

**JAZZ US HOLDINGS INC.**

**QUARTERLY REPORT**

**Period Ended March 31, 2016**

## **EXPLANATORY NOTE**

This quarterly report is being provided to the Trustee and any record Holder of the notes under Section 4.03 of the Indenture governing the Senior Notes Due 2018 of Jazz US Holdings Inc. Because the Securities and Exchange Commission does not accept filings from voluntary filers such as Jazz US Holdings Inc. who have not previously filed a registration statement under either the Securities Act of 1933 or the Securities Exchange Act of 1934, this report will not be filed with the Securities and Exchange Commission. For the sake of convenience and comparison with reports from prior periods, the information in this report is presented using the item numbers and other presentation styles of a Quarterly Report on Form 10-Q.

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**Period Ended March 31, 2016**

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**PART I — FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**Jazz US Holdings Inc. and Subsidiaries**

**Consolidated Balance Sheets**  
(in thousands)

	<u>March 31, 2016</u>	<u>December 31, 2015</u>
	<u>(unaudited)</u>	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 25,418	\$ 23,488
Receivables:		
Trade receivables, net of allowance for doubtful accounts of \$0 at March 31, 2016 and December 31, 2015	30,908	27,399
Other receivables	1,600	1,503
Inventories	29,993	29,915
Deferred tax asset	2,847	3,642
Other current assets	1,853	3,121
Total current assets	<u>92,619</u>	<u>89,068</u>
Property, plant and equipment, net	95,125	95,699
Intangible assets, net	19,036	20,048
Goodwill	7,000	7,000
Other assets	22,660	22,714
Total assets	<u>\$ 236,440</u>	<u>\$ 234,529</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	20,780	18,233
Accrued compensation and benefits	5,704	6,560
Deferred revenues and customers' advances	4,920	6,371
Other current liabilities	12,531	18,221
Total current liabilities	<u>43,935</u>	<u>49,385</u>
Long term liabilities:		
Long-term bank debt	19,100	19,100
Notes	46,641	45,826
Deferred tax liability	2,667	2,667
Employee related liabilities	1,927	2,102
Other long-term liabilities	2,116	2,104
Total liabilities	<u>116,386</u>	<u>121,184</u>
Stockholders' equity:		
Ordinary shares of \$0.001 par value;		
Authorized: 1,000 shares;		
Issued: 100 shares;		
Outstanding: 100 shares;		
Additional paid-in capital	74,986	74,986
Cumulative stock based compensation	5,559	4,971
Accumulated other comprehensive loss	(459)	(327)
Retained earnings	39,968	33,715
Total stockholders' equity	<u>120,054</u>	<u>113,345</u>
Total liabilities and stockholders' equity	<u>\$ 236,440</u>	<u>\$ 234,529</u>

See accompanying notes.

**Jazz US Holdings Inc. and Subsidiaries**

**Unaudited Consolidated Statements of Operations**  
**(in thousands)**

	<b>Three months ended</b>	
	<b>March 31, 2016</b>	<b>March 31, 2015</b>
Revenues	\$ 68,665	\$ 66,006
Cost of revenues	48,009	48,501
Gross profit	20,656	17,505
Operating expenses:		
Research and development	4,342	4,124
Selling, general and administrative	4,877	4,665
Total operating expenses	9,219	8,789
Operating profit	11,437	8,716
Interest expenses, net	(1,327)	(1,336)
Other financing expense, net	(900)	(724)
Profit before income taxes	9,210	6,656
Income tax benefit (expense)	(2,836)	9,194
Net profit	\$ 6,374	\$ 15,850

**See accompanying notes.**

**Jazz US Holdings Inc. and Subsidiaries**

**Unaudited Consolidated Statements of Comprehensive Income  
(Loss)  
(in thousands)**

	<b>Three months ended</b>	
	<b>March 31, 2016</b>	<b>March 31, 2015</b>
Net income	\$ 6,374	\$ 15,850
Change in employees plan assets and benefit obligations	(132)	(300)
Comprehensive income	<u>\$ 6,242</u>	<u>\$ 15,550</u>

**See accompanying notes.**

**Jazz US Holdings Inc. and Subsidiaries**  
**Unaudited Consolidated Statements of Cash Flows**  
(in thousands)

	<b>Three months ended</b>	
	<b>March 31, 2016</b>	<b>March 31, 2015</b>
<b>Operating activities:</b>		
Net income	\$ 6,374	\$ 15,850
Adjustments to reconcile net profit for the period to net cash provided by operating activities:		
Depreciation and amortization of intangible assets	8,427	11,813
Notes accretion and amortization of deferred financing costs	880	724
Stock based compensation expense	466	210
Changes in operating assets and liabilities:		
Trade receivables	(3,449)	1,513
Inventories	(78)	(3,370)
Other receivables and other current assets	1,158	976
Accounts payable	3,946	935
Due to related parties, net	(5,756)	(3,844)
Accrued compensation and benefits	(856)	388
Deferred revenue and customers' advances	(1,451)	(950)
Other current liabilities	(12)	1,364
Deferred tax liability, net	795	--
Employee related liabilities and long-term liabilities	(294)	(13,133)
Net cash provided by operating activities	<u>10,150</u>	<u>12,476</u>
<b>Investing activities:</b>		
Purchases of property and equipment	(8,220)	(8,341)
Proceeds related to property and equipment	--	196
Advance payment to related party	--	(13,000)
Net cash used in investing activities	<u>(8,220)</u>	<u>(21,145)</u>
<b>Financing activities:</b>		
Debt repayment	--	(44,683)
Net cash used in financing activities	<u>--</u>	<u>(44,683)</u>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>1,930</b>	<b>(53,352)</b>
Cash and cash equivalents at beginning of the period	23,488	73,387
Cash and cash equivalents at end of the period	<u>\$ 25,418</u>	<u>\$ 20,035</u>

Non-cash activities:

	<b>Three months ended</b>	
	<b>March 31, 2016</b>	<b>March 31, 2015</b>
Investments in property, plant and equipment	<u>\$ 2,465</u>	<u>\$ 4,274</u>

Supplemental disclosure of cash flow information:

	<b>Three months ended</b>	
	<b>March 31, 2016</b>	<b>March 31, 2015</b>
Cash paid during the period for interest	<u>\$ 2,517</u>	<u>\$ 2,581</u>
Cash paid during the period for income taxes	<u>\$ 59</u>	<u>\$ 418</u>

See accompanying notes.

## **Jazz US Holdings Inc. and Subsidiaries**

### **Notes to Unaudited Consolidated Financial Statements**

#### **Note 1: Business and Formation**

##### *The Company*

Jazz US Holdings Inc. is based in Newport Beach, California and through its direct and indirect wholly-owned subsidiaries Jazz Semiconductor, Inc. and Newport Fab LLC (“the Company”), is an independent semiconductor foundry focused on specialty process technologies for the manufacture of analog intensive mixed-signal semiconductor devices. The Company’s specialty process technologies include advanced analog, radio frequency, high voltage, bipolar and silicon germanium bipolar complementary metal oxide (“SiGe”) semiconductor processes, for the manufacture of analog and mixed-signal semiconductors. Its customers’ analog and mixed-signal semiconductor devices are used in cellular phones, wireless local area networking devices, digital TVs, set-top boxes, gaming devices, switches, routers and broadband modems.

Since 2008 when Tower Semiconductor Ltd. (“Tower”) acquired all the shares of Jazz Technologies, Inc, the Company has been a wholly-owned subsidiary of Tower. Since November 2015 (see below), the Company has been a wholly-owned subsidiary of Jazz Technologies, Inc. (now known as Tower US Holdings Inc.), which remains wholly owned by Tower.

In November 2015, Jazz Technologies Inc. transferred all of its liabilities and all of its assets, including its ownership of all of the shares of Jazz Semiconductor Inc., to Jazz US Holdings Inc., a newly established company registered under the laws of Delaware and fully owned by Jazz Technologies Inc. (now known as Tower US Holdings Inc.) which is wholly owned by Tower. The transaction had the effect of establishing Jazz US Holdings as an intermediate holding company, holding all of the shares of Jazz Semiconductor.

On December 22, 2015, pursuant to a supplemental indenture entered into among Tower US Holdings, Inc. (formerly Jazz Technologies, Inc.), Jazz US Holdings Inc. and the trustee for the convertible senior notes due December 2018, Jazz US Holdings Inc. replaced Jazz Technologies, Inc. as obligor under these notes.

Because the November 2015 reorganization involved companies under common control, the financial statements of Jazz US Holdings Inc. and subsidiaries are presented as if the reorganization had occurred on the first day of earliest year presented.

As used in this quarterly report, “we,” “us,” “our,” “Jazz,” the “Company” and words of similar import refer to Jazz Technologies Inc., including its subsidiaries, for the period preceding November 23, 2015, and Jazz US Holdings Inc., including its subsidiaries following such date. “Jazz Semiconductor” refers solely to Jazz Semiconductor, Inc.

Because the Securities and Exchange Commission does not accept filings from voluntary filers such as Jazz US Holdings Inc. who have not previously filed a registration statement under either the Securities Act of 1933 or the Securities Exchange Act of 1934, this quarterly report and future quarterly and annual reports of financial information by the Company will not be filed with the Securities and Exchange Commission, but will be provided directly to the Trustee and any record Holder of the notes in accordance with Section 4.03 of the Indenture governing the Senior Notes Due 2018 and will also be available on the TowerJazz website at [www.towerjazz.com](http://www.towerjazz.com) under the “Financial Statements” tab, which is under the “Investors” tab. To view the historical SEC filings by the Company on the SEC’s EDGAR website, go to [www.sec.gov](http://www.sec.gov), and search for filings made by Jazz Technologies, Inc.

#### **Note 2: Summary of Significant Accounting Policies**

##### *Basis of Presentation and Consolidation*

The Company prepares its consolidated financial statements in accordance with SEC and U.S. generally accepted accounting principles (“US GAAP”) requirements and includes all adjustments of a normal recurring nature that are necessary to fairly present its condensed consolidated results of operations, financial position, and cash flows for all periods presented. The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Interim period results are not necessarily indicative of full year results. This quarterly report should be read in conjunction with the Company’s most recent Annual Report.

The condensed consolidated financial statements included herein are unaudited; however, they contain all normal recurring adjustments that, in the opinion of management, are necessary to present fairly the Company’s consolidated financial position at March 31, 2016 and December 31, 2015, and the consolidated results of its operations and cash flows for the three months ended March 31, 2016 and March 31, 2015. All intercompany accounts and transactions have been

eliminated. Certain amounts have been reclassified in order to conform to 2016 presentation.

### ***Use of Estimates***

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (“US GAAP”) requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ materially from those estimates.

### ***Fair Value of Financial Instruments***

The Company measures its financial assets and liabilities in accordance with US GAAP. For financial instruments, including cash and cash equivalents, accounts receivable, accounts payable and accrued expenses, the carrying amounts approximate fair value due to their short maturities.

### ***Concentrations***

Financial instruments that potentially subject the Company to concentration of credit risk consist principally of cash, cash equivalents and trade accounts receivable.

The Company generally does not require collateral for insurance of receivables. An allowance for doubtful accounts is determined with respect to those amounts that were determined to be doubtful of collection. The Company performs ongoing credit evaluations of its customers.

Accounts receivables representing 10% or more of net accounts receivable balance consist of one customer that accounted for 49% as of March 31, 2016 and 42% as of December 31, 2015.

Net revenues from significant customers representing 10% or more of net revenues consist of one customer that accounted for 38% for the three month ended March 31, 2016 and 39% for the three month ended March 31, 2015.

As a result of the Company’s concentration of its customer base, loss or cancellation of business from, or significant changes in scheduled deliveries of products sold to, these customers, or a change in their financial position, could materially and adversely affect the Company’s consolidated financial position, results of operations and cash flows.

The Company operates a single manufacturing facility located in Newport Beach, California. A major interruption in the manufacturing operations at this facility would have a material adverse affect on the consolidated financial position and results of operations of the Company.

### ***Initial Adoption of New Standards***

In March 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-09, Compensation - Stock Compensation (Topic 718). This guidance identifies areas for simplification involving several aspects of accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, an option to recognize gross stock compensation expense with actual forfeitures recognized as they occur, as well as certain classifications on the statement of cash flows. This guidance is effective for the annual reporting period beginning after December 15, 2016, including interim periods within that reporting period, with early adoption permitted. The Company has early adopted the update with the most significant area of change is the accounting for forfeitures, where, as of January 1, 2016, we account for on a gross basis and recognize actual forfeitures as they occur. The update requires the adoption related to forfeitures be accounted for using the modified retrospective method where the effect of the change relating to previous years was recognized as an adjustment to the opening balance of retained earnings.

In May 2014, the Financial Accounting Standards Board (“FASB”) amended the existing accounting standards for revenue recognition, ASU 2014-09, “Revenue from Contracts with Customers”. The amendments are based on the principle that revenue should be recognized to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The Company is required to adopt the amendments in the first quarter of 2018. Early adoption is not permitted. The amendments may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of initial application. The Company is currently evaluating the impact of these amendments and the transition alternatives on its consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-05, Customer's Accounting of Fees Paid in Cloud Computing Arrangement, which provides guidance on accounting for fees paid in cloud computing arrangements. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a services contract. All software licenses recognized under this guidance will be accounted for consistent with other licenses of intangible assets. The guidance is effective starting the first quarter of 2016. The guidance did not have a material effect on the Company's Consolidated Financial Statements.

In November 2015, the FASB issued ASU 2015-17, Balance Sheet Classification of Deferred Taxes. ASU 2015-17 simplifies the presentation of deferred income taxes and requires that deferred tax assets and liabilities, as well as any related valuation allowance, be classified as noncurrent in a classified statement of financial position. The update becomes effective for the Company for the first quarter of 2017. The update is not expected to have a material effect on the Company's Consolidated Financial Statements.

### Note 3: Other Balance Sheet Details

#### *Inventories*

Inventories, net of reserves, consist of the following at March 31, 2016 and December 31, 2015 (in thousands):

	March 31, 2016	December 31, 2015
Raw material	\$ 5,526	\$ 5,970
Work in process	22,822	22,058
Finished goods	1,645	1,887
	<u>\$ 29,993</u>	<u>\$ 29,915</u>

#### *Property, plant and equipment*

Property, plant and equipment consist of the following at March 31, 2016 and December 31, 2015 (in thousands):

	Useful life (In years)	March 31, 2016	December 31, 2015
Building (including facility infrastructure)	10-19	\$ 38,825	\$ 38,449
Machinery and equipment	3-15	281,886	275,421
		320,711	313,870
Accumulated depreciation		(225,586)	(218,171)
		<u>\$ 95,125</u>	<u>\$ 95,699</u>

In connection with the periodic review of the estimated remaining useful lives of property and equipment at the Company's foundry manufacturing facility, it was determined in the second quarter of 2015, that the estimated useful lives of machinery and equipment should be extended to 15 years from 7 years and the useful lives of certain facility infrastructure should be extended from 14 years up to 19 years. The Company extended the estimated useful life of these assets as a result of the extended use of mature technologies, longer processes and product life cycles, the versatility of manufacturing equipment to provide better flexibility to meet changes in customer demand and the ability to re-use equipment over several technology cycles significantly extending the estimated usage period of such assets. For the three month period ended March 31, 2016, the impact of these extended estimated useful lives was approximately \$2.0 million of reduced depreciation expenses which resulted in a net increase of approximately \$1.3 million in net profit. The Company believes the current estimates of useful lives are reasonable, sustainable and better reflect the future anticipated usage of these assets.

#### *Intangible Assets*

Intangible assets consist of the following at March 31, 2016 (in thousands):

	Weighted Average Life (years)	Cost	Accumulated Amortization	Net
Technology	4:9	\$ 3,300	\$ 2,948	\$ 352
Patents and other core technology rights	9	15,100	12,645	2,455
In process research and development	--	1,800	1,800	--

Customer relationships	15	2,600	1,306	1,294
Trade name	9	5,200	4,354	846
Facilities lease	19	33,500	19,411	14,089
Total identifiable intangible assets		<u>\$ 61,500</u>	<u>\$ 42,464</u>	<u>\$ 19,036</u>

Intangible assets consist of the following at December 31, 2015 (in thousands):

	Weighted Average Life (years)	Cost	Accumulated Amortization	Net
Technology	4.9	\$ 3,300	\$ 2,865	\$ 435
Patents and other core technology rights	9	15,100	12,225	2,875
In process research and development	--	1,800	1,800	--
Customer relationships	15	2,600	1,263	1,337
Trade name	9	5,200	4,210	990
Facilities lease	19	33,500	19,089	14,411
Total identifiable intangible assets		<u>\$ 61,500</u>	<u>\$ 41,452</u>	<u>\$ 20,048</u>

The amortization related to technology, patents and other core technologies rights, and facilities lease is charged to cost of revenues. The amortization related to customer relationships and trade name is charged to operating expenses.

#### Note 4: Wells Fargo Asset-Based Revolving Credit Line

In December 2013, the Company entered into an agreement with Wells Fargo Capital Finance, part of Wells Fargo & Company (“Wells Fargo”), for a five-year secured asset-based revolving credit line in the total amount of up to \$70 million maturing in December 2018 (the “Credit Line Agreement”). The applicable interest on the loans under the Credit Line Agreement is at a rate equal to, at lender’s option, either the lender’s prime rate plus a margin ranging from 0.25% to 0.75% or the LIBOR rate plus a margin ranging from 1.5% to 2.0% per annum.

The outstanding borrowing availability varies from time to time based on the levels of the Company’s eligible accounts receivable, eligible equipment, eligible inventories and other terms and conditions described in the Credit Line Agreement. The obligations under the Credit Line Agreement are secured by security interest on all the assets of the Company. The Credit Line Agreement contains customary covenants and other terms, as well as customary events of default. If any event of default will occur, Wells Fargo may declare all borrowings under the facility due immediately and foreclose on the collateral. Furthermore, an event of default under the Credit Line Agreement would result in an increase in the interest rate on any amounts outstanding. The Company’s obligations pursuant to the Credit Line Agreement are not guaranteed by Tower.

Borrowing availability under the Credit Line Agreement as of March 31, 2016 was approximately \$61 million, of which approximately \$20 million had been utilized as of such date (comprised of approximately \$19 million through loans and approximately \$1 million in letters of credit).

As of March 31, 2016, the Company was in compliance with all of the covenants under this facility.

#### Note 5: Notes

##### *Introduction*

As of March 31, 2016 and December 31, 2015 the Company had \$58 million principal amount of notes outstanding due December 2018.

##### *Jazz 2010 Notes redeemed during January 2015*

In July 2010, the Company issued notes in the principal amount of approximately \$94 million due June 2015 (the “2010 Notes”). Interest on the 2010 Notes at a rate of 8% per annum was payable semiannually.

As of January 8, 2015, the 2010 Notes had been fully redeemed mainly through: (i) an early redemption of approximately \$45 million outstanding amount, as permitted by the terms of the indenture governing the 2010 Notes, completed in January 2015; and (ii) the 2014 Exchange Agreement (as defined and discussed below).

As a result, as of January 8, 2015, no outstanding amount is due towards the 2010 Notes.

### ***Jazz 2014 Notes Exchange Agreement***

In March 2014, the Company, certain of its domestic subsidiaries and Tower entered into an exchange agreement (the “2014 Exchange Agreement”) with certain 2010 Notes holders (the “2014 Participating Holders”) according to which the Company issued new unsecured convertible senior notes due December 2018 (the “2014 Notes”) in exchange for approximately \$45 million in aggregate principal amount of 2010 Notes.

In addition, in March 2014, the Company, Tower and certain of the 2014 Participating Holders (the “Purchasers”) entered into a purchase agreement (the “Purchase Agreement”) pursuant to which the Purchasers purchased \$10 million aggregate principal amount of 2014 Notes for cash consideration.

Holder of the 2014 Notes may submit a conversion request with respect to their 2014 Notes to be settled through cash or ordinary shares of Tower, in which event the conversion price is set to \$10.07 per share, reflecting a 20 percent premium over the average closing price for Tower’s ordinary shares for the five trading days ending on the day prior to the signing date of the 2014 Exchange Agreement and Purchase Agreement. Interest on the 2014 Notes at a rate of 8% per annum is payable semiannually.

The 2014 Notes are unsecured senior obligations of the Company, rank equally with all other existing and future unsecured senior indebtedness of the Company, and are effectively subordinated to all existing and future secured indebtedness of the Company, including the Company’s secured Credit Line Agreement with Wells Fargo (see Note 4 above), to the extent of the value of the collateral securing such indebtedness. The 2014 Notes rank senior to all existing and future subordinated debt. The 2014 Notes are not guaranteed by Tower.

Holder of the 2014 Notes are entitled, subject to certain conditions and restrictions, to require the Company to repurchase the 2014 Notes at par plus accrued interest and a 1% redemption premium in the event of certain change of control transactions as set forth in the Indenture governing the 2014 Notes.

The Indenture contains certain customary covenants, including covenants restricting the Company’s ability and the ability of its subsidiaries to, among other things, incur additional debt, incur additional liens, make specified payments and make certain asset sales.

Jazz’s obligations under the 2014 Notes are guaranteed by Jazz’s wholly owned domestic subsidiaries. The Company has not provided condensed consolidated financial information for such subsidiaries because the subsidiaries have no independent assets or operations, the subsidiary guarantees are full and unconditional and joint and several and the subsidiaries of the Company, other than the subsidiary guarantors, are minor.

As of March 31, 2016, approximately \$58 million principal amount of 2014 Notes was outstanding.

### **Note 6: Income Taxes**

The statute of limitations with respect to tax year 2010 expired in March 31, 2015. As a result, a tax benefit in the amount of approximately \$11 million was recorded in the three months ended March 31, 2015.

In May 2016, the U.S. tax authorities commenced an audit of the Company’s tax returns for the years 2011, 2013 and 2014. There is no indication to date whether the Company will be required to pay any additional taxes pursuant to said audit.

### **Note 7: Employee Benefit Plans**

The pension and other post-retirement benefit plans amount to \$0.2 million income, net for the three months ended March 31, 2015. No such benefit, net was recorded for the three months ended March 31, 2016.

### **Note 8: Stockholders’ Equity**

As discussed in Note 2 above, during the three months ended March 31, 2016, the Company early adopted the provisions of ASU 2016-09 Compensation - Stock Compensation (Topic 718). The cumulative effect of the adoption on prior periods was booked as an adjustment to the opening balance of retained earnings in the amount of \$0.1 million. The amount represents the difference between the recognition of compensation expenses on a gross basis comparing with the previous policy of applying forecasted forfeiture rate to the compensation expenses. For the three months ended March 31, 2016, the company recorded compensation expenses of \$0.5 million which includes the adoption effect.

During the three months ended March 31, 2016, the Company awarded to some of its employees a total of 7,000 restricted share units (“RSUs”) with a three year vesting schedule.

The Company recorded \$0.5 million and \$0.2 million, respectively, of compensation expenses relating to options and RSU's granted to employees for the three months ended March 31, 2016 and 2015.

**Note 9: Related Party Transactions**

	March 31, 2016	December 31, 2015
Due from related parties (included in the accompanying balance sheets)	\$ 23,055	\$ 22,997
Less: Due to related parties (included in the accompanying balance sheets)	(8,287)	(13,986)
Net balance due from related parties	<u>\$ 14,768</u>	<u>\$ 9,011</u>

Related parties' balances are with Tower and its subsidiaries and are mainly for purchases from, and payments made on behalf of, the other party, purchase and sale of tools lease of tools, service charges, business development services, procurement services and other services. In addition, as described in Note 5 above, the Company issued to its 2014 Participating Holders and Purchasers an aggregate of approximately \$58.3 million of Notes, which are convertible into an aggregate of up to approximately 5.8 million ordinary shares of Tower at a conversion price of \$10.07 per share, the value of which was determined to be approximately \$4.50 for each Tower share underlying the 2014 Notes. This value was given by Tower to the Company and was settled through a monetary deposit advance payment on account of future conversions and is presented under Other Assets in the balance sheet. See also Note 9 to the Company's consolidated financial statements for the year ended December 31, 2015.

**Note 10: Commitments and Contingencies**

**Leases**

Our headquarters and manufacturing facility are located in Newport Beach, California. The Company leases its fabrication facility and offices under lease contracts that the Company can extend until 2027. In 2015, the Company exercised its option to extend the lease term from 2017 to 2022, while maintaining the option to extend the lease term at its sole discretion from 2022 to 2027. Under our amended leases, the Company's rental payments consist of fixed base rent and fixed management fees and our pro rata share of certain expenses incurred by the landlord in the ownership of these buildings, including property taxes, building insurance and common area maintenance. These lease expenses are included in operating expenses in the accompanying consolidated statements of operations. The Company and the landlord further amended the lease to setting forth certain obligations of the Company and the landlord, including certain noise abatement actions at the fabrication facility.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

*The following discussion and analysis should be read in conjunction with the financial statements and related notes contained elsewhere in this report. See our Annual Report for the fiscal year ended December 31, 2015 and subsequent quarterly reports for information regarding certain risk factors known to us that could cause reported financial information not to be necessarily indicative of future results.*

**FORWARD LOOKING STATEMENTS**

This report may contain "forward-looking statements" within the meaning of the federal securities laws made pursuant to the safe harbor provisions of the Private Securities Litigation Report Act of 1995. These statements, which represent our expectations or beliefs concerning various future events, may contain words such as "may," "will," "expects," "anticipates," "intends," "plans," "believes," "estimates," or other words indicating future results. Such statements may include but are not limited to statements concerning the following:

- anticipated trends in revenues;
- growth opportunities in domestic and international markets;
- new and enhanced channels of distribution;
- customer acceptance and satisfaction with our products;
- expected trends in operating and other expenses;
- purchase of raw materials at levels to meet forecasted demand;
- ability to timely fulfill customers' demand;

- anticipated cash and intentions regarding usage of cash;
- changes in effective tax rates; and
- anticipated product enhancements or releases.

This report, including these forward-looking statements, are subject to risks and uncertainties, including those risks and uncertainties described in our Annual Report for the fiscal year ended December 31, 2015 and subsequent quarterly reports, that could cause actual results to differ materially from those anticipated as of the date of this report. We assume no obligation to update any forward-looking statements to reflect events or circumstances arising after the date of this report.

## RESULTS OF OPERATIONS

For the three months ended March 31, 2016, we had a net profit of \$6.4 million compared to a net profit of \$15.9 million for the three months ended March 31, 2015.

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

	<b>Three Months Ended</b>	
	<b>March 31, 2016</b>	<b>March 31, 2015</b>
Revenue	100%	100%
Cost of revenue	69.9	73.5
Gross profit	30.1	26.5
Operating expenses:		
Research and development	6.3	6.2
Selling, general and administrative	7.1	7.1
Total operating expenses	13.4	13.3
Operating profit	16.7	13.2
Interest expenses, net	(1.9)	(2.0)
Other financing expense, net	(1.3)	(1.1)
Income tax benefit (expense)	(4.1)	13.9
Net profit	9.4%	24.0%

### Comparison of Three Months Ended March 31, 2016 and March 31, 2015

#### *Revenue*

Our net revenue for the three months ended March 31, 2016 amounted to \$68.7 million, as compared to \$66.0 million for the corresponding period in 2015. The revenue increase is mainly attributable to higher wafer quantities sold during the three months ended March 31, 2016.

#### *Cost of Revenue*

Cost of revenue amounted to \$48.0 million for the three months ended March 31, 2016, as compared to \$48.5 million for the corresponding period in 2015.

#### **Gross Profit**

Gross profit was \$20.7 million in the three months ended March 31, 2016, as compared to \$17.5 million in the corresponding period in 2015, a \$3.2 million improvement that resulted from the components described above.

#### **Operating Expenses**

Operating expenses for the three months ended March 31, 2016 amounted to \$9.2 million, as compared to \$8.8 million in the three months ended March 31, 2015, reflecting a sustained level of approximately 13% of revenue.

## **Interest Expenses, Net and Other Financing Expense, Net**

Interest expenses, net and other financing expense, net for the three months ended March 31, 2016 amounted to \$2.2 million, as compared to \$2.1 million in the corresponding period in 2015.

## **Income Tax Benefit**

Income tax expense amounted to \$2.8 million in the three months ended March 31, 2016, as compared to income tax benefit of \$9.2 million in the three months ended March 31, 2015. The statute of limitations with respect to tax year 2010 expired in March 2015. As a result, we recorded a tax benefit for such year in the amount of approximately \$11 million during the three months ended March 31, 2015.

## **Net Profit**

Net profit for the three months ended March 31, 2016 amounted to \$6.4 million as compared to net profit of \$15.9 million in the three months ended March 31, 2015. The decrease in the net profit is mainly due to the following items described above: higher tax expense of \$12.0 million which was partially offset by \$2.7 million higher operating profit.

## **Item 4. Controls and Procedures.**

### *Disclosure Controls and Procedures*

Based on the evaluation as of the end of the period covered by this report, our principal executive officer and chief financial officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) were effective as of the end of the period covered by this report.

Our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives, and our principal executive officer and our principal financial officer have concluded that these controls and procedures are effective at the “reasonable assurance” level. We believe that a control system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the control system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

### *Changes in Internal Control Over Financial Reporting*

There were no changes in our internal controls over financial reporting that occurred during the period covered by this Quarterly Report that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

## **PART II - OTHER INFORMATION**

### **Item 1. Legal Proceedings**

There are no material pending legal proceedings, other than ordinary routine litigation incidental to our business, to which we are a party or any of our property is subject.

### **Item 1A. Risk Factors**

In addition to the other information contained in this report, you should carefully consider the risk factors associated with our business previously disclosed in Item 1A to Part I of our Annual Report for the fiscal year ended December 31, 2015. Our business, financial condition and/or results of operations could be materially adversely affected by any of these risks. Additional risks not presently known to us or that we currently deem immaterial may also impair our business and operations.