

**TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY
UNAUDITED CONDENSED INTERIM
CONSOLIDATED FINANCIAL STATEMENTS
AS OF SEPTEMBER 30, 2007**

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY

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CONSOLIDATED FINANCIAL STATEMENTS
AS OF SEPTEMBER 30, 2007**

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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, 2007

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

- Balance sheet as of September 30, 2007.
- Statements of operations for the nine months and three months ended September 30, 2007.
- Statements of changes in shareholders' equity for the nine months and three months ended September 30, 2007.
- Statements of cash flows for the nine months and three months ended September 30, 2007.

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 that 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, results of operations and cash flows as of the date and for the periods presented is summarized in Note 4.

Brightman Almagor & Co.
Brightman Almagor & Co.

Certified Public Accountants
A Member Firm of Deloitte Touche Tohmatsu

Tel Aviv, Israel
November 6, 2007

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

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

	As of September 30,		December 31,
	2007	2006	2006
	(unaudited)		
A S S E T S			
CURRENT ASSETS			
Cash and cash equivalents	\$ 42,600	\$ 61,746	\$ 39,710
Short-term interest-bearing deposits	--	--	1,230
Proceeds receivables relating public offering	13,932	--	--
Trade accounts receivable:			
Related parties	13,785	8,928	13,625
Others	26,513	16,708	17,873
Other receivables	1,260	12,807	5,425
Inventories	35,431	33,149	34,763
Other current assets	1,040	1,737	1,473
Total current assets	134,561	135,075	114,099
PROPERTY AND EQUIPMENT, NET	494,361	527,388	539,292
INTANGIBLE ASSETS, NET	36,386	49,291	44,981
OTHER ASSETS , NET	1,286	1,457	1,346
TOTAL ASSETS	\$ 666,594	\$ 713,211	\$ 699,718
 LIABILITIES AND SHAREHOLDERS' EQUITY			
CURRENT LIABILITIES			
Current maturities of convertible debentures	\$ 7,340	\$ 6,522	\$ 6,632
Trade accounts payable	39,480	59,687	55,128
Other current liabilities	20,041	15,354	22,096
Total current liabilities	66,861	81,563	83,856
LONG-TERM DEBT FROM BANKS	362,162	355,138	356,947
DEBENTURES	116,865	61,657	62,175
LONG-TERM CUSTOMERS' ADVANCES	36,072	50,004	46,042
OTHER LONG-TERM LIABILITIES	15,397	15,547	17,708
Total liabilities	597,357	563,909	566,728
SHAREHOLDERS' EQUITY	69,237	149,302	132,990
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 666,594	\$ 713,211	\$ 699,718

See notes to consolidated interim financial statements

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY
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,
	2007	2006	2007	2006	2006
	(unaudited)		(unaudited)		
REVENUES	\$ 169,235	\$ 131,933	\$ 56,569	\$ 51,503	\$ 187,438
COST OF SALES	<u>211,130</u>	<u>194,666</u>	<u>68,252</u>	<u>68,244</u>	<u>267,390</u>
GROSS LOSS	<u>(41,895)</u>	<u>(62,733)</u>	<u>(11,683)</u>	<u>(16,741)</u>	<u>(79,952)</u>
OPERATING COSTS AND EXPENSES					
Research and development	10,253	11,107	3,301	4,179	14,984
Marketing, general and administrative	<u>22,929</u>	<u>18,106</u>	<u>7,753</u>	<u>7,308</u>	<u>24,512</u>
	<u>33,182</u>	<u>29,213</u>	<u>11,054</u>	<u>11,487</u>	<u>39,496</u>
OPERATING LOSS	(75,077)	(91,946)	(22,737)	(28,228)	(119,448)
FINANCING EXPENSE, NET	(30,249)	(37,957)	(10,695)	(12,382)	(48,148)
GAIN ON DEBT RESTRUCTURING	--	80,071	--	80,071	80,071
OTHER INCOME, NET	<u>73</u>	<u>597</u>	<u>--</u>	<u>6</u>	<u>597</u>
INCOME (LOSS) FOR THE PERIOD	<u>\$ (105,253)</u>	<u>\$ (49,235)</u>	<u>\$ (33,432)</u>	<u>\$ 39,467</u>	<u>\$ (86,928)</u>
BASIC EARNING (LOSS) PER ORDINARY SHARE					
Earning (loss) per share	<u>\$ (0.90)</u>	<u>\$ (0.63)</u>	<u>\$ (0.27)</u>	<u>\$ 0.46</u>	<u>\$ (1.05)</u>
Income (loss) used to compute basic earning (loss) per share	<u>(105,253)</u>	<u>(49,235)</u>	<u>(33,432)</u>	<u>39,467</u>	<u>(86,928)</u>
Weighted average number of ordinary shares outstanding - in thousands	<u>117,084</u>	<u>78,607</u>	<u>123,970</u>	<u>85,087</u>	<u>82,581</u>
DILUTED EARNING (LOSS) PER ORDINARY SHARE					
Earning (loss) per share	<u>\$ (0.90)</u>	<u>\$ (0.63)</u>	<u>\$ (0.27)</u>	<u>\$ 0.30</u>	<u>\$ (1.05)</u>
Income (loss) used to compute diluted earning (loss) per share	<u>(105,253)</u>	<u>(49,235)</u>	<u>(33,432)</u>	<u>41,433</u>	<u>(86,928)</u>
Weighted average number of ordinary shares outstanding - in thousands	<u>117,084</u>	<u>78,607</u>	<u>123,970</u>	<u>139,214</u>	<u>82,581</u>

See notes to consolidated interim financial statements.

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

	Ordinary shares		Additional paid-in capital	Capital notes	Equity component of convertible debentures and cumulative stock based compensation	Accumulated deficit	Treasury stock	Total
	Shares	Amount						
BALANCE - JANUARY 1, 2007	102,052,767	\$ 24,187	\$ 564,580	\$ 176,401	\$ 23,576	\$ (646,682)	\$ (9,072)	\$ 132,990
Changes during the nine-month period (unaudited):								
Issuance of shares and warrants	22,705,598	5,398	28,345					33,743
Conversion of convertible debentures into shares	549,184	131	523		(240)			414
Employee stock-based compensation					5,977			5,977
Exercise of share options	26,124	5	30					35
Stock-based compensation (see Note 3C)			1,331					1,331
Loss for the period						(105,253)		(105,253)
BALANCE - SEPTEMBER 30, 2007 (unaudited)	<u>125,333,673</u>	<u>\$ 29,721</u>	<u>\$ 594,809</u>	<u>\$ 176,401</u>	<u>\$ 29,313</u>	<u>\$ (751,935)</u>	<u>\$ (9,072)</u>	<u>\$ 69,237</u>
BALANCE - JANUARY 1, 2006	68,232,056	16,548	522,237		(26)	(559,754)	(9,072)	(30,067)
Changes during the nine-month period (unaudited):								
Issuance of shares and warrants	3,910,514	842	6,933					7,775
Equity component of convertible debentures					27,985			27,985
Conversion of convertible debentures into shares	14,931,280	3,273	13,039		(6,920)			9,392
Employee stock-based compensation					2,355			2,355
Exercise of warrants	350,000	81	469					550
Stock-based compensation related to the Facility Agreement with the Banks			4,146					4,146
Capital notes				176,401				176,401
Loss for the period						(49,235)		(49,235)
BALANCE - SEPTEMBER 30, 2006 (unaudited)	<u>87,423,850</u>	<u>\$ 20,744</u>	<u>\$ 546,824</u>	<u>\$ 176,401</u>	<u>\$ 23,394</u>	<u>\$ (608,989)</u>	<u>\$ (9,072)</u>	<u>\$ 149,302</u>
BALANCE - JULY 1, 2007	123,495,958	29,283	586,265	176,401	27,700	(718,503)	(9,072)	92,074
Changes during the three-month period (unaudited):								
Issuance of shares and warrants	1,782,610	425	7,161					7,586
Conversion of convertible debentures into shares	50,356	12	48		(23)			37
Employee stock-based compensation					1,636			1,636
Exercise of options	4,749	1	4					5
Stock-based compensation (see Note 3C)			1,331					1,331
Loss for the period						(33,432)		(33,432)
BALANCE - SEPTEMBER 30, 2007 (unaudited)	<u>125,333,673</u>	<u>\$ 29,721</u>	<u>\$ 594,809</u>	<u>\$ 176,401</u>	<u>\$ 29,313</u>	<u>\$ (751,935)</u>	<u>\$ (9,072)</u>	<u>\$ 69,237</u>
BALANCE - JULY 1, 2006	85,768,622	20,366	540,885	--	20,381	(648,456)	(9,072)	(75,896)
Changes during the three-month period (unaudited):								
Issuance of shares	472,438	105	580					685
Equity component of convertible debentures					1,624			1,624
Conversion of convertible debentures into shares	832,790	192	744		(385)			551
Employee stock-based compensation					1,774			1,774
Exercise of warrants	350,000	81	469					550
Stock-based compensation related to the Facility Agreement with the Banks			4,146					4,146
Capital notes				176,401				176,401
Income for the period						39,467		39,467
BALANCE - SEPTEMBER 30, 2006 (unaudited)	<u>87,423,850</u>	<u>\$ 20,744</u>	<u>\$ 546,824</u>	<u>\$ 176,401</u>	<u>\$ 23,394</u>	<u>\$ (608,989)</u>	<u>\$ (9,072)</u>	<u>\$ 149,302</u>
BALANCE - JANUARY 1, 2006	68,232,056	\$ 16,548	\$ 522,237	--	(26)	(559,754)	(9,072)	(30,067)
Changes during 2006 :								
Issuance of shares and warrants	16,729,145	3,860	23,038					26,898
Equity component of convertible debentures					27,997			27,997
Conversion of convertible debentures into shares	16,734,316	3,696	14,681		(7,758)			10,619
Employee stock-based compensation					3,363			3,363
Exercise of options	7,250	2	9					11
Exercise of warrants	350,000	81	469					550
Stock-based compensation related to the Facility Agreement with the Banks			4,146					4,146
Capital notes				176,401				176,401
Loss for the year						(86,928)		(86,928)
BALANCE - DECEMBER 31, 2006	<u>102,052,767</u>	<u>\$ 24,187</u>	<u>\$ 564,580</u>	<u>\$ 176,401</u>	<u>\$ 23,576</u>	<u>\$ (646,682)</u>	<u>\$ (9,072)</u>	<u>\$ 132,990</u>

See notes to consolidated interim financial statements.

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY
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,
	2007	2006	2007	2006	2006
	(unaudited)		(unaudited)		
CASH FLOWS - OPERATING ACTIVITIES					
Income (loss) for the period	\$ (105,253)	\$ (49,235)	\$ (33,432)	\$ 39,467	\$ (86,928)
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	120,048	124,655	37,718	42,064	170,816
Effect of indexation and translation on debentures	3,883	2,500	3,705	1,404	2,569
Write down of customer advance	(3,000)	--	(3,000)	--	--
Other income, net	(73)	(597)	--	(6)	(597)
Gain on debt restructuring	--	(80,071)	--	(80,071)	(80,071)
Changes in assets and liabilities:					
Decrease (Increase) in trade accounts receivable	(8,800)	(8,860)	5,178	(4,010)	(14,722)
Decrease (increase) in other receivables and other current assets	3,180	(9,496)	1,804	(7,640)	(2,662)
Decrease (increase) in inventories	(1,929)	(12,449)	1,000	(3,526)	(14,064)
Increase (decrease) in trade accounts payable	8,711	(3,583)	(8,409)	(6,064)	(4,734)
Increase (decrease) in other current liabilities	(2,402)	3,736	(1,309)	1,623	6,551
Increase (decrease) in other long-term liabilities	(172)	(1,752)	606	(73)	(3,285)
	14,193	(35,152)	3,861	(16,832)	(27,127)
Decrease in long-term customers' advances, net	(1,222)	(1,504)	(300)	(690)	(2,306)
Net cash provided by (used in) operating activities	12,971	(36,656)	3,561	(17,522)	(29,433)
CASH FLOWS - INVESTING ACTIVITIES					
Decrease in designated cash, short-term and long-term interest-bearing deposits, net	--	31,661	--	2,909	31,661
Investments in property and equipment	(67,827)	(109,772)	(18,039)	(77,085)	(161,187)
Investment grants received	1,568	4,489	131	1,191	5,219
Proceeds related to sale and disposal of property and equipment	89	600	--	9	600
Investments in other assets	(911)	(4,168)	--	(618)	(5,074)
Decrease (increase) in short-term interest-bearing deposits	1,230	--	--	--	(1,230)
Net cash used in investing activities	(65,851)	(77,190)	(17,908)	(73,594)	(130,011)
CASH FLOWS - FINANCING ACTIVITIES					
Proceeds from issuance of debentures and warrants, net	37,410	58,797	37,410	36,937	58,766
Proceeds from long-term debt	--	15,384	--	6,794	18,295
Repayment of long-term debt	(1,125)	--	(1,125)	--	--
Proceeds from issuance of ordinary shares and warrants, net	26,538	--	(66)	--	20,673
Proceeds on account of a warrant	--	550	--	550	550
Proceeds on account of share capital	--	100,000	--	100,000	100,000
Repayment of debenture	(7,088)	(6,476)	--	--	(6,476)
Proceeds from exercise of share options	35	--	5	--	9
Net cash provided by financing activities	55,770	168,255	36,224	144,281	191,817
INCREASE IN CASH AND CASH EQUIVALENTS	2,890	54,409	21,877	53,165	32,373
CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD	39,710	7,337	20,723	8,581	7,337
CASH AND CASH EQUIVALENTS - END OF PERIOD	\$ 42,600	\$ 61,746	\$ 42,600	\$ 61,746	\$ 39,710
NON-CASH ACTIVITIES					
Investments in property and equipment	\$ 15,313	\$ 32,952	\$ 7,817	\$ 26,562	\$ 42,575
Stock-based compensation related to the Facility Agreement with the Banks	\$ --	\$ 4,146	\$ --	\$ 4,146	\$ 4,146
Stock-based compensation (see Note 3C)	\$ 1,331	\$ --	\$ 1,331	\$ --	\$ --
Investments in other assets	\$ --	\$ --	\$ --	\$ --	\$ 433
Conversion of long-term liability in respect of customers' advances to share capital	\$ 6,414	\$ 5,972	\$ 2,709	\$ 685	\$ 7,621
Proceeds receivables related public offering	\$ 13,932	\$ --	\$ 13,932	\$ --	\$ --
Conversion of Convertible debentures to share capital	\$ 414	\$ 9,392	\$ 37	\$ 551	\$ 10,619
Conversion of long term debt to capital notes	\$ --	\$ 76,401	\$ --	\$ 76,401	\$ 76,401
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION					
Cash paid during the period for interest	\$ 19,600	\$ 28,611	\$ 6,224	\$ 7,819	\$ 35,008
Cash paid during the period for income taxes	\$ 43	\$ 126	\$ 18	\$ 70	\$ 134

See notes to consolidated interim financial statements.

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY
NOTES TO UNAUDITED CONDENSED INTERIM CONSOLIDATED
FINANCIAL STATEMENTS AS OF SEPTEMBER 30, 2007

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

NOTE 1 - GENERAL

A. Basis for Presentation

- (1) The unaudited condensed interim consolidated financial statements as of September 30, 2007 and for the nine months then ended (“interim financial statements”) of Tower Semiconductor Ltd. and subsidiary (“the Company”) should be read in conjunction with the audited consolidated financial statements of the Company as of December 31, 2006 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.
- (2) The interim financial statements have been prepared in conformity with generally accepted accounting principles (“GAAP”) in Israel (“Israeli GAAP”). The interim financial statements differ in certain respects from GAAP in the United States of America (“U.S. GAAP”), as indicated in Note 4. 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, except for the accounting principles detailed in paragraph 3 below.
- (3) **Recent Accounting Pronouncements by the Israeli Accounting Standards Board**
 - a. **Accounting Standard No. 29 “Adoption of International Financial Reporting Standards”**

In July 2006, the Israeli Accounting Standards Board published Accounting Standard No. 29 – “Adoption of International Financial Reporting Standards” - IFRS (“the Standard”). According to the Standard, an entity subject to the Israeli Securities Law and authoritative regulations thereunder, excluding foreign corporations, that do not prepare their financial statements in accordance with Israeli GAAP, as defined by the Israeli Securities Law will be required to prepare financial statements in accordance with the IFRS and related interpretations published by the International Accounting Standards Board, for the reporting periods commencing January 1, 2008, including interim periods.

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY
NOTES TO UNAUDITED CONDENSED INTERIM CONSOLIDATED
FINANCIAL STATEMENTS AS OF SEPTEMBER 30, 2007
(dollars in thousands, except share data and per share data)

NOTE 1 - GENERAL (cont.)

A. Basis for Presentation (cont.)

(3) Recent Accounting Pronouncements by the Israeli Accounting Standards Board (cont.)

a. Accounting Standard No. 29 “Adoption of International Financial Reporting Standards” (cont.)

An entity adopting IFRS as of January 1, 2008 and electing to report comparative figures in accordance with the IFRS for only 2007, will be required to prepare opening balance-sheet amounts as of January 1, 2007 based on the IFRS. Reporting in accordance with the IFRS will be carried out based on the provisions of IFRS No. 1, “First-time Adoption of IFRS Standards”, which establishes guidance on implementing and transitioning from financial reporting based on domestic national accounting standards to reporting in accordance with IFRS. IFRS No. 1 supersedes the transitional provisions established in other IFRSs (including those established in former domestic national accounting standards), stating that all IFRSs should be adopted retroactively for the opening balance-sheet amounts. Nevertheless, IFRS No. 1 grants exemptions on certain issues by allowing the alternative of not applying the retroactive application in respect thereof.

The Company, which as a dual listed company can alternatively choose to adopt the US GAAP, is currently in the process of examining the effect of the transition to IFRS or to US GAAP on the Company's financial position and results of operations, and has not yet made any decision in this regard.

b. Accounting Standard No. 26 “Inventory”

In August 2006, the Israeli Accounting Standards Board published Accounting Standard No. 26 - “Inventory” (“the Standard”), which outlines the accounting treatment for inventory. The Standard applies to all types of inventory, other than building earmarked for sale and addressed by Accounting Standard No.2 (“Construction of Buildings for Sale”), inventory of work in progress stemming from performance contracts, addressed by Accounting Standard No.4 (“Work Based on Performance Contract”), financial instruments and biological assets relating to agricultural activity and agricultural production during harvest.

The Standard applies to financial statements covering periods beginning January 1, 2007 and onwards and should be implemented retroactively.

The Standard did not affect the Company's financial position, results of operations and cash flows.

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY
NOTES TO UNAUDITED CONDENSED INTERIM CONSOLIDATED
FINANCIAL STATEMENTS AS OF SEPTEMBER 30, 2007

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

NOTE 1 - GENERAL (cont.)

A. Basis for Presentation (cont.)

(3) Recent Accounting Pronouncements by the Israeli Accounting Standards Board (cont.)

c. Accounting Standard No. 27 “Fixed Assets”

In September 2006, the Israeli Accounting Standards Board published Accounting Standard No. 27 (“the Standard”), which establishes the accounting treatment for fixed assets, including recognition of assets, determination of their book value, related depreciation, losses from impairment as well as the disclosure required in the financial statements. The Standard states that a fixed-asset item will be measured at the initial recognition date at cost. The cost should also include the initial estimate of costs required to dismantle and remove the item.

Following the initial recognition, the Standard permits the entity to implement in its accounting policy the measurement of the fixed assets by the cost method or by revaluation so long as this policy is implemented in regard to all the items in that group.

Under the cost method, an item will be presented at cost less accumulated depreciation net book value, less accumulated impairment losses.

Under the revaluation method, an item whose fair value can be measured reliably will be presented at its estimated amount, which equals its fair value at the revaluation date, net of depreciation accumulated subsequently and less accumulated impairment losses. A resulting increase in an asset's value due to the revaluation should be allocated directly to shareholders' equity (“revaluation reserve”).

The Standard applies to financial statements covering periods beginning January 1, 2007 and onwards and is implemented retroactively. The Standard did not affect the Company's financial position or results of operations, except for reclassification in the balance sheet and cash flows report of spare parts from inventory to fixed assets.

In April 2007, the Israeli Accounting Standard Board published Standard No. 28 that amends Standard No. 27 to allow, at transition, the exemptions allowed under IFRS 1 regarding fixed assets.

The Standard did not affect the Company's financial position, results of operations and cash flows.

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NOTES TO UNAUDITED CONDENSED INTERIM CONSOLIDATED
FINANCIAL STATEMENTS AS OF SEPTEMBER 30, 2007
(dollars in thousands, except share data and per share data)

NOTE 1 - GENERAL (cont.)

A. Basis for Presentation (cont.)

(3) Recent Accounting Pronouncements by the Israeli Accounting Standards Board (cont.)

d. Accounting Standard No. 23, "Accounting for Transactions between an Entity and a controlling party"

In December 2006 the Israeli Accounting Standards Board published Accounting Standard No. 23, "Accounting for Transactions between an Entity and a Controlling Party" ("the Standard"). The Standard applies to entities subject to the Israeli Securities Law-1968. The Standard establishes the requirements for accounting for transactions between an entity and its controlling party which involve the disposition of an asset, the taking on of a liability, reimbursement or debt concession, and the receiving of loans. The Standard does not apply to business combinations under common control. The Standard stipulates that transactions between an entity and a controlling party will be measured based on fair value; transactions which in nature are owner investments should be reported directly in equity and not be recognized in the controlled entity's profit and loss; the differences between the consideration set in transactions between an entity and a controlling party and their fair value will be allocated directly to equity; and current and deferred taxes pertaining to the items allocated to equity due to transactions with controlling parties will be allocated directly to equity as well.

The Standard applies to transactions between an entity and a controlling party taking place subsequent to January 1, 2007 and for loans granted by or given to a controlling party prior to the Standard's coming into effect, starting on the Standard's effective date.

The Standard did not affect the Company's financial position, results of operations and cash flows.

e. Accounting Standard No. 30 - "Intangible Assets"

In March 2007, The Israeli Accounting Standards Board published Accounting Standard No. 30, "Intangible Assets" ("the Standard"), which sets the accounting treatment for intangible assets that are not covered by any other standard, as well as the disclosure requirements in the financial statements for the entity's intangible assets.

TOWER SEMICONDUCTOR LTD. AND SUBSIDIARY
NOTES TO UNAUDITED CONDENSED INTERIM CONSOLIDATED
FINANCIAL STATEMENTS AS OF SEPTEMBER 30, 2007
(dollars in thousands, except share data and per share data)

NOTE 1 - GENERAL (cont.)

A. Basis for Presentation (cont.)

(3) Recent Accounting Pronouncements by the Israeli Accounting Standards Board (cont.)

e. Accounting Standard No. 30 - "Intangible Assets" (cont.)

According to the Standard:

An intangible asset shall be measured initially at cost.

Expenditures arising from research (or from the research phase of an internal project) shall not be recognized as an asset and should be expensed when incurred. An intangible asset arising from development (or from the development phase of an internal project) shall be recognized if, and only if, the criteria for recognition as an intangible asset in the Standard are met. Expenditure on an intangible item that was not recognized initially, shall not be recognized as part of the cost of an intangible asset at a later date.

After initial recognition, an entity may choose to measure an intangible asset at its cost less any accumulated amortization and any accumulated impairment losses, or for an intangible asset that has an active market, as defined in the Standard, the intangible asset may be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated amortization and any subsequent accumulated impairment losses. An entity shall assess whether the useful life of an intangible asset is finite or indefinite. The amortization of an intangible asset with a finite useful life shall be over its useful life using a systematic basis. An intangible asset with an indefinite useful life shall not be amortized. Instead, an entity is required to test an intangible asset with an indefinite useful life for impairment by comparing its recoverable amount with its carrying amount annually, or whenever there is an indication that the intangible asset maybe impaired.

This Standard shall apply to financial statements for annual periods beginning on or after January 1, 2007.

The Standard did not affect the Company's financial position, results of operations and cash flows.

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

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NOTE 1 - GENERAL (cont.)

A. Basis for Presentation (cont.)

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

B. Establishment and Operations of New Fabrication Facility ("Fab 2")

In 2001, the Company's Board of Directors approved the establishment of the Company's second wafer fabrication facility in Israel ("Fab 2"). In Fab 2, the Company manufactures semiconductor integrated circuits on silicon wafers in geometries of 0.18 to 0.13 micron on 200-millimeter wafers. In connection with the establishment, equipping and financing of Fab 2, the Company has entered into several related agreements and other arrangements and since 2001 has completed public and private financing transactions. For additional information, see Note 11A to the 2006 audited consolidated financial statements.

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, see Note 11A to the 2006 audited consolidated financial statements.

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NOTE 1 - GENERAL (cont.)

C. Financing of the Company's Ongoing Operations

In recent years, the Company has experienced significant recurring losses, recurring negative cash flows from operating activities and an increasing accumulated deficit. The Company is working in various ways to mitigate its financial difficulties and among them are the following:

Since the second half of 2005, the Company increased its customer base, mainly in Fab 2, modified its organizational structure to better address its customers and its market positioning, increased its sales and its EBITDA, reduced its losses, increased its capacity level, utilization rates and raised funds (see Note 3 below and Notes 12C(2); 12I; 12J; and 12K to the 2006 audited consolidated financial statements) and restructured its bank debt (see Note 11A(6) to the 2006 audited consolidated financial statements).

In March 2006, the board of directors of the Company approved a plan to ramp up Fab 2's capacity to approximately 24,000 wafers per month in order to help meet customer needs and product qualification needs, based on its customer pipeline and reinforced by forecasted market conditions. This plan was completed as of the balance sheet date.

For details regarding the financing efforts of the ramp-up plan to reach capacity of 24,000 wafers per month, including the definitive amendment to the Company's facility agreement with two leading Israeli banks ("Banks") for the restructuring of its debt and the securities purchase agreement with Israel Corporation Ltd. ("TIC") according to which TIC invested \$100,000 in the Company, which both closed in September 2006, see Notes 11A(6) and 11A(4) to the 2006 audited consolidated financial statements.

For further ramp up and financing plan to reach capacity beyond the 24,000 wafers per month, see below Note 3B and 3C.

Further, the Company continues to examine alternatives for additional funding sources in order to further ramp-up the equipping of Fab2.

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NOTE 2 - INVENTORIES

Inventories consist of the following (*):

	September 30,		December 31,
	2007	2006	2006
	(unaudited)		
Raw materials	\$ 11,323	\$ 10,098	\$ 11,234
Work in process	23,663	22,277	22,884
Finished goods	445	774	645
	\$ 35,431	\$ 33,149	\$ 34,763

(*) Net of aggregate write downs to net realizable value of \$2,013, \$2,543 and \$6,707 as of September 30, 2007, September 30, 2006 and December 31, 2006, respectively.

NOTE 3 - RECENT DEVELOPMENTS

- A. March 2007 Private placement in the US** - In March 2007, the Company completed a private placement of its securities in which it sold ordinary shares and warrants for the purchase of ordinary shares, raising a total of approximately \$29,000 in gross proceeds. In the private placement, the Company issued approximately 18.8 million shares, warrants exercisable into approximately 9.4 million shares at an exercise price of \$2.04 (subject to possible adjustments under certain circumstances), exercisable until March 15, 2012 ("Series I Warrants"), and short-term warrants exercisable into approximately 18.8 million shares at an exercise price of \$1.70, which was identical to the closing price of the Company's Ordinary Shares on the NASDAQ on the trading day immediately prior to the closing of the private placement ("Series II Warrants"), exercisable until December 31, 2007. Subject to certain conditions, the Company can compel the exercise of the Series II Warrants if during any 20 out of 30 consecutive trading days the closing price of the Company's shares on NASDAQ exceeds \$2.12.

See Note 4F for disclosure of the accounting treatment in accordance with U.S. GAAP.

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NOTE 3 - RECENT DEVELOPMENTS (cont.)

- B. 2007 Long-Term Bonds Issued in Israel** - In the second half of 2007, the Company consummated a private placement with Israeli institutions of long-term convertible and non-convertible bonds and warrants, by which the Company raised a gross amount of approximately \$40,000, to be used for the funding of equipment required for a ramp up plan in Fab 2 to increase its capacity to beyond 24,000 wafers per month (see also Note 3C). In the funding, 342 units were sold, each comprised of: (i) long-term nonconvertible-bonds, repayable in six equal annual installments between the dates of December 2011 and December 2016, with a face amount of NIS 250,000 (approximately \$59.7) and carrying an annual interest rate of 8 percent; (ii) long-term convertible-bonds repayable in December 2012 with a 17.2 NIS conversion price (approximately \$4.11) with a face amount of NIS 262,500 (approximately \$62.7), carrying an annual interest of 8 percent, and (iii) 5,800 warrants, each exercisable until 2011, for one Tower ordinary share at a price of \$2.04 (approximately 8.54 NIS). The bonds are linked to the Israeli Consumer Price Index (CPI) and were issued at 95.5% of par value. The conversion and exercise prices are subject to reduction in certain limited circumstances.

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

In accordance with Standard No. 22, the allocation of the gross proceeds to the unit components was based on the relative fair value of each component. The warrants issued have been classified in equity. No proceeds were allocated to the equity component of the convertibles debenture as it was determined to be immaterial.

- C. September 2007 agreements with the Company's lender Banks and TIC** - In September 2007, the Company signed and closed definitive agreements, based on the July letters of intent, with its lender banks, Bank Leumi and Bank Hapoalim, and with Israel Corporation, one of its primary shareholders, providing for credit lines totaling up to \$60,000, to be used for the funding of equipment required for a ramp up plan in Fab 2 to increase its capacity to beyond 24,000 wafers per month (see also Note 3B). As of September 30, 2007, no amounts were borrowed under these credit lines. Loans under the credit lines will bear interest at an annual rate of 3-month LIBOR plus 3 percent and will be repayable by the earlier of 2 years from the date a loan is borrowed and March 31, 2010. The Company paid the banks and TIC customary fees, and issued to them an aggregate of approximately 5.4 million warrants with an exercise price of \$2.04.
- D. Long-term customers' advance** - Due to recent changes in one of the Company's Wafer Partner's operations and its recent exit of its semiconductor activities, the Company evaluated the balance of long-term customer advances and determined that a write-down of \$3,000 in the outstanding amount is appropriate. The remaining balance of long-term customer advances represents the Company's best estimate of the maximum exposure of future utilizations.

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NOTE 4 - 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 Note 4(I) below for the presentation of the Company's unaudited balance sheet as of September 30, 2007 in accordance with U.S. GAAP.

A. Recent Accounting Pronouncements by the FASB

SFAS No. 157, "Fair Value Measurements"

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" (SFAS No. 157). The purpose of SFAS No. 157 is to define fair value, establish a framework for measuring fair value, and enhance disclosures about fair value measurements.

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

Fair Value Measurements on earnings as of September 30, 2007:

	<u>Significant Unobservable Inputs</u>
Derivatives	\$ 10,720
Facility Agreement	<u>358,572</u>
Total	<u>\$ 369,262</u>

Fair Value Measurements Using Significant Unobservable Inputs:

	<u>Derivatives</u>	<u>Facility Agreement</u>	<u>Total</u>
Beginning balance	\$ 11,264	357,108	\$ 368,372
Unrealized gains or losses included in earnings	<u>(544)</u>	<u>1,464</u>	<u>920</u>
Ending balance	<u>\$ 10,720</u>	<u>358,572</u>	<u>\$ 369,292</u>

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NOTE 4 - MATERIAL DIFFERENCES BETWEEN ISRAELI AND U.S. GAAP (cont.)

(A) Recent Accounting Pronouncements by the FASB (cont.)

SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities"

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS No. 159). SFAS No. 159 permits companies to choose to measure certain financial instruments and certain other items at fair value. The standard requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. SFAS No. 159 is effective for the Company beginning in the first quarter of fiscal year 2008, although earlier adoption is permitted. The Company decided to early adopt the provisions of SFAS No. 159 effective January 1, 2007, and elected to carry at fair value the Facility agreement, see H below.

FIN No. 48. Accounting for Uncertainty in Income Taxes

On July 13, 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109" ("FIN 48"), which clarifies the accounting for uncertainty in tax positions. This Interpretation requires recognition in the financial statements of the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. A tax position that meets the more-likely-than-not recognition threshold shall initially and subsequently be measured as the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. Measurement of a tax position that meets the more-likely-than-not recognition threshold shall consider the amounts and probabilities of the outcomes that could be realized upon ultimate settlement using the facts, circumstances, and information available at the reporting date. The provisions of FIN 48 are effective for the 2007 fiscal year with the cumulative effect of the change in accounting principles recorded as an adjustment to the opening balance of retained earnings. FIN 48 did not have a material effect on the financial condition, results of operations or liquidity of the Company.

B. Presentation of Net Long-Term Liabilities in Respect of Employee Severance Pay

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, 2007, an amount of \$13,495 would be reclassified from other long-term liabilities as long-term investments.

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NOTE 4 - MATERIAL DIFFERENCES BETWEEN ISRAELI AND U.S. GAAP (cont.)

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

Complying with SFAS 133 as amended and the related interpretations thereon as they apply to the Company's hedging transactions, as of September 30, 2007, such transactions would have resulted in: an increase in other long-term investments in the amount of \$751; an accumulated other comprehensive loss component of equity balance as of September 30, 2007 in the amount of \$246 (as of December 31, 2006, an accumulated other comprehensive loss component of equity balance in the amount of \$203); and in a decrease of \$997 in property and equipment, net as of September 30, 2007.

D. Issuance of Debentures

Under Accounting Principles Board Opinion No. 14 ("APB 14"), the proceeds from the sale of the securities in the Company's January 2002 Israeli public offering are to be allocated to each of the securities issued based on their relative fair value, while according to Israeli GAAP such treatment was not required. Complying with APB 14, based on the average market value of each of the components issued in the first three days following their issuance (in January 2002), would have resulted in an increase in shareholders' equity as of the issuance date in the amount of \$2,363 (net of \$196 related issuance expenses), and a decrease in convertible debentures as of such date in the amount of \$2,559. The additional accumulated effect of amortization of the discount on the convertible debentures under U.S. GAAP as of September 30, 2007 would have been \$562. Commencing with the adoption of Standard No. 22 in January 2006, allocation of proceeds in a unit, to its components, is based on relative fair values under Israeli GAAP as well as under US GAAP.

Under US GAAP, convertible debentures have to be evaluated to determine if they contain an embedded derivative that warrant bifurcation. Conversion features embedded in convertible debentures will need to be evaluated as to whether they can be classified as equity based on the criteria established in EITF Issues 00-19 and 05-2. The Company evaluated the conversion features embedded in its debentures (i.e., sale of convertible debentures in 2002 - "2002 debentures", sale of convertible debentures in 2005 - "2005 debentures", sale of convertible debentures in 2006 - "2006 debentures" and the 2007 long-term bonds issued in Israel - "2007 debentures") and concluded that the conversion feature embedded in the 2005 and 2006 debentures warrant bifurcation while the conversion feature embedded in the 2002 and 2007 debentures need not be separated.

2002 debentures:

Under US GAAP, the equity component, in the amount of \$1,681, classified in equity under Israeli GAAP should have not been separated and was required to be included as part of the carrying amount of the debentures.

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NOTE 4 - MATERIAL DIFFERENCES BETWEEN ISRAELI AND U.S. GAAP (cont.)

D. Issuance of Debentures (cont.)

2005 and 2006 debentures:

Under US GAAP, the equity component of the 2005 and 2006 debentures, in the amounts of \$12,288 and \$6,030 respectively, as of September 30, 2007, classified as equity under Israeli GAAP were reclassified as liabilities and the conversion features were bifurcated from the debt host and marked to market through earnings. The initial amount allocated to the bifurcated conversion features were determined using the "with and without" method based on the fair value of the embedded derivative prescribed in DIG Issue B6.

2007 debentures:

The accounting treatment under US GAAP is the same as under Israeli GAAP.

All the above would have resulted, as of September 30, 2007, mainly in a decrease in debentures in the amount of \$2,077; an increase in the shareholder's equity in the amount of \$2,771; and an increase in other assets in the amount of \$694. The Company's loss for the nine month period ended September 30, 2007 would have increased in the amounts of \$5,144.

E. Issued warrants presentation

Under U.S. GAAP, the Company's series 5 warrants were initially recorded as a liability due to the ratchet provision included in them. Upon the effective date of the prospectus filed in Israel registering such warrants, the ratchet expired and the series 5 warrants were eligible for equity classification based on the criteria in EITF 00-19.

Complying with the above would have resulted as of September 30, 2007 mainly in a decrease in other long-term liabilities and an increase in shareholder's equity in the amount of \$2,548. The Company's loss for the nine month period ended September 30, 2007 would have increased in the amounts of \$540.

F. March 2007 private placement of ordinary shares and warrants

Under US GAAP, all components in the private placement should be classified in equity.

G. Employee stock based compensation

The Company adopted, effective January 1, 2006, SFAS 123R according to which the compensation expense related to employee and directors share option awards would have resulted in an increase in the compensation expenses for the nine month period ending September 30, 2007 in the amount of \$908. The Company elected the modified prospective method as its transition method. The adoption of SFAS 123R for US GAAP along with the adoption of Standard No. 24 for Israeli GAAP, decreased the potential differences between US GAAP and Israeli GAAP as they relate to stock based compensation.

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NOTE 4 - MATERIAL DIFFERENCES BETWEEN ISRAELI AND U.S. GAAP (cont.)

H. Facility Agreement

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

During the first quarter of 2007, the Company decided to early adopt the provisions of SFAS No. 159 *The Fair Value Option for Financial Assets and Financial Liabilities*. As required by such Standard the Company also adopted the provisions of FASB 157 *Fair Value Measurements*. The adoption of the Standard is effective January 1, 2007. According to the Standard the Company can choose to carry at fair value eligible items as defined in the Standard, from the date of early adoption and accordingly the Company decided to apply the fair value option to the facility agreement.

The effect of applying the fair value option to the facility agreement as of January 1, 2007 was \$65,207 which has been recorded as a cumulative effect adjustment to retained earnings (no tax effects have been recorded). The carrying amount of the facility agreement prior to the adoption was \$432,430 and immediately after was \$367,223. The Company reasoned its election of the fair value option for the facility agreement on the fact that the application of FASB 15 to the facility agreement did not reflect the economic benefits that were achieved with the consummation of the amendment to the facility agreement and that the application of the fair value better reflects such benefits. Also the adoption of the fair value option will decrease the GAAP difference that currently exists between Israeli GAAP and IFRS vs. US GAAP.

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NOTE 4 - MATERIAL DIFFERENCES BETWEEN ISRAELI AND U.S. GAAP (cont.)

H. Facility Agreement (cont.)

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

All the above resulted in a decrease of \$6,581 in shareholders equity and an increase of the same amount in the long-term loans from the banks as of September 30, 2007. The decrease in shareholders equity includes the cumulative effect as of December 31, 2006, which decreased the accumulated deficit in the amount of \$65,207. The Company's loss for nine month period ended September 30, 2007 would have decreased in the amounts of \$3,696.

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NOTE 4 - MATERIAL DIFFERENCES BETWEEN ISRAEL AND U.S. GAAP (Cont.)

I. Balance Sheets in accordance with U.S. GAAP

	U.S. GAAP remark	As of September 30, 2007			As of December 31, 2006		
		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		\$ 42,600		\$ 42,600	\$ 39,710		\$ 39,710
Short-term interest-bearing deposits		--		--	1,230		1,230
Proceeds receivables relating public offering		13,932		13,932	--		--
Trade accounts receivable :							
Related Parties		13,785		13,785	13,625		13,625
Others		26,513		26,513	17,873		17,873
Other receivables		1,260		1,260	5,425		5,425
Inventories		35,431		35,431	34,763		34,763
Other current assets		1,040		1,040	1,473		1,473
Total current assets		<u>134,561</u>	<u>--</u>	<u>134,561</u>	<u>114,099</u>	<u>--</u>	<u>114,099</u>
LONG-TERM INVESTMENTS	B,C	--	14,246	14,246	--	15,325	15,325
PROPERTY AND EQUIPMENT, NET	C	494,361	(997)	493,364	539,292	(1,745)	537,547
INTANGIBLE ASSETS, NET		36,386	--	36,386	44,981	--	44,981
OTHER ASSETS, NET	D	1,286	694	1,980	1,346	834	2,180
TOTAL ASSETS		<u>\$ 666,594</u>	<u>\$ 13,943</u>	<u>\$ 680,537</u>	<u>\$ 699,718</u>	<u>\$ 14,414</u>	<u>\$ 714,132</u>
LIABILITIES AND SHAREHOLDERS' EQUITY							
CURRENT LIABILITIES							
Current maturities of convertible debentures	D	7,340	166	7,506	6,632	270	6,902
Trade accounts payable		39,480		39,480	55,128		55,128
Other current liabilities		20,041		20,041	22,096		22,096
Total current liabilities		<u>66,861</u>	<u>166</u>	<u>67,027</u>	<u>83,856</u>	<u>270</u>	<u>84,126</u>
LONG-TERM DEBT FROM BANKS	H	362,162	6,581	368,743	356,947	75,483	432,430
DEBENTURES	D	116,865	(2,243)	114,622	62,175	21,688	83,863
LONG-TERM CUSTOMERS' ADVANCES		36,072		36,072	46,042		46,042
OTHER LONG-TERM LIABILITIES	B,E	15,397	10,947	26,344	17,708	10,447	28,155
Total liabilities		<u>597,357</u>	<u>15,451</u>	<u>612,808</u>	<u>566,728</u>	<u>107,888</u>	<u>674,616</u>
SHAREHOLDERS' EQUITY		69,237	(1,508)	67,729	132,990	(93,474)	39,516
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		<u>\$ 666,594</u>	<u>\$ 13,943</u>	<u>\$ 680,537</u>	<u>\$ 699,718</u>	<u>\$ 14,414</u>	<u>\$ 714,132</u>

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NOTE 4 - MATERIAL DIFFERENCES BETWEEN ISRAELI AND U.S. GAAP (cont.)

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

Complying with FASB No. 159 (H above), SFAS 133 (C above), APB 14 (D above) and SFAS 123R (G above) would have resulted in an increase in the loss for the nine-month period ended September 30, 2007 in the amount of \$3,692. The loss for the nine-month period ended September 30, 2006 would have increased in the amount of \$82,396 (mainly due to the difference in accounting for the debt modification under Israeli GAAP as of September 30, 2006, prior to the early adoption of SFAS 159 effective January 1, 2007 as detailed above). Giving effect to all the above, the loss for the nine-month periods ended September 30, 2007 and 2006 would be \$108,945 and \$131,631.

For the cumulative effect adjustment to retained earnings in the amount of \$65,207 following the early adoption of SFAS 159, See H above.

K. Comprehensive Income (Loss) in Accordance with U.S. GAAP (SFAS 130)

Comprehensive income (loss) represents the change in shareholder's equity during a reporting period from transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a reporting period except those resulting from investments by owners and distributions to owners. Other comprehensive income (loss) represents gains and losses that under U.S. GAAP are included in comprehensive income but excluded from net income. Following are statements of comprehensive loss in accordance with U.S. GAAP:

	Nine months ended	
	September 30,	
	2007	2006
	(unaudited)	
Loss for the period, according to U.S. GAAP(see J above)	\$ (108,945)	\$ (131,631)
Other comprehensive loss:		
Reclassification of unrealized losses on derivatives	996	996
Unrealized gains on Derivatives	(1,039)	(130)
Net comprehensive loss for the period	\$ (108,988)	\$ (130,765)

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NOTE 4 - MATERIAL DIFFERENCES BETWEEN ISRAELI AND U.S. GAAP (cont.)

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

In accordance with SFAS 128, the basic and diluted loss per share for the nine-month and the three-month periods ended September 30, 2007 would be \$0.93 and \$0.28, respectively (during the corresponding periods - \$1.67 and \$0.52, respectively).

M. Statements of Cash Flows in Accordance with U.S. GAAP (SFAS 95)

Complying with SFAS 95 would not have materially affected the cash flows of the Company for the nine-month periods ended September 30, 2007 and 2006.

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

The information contained in this section should be read in conjunction with (1) our unaudited condensed interim consolidated financial statements as of September 30, 2007 and for the nine months then ended and related notes included in this report; and (2) our audited consolidated financial statements and related notes included in our Annual Report on Form 20-F for the year ended December 31, 2006 and the other information contained in such Annual Report, particularly the information under the caption "Operating and Financial Review and Prospects. Our financial statements have been prepared in accordance with generally accepted accounting principles ("GAAP") in Israel. Differences between Israeli GAAP and US GAAP as they relate to our financial statements are described in Note 4 to our unaudited condensed interim consolidated financial statements as of September 30, 2007 and in note 19 to our audited consolidated financial statements as of December 31, 2006.

Results of Operations

The following table sets forth certain statement of operations data as a percentage of total revenues for the periods indicated:

Nine months Ended	
September 30,	
<u>2007</u>	<u>2006</u>
(unaudited)	

Statement of Operations Data:

Total revenues	100.0%	100.0%
Cost of total revenues	<u>124.8</u>	<u>147.5</u>
Gross loss	(24.8)	(47.5)
Research and development expenses, net.....	6.1	8.4
Marketing, general and administrative expenses	<u>13.5</u>	<u>13.7</u>
Operating loss.....	(44.4)	(69.7)
Financing expense, net	(17.9)	(28.8)
Gain on debt restructuring	--	60.7
Other income, net	<u>0.0</u>	<u>0.5</u>
Loss	<u>(62.2)%</u>	<u>(37.3)</u>

Nine Months Ended September 30, 2007 compared to Nine Months Ended September 30, 2006

Revenues. Revenues for the nine months ended September 30, 2007 increased by 28.3% to \$169.2 million from \$131.9 million for the nine months ended September 30, 2006. This \$37.3 million increase was mainly attributed to a higher volume of wafer shipments.

Cost of Total Revenues. Cost of total revenues for the nine months ended September 30, 2007 amounted to \$211.1 million, compared with \$194.7 million for the nine months ended September 30, 2006. This increase of 8.4% in cost of revenues, which is relatively low in relation to the 28.3% increase in sales, was mainly achieved due to the Company's cost structure, according to which the Company has reasonable margins for each incremental dollar of revenue and a reduction in depreciation and amortization expenses, as described below. During the second quarter of 2007, the Company reassessed the estimated useful lives of its machinery and equipment and as a result, with effect from April 1, 2007, its machinery and equipment is to be depreciated over estimated useful lives of 7 years rather than 5 years prior to such date. The change reflects the Company's best estimate of the useful lives of its machinery and equipment and was based on experience accumulated from Fab 1 and recent trends in industry practices. The Company believes that the change better reflects the economics associated with the ownership of the equipment. This change has been accounted for as a change in estimate and was applied prospectively. Total depreciation and amortization expenses included in Cost of Total Revenues was approximately \$102 million for the nine months ended September 30, 2007, as compared to approximately \$114 million for the nine months ended September 30, 2006, said reduction was mainly attributed to the aforementioned change.

Gross Loss. Gross loss for the nine months ended September 30, 2007 was \$41.9 million, compared to a gross loss of \$62.7 million for the nine months ended September 30, 2006. The decrease in the gross loss was mainly attributable to the 28% increase in sales as compared to a 8% increase in Cost of Total Sales as described above.

Research and Development expenses. Research and development expenses for the nine months ended September 30, 2007 amounted to \$10.3 million, compared to \$11.1 million for the nine months ended September 30, 2006.

Marketing, General and Administrative Expenses. Marketing, general and administrative expenses for the nine months ended September 30, 2007 amounted to \$22.9 million, compared to \$18.1 million for the nine months ended September 30, 2006. The increase is primarily due to stock based compensation expenses and increased expenses deriving directly from the higher revenues mentioned above.

Operating Loss. Operating loss for the nine months ended September 30, 2007 was \$75.1 million, compared to \$91.9 million for the nine months ended September 30, 2006. The decrease in the operating loss is attributable mainly to the decrease in the gross loss described above.

Financing Expenses, Net. Financing expenses, net, for the nine months ended September 30, 2007 were \$30.2 million, compared to financing expenses, net, of \$38.0 million for the nine months ended September 30, 2006. This decrease is mainly due to the consummation of the debt restructuring with our banks which was closed in the third quarter of 2006, pursuant to which, approximately 30% of our then outstanding loans were converted into capital notes and the interest rate applicable to the interest payments was reduced from the three month LIBOR rate plus 2.5% to the three month LIBOR rate plus LIBOR plus 1.1%.

Gain On Debt Restructuring. Gain on debt restructuring for the nine months ended September 30, 2006 was \$80.1 million. This one-time gain resulted from the consummation of our debt restructuring with our banks, which was closed in the third quarter of 2006.

Other Income, Net. Other income, net, for the nine months ended September 30, 2007 was \$0.01 million, compared to \$0.6 million for the nine months ended September 30, 2006.

Loss. Our loss for the nine months ended September 30, 2007 was \$105.3 million, compared to \$49.2 million for the nine months ended September 30, 2006. This increase is primarily attributable to the \$80.1 million one time gain on debt restructuring with our banks which was closed in the third quarter of 2006 offset by the decrease in the operating loss of \$16.8 million and a \$7.8 million decrease in finance expenses.

Impact of Inflation and Currency Fluctuations

The dollar cost of our operations in Israel is influenced by the timing of any change in the rate of inflation in Israel and the extent to which such change is not offset by a change in valuation of the NIS in relation to the dollar. During the nine months ended September 30, 2007, the exchange rate of the dollar in relation to the NIS decreased by 5%, and the Israeli Consumer Price Index ("CPI") increased by 2.3%. (During the nine months ended September 30, 2006, there was a decrease of 6.5% in the exchange rate of the dollar in relation to the NIS and an increase of 0.8% in the CPI.)

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

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

Liquidity and Capital Resources

As of September 30, 2007, we had an aggregate of \$42.6 million in cash and cash equivalents. This compares to \$61.7 million we had as of September 30, 2006 in cash and cash equivalents.

During the nine months ended September 30, 2007, we received \$63.9 million in net proceeds from the issuance of debentures, ordinary shares and warrants, \$1.6 million from Investment Center grants and generated a net amount of \$13.0 million from our operating activities. These liquidity resources financed the capital expenditure investments we made during the nine months ended September 30, 2007, which aggregated \$68.7 million, mainly in connection with the purchase and installation of equipment and other assets for the ramp up of Fab 2 and repayment of convertible debentures in the amount of \$7.1 million.

As of September 30, 2007, we had long-term bank loans, at present value, in the amount of \$362.2 million we obtained in connection with the establishment of Fab 2. As of such date, we also had outstanding convertible debentures in the aggregate amount of \$156.5 million, of which \$7.3 million are presented as current maturities and \$20.0 million are presented as an equity component of the convertible debentures as part of shareholders' equity.