

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

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY

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CONSOLIDATED FINANCIAL STATEMENTS
AS OF SEPTEMBER 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 September 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 September 30, 2004.
- Statements of operations for the nine months and three months ended September 30, 2004.
- Statements of changes in shareholders' equity for the nine months and three months ended September 30, 2004.
- Statements of cash flows for the nine months and three months ended September 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
October 21, 2004

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

	As of September 30,		December 31,
	2004	2003	2003
	(unaudited)		
A S S E T S			
CURRENT ASSETS			
Cash and cash equivalents	\$ 21,877	\$ 4,218	\$ 12,448
Short-term interest-bearing deposits	--	2,500	--
Designated cash and short-term interest-bearing deposits	36,576	1,659	44,042
Trade accounts receivable (net of allowance for doubtful accounts of \$0, \$110 and \$0, respectively)	25,961	9,302	11,631
Other receivables	18,385	14,564	11,073
Inventories	30,371	17,058	19,382
Other current assets	1,243	1,681	1,729
Total current assets	<u>134,413</u>	<u>50,982</u>	<u>100,305</u>
LONG-TERM INVESTMENTS			
Long-term interest-bearing deposits designated for Fab 2 operations	4,934	11,945	4,848
Other long-term investments	6,000	6,000	6,000
	<u>10,934</u>	<u>17,945</u>	<u>10,848</u>
PROPERTY AND EQUIPMENT, NET	<u>613,561</u>	<u>576,425</u>	<u>568,412</u>
OTHER ASSETS, NET	<u>97,961</u>	<u>105,260</u>	<u>108,770</u>
TOTAL ASSETS	<u>\$ 856,869</u>	<u>\$ 750,612</u>	<u>\$ 788,335</u>
LIABILITIES AND SHAREHOLDERS' EQUITY			
CURRENT LIABILITIES			
Short-term debt	\$ --	\$ 4,000	\$ --
Trade accounts payable	61,202	65,772	40,249
Other current liabilities	9,082	9,382	9,564
Total current liabilities	<u>70,284</u>	<u>79,154</u>	<u>49,813</u>
LONG-TERM DEBT	497,000	347,000	431,000
CONVERTIBLE DEBENTURES	25,643	25,552	25,783
LONG-TERM LIABILITY IN RESPECT OF CUSTOMERS' ADVANCES	65,069	46,920	46,347
OTHER LONG-TERM LIABILITIES	7,792	5,869	5,935
Total liabilities	<u>665,788</u>	<u>504,495</u>	<u>558,878</u>
SHAREHOLDERS' EQUITY			
Ordinary shares, NIS 1.00 par value - authorized 150,000,000, 100,000,000 and 150,000,000 shares, respectively; issued 66,934,971, 50,079,146 and 52,996,097 shares, respectively	16,260	12,479	13,150
Additional paid-in capital	517,258	415,645	427,881
Proceeds on account of share capital	--	--	16,428
Shareholder receivables	(26)	(26)	(26)
Accumulated deficit	(333,339)	(172,909)	(218,904)
	<u>200,153</u>	<u>255,189</u>	<u>238,529</u>
Treasury stock, at cost - 1,300,000 shares	(9,072)	(9,072)	(9,072)
Total shareholders' equity	<u>191,081</u>	<u>246,117</u>	<u>229,457</u>
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	<u>\$ 856,869</u>	<u>\$ 750,612</u>	<u>\$ 788,335</u>

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)

	Nine months ended September 30,		Three months ended September 30,		Year ended December 31,
	2004	2003	2004	2003	2003
	(unaudited)		(unaudited)		
SALES	\$ 95,990	\$ 41,545	\$ 35,091	\$ 16,074	\$ 61,368
COST OF SALES	<u>162,242</u>	<u>75,816</u>	<u>57,843</u>	<u>38,548</u>	<u>122,395</u>
GROSS LOSS	<u>.....(66,252)</u>	<u>.....(34,271)</u>	<u>.....(22,752)</u>	<u>.....(22,474)</u>	<u>.....(61,027)</u>
OPERATING COSTS AND EXPENSES					
Research and development	11,208	12,551	3,952	3,895	20,709
Marketing, general and administrative	<u>16,176</u>	<u>17,064</u>	<u>5,155</u>	<u>6,300</u>	<u>22,615</u>
	<u>.....27,384</u>	<u>.....29,615</u>	<u>.....9,107</u>	<u>.....10,195</u>	<u>.....43,324</u>
OPERATING LOSS	(93,636)	(63,886)	(31,859)	(32,669)	(104,351)
FINANCING EXPENSE, NET	(20,907)	(4,293)	(7,567)	(4,264)	(9,826)
OTHER INCOME (EXPENSE), NET	<u>108</u>	<u>(87)</u>	<u>14</u>	<u>(153)</u>	<u>(84)</u>
LOSS FOR THE PERIOD	<u>\$ (114,435)</u>	<u>\$ (68,266)</u>	<u>\$ (39,412)</u>	<u>\$ (37,086)</u>	<u>\$ (114,261)</u>
BASIC LOSS PER ORDINARY SHARE					
Loss per share	\$ <u>(1.78)</u>	\$ <u>(1.49)</u>	\$ <u>(0.60)</u>	\$ <u>(0.77)</u>	\$ <u>(2.40)</u>
Loss used to compute basic loss per share	\$ <u>(114,435)</u>	\$ <u>(68,266)</u>	\$ <u>(39,412)</u>	\$ <u>(37,086)</u>	\$ <u>(114,114)</u>
Weighted average number of ordinary shares outstanding - in thousands	<u>64,392</u>	<u>45,788</u>	<u>65,625</u>	<u>48,360</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	Proceeds	Shareholder	Accumulated	Treasury	Total
	Shares	Amount	paid-in	on	receivables	deficit	stock	
			capital	account of	and			
				share capital	unearned			
					compensation			
BALANCE - JANUARY 1, 2004	52,996,097	\$ 13,150	\$ 427,881	\$ 16,428	\$ (26)	\$ (218,904)	\$ (9,072)	\$ 229,457
Changes during nine-month period (unaudited):								
Issuance of shares	2,399,124	539	16,196	(16,428)				307
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						(114,435)		(114,435)
BALANCE - SEPTEMBER 30, 2004 (unaudited)	<u>66,934,971</u>	<u>\$ 16,260</u>	<u>\$ 517,258</u>	<u>\$ --</u>	<u>\$ (26)</u>	<u>\$ (333,339)</u>	<u>\$ (9,072)</u>	<u>\$ 191,081</u>
BALANCE - JANUARY 1, 2003	44,735,532	\$ 11,294	\$ 400,808	\$ --	\$ (53)	\$ (104,643)	\$ (9,072)	\$ 298,334
Changes during nine-month period (unaudited):								
Stock-based compensation related to the Fab 2 constructor			145					145
Issuance of shares, net of related costs	5,343,614	1,185	14,692					15,877
Amortization of unearned compensation					27			27
Loss for the period						(68,266)		(68,266)
BALANCE - SEPTEMBER 30, 2003 (unaudited)	<u>50,079,146</u>	<u>\$ 12,479</u>	<u>\$ 415,645</u>	<u>\$ --</u>	<u>\$ (26)</u>	<u>\$ (172,909)</u>	<u>\$ (9,072)</u>	<u>\$ 246,117</u>
BALANCE - JULY 1, 2004	66,894,593	\$ 16,251	\$ 517,041	\$ --	\$ (26)	\$ (293,927)	\$ (9,072)	\$ 230,267
Changes during three-month period (unaudited):								
Issuance of shares	40,378	9	217					226
Loss for the period						(39,412)		(39,412)
BALANCE - SEPTEMBER 30, 2004 (unaudited)	<u>66,934,971</u>	<u>\$ 16,260</u>	<u>\$ 517,258</u>	<u>\$ --</u>	<u>\$ (26)</u>	<u>\$ (333,339)</u>	<u>\$ (9,072)</u>	<u>\$ 191,081</u>
BALANCE - JULY 1, 2003	49,241,064	\$ 12,291	\$ 413,334	\$ --	\$ (26)	\$ (135,823)	\$ (9,072)	\$ 280,704
Changes during three-month period (unaudited):								
Issuance of shares, net of related costs	838,082	188	2,311					2,499
Loss for the period						(37,086)		(37,086)
BALANCE - SEPTEMBER 30, 2003 (unaudited)	<u>50,079,146</u>	<u>\$ 12,479</u>	<u>\$ 415,645</u>	<u>\$ --</u>	<u>\$ (26)</u>	<u>\$ (172,909)</u>	<u>\$ (9,072)</u>	<u>\$ 246,117</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)

	Nine months ended September 30,		Three months ended September 30,		Year ended December 31,
	2004	2003	2004	2003	2003
	(unaudited)		(unaudited)		
CASH FLOWS - OPERATING ACTIVITIES					
Loss for the period	\$ (114,435)	\$ (68,266)	\$ (39,412)	\$ (37,086)	\$ (114,261)
Adjustments to reconcile loss for the period to net cash provided by (used in) operating activities:					
Income and expense items not involving cash flows:					
Depreciation and amortization	86,188	30,386	30,782	21,508	54,611
Effect of indexation and translation on convertible debentures	(280)	(1,055)	86	(1,055)	(878)
Other expense (income), net	(108)	87	(14)	153	84
Changes in assets and liabilities:					
Increase in trade accounts receivable	(14,330)	(1,846)	(6,848)	(3,861)	(4,175)
Decrease (increase) in other receivables and other current assets	(1,382)	782	1,786	1,431	1,264
Increase in inventories	(10,989)	(3,897)	(4,659)	(3,783)	(6,221)
Increase (decrease) in trade accounts payable	3,332	4,765	(147)	901	801
Increase (decrease) in other current liabilities	(802)	1,285	(76)	60	1,467
Increase (decrease) in other long-term liabilities	1,766	463	(508)	(142)	529
	(51,040)	(37,296)	(19,010)	(21,874)	(66,779)
Increase (decrease) in long-term liability in respect of customers' advances, net	19,438	(326)	19,942	(326)	(899)
Net cash provided by (used in) operating activities	(31,602)	(37,622)	932	(22,200)	(67,678)
CASH FLOWS - INVESTING ACTIVITIES					
Decrease in designated cash, short-term and long-term interest-bearing deposits, net	7,380	49,627	5,687	854	14,341
Investments in property and equipment	(131,622)	(143,975)	(51,335)	(40,311)	(179,310)
Investment grants received	23,945	27,839	11,443	10,483	33,811
Proceeds from sale of equipment	139	184	35	120	222
Investments in other assets	(702)	(17,502)	--	(1,005)	(22,098)
Decrease in deposits, net	--	8,000	--	2,500	10,500
Net cash used in investing activities	(100,860)	(75,827)	(34,170)	(27,359)	(142,534)
CASH FLOWS - FINANCING ACTIVITIES					
Proceeds from issuance of shares, net	75,225	15,810	--	2,500	24,375
Proceeds from long-term debt	66,000	97,000	36,000	40,000	--
Proceeds on account of share capital	--	--	--	--	16,428
Repayment of long-term debt	--	(3,000)	--	(1,000)	(13,000)
Proceeds from exercise of share options	666	--	--	--	--
Proceeds from long-term debt, net in connection with re-borrowing	--	--	--	--	187,000
Net cash provided by financing activities	141,891	109,810	36,000	41,500	214,803
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	9,429	(3,639)	2,762	(8,059)	4,591
CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD	12,448	7,857	19,115	12,277	7,857
CASH AND CASH EQUIVALENTS - END OF PERIOD	\$ 21,877	\$ 4,218	\$ 21,877	\$ 4,218	\$ 12,448
NON-CASH ACTIVITIES					
Investments in property and equipment	\$ 40,229	\$ 30,612	\$ 33,054	\$ 17,990	\$ 17,160
Stock-based compensation related to the Facility Agreement with the Banks	\$ --	\$ --	\$ --	\$ --	\$ 4,205
Investments in other assets	\$ --	\$ 6,357	\$ --	\$ --	\$ 3,153
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION					
Cash paid during the period for interest	\$ 18,387	\$ 11,556	\$ 6,410	\$ 3,677	\$ 15,674
Cash paid during the period for income taxes	\$ 108	\$ 198	\$ 11	\$ 96	\$ 239

See notes to condensed interim consolidated financial statements.

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY
NOTES TO UNAUDITED CONDENSED INTERIM CONSOLIDATED
FINANCIAL STATEMENTS AS OF SEPTEMBER 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 September 30, 2004 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, 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.

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, some of which were amended several times, risks and uncertainties, see Note 13A to the 2003 audited consolidated financial statements. For further details concerning expected non-compliance with certain of the financial ratios and covenants under the Facility Agreement and the Company's plans for settling this non-compliance and its estimation that achieving satisfactory arrangement with the Banks is probable, see Note 3D below.

During the third quarter of 2003, in which Fab 2's construction 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 the transfer of the Fab 2 technology that had been previously capitalized.

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY
NOTES TO UNAUDITED CONDENSED INTERIM CONSOLIDATED
FINANCIAL STATEMENTS AS OF SEPTEMBER 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:

	Nine months ended <u>September 30,</u>			
	<u>2004</u>		<u>2003</u>	
	(unaudited)			
Customer A	20	%	11	%
Customer B	20		--	
Customer C	10		26	
Customer D	6		15	
Customer E	3		12	
Other customers (*)	18		4	

(*) Represents sales to three different customers each of whom accounted for between 5% and 8% of sales during the nine months ended September 30, 2004, and to two different customers each of whom accounted for 2% of sales during the nine months ended September 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 additional 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 other matters, 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
NOTES TO UNAUDITED CONDENSED INTERIM CONSOLIDATED
FINANCIAL STATEMENTS AS OF SEPTEMBER 30, 2004
(dollars in thousands, except share data and per share data)

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, 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 \$141,956 has been already received from the Investment Center.

C. Hedging Activities

During the reported period, the Company entered into hedging transactions, primarily agreements to hedge interest rate exposure on long-term bank loans under the Facility Agreement, in the aggregate amount as of September 30, 2004 of \$80,000. As of the balance sheet date, out of the total \$497,000 long-term bank loans under that agreement, \$292,000 is under hedging transactions.

D. Facility Agreement - Financial Ratios and Covenants

According to the Facility Agreement with the Banks, the Company is obligated to comply with certain financial ratios and covenants. As of the balance sheet date, the Company was in full compliance with all these financial ratios and covenants. Due to the recent and current slow-down in the semiconductor markets, management currently estimates that the Company may not comply with certain of the financial ratios and covenants. The Company is currently in the process of preparing an updated working-plan for 2005 for Fab 2, which will be based on prevailing and the Company's forecast of market conditions. Accordingly, if required, management intends to request its Banks to agree to amend the financial ratios and covenants in order to align them with the updated Fab 2 working-plan for 2005. Management estimates that it is probable that satisfactory arrangements with the Banks will be achieved. According to the Facility Agreement, satisfying the financial ratios and covenants is a material provision. Achieving arrangements with the Banks is material for the continuation of equipping, operating and construction of Fab 2.

The 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 balance sheet date amounted to \$497,000), and the Banks would be entitled to exercise the remedies available to them under the Facility Agreement, including enforcement of their lien against all the Company's assets.

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

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 an 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).

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. According to the agreement, in August 2004 Siliconix advanced the Company \$20,000 to be used primarily for the purchase of additional equipment required to satisfy Siliconix's orders. The advanced amount will be credited towards the purchase price of wafers. The unused remaining balance of the \$20,000 (\$18,352 as of September 30, 2004) is included in designated cash and short-term interest-bearing deposits in the consolidated balance sheet.

C. Class Action

In August 2004, the United States District Court dismissed the class action filed by certain of the Company's shareholders in the United States 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. In September 2004, one of the lead plaintiffs filed a notice of appeal of the decision dismissing the complaint. As of the approval date of the interim financial statements such an appeal was not submitted. The Company believes that the complaint is without merit and is vigorously contesting it.

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

NOTE 4 - OTHER RECENT DEVELOPMENTS (cont.)

D. Share Option Plans

- (1) *Employee share Option Plans* - The net increase to the total outstanding options under the Company's various employee share option plans during the nine-month period ended September 30, 2004, amounted to 1,322,296 options.
- (2) *Share Option Plans for Directors* - As of the approval date of the interim financial statements, the Audit Committee and the Board of Directors of the Company approved a new share option plan pursuant to which the Company's directors may be granted options to purchase up to 2,600,000 Ordinary Shares of the Company. The plan calls for initial grants of 40,000 options to each new director appointed to the Board of Directors following September 2004, and additional grants of 20,000 options per annum to each member of the Board of Directors, shall be made. According to the plan the exercise price will be equal to the market price of the Company's shares on each grant date. Options granted under the plan will vest twelve months after the date of grant and will be exercisable for a period that ends at the earlier of ten years from the date of grant or three years after termination of service.

As of the approval date of the interim financial statements, the Board of Directors of the Company approved an extension of the exercise period of the outstanding options held by directors of the Company under the existing directors' share option plan (280,000 options), in the case of a director's termination of service from the Board of Directors. The exercise period was extended from ninety days following the date of termination to three years following the date of termination.

The new directors' share option plan and the extension of the existing plan are subject to the approval of the Company's shareholders.

E. Authorized Ordinary Shares

In September 2004, the Board of Directors of the Company approved an increase in the Company's authorized ordinary shares from 150,000,000 shares to 250,000,000 shares. The increase is subject to the approval of the Company's shareholders.

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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 September 30, 2004 in accordance with U.S. GAAP.

A. Presentation of Designated Cash and Short-Term and Long-Term Interest-Bearing Deposits

In accordance with U.S. GAAP, the Company's designated cash, short-term and long-term interest-bearing deposits should be excluded from current assets and long-term investments and presented separately as a non-current asset. Accordingly, as of September 30, 2004, \$36,576 and \$4,934 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 September 30, 2004 an amount of \$16,553 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 September 30, 2004 would have resulted in: an increase in other long-term liabilities in the amount of \$6,282; a decrease in other comprehensive loss for the nine months ended September 30, 2004 in the net amount of \$4,634; an accumulated other comprehensive loss component of equity balance as of September 30, 2004 in the amount of \$11,263; and in a decrease of \$4,951 in property and equipment, net as of September 30, 2004.

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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 September 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:

	Nine months ended		Three months ended	
	September 30,		September 30,	
	2004	2003	2004	2003
	(unaudited)		(unaudited)	
Pro forma loss				
Loss for the period, as reported according to U.S. GAAP (see H below)	\$ (114,435)	\$ (68,266)	\$ (39,412)	\$ (37,086)
Less – stock-based compensation determined under APB 25	--	27	--	--
Add - stock-based compensation determined under SFAS 123	(3,584)	(7,276)	(1,261)	(1,587)
Pro forma loss	<u>\$ (118,019)</u>	<u>\$ (75,515)</u>	<u>\$ (40,673)</u>	<u>\$ (38,673)</u>
Basic loss per share				
As reported according to U.S. GAAP (see I below)	<u>\$ (1.78)</u>	<u>\$ (1.49)</u>	<u>\$ (0.60)</u>	<u>\$ (0.77)</u>
Pro forma	<u>\$ (1.84)</u>	<u>\$ (1.65)</u>	<u>\$ (0.62)</u>	<u>\$ (0.80)</u>

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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 September 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 nine-month and three-month periods ended September 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 other matters, 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 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

		As of September 30, 2004			As of December 31, 2003		
	U.S. GAAP remark	As per Israeli GAAP	Adjust- ments (unaudited)	As per U.S. GAAP	As per Israeli GAAP	Adjust- ments	As per U.S. GAAP
ASSETS							
CURRENT ASSETS							
Cash and cash equivalents		\$ 21,877	\$	\$ 21,877	\$ 12,448	\$	\$ 12,448
Designated cash and short-term interest-bearing deposits	A	36,576	(36,576)	--	44,042	(44,042)	--
Trade accounts receivable		25,961		25,961	11,631		11,631
Other receivables		18,385		18,385	11,073		11,073
Inventories		30,371		30,371	19,382		19,382
Other current assets		1,243		1,243	1,729		1,729
Total current assets		134,413	(36,576)	97,837	100,305	(44,042)	56,263
LONG-TERM INVESTMENTS							
Long-term interest-bearing deposits designated for Fab 2 operations	A	4,934	(4,934)	--	4,848	(4,848)	--
Other long-term investments	B	6,000	16,553	22,553	6,000	14,607	20,607
		10,934	11,619	22,553	10,848	9,759	20,607
PROPERTY AND EQUIPMENT, NET							
	C	613,561	(4,951)	608,610	568,412	(5,947)	562,465
DESIGNATED CASH AND SHORT-TERM AND LONG-TERM INTEREST-BEARING DEPOSITS							
	A	--	41,510	41,510	--	48,890	48,890
OTHER ASSETS, NET							
	E	97,961	(196)	97,765	108,770	(196)	108,574
TOTAL ASSETS		\$ 856,869	\$ 11,406	\$ 868,275	\$ 788,335	\$ 8,464	\$ 796,799
LIABILITIES AND SHAREHOLDERS' EQUITY							
CURRENT LIABILITIES							
Trade accounts payable		\$ 61,202	\$	\$ 61,202	\$ 40,249	\$	\$ 40,249
Other current liabilities		9,082		9,082	9,564		9,564
Total current liabilities		70,284	--	70,284	49,813	--	49,813
LONG-TERM DEBT							
		497,000		497,000	431,000		431,000
CONVERTIBLE DEBENTURES							
	E	25,643	(2,559)	23,084	25,783	(2,559)	23,224
LONG-TERM LIABILITY IN RESPECT OF CUSTOMERS' ADVANCES							
		65,069		65,069	46,347		46,347
LIABILITY IN RESPECT OF A VARIABLE NUMBER OF SHARES TO BE ISSUED							
	F	--		--	--	16,428	16,428
OTHER LONG-TERM LIABILITIES							
	B, C	7,792	22,835	30,627	5,935	24,527	30,462
Total liabilities		665,788	20,276	686,064	558,878	38,396	597,274
SHAREHOLDERS' EQUITY							
Ordinary shares, NIS 1.00 par value - authorized 150,000,000 shares; issued 66,934,971 and 52,996,097 shares, respectively		16,260		16,260	13,150		13,150
Additional paid-in capital	E	517,258	2,363	519,621	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	--	(11,263)	(11,263)	--	(15,897)	(15,897)
Accumulated deficit		(333,339)	30	(333,309)	(218,904)	30	(218,874)
		200,153	(8,870)	191,283	238,529	(29,932)	208,597
Treasury stock, at cost - 1,300,000 shares		(9,072)		(9,072)	(9,072)		(9,072)
Total shareholders' equity		191,081	(8,870)	182,211	229,457	(29,932)	199,525
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		\$ 856,869	\$ 11,406	\$ 868,275	\$ 788,335	\$ 8,464	\$ 796,799

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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 nine-month and three-month periods ended September 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 nine-month and three-month periods ended September 30, 2004 would be \$1.78 and \$0.60, respectively (during the corresponding periods - \$1.49 and \$0.77, respectively).