel Aviv, Israel
July 21, 2004

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

	As of June 30,		December 31,
	2004	2003	2003
	(unaudited)		
A S S E T S			
CURRENT ASSETS			
Cash and cash equivalents	\$ 19,115	\$ 12,277	\$ 12,448
Short-term interest-bearing deposits	--	5,000	--
Cash and short-term interest-bearing deposits designated for investments relating to Fab 2	42,279	2,021	44,042
Trade accounts receivable (net of allowance for doubtful accounts of \$0, \$71 and \$0, respectively)	19,113	5,441	11,631
Other receivables	20,067	20,717	11,073
Inventories	25,712	13,275	19,382
Other current assets	2,112	2,455	1,729
Total current assets	128,398	61,186	100,305
LONG-TERM INVESTMENTS			
Long-term interest-bearing deposits designated for investments relating to Fab 2	4,918	12,437	4,848
Other long-term investments	6,000	6,000	6,000
	10,918	18,437	10,848
PROPERTY AND EQUIPMENT, NET	589,271	574,196	568,412
OTHER ASSETS, NET	102,094	107,823	108,770
TOTAL ASSETS	\$ 830,681	\$ 761,642	\$ 788,335
LIABILITIES AND SHAREHOLDERS' EQUITY			
CURRENT LIABILITIES			
Short-term debt	\$ --	\$ 4,000	\$ --
Trade accounts payable	51,082	79,810	40,249
Other current liabilities	8,853	9,322	9,564
Total current liabilities	59,935	93,132	49,813
LONG-TERM DEBT	461,000	308,000	431,000
CONVERTIBLE DEBENTURES	25,508	26,549	25,783
LONG-TERM LIABILITY IN RESPECT OF CUSTOMERS' ADVANCES	45,762	47,246	46,347
OTHER LONG-TERM LIABILITIES	8,209	6,011	5,935
Total liabilities	600,414	480,938	558,878
SHAREHOLDERS' EQUITY			
Ordinary shares, NIS 1.00 par value - authorized 150,000,000, 100,000,000 and 150,000,000 shares, respectively; issued 66,894,593, 49,241,064 and 52,996,097 shares, respectively	16,251	12,291	13,150
Additional paid-in capital	517,041	413,334	427,881
Proceeds on account of share capital	--	--	16,428
Shareholder receivables	(26)	(26)	(26)
Accumulated deficit	(293,927)	(135,823)	(218,904)
	239,339	289,776	238,529
Treasury stock, at cost - 1,300,000 shares	(9,072)	(9,072)	(9,072)
Total shareholders' equity	230,267	280,704	229,457
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 830,681	\$ 761,642	\$ 788,335

See notes to condensed interim consolidated financial statements.

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

	Six months ended		Three months ended		Year ended
	June 30,		June 30,		December 31,
	2004	2003	2004	2003	2003
	<u>(unaudited)</u>		<u>(unaudited)</u>		
SALES	\$ 60,899	\$ 25,471	\$ 33,652	\$ 12,879	\$ 61,368
COST OF SALES	<u>104,399</u>	<u>37,268</u>	<u>54,250</u>	<u>19,334</u>	<u>122,395</u>
GROSS LOSS	<u>(43,500)</u>	<u>(11,797)</u>	<u>(20,598)</u>	<u>(6,455)</u>	<u>(61,027)</u>
OPERATING COSTS AND EXPENSES					
Research and development	7,256	8,656	3,751	4,799	20,709
Marketing, general and administrative	<u>11,021</u>	<u>10,764</u>	<u>5,430</u>	<u>5,120</u>	<u>22,615</u>
	<u>18,277</u>	<u>19,420</u>	<u>9,181</u>	<u>9,919</u>	<u>43,324</u>
OPERATING LOSS	<u>(61,777)</u>	<u>(31,217)</u>	<u>(29,779)</u>	<u>(16,374)</u>	<u>(104,351)</u>
FINANCING EXPENSE, NET	<u>(13,340)</u>	<u>(29)</u>	<u>(6,809)</u>	<u>(515)</u>	<u>(9,826)</u>
OTHER INCOME (EXPENSE), NET	<u>94</u>	<u>66</u>	<u>56</u>	<u>59</u>	<u>(84)</u>
LOSS FOR THE PERIOD	<u>\$ (75,023)</u>	<u>\$ (31,180)</u>	<u>\$ (36,532)</u>	<u>\$ (16,830)</u>	<u>\$ (114,261)</u>
BASIC LOSS PER ORDINARY SHARE					
Loss per share	<u>\$ (1.16)</u>	<u>\$ (0.70)</u>	<u>\$ (0.55)</u>	<u>\$ (0.37)</u>	<u>\$ (2.40)</u>
Loss used to compute basic loss per share	<u>\$ (75,009)</u>	<u>\$ (31,180)</u>	<u>\$ (36,525)</u>	<u>\$ (16,830)</u>	<u>\$ (114,114)</u>
Weighted average number of ordinary shares outstanding - in thousands	<u>64,812</u>	<u>44,481</u>	<u>66,632</u>	<u>45,515</u>	<u>47,608</u>

See notes to condensed interim consolidated financial statements.

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

	Ordinary shares		Additional paid-in capital	Proceeds on account of share capital	Shareholder receivables and unearned compensation	Accumulated deficit	Treasury stock	Total
	Shares	Amount						
BALANCE - JANUARY 1, 2004	52,996,097	\$ 13,150	\$ 427,881	\$ 16,428	\$ (26)	\$ (218,904)	\$ (9,072)	\$ 229,457
Changes during six-month period (unaudited):								
Issuance of shares	2,358,746	530	15,979	(16,428)				81
Issuance of shares, net of related costs								
- public offering	11,444,500	2,550	72,536					75,086
Exercise of share options	95,250	21	645					666
Loss for the period						(75,023)		(75,023)
BALANCE - JUNE 30, 2004 (unaudited)	<u>66,894,593</u>	<u>\$ 16,251</u>	<u>\$ 517,041</u>	<u>\$ --</u>	<u>\$ (26)</u>	<u>\$ (293,927)</u>	<u>\$ (9,072)</u>	<u>\$ 230,267</u>
BALANCE - JANUARY 1, 2003	44,735,532	\$ 11,294	\$ 400,808	\$ --	\$ (53)	\$ (104,643)	\$ (9,072)	\$ 298,334
Changes during six-month period (unaudited):								
Stock-based compensation related to the Fab 2 constructor			145					145
Issuance of shares, net of related costs	4,505,532	997	12,381					13,378
Amortization of unearned compensation					27			27
Loss for the period						(31,180)		(31,180)
BALANCE - JUNE 30, 2003 (unaudited)	<u>49,241,064</u>	<u>\$ 12,291</u>	<u>\$ 413,334</u>	<u>\$ --</u>	<u>\$ (26)</u>	<u>\$ (135,823)</u>	<u>\$ (9,072)</u>	<u>\$ 280,704</u>
BALANCE - APRIL 1, 2004	66,882,383	\$ 16,248	\$ 516,962	\$ --	\$ (26)	\$ (257,395)	\$ (9,072)	\$ 266,717
Changes during three-month period (unaudited):								
Issuance of shares	11,960	3	78					81
Exercise of share options	250		1					1
Loss for the period						(36,532)		(36,532)
BALANCE - JUNE 30, 2004 (unaudited)	<u>66,894,593</u>	<u>\$ 16,251</u>	<u>\$ 517,041</u>	<u>\$ --</u>	<u>\$ (26)</u>	<u>\$ (293,927)</u>	<u>\$ (9,072)</u>	<u>\$ 230,267</u>
BALANCE - APRIL 1, 2003	44,735,532	\$ 11,294	\$ 400,887	\$ --	\$ (34)	\$ (118,993)	\$ (9,072)	\$ 284,082
Changes during three-month period (unaudited):								
Issuance of shares, net of related costs	4,505,532	997	12,447					13,444
Amortization of unearned compensation					8			8
Loss for the period						(16,830)		(16,830)
BALANCE - JUNE 30, 2003 (unaudited)	<u>49,241,064</u>	<u>\$ 12,291</u>	<u>\$ 413,334</u>	<u>\$ --</u>	<u>\$ (26)</u>	<u>\$ (135,823)</u>	<u>\$ (9,072)</u>	<u>\$ 280,704</u>
BALANCE - JANUARY 1, 2003	44,735,532	\$ 11,294	\$ 400,808	\$ --	\$ (53)	\$ (104,643)	\$ (9,072)	\$ 298,334
Changes during 2003:								
Stock-based compensation related to the Fab 2 constructor			145					145
Stock-based compensation related to the Facility Agreement with the Banks			4,205					4,205
Issuance of shares, net of related costs	8,260,565	1,856	22,723					24,579
Proceeds on account of share capital				16,428				16,428
Amortization of unearned compensation					27			27
Loss for the year						(114,261)		(114,261)
BALANCE - DECEMBER 31, 2003	<u>52,996,097</u>	<u>\$ 13,150</u>	<u>\$ 427,881</u>	<u>\$ 16,428</u>	<u>\$ (26)</u>	<u>\$ (218,904)</u>	<u>\$ (9,072)</u>	<u>\$ 229,457</u>

See notes to condensed interim consolidated financial statements.

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

	Six months ended		Three months ended		Year ended
	June 30,		June 30,		December 31,
	2004	2003	2004	2003	2003
	(unaudited)		(unaudited)		
CASH FLOWS - OPERATING ACTIVITIES					
Loss for the period	\$ (75,023)	\$ (31,180)	\$ (36,532)	\$ (16,830)	\$ (114,261)
Adjustments to reconcile loss for the period to net cash used in operating activities:					
Income and expense items not involving cash flows:					
Depreciation and amortization	55,406	8,878	28,477	4,207	54,611
Effect of indexation and translation on convertible debentures	(366)	--	534	--	(878)
Other expense (income), net	(94)	(66)	(56)	(59)	84
Changes in assets and liabilities:					
Decrease (increase) in trade accounts receivable	(7,482)	2,015	(3,558)	1,259	(4,175)
Decrease (increase) in other receivables and other current assets	(3,168)	(649)	(1,420)	1,898	1,264
Increase in inventories	(6,330)	(114)	(4,128)	(70)	(6,221)
Increase in trade accounts payable	3,479	3,864	170	455	801
Increase (decrease) in other current liabilities	(726)	1,225	640	1,733	1,467
Increase in other long-term liabilities	2,274	605	42	262	529
	(32,030)	(15,422)	(15,831)	(7,145)	(66,779)
Increase (decrease) in long-term liability in respect of customers' advances	(504)	--	13	--	(899)
Net cash used in operating activities	<u>(32,534)</u>	<u>(15,422)</u>	<u>(15,818)</u>	<u>(7,145)</u>	<u>(67,678)</u>
CASH FLOWS - INVESTING ACTIVITIES					
Decrease in cash, short-term and long-term interest-bearing deposits designated for investments relating to Fab 2	1,693	48,773	35,802	19,522	14,341
Investments in property and equipment	(80,287)	(103,664)	(55,033)	(55,631)	(179,310)
Investment grants received	12,502	17,356	9,991	10,636	33,811
Proceeds from sale of equipment	104	64	66	57	222
Investments in other assets	(702)	(16,497)	--	(10,737)	(22,098)
Decrease in deposits, net	--	5,500	3,000	4,000	10,500
Net cash used in investing activities	<u>(66,690)</u>	<u>(48,468)</u>	<u>(6,174)</u>	<u>(32,153)</u>	<u>(142,534)</u>
CASH FLOWS - FINANCING ACTIVITIES					
Proceeds from (costs related to) issuance of shares, net	75,225	13,310	(240)	13,425	24,375
Proceeds from exercise of share options	666	--	1	--	--
Proceeds on account of share capital	--	--	--	--	16,428
Repayment of long-term debt	--	(2,000)	--	(1,000)	(13,000)
Proceeds from long-term debt, net in connection with re-borrowing	--	--	--	--	187,000
Proceeds from long-term debt	30,000	57,000	30,000	27,000	--
Net cash provided by financing activities	<u>105,891</u>	<u>68,310</u>	<u>29,761</u>	<u>39,425</u>	<u>214,803</u>
INCREASE IN CASH AND CASH EQUIVALENTS	6,667	4,420	7,769	127	4,591
CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD	<u>12,448</u>	<u>7,857</u>	<u>11,346</u>	<u>12,150</u>	<u>7,857</u>
CASH AND CASH EQUIVALENTS - END OF PERIOD	<u>\$ 19,115</u>	<u>\$ 12,277</u>	<u>\$ 19,115</u>	<u>\$ 12,277</u>	<u>\$ 12,448</u>
NON-CASH ACTIVITIES					
Investments in property and equipment	\$ 28,182	\$ 39,774	\$ 26,183	\$ 30,468	\$ 17,160
Stock-based compensation related to the Facility Agreement with the Banks	\$ --	\$ --	\$ --	\$ --	\$ 4,205
Investments in other assets	\$ 19	\$ 7,374	\$ --	\$ 2,528	\$ 3,153
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION					
Cash paid during the period for interest	\$ 11,977	\$ 7,879	\$ 5,446	\$ 3,462	\$ 15,674
Cash paid during the period for income taxes	\$ 97	\$ 102	\$ 61	\$ 49	\$ 239

See notes to condensed interim consolidated financial statements.

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY
NOTES TO UNAUDITED CONDENSED INTERIM CONSOLIDATED
FINANCIAL STATEMENTS AS OF JUNE 30, 2004
(dollars in thousands, except share data and per share data)

NOTE 1 - BASIS OF PRESENTATION

- A.** The unaudited condensed interim consolidated financial statements as of June 30, 2004 and for the six 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, 2003 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 financial position and results of operations as of the date and 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, differ in certain respects from GAAP in the United States of America (“U.S. GAAP”), as indicated in Note 5.

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 and Operations 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. Fab 2 is designated to manufacture semiconductor integrated circuits on silicon wafers in geometries of 0.18 micron and below on 200-millimeter wafers. The Company has entered into several related agreements and other arrangements and has completed public and private financing deals, which, as of the approval date of the interim financial statements, have provided an aggregate of \$1,226,100 of financing for Fab 2.

During the third quarter of 2003, in which Fab 2 was substantially completed, the Company began commercial production and shipment of wafers to its customers utilizing the 0.18 micron process technology. With the commencement of Fab 2 operations, the Company began to depreciate and amortize Fab 2 assets, as well as to expense most of the ongoing direct costs related to the construction and equipping of Fab 2 and transfer of the Fab 2 technology that had been previously capitalized.

The Fab 2 project is a complex undertaking, which entails substantial risks and uncertainties. For further details concerning the Fab 2 project and related agreements, which were amended several times, risks and uncertainties, see Note 13A to the 2003 audited consolidated financial statements.

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY
NOTES TO UNAUDITED CONDENSED INTERIM CONSOLIDATED
FINANCIAL STATEMENTS AS OF JUNE 30, 2004
(dollars in thousands, except share data and per share data)

NOTE 2 - MAJOR CUSTOMERS

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

	Six months ended <u>June 30,</u>	
	<u>2004</u>	<u>2003</u>
	(unaudited)	
Customer A	19 %	-- %
Customer B	16	--
Customer C	14	25
Customer D	7	22
Customer E	3	19
Other customers (*)	16	12

(*) Represents sales to three different customers each of whom accounted for between 1% and 9% of sales during the six months ended June 30, 2004, and to three customers (2%-6%) during the six months ended June 30, 2003.

NOTE 3 - RECENT DEVELOPMENTS RELATING TO FAB 2

A. Ordinary Shares Issued to the Primary Wafer Partners and Equity Investors

In January 2004, the primary Wafer Partners and Equity Investors were issued an aggregate of 2,346,786 Ordinary Shares of the Company in consideration for their final \$16,428 committed investment made in December 2003. The shares were issued at a per share price of \$7.00, a price equal to the offering price at the public offering described in Note 4A.

B. Approved Enterprise Status

Under the terms of the Fab 2 approved enterprise program, investments in respect of Fab 2 are to be completed by December 31, 2005, five years from the date the approval certificate was obtained. Due to the later than planned commencement of construction of Fab 2 and prevailing market conditions, the Company does not currently expect to complete Fab 2 investments by the end of 2005. Following the Company's notification to the Investment Center of its revised investment schedule contemplated in an updated plan for the construction and equipping of Fab 2, including, among others, its reduced rate of annual investments and lower than projected expectations for Fab 2 sales, the Company received from the Investment Center, in July 2004, an approval to said revised investment schedule.

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY
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NOTE 3 - RECENT DEVELOPMENTS RELATING TO FAB 2 (cont.)

B. Approved Enterprise Status (cont.)

While Israeli law currently limits the ability of the Investment Center to extend the investment period beyond five years, the Company's management estimates, based on discussions held with the Investment Center, prior and subsequent to the balance sheet date, that it is probable that satisfactory arrangements will be made to enable the extension of the investment period.

Under the terms of the approved enterprise program, the Company is eligible to receive grants of 20% of up to \$1,250,000 invested in Fab 2 plant and equipment, or an aggregate of up to \$250,000, of which as of the balance sheet date, an aggregate of \$130,513 has been already received from the Investment Center.

C. Hedging Activities

During the reported period, the Company entered into hedging transactions as follows:

- (1) Foreign exchange agreements (cylinder options, options and forward contracts) to hedge exposure related to purchase of machinery and equipment and salary and wage costs, the aggregate outstanding amounts of which as of June 30, 2004 was \$4,071 and \$3,000, respectively.
- (2) Agreements to hedge interest rate exposure on long-term bank loans under the Facility Agreement, in the aggregate amount as of June 30, 2004 of \$80,000. As of the balance sheet date, out of the total \$461,000 long-term bank loans under that agreement, \$292,000 is under hedging transactions.

NOTE 4 - OTHER RECENT DEVELOPMENTS

A. Public Offering Completed in the First Quarter of 2004

During the first quarter of 2004, the Company completed a public offering of its Ordinary Shares at a price of \$7.00 per share. Following the offering, and including the partial exercise of over-allotment option the Company granted the underwriters, the Company issued 11,444,500 of its Ordinary Shares, in consideration for gross proceeds of \$80,112 (net of related costs - \$75,086).

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY
NOTES TO UNAUDITED CONDENSED INTERIM CONSOLIDATED
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NOTE 4 - OTHER RECENT DEVELOPMENTS (cont.)

B. Siliconix

In May 2004, the Company and chip maker Siliconix incorporated, an 80% 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 valued at approximately \$200,000 for the purchase of wafers to be manufactured in the Company's Fab 1 over a seven to ten year period. Approximately \$53,000 of that amount will be delivered over an initial three year period starting after the completion of the transfer of Siliconix's technology to Fab 1. The agreement provides that Siliconix will advance the Company \$20,000 to be used primarily for the purchase of additional equipment required to satisfy Siliconix's orders, which will be credited towards the purchase price of the wafers. Management estimates that the receipt of the \$20,000 shall occur during the third quarter of 2004.

C. Class Action

In July 2003, certain shareholders of the Company filed a shareholders' class action complaint in the United States against the Company and certain of its directors, Wafer Partners and Equity Investors (the "Defendants"). The plaintiffs have 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 plaintiffs seek damages in unspecified amounts, which could be substantial, and unspecified rescissory relief. The Company believes that the complaint is without merit and is vigorously contesting it. In January 2004, the Defendants filed with the court a motion to dismiss the action, and in April 2004 the plaintiffs filed an opposition to the motion to dismiss. In May 2004, the Defendants filed a reply brief and in July 2004, the plaintiffs filed a sur-reply memorandum in further opposition to the Defendants' motion to dismiss. As of the date of the interim financial statements, the Court has not rendered a decision with regard to the motion to dismiss.

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NOTES TO UNAUDITED CONDENSED INTERIM CONSOLIDATED
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NOTE 5 - 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. See G below for the presentation of the Company's unaudited balance sheet as of June 30, 2004 in accordance with U.S. GAAP.

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

In accordance with U.S. GAAP, cash, short-term and long-term interest-bearing deposits designated for investments relating to Fab 2 should be excluded from current assets and long-term investments and presented separately as a non-current asset. Accordingly, as of June 30, 2004, \$42,279 and \$4,918 were reclassified, respectively, from current assets and long-term investments to a long-term asset (as of December 31, 2003 - \$44,042 and \$4,848, respectively).

B. 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, while according to Israeli GAAP such an offset is required. Accordingly, as of June 30, 2004 an amount of \$15,492 was reclassified from other long-term liabilities to long-term investments (as of December 31, 2003 - \$14,607).

C. 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 June 30, 2004 would have resulted in: an increase in other long-term liabilities in the amount of \$4,003; a decrease in other comprehensive loss for the six months ended June 30, 2004 in the net amount of \$6,581; an accumulated other comprehensive loss component of equity balance as of June 30, 2004 in the amount of \$9,316; and in a decrease of \$5,283 in property and equipment, net as of June 30, 2004.

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

NOTE 5 - MATERIAL DIFFERENCES BETWEEN ISRAELI AND U.S. GAAP (cont.)

D. Implementation of SFAS 123 and SFAS 148

Had compensation cost for the Company's share option plans been determined based on fair value at the grant dates for awards made through June 30, 2004 in accordance with SFAS 123, as amended by SFAS 148, the Company's pro forma loss and loss per share would have been as follows:

	Six months ended		Three months ended	
	June 30,		June 30,	
	2004	2003	2004	2003
	(unaudited)		(unaudited)	
Pro forma loss				
Loss for the period, as reported according to U.S. GAAP (see H below)	\$ (75,023)	\$ (31,180)	\$ (36,532)	\$ (16,830)
Less – stock-based compensation determined under APB 25	--	27	--	8
Add - stock-based compensation determined under SFAS 123	(2,322)	(5,690)	(991)	(4,079)
Pro forma loss	\$ (77,345)	\$ (36,843)	\$ (37,523)	\$ (20,901)
Basic loss per share				
As reported according to U.S. GAAP (see I below)	\$ (1.18)	\$ (0.70)	\$ (0.56)	\$ (0.37)
Pro forma	\$ (1.22)	\$ (0.83)	\$ (0.57)	\$ (0.46)

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NOTE 5 - MATERIAL DIFFERENCES BETWEEN ISRAELI AND U.S. GAAP (cont.)

E. Sale of Securities

Under Accounting Principles Board Opinion No. 14 (“APB 14”), the proceeds from the sale of the securities in January 2002 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 (in January 2002), would have resulted in an increase in shareholders’ equity as of June 30, 2004 and December 31, 2003 in the amount of \$2,363 (net of \$196 related issuance expenses), and a decrease in convertible debentures as of such dates in the amount of \$2,559. The effect of amortization of the discount on the convertible debentures under U.S.GAAP for the six-month and three-month periods ended June 30, 2004 would have been immaterial.

F. Presentation of Proceeds on Account of Shares in Accordance with U.S. GAAP (SFAS 150)

According to SFAS No. 150, “Accounting For Certain Financial Instruments with Characteristics of Both Liabilities and Equity”, a financial instrument that embodies an unconditional obligation (as defined in that guidance), that the issuer must or may settle by issuing a variable number of its equity shares, shall be classified as a liability if, at inception, the monetary value of the obligation is based solely or predominantly on, among others, a fixed monetary amount known at inception. Accordingly, the \$16,428 described in Note 3A, and which according to Israeli GAAP was presented as of December 31, 2003 as “Proceeds on account of share capital”, were reclassified as of December 31, 2003 under SFAS 150 as “Liability in respect of variable number of shares to be issued”. Such presentation for the U.S. GAAP purposes was required since as of December 31, 2003, the amount of shares the Company was to issue in consideration of the aggregate of \$16,428 was not determined as of such date, and was actually based on mechanisms that embody a variable number of shares. Following the issuance of shares, as described in Note 3A, the \$16,428 amount is presented for U.S. GAAP purposes as well as paid in equity.

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NOTE 5 - MATERIAL DIFFERENCES BETWEEN ISRAELI AND U.S. GAAP (cont.)

G. Balance Sheets in Accordance with U.S. GAAP

	U.S. GAAP remark	As of June 30, 2004			As of December 31, 2003		
		As per Israeli GAAP	Adjust- ments	As per U.S. GAAP	As per Israeli GAAP	Adjust- ments	As per U.S. GAAP
ASSETS							
CURRENT ASSETS							
Cash and cash equivalents		\$ 19,115	\$	\$ 19,115	\$ 12,448	\$	\$ 12,448
Cash and short-term interest-bearing deposits designated for investments relating to Fab 2	A	42,279	(42,279)	--	44,042	(44,042)	--
Trade accounts receivable		19,113		19,113	11,631		11,631
Other receivables		20,067		20,067	11,073		11,073
Inventories		25,712		25,712	19,382		19,382
Other current assets		2,112		2,112	1,729		1,729
Total current assets		<u>128,398</u>	<u>(42,279)</u>	<u>86,119</u>	<u>100,305</u>	<u>(44,042)</u>	<u>56,263</u>
LONG-TERM INVESTMENTS							
Long-term interest-bearing deposits designated for investments relating to Fab 2	A	4,918	(4,918)	--	4,848	(4,848)	--
Other long-term investments	B	6,000	15,492	21,492	6,000	14,607	20,607
		<u>10,918</u>	<u>10,574</u>	<u>21,492</u>	<u>10,848</u>	<u>9,759</u>	<u>20,607</u>
PROPERTY AND EQUIPMENT, NET	C	<u>589,271</u>	<u>(5,283)</u>	<u>583,988</u>	<u>568,412</u>	<u>(5,947)</u>	<u>562,465</u>
CASH AND SHORT-TERM AND LONG-TERM INTEREST-BEARING DEPOSITS DESIGNATED FOR INVESTMENTS RELATING TO FAB 2	A	<u>--</u>	<u>47,197</u>	<u>47,197</u>	<u>--</u>	<u>48,890</u>	<u>48,890</u>
OTHER ASSETS, NET	E	<u>102,094</u>	<u>(196)</u>	<u>101,898</u>	<u>108,770</u>	<u>(196)</u>	<u>108,574</u>
TOTAL ASSETS		<u>\$ 830,681</u>	<u>\$ 10,013</u>	<u>\$ 840,694</u>	<u>\$ 788,335</u>	<u>\$ 8,464</u>	<u>\$ 796,799</u>
LIABILITIES AND SHAREHOLDERS' EQUITY							
CURRENT LIABILITIES							
Trade accounts payable		\$ 51,082	\$	\$ 51,082	\$ 40,249	\$	\$ 40,249
Other current liabilities		8,853		8,853	9,564		9,564
Total current liabilities		59,935	--	59,935	49,813	--	49,813
LONG-TERM DEBT		461,000		461,000	431,000		431,000
CONVERTIBLE DEBENTURES	E	25,508	(2,559)	22,949	25,783	(2,559)	23,224
LIABILITY IN RESPECT OF A VARIABLE NUMBER OF SHARES TO BE ISSUED	F	--		--	--	16,428	16,428
LONG-TERM LIABILITY IN RESPECT OF CUSTOMERS' ADVANCES		45,762		45,762	46,347		46,347
OTHER LONG-TERM LIABILITIES	B, C	8,209	19,495	27,704	5,935	24,527	30,462
Total liabilities		<u>600,414</u>	<u>16,936</u>	<u>617,350</u>	<u>558,878</u>	<u>38,396</u>	<u>597,274</u>
SHAREHOLDERS' EQUITY							
Ordinary shares, NIS 1.00 par value - authorized 150,000,000 shares; issued 66,894,593 and 52,996,097 shares, respectively		16,251		16,251	13,150		13,150
Additional paid-in capital	E	517,041	2,363	519,404	427,881	2,363	430,244
Proceeds on account of share capital	F	--		--	16,428	(16,428)	--
Shareholder receivables		(26)		(26)	(26)		(26)
Accumulated other comprehensive loss	C	--	(9,316)	(9,316)	--	(15,897)	(15,897)
Accumulated deficit		(293,927)	30	(293,897)	(218,904)	30	(218,874)
		<u>239,339</u>	<u>(6,923)</u>	<u>232,416</u>	<u>238,529</u>	<u>(29,932)</u>	<u>208,597</u>
Treasury stock, at cost - 1,300,000 shares		(9,072)		(9,072)	(9,072)		(9,072)
Total shareholders' equity		<u>230,267</u>	<u>(6,923)</u>	<u>223,344</u>	<u>229,457</u>	<u>(29,932)</u>	<u>199,525</u>
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		<u>\$ 830,681</u>	<u>\$ 10,013</u>	<u>\$ 840,694</u>	<u>\$ 788,335</u>	<u>\$ 8,464</u>	<u>\$ 796,799</u>

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NOTE 5 - MATERIAL DIFFERENCES BETWEEN ISRAELI AND U.S. GAAP (cont.)

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

Complying with SFAS 133 and SFAS 138 (C above) and APB 14 (E above) would not have materially affected the results of operations for the six-month and three-month periods ended June 30, 2004 and 2003.

I. 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 H above), the basic and diluted loss per share for the six-month and three-month periods ended June 30, 2004 would be \$1.18 and \$0.56, respectively (during the corresponding periods - \$0.70 and \$0.37, respectively).