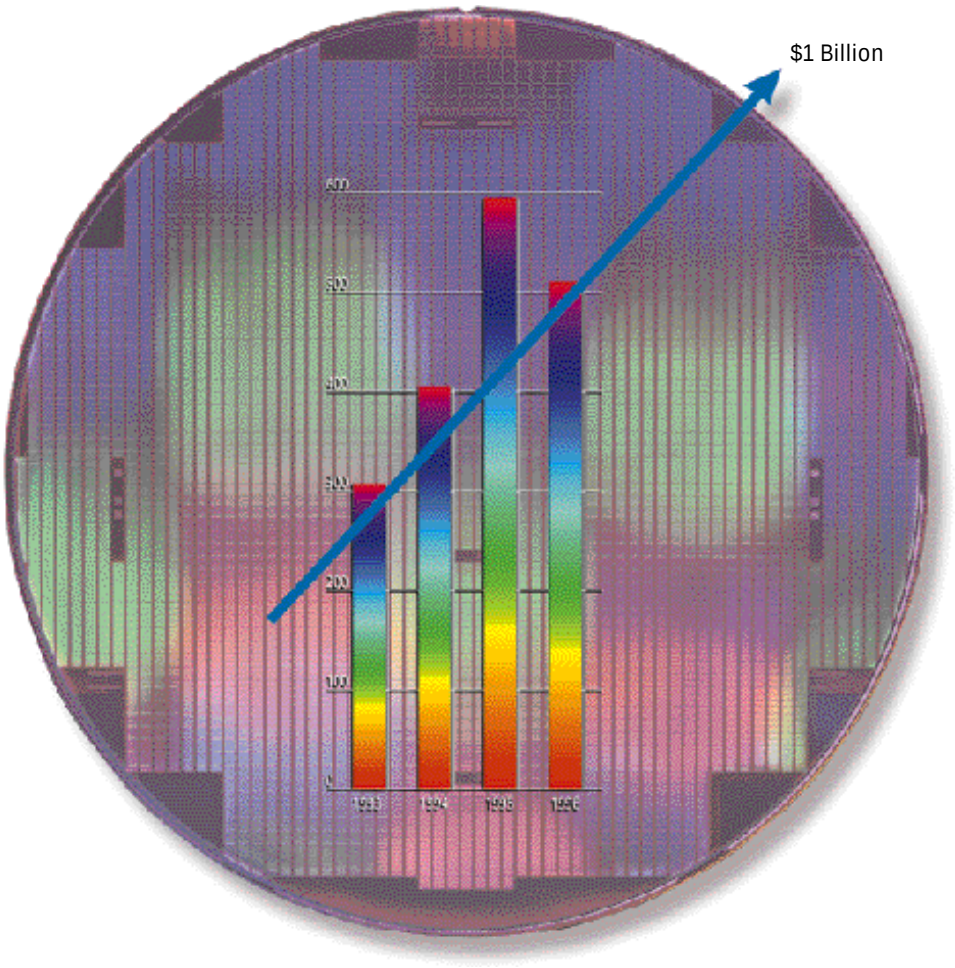
CYPRESS

1996 ANNUAL REPORT

"Our goal in 1996 is to take the first of two equal steps toward our 1997 $1 billion revenue goal."

T.J. Rodgers, 1995 Annual Report



CYPRESS

CORPORATE PROFILE

Cypress Semiconductor Corporation, now in its second decade, provides a broad range of high-performance integrated circuits to leading computer, networking, and telecommunications companies worldwide. The Company's product lines includes static RAM (random access memory) and EPROM (erasable programmable read only memory) memories, programmable logic devices (PLDs), data communications products, chipsets, timing devices, and USB (Universal Serial Bus) microcontrollers.

Cypress products are marketed via direct sales offices in North America, Europe, and Asia, complemented by a worldwide network of distributors and sales representative firms.

Cypress manufactures its products at four wafer manufacturing plants in California, Minnesota, and Texas. In 1996, the Company opened a new dedicated test and assembly facility in the Philippines.

Cypress was founded in 1982 and is listed on the New York Stock Exchange under the symbol "CY." Corporate headquarters are located in San Jose, California. Company information can be accessed via the Internet at http://www.cypress.com.

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Cypress employees produced this report to provide the maximum amount of useful information on the Company in an accessible form, at a minimum of cost. We appreciate their time and effort.

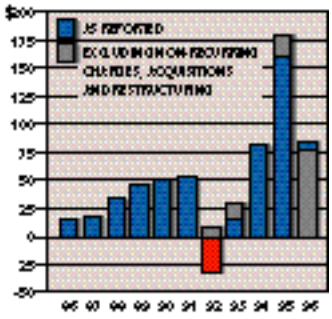
The following "CEO Report," and the sections entitled "Marketing Perspective" and "Management's Discussion and Analysis" may contain forward-looking statements about the prospects for Cypress as well as the semiconductor industry more generally including without limitation statements about revenue goals, growth rate goals, market share goals, market size and growth projections, new product introductions, planned manufacturing capacity, and efficiency and cost goals. Actual results could differ materially from those described in the forward-looking statements as a result of various factors including, but not limited to, the factors identified in the Letter to Shareholders, the Market Perspective section, and the Management's Discussion and Analysis section, as well as the following: (i) increased competition which could result in lost sales or price erosion; (ii) changes in product demand by the electronics and semiconductor industries, which are noted for rapidly changing needs, coupled with an inability by Cypress to generate product enhancements or new product introductions which will keep pace with or meet those rapidly changing needs; (iii) failure by Cypress to develop or introduce successfully new products in areas of expected new or increased demand, or development and introduction of superior new products serving those areas by others; (iv) failure of expected growth in demand for, or areas of expected new demand for, semiconductor products to materialize; (v) failure to successfully bring on line and utilize additional manufacturing capacity; (vi) inability to develop and/or adopt more advanced manufacturing technology; (vii) inability of the Company's patents or other proprietary rights to ensure adequate protection against encroachment on the Company's technology by competitors; and (viii) changes in the market for semiconductor stocks.

FINANCIAL HIGHLIGHTS

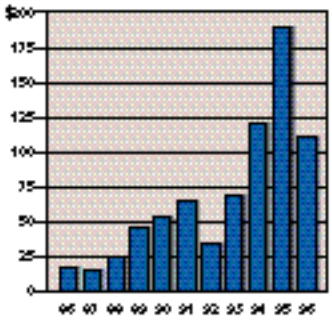
(Dollar and share amounts in thousands, except per share amounts)
(All share data has been adjusted to reflect the 1995 stock split)

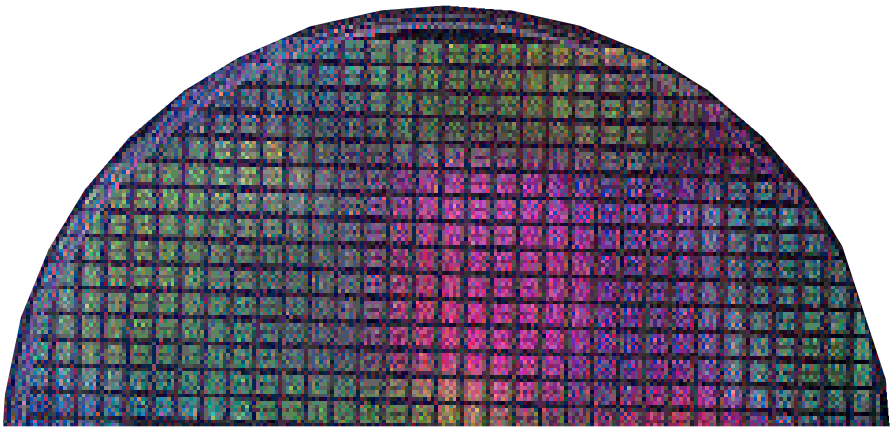
	1996	1995	Change
For the year:			
Revenues	$528,385	$596,071	(11%)
Operating income	81,594	159,171	(49%)
Net income	53,029	102,477	(48%)
Net income per share:			
Primary	$ 0.63	$ 1.15	(45%)
Fully diluted	0.62	1.09	(43%)
At year-end:			
Total assets	$794,047	$750,728	6%
Cash and short-term investments	93,786	161,618	(42%)
Stockholders' equity	510,746	472,099	8%
Stockholders' equity per share	$ 5.55	$ 4.84	15%
Weighted average common and common equivalent shares:			
Primary	83,661	89,347	(6%)
Fully diluted	92,016	97,583	(6%)

Pretax Income (Loss)
(Millions)



Cash Generated by Operations
(Millions)





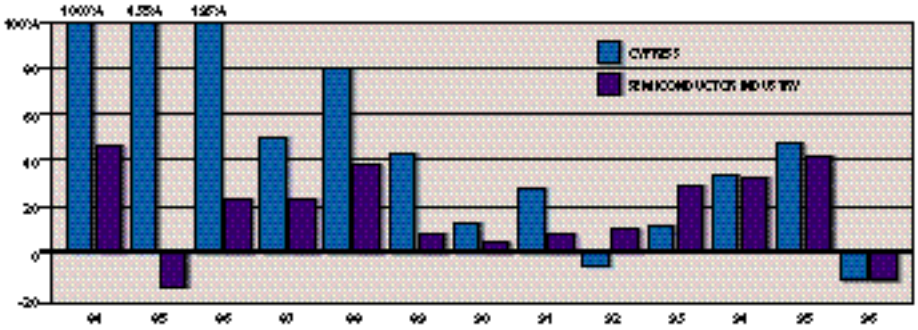
CEO REPORT

T.J. Rodgers, Cypress Semiconductor co-founder, president, and CEO.

TO OUR SHAREHOLDERS

Our 1996 revenue of $528.4 million and an earnings per share (EPS) of $0.62 were down from last year's figures of $596.1 million in revenue and $1.09 in EPS. Even though 1996 was a tough year for Cypress, it is still a year we can be proud of. I wrote in last year's annual report: "Our goal [for 1996] is to take the first of two equal steps toward our $1 billion 1997 revenue goal." We went backward in revenue in 1996 and consequently will redouble our efforts. This letter will outline our growth plan, and some of the accomplishments we have already made relative to that plan.

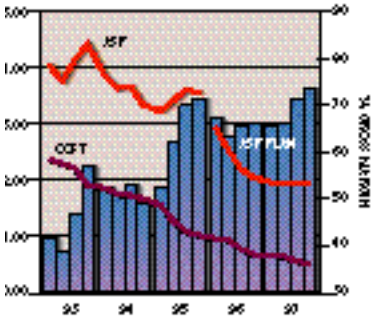
Annual Growth Rate vs. Industry



Cypress's revenue growth has met or exceeded that of the traditionally fast-growing semiconductor industry in 11 of the last 13 years. The problem in 1996 was that the industry contracted dramatically.

SRAM PRICE RECESSION

256K SRAM ASP, Cost, Gross Margin



Cypress's 1995 actual and operating plan data for the price, cost, and gross margin of our highest-volume product, the 256K SRAM. Sharp declines in average selling prices led to a year-on-year decline in EPS.

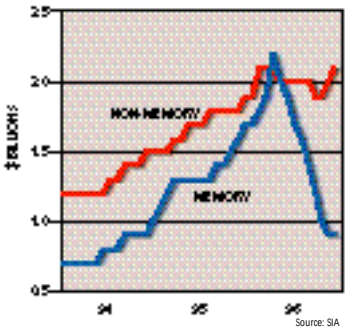
Cypress's failure to grow in 1996 was caused by extremely rapid price erosion in the static random access memory (SRAM) market. The numbers in the graphic at left from 1993 through 1995 are actual, while the figures for 1996 and 1997 are taken directly from Cypress's 1995 operating plan, i.e., our December 1995 projections for 1996 and 1997.

From 1993 through 1995, the average selling price (ASP) of our 256K SRAM drifted down from about $4.00 to about $3.50. During the 1995 planning process, we assumed SRAM ASPs would fall rapidly (43%) from about $3.50 to about $2.00 in 1996. Anticipating that precipitous decline, we also embarked on an aggressive program to get our manufacturing cost well below $1.00 by redesigning the 256K SRAM multiple times, and by moving its assembly and test operations to our new, low-cost Philippines facility. We expected our gross margins to dip in early 1996 from their all-time high levels of Q4 1995 because even our aggressive cost-reduction plan was not expected to be able to keep up with projected rapid ASP

declines early in the year. By Q4 1996, we planned to sell 256K SRAMs for $1.95, to manufacture them for $0.80, and to make a $1.15 gross profit on each unit.

The actual price declines in 1996 exceeded our aggressive plan. In Q4 1996, we sold 11.6 million units of the 256K SRAM. They were manufactured for $0.81, close to the planned cost of $0.80 per unit, but sold at an average price of only $1.21. Our gross margins were thus reduced by $0.75 per unit. Multiplying that figure by 11.6 million units sold shows a total profit shortfall of $8.7 million relative to our plan, the equivalent of $0.07 a share—over one-fifth of our year-to-year EPS decline based on one product for the fourth quarter. Price declines on the 256K and a few other commodity SRAMs accounted for two-thirds of our year-to-year decline in EPS. This situation was pervasive in all memory businesses.

North American Semiconductor Sales



A graph of semiconductor sales in North America shows clearly that the 1996 semiconductor industry problem was memory-driven and quite severe.

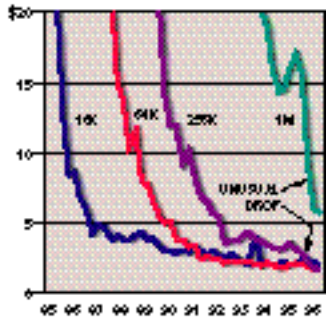
SRAM BUSINESS AS USUAL

Huge drops in SRAM prices repeat themselves cycle after cycle. Typically, SRAM pricing starts out at greater than $20, but drops to the $10 range before volume shipments commence. As the markets mature and prices decline, competitors exit the market, causing the SRAM price to drop to and stabilize at about $2.00. This phenomenon is known in Silicon Valley as “Gelbach’s Law,” referring to former Intel VP of marketing Ed Gelbach’s famous line, “Every RAM eventually sells for $2.00.”

As the actual Cypress SRAM prices in the graph demonstrate, the 256K SRAM price curve is similar to that of prior-generation SRAMs. The difference in this cycle—the change that has temporarily hurt Cypress’s earnings—is the rather rapid downturn at the very end of the 256K SRAM pricing curve and an unusually steep decline in the ASPfor the 1-megabit (Mb) SRAM. The combined impact of above-normal price declines on these two products accounts for most of the current squeeze on Cypress’s revenue growth and earnings. These price declines temporarily outpaced our ongoing manufacturing cost reductions. Eventually, 256K SRAM price and cost will regain equilibrium, and margins should recover, as they have in every past generation.

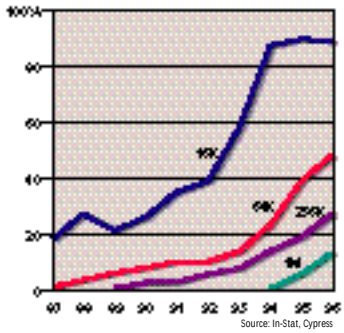
Cypress has a history of surviving hard times in the SRAM business—and emerging with a larger market share when prices stabilize. The graph at right illustrates this point by plotting Cypress’s market-share data for fast SRAM generations.

SRAM Average Selling Prices



Cypress’s actual quarterly selling prices for fast SRAMs show a dramatic, if predictable, decline in every generation. The decline in 1996 for 256K and 1Mb devices was steeper than normal.

Fast SRAM Market Share



The data show Cypress’s market share for high-performance (45 ns or faster) asynchronous SRAMs.

RESTORING SRAM MARGINS

We plan to bring our SRAM manufacturing costs in line with SRAM prices by relentlessly reducing the cost of our chips, packages, and testing. Continuous improvement in chip, assembly, and test costs are the primary elements of a manufacturing engine that will restore reasonable margins on our 256K SRAMs.

In chip manufacturing, by migrating our 256K SRAMs into ever more advanced technologies, with line widths currently down to 0.35 microns, Cypress has been able to jam more chips on a wafer, reducing costs. We started with 400 chips per wafer (CPW) in 1989 and improved by a factor of seven to over 2,800 CPW today. Advanced technologies not only pack more chips on a wafer but also make those chips both faster and lower in power consumption.

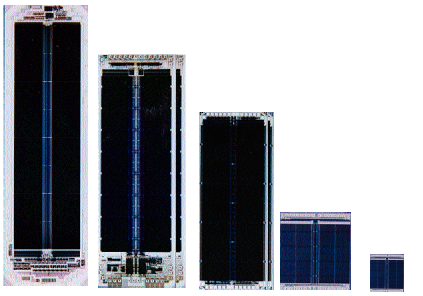
In packaging, Cypress's new 162,000-square-foot Philippine assembly and test facility was designed from the ground up for low cost, improving assembly productivity and reducing our assembly cost from $0.20 per unit in 1995 to $0.14 per unit in 1997. A reduction of $0.06 per unit may not sound like much, but multiplying that number by 50 million 256K SRAMs per year means profitability will increase $3.0 million per year on one product.

Cypress's test productivity also is improving. Our second-generation equipment in the Philippines tested eight units in parallel on each of two handlers. Our third-generation equipment tests 64 units simultaneously on eight handlers. The cost savings are expected to be $0.02 per 256K SRAM or $1.0 million more profit per year.

The advanced 256K SRAMs shown in the top photo, manufactured on 0.5-micron and 0.35-micron technologies, also command a price premium. When SRAMs are operated in a battery standby mode, commonly used in pagers and cellular telephones, they consume only 0.01 milliamperes (mA) of current, versus the 20 mA of battery current—2,000 times greater—consumed by the older products (an acceptable level for the datacom, telecom, and personal computer markets). The unique combination of high speed and low power in an SRAM carries an approximate $0.50 price premium in the marketplace—enough to double margins when prices are in the sub-$2.00 range.

We run our SRAM business the way Lombardi's Green Bay Packers played football in the 1960s: straightforward with no gimmicks, running between the tackles, winning with excellent execution. The SRAM business is "no excuses" foot-

Cypress 256K SRAMs:
Process Shrinks and Cost Reductions



0.8µm 20 ns 400 CPW | 0.65µm 12 ns 511 CPW | 0.6µm 15 ns 822 CPW | 0.5µm 12 ns 1800 CPW | 0.35µm 10 ns 2812 CPW

his photograph shows cost reductions through five generions of Cypress 256K SRAM chips. The 0.8-micron 256K AM chip cost $1.50 to manufacture. The 0.35-micron 256K AM chip will cost only $0.28 to manufacture at maturity.

Cypress Philippines Test Productivity

ypress's new Philippines assembly and test facility uses quipment that tests 64 units simultaneously on eight andlers—8× as many as previous-generation equipment. he cost savings on testing are expected to be $0.02 per 56K SRAM, or $1.0 million more profit per year.

ball, a business at which we have excelled for a decade. We are in the process of improving SRAM profitability—partly because tough times have squeezed out players who do not have the determination to stay on the field.

STRONG FUNDAMENTALS

The strategies of continuously reducing costs and increasing market share are designed to buttress the bottom line in hard times. Although our reported EPS figures of $0.01 and $0.02 in the third and fourth quarters of the year are hardly robust, our profit and loss statement is healthier than those EPS figures indicate.

For example, in the third quarter of 1996, Cypress's bottom-line earnings of $0.01 per share is derived from operating earnings of $0.08 per share, adjusted for three non-recurring events. The $7.0 million restructuring credit consisted of two parts: a $17 million credit related to our victory in the Texas Instruments case, and a $10 million charge to move production wafer manufacturing out of San Jose, making Fab I an R&D-only facility. The third non-recurring charge was a $16 million inventory reserve to provide increased coverage during tough times. As of Q4 1996, we had over a third of our inventory reserved, and total inventory reserves almost doubled the Q4 1995 reserves.

We believe that Q3 1996 marked the bottom of the current recession for Cypress. Our Q4 results brought improved revenue and EPS, and we believe we are currently on track for a modest improvement in Q1 1997. If this prediction holds true, we will be able to say that Cypress survived this most difficult SRAM price recession while turning a profit in each quarter, an accomplishment other SRAM-intensive companies failed to match.

RELATIVE PERFORMANCE

The last boom quarter for the semiconductor market was Q2 1995, after which semiconductor oversupply began to impact our industry. Cypress's profit performance during the 1996 semiconductor recession was respectable, and our investors have recognized that fact in our relative share price.

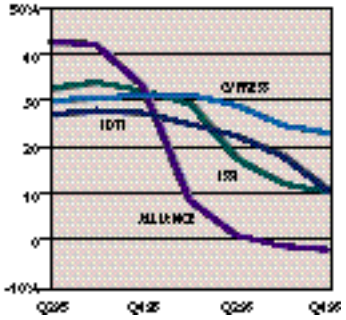
Despite reasonable relative profit performance, Cypress's revenue growth has failed to stay on track to reach the $1 billion 1997 sales target called for in our Mission Statement. Cypress's revenue of $528.4 million slipped 11% relative to our 1995 revenue of $596.1 million. Nonetheless, our 1995 revenue represented

Q3 Profit & Loss Statement

	OPERATING		ADJUST-MENTS	REPORTE	
Revenue	$109,647	100.0%		$109,647	1C
Cost of Revenue	65,075	59.3%	$16,000	81,075	7
R&D	19,826	18.1%		19,826	1
SG&A	14,998	13.7%		14,998	1
Restructuring	0		(7,018)	(7,018)	
Other income	152			152	
PBT	9,900	9.0%		918	
PAT	6,287	5.7%		583	
EPS (primary)	$0.08			$0.01	

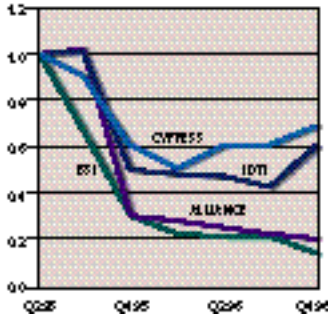
Cypress's profit and loss statement for Q396 is shown b and after the impact of special one-time events.

Cumulative PBT% vs. Q295



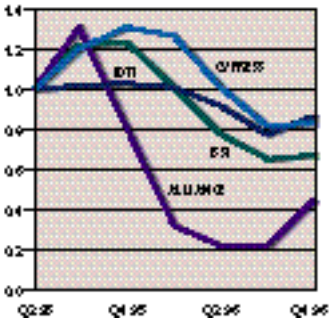
Cumulative pretax profitability of SRAM-intensive companies, measured as a percentage of sales.

Share Price vs. Q295



Share price analysis of SRAM-intensive companies. Due to the 1996 semiconductor memory recession, Cypress's share price at the end of Q496 was down a disappointing 28% relative to its share price at the end of Q295. However, the market valuation of other SRAM-intensive semiconductor companies declined as much as 80%.

Revenue vs. Q295 Base

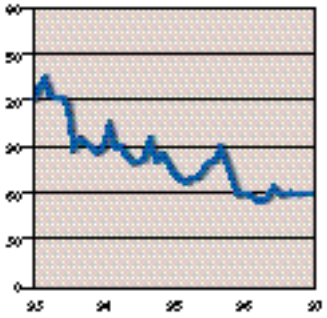


Revenue analysis of SRAM-intensive companies, normalized to Q295. Cypress's revenues have dropped by 16%. Shrinking revenue is unacceptable to Cypress and our investors, but we have performed well on a relative basis.

0.41% of the worldwide semiconductor total available market (TAM) of $144.4 billion, according to industry estimates. Our 1996 revenue of $528.4 million also represented 0.41% of 1996's worldwide semiconductor TAM of $129 billion. Cypress's revenue thus has contracted in direct proportion to the market—but our mission is to grow and take market share, not to perform at market.

Ironically, the same process shrinks that preserve profitability (photo on page 4) have limited Cypress's ability to take market share. The 0.35-micron 256K SRAM shown on that page is our ninth major redesign of the product. The need for so many redesigns illustrates the conflict between revenue and profitability, the corporate top and bottom lines. The company that focuses on redesigning high-volume products to improve efficiency (profitability) cannot use these same design resources to create new products to generate new revenue. It is precisely Cypress's focus on the bottom line since 1993 that has limited our ability to grow revenues as quickly as we would have liked.

Design Cycle Time



Cypress's design cycle time has dropped from over two years to about one year, due to a structured cycle time reduction effort.

GROWING BOTH SALES AND PROFITS

The solution to this trade-off—given the funds and time to build infrastructure—is to do both, to redesign products for efficiency and to design totally new products. Over the last three years, we have been focusing on two ways to increase our design output: faster design cycle times (more chips per designer) and expanded design capability (more designers).

No semiconductor company can find all the designers it needs in the extremely tight Silicon Valley engineering market. In response, we started our first remote design center in 1987 in Starkville, Mississippi. That successful design center now employs 31 engineers. Since then, we have added design centers through acquisition (Washington, Colorado, Minnesota, England, Germany) and through start-up (Oregon, Texas, India). Our design headcount increased 26% in 1996. We are about to complete our first round-the-clock design project, an SRAM for digital signal processors (DSPs), that is designed 12 hours per day in Mississippi and 12 hours in India. The database is transferred from site to site electronically on our private intranet.

Cypress Design Centers

Cypress now has design centers around the world, including new locations in England, Germany, and India, effectively enabling work on designs 24 hours a day.

NEW PRODUCTS

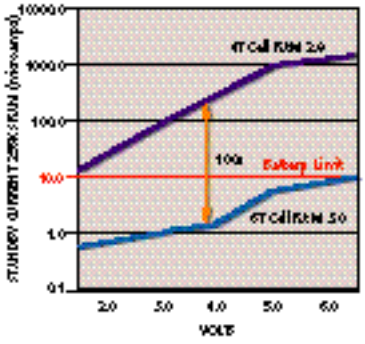
Our design centers already have produced several new product families for Cypress; we expect the revenue from them to be significant in 1997. Here, I describe a few of our major new product initiatives.

SRAMs for Portable Systems

In early 1995, Cypress released for design and production its proprietary RAM3™ process technology. Developed in a 0.5-micron feature size, this process, and its attendant SRAM and logic cells, already are being produced in Cypress fabs at a leading-edge 0.35-micron size, increasing die per wafer and reducing manufacturing costs.

RAM3 provides a significant advantage for Cypress customers: a six-transistor (6T) SRAM cell that eliminates power-draining resistors and dramatically reduces standby power requirements relative to conventional four-transistor (4T) devices. While many companies have attempted to develop 6T designs, the relatively large size of 6T cells has precluded their use in high-speed, high-volume applications. But Cypress engineers delivered 6T designs in the same size "footprint" as existing high-speed 4T cells. The new cells are based partly on another Cypress process innovation—a special "Self-Aligned Contact"—an approach that shrinks the space required between metal contacts.

Low Power Advantage of 6T Cells



Cypress's new six-transistor SRAM cell dramatically reduces standby current requirements relative to four-transistor devices.

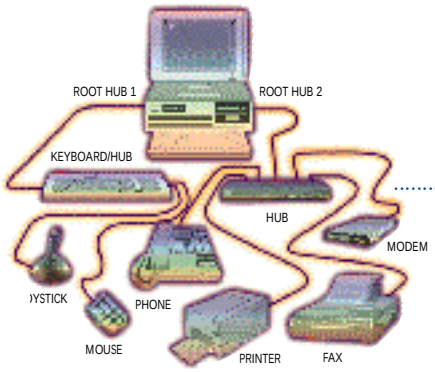
Developed in Cypress's dedicated research and development Fab I facility, RAM3 positions Cypress as a leader in the race to produce supersmall SRAMs with speed and power characteristics that previously were deemed impossible. Low-power SRAMs are critical to mobile and wireless equipment—such as cellular handsets, land mobile radio systems, wireless pagers, and personal digital assistants (PDAs)—currently under development by strategic Cypress customers, including Motorola, NEC, and Ericsson.

Motorola's i280 pocket phone uses Cypress's high-speed, low-power SRAMs.

USB Controller to Connect PCs

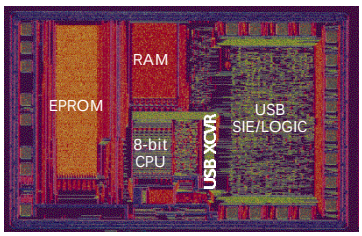
USB (Universal Serial Bus) is an industry standard for serial communications that is supported by Intel® and Microsoft®. The bus is a four-wire connection that provides true "plug-and-play" capabilities for PCs and their peripherals. The simple, inexpensive USB socket will replace most of the odd, complicated sockets on the back of the PC.

PC with USB Interconnection



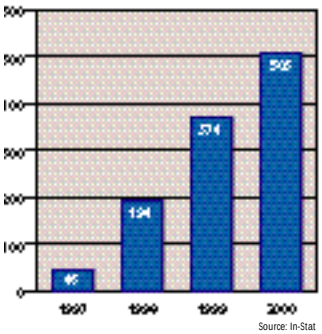
lew Universal Serial Bus technology enables as nany as 127 peripherals to be routed through hubs o a PC.

USB Microcontroller



Cypress's CY7C63000 Universal Serial Bus microcontroller integrates logic, static and non-volatile memories, and a tiny microcontroller to enable a range of USB PC peripheral devices. The product was designed in collaboration with Microsoft.

USB Market



The market for USB chips is projected to grow to 500 million units per year by the year 2000.

The next generation of PCs, which will begin to reach the market this year, will have two USB "root hub" connectors. Each of these root hub ports can be connected to a peripheral device, such as a keyboard, or to a stand-alone "hub," which allows four more USB devices to be connected to the PC in a cascading configuration. In this system, as illustrated in the graphic at left, one of the USB root hub slots on the computer is attached to a keyboard / hub, which serves both to connect the keyboard and to provide downstream connectors. A mouse and a joystick are attached to the keyboard hub, which in turn connects them to the PC. The second root hub connection shown connects a stand-alone hub, which, in turn, connects a modem, printer, fax, and telephone to the PC.

The "serial" in USB means that the bits move back and forth along the interconnect one at a time. For this reason, and because as many as 127 different peripherals can be routed through hubs to the PC, the USB connections are best managed by an intelligent processor that can sort out all the traffic. The three tiers in the USB hierarchy are the USB root hub in the PC; the USB peripheral hub, which connects to the computer and may cascade other devices into the computer; and the USB peripheral controller, which connects a single device to a hub or to the root hub.

Cypress is currently finalizing design of a root hub for integration into our hyperCache™ chipset. Our first USB product, the CY7C63000 (die photo at left), is a peripheral controller designed to link a mouse or joystick to a PC. It contains the USB drive circuitry; the logic interface for the USB drive circuitry; SRAM to store data; EPROM to store the computer program, increase customer flexibility, and reduce time to market; and an eight-bit reduced instruction set (RISC) microcontroller specifically optimized for USB. The product was developed in collaboration with Microsoft. We will follow with a series of USB products this year.

Because of the multiple connections made by USB in each PC, the market for USB chips should be huge, a multiple of the unit market of PCs. Some estimates for the USB chip market exceed 500 million units by the year 2000.

Programmable Clocks

Cypress acquired IC Designs, a PC clock company located in Seattle, Washington, in 1994. The clock in most electronic systems is a quartz crystal that resonates at a precise frequency when embedded in an electronic circuit. The problem is that

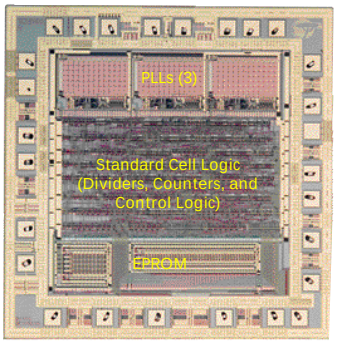
most PCs use multiple clocks—including, for example, 66 MHz for the Pentium® processor, 16 MHz for the keyboard, 24 MHz for the floppy disk drive, and 48 MHz for USB. IC Designs, now part of Cypress's Computer Products Division, creates silicon chips that rely on a single, low-cost crystal to set one clock frequency and then synthesize the other required clock frequencies, thereby reducing the number of crystals required in a PC or any clocked system.

The common method used to synthesize frequencies from the basic crystal frequency is called frequency division. For example, a circuit that counts every other cycle of a 66 MHz clock provides a 33 MHz clock. The basic idea is to run a single crystal clock signal through logic to produce multiple clock signals. Our competitors change their logic (redesign their chips) to accommodate the custom clock frequency requests of their customers.

Cypress had a better idea: Augment our clock chips with EPROM technology, another Cypress core competency, to create a new generation of clocks that can be custom-programmed, enabling us to respond to orders in hours, not weeks. As shown in the die photo, Cypress's programmable clocks provide multiple oscillators—phase-locked loops (PLLs)—with frequencies that can be custom-programmed by EPROM storage bits. This capability is unique to Cypress.

We believe Cypress has grown to become the largest manufacturer of computer clock chips, primarily based on our strengths of low-cost manufacturing and field programmability of clock frequencies.

Programmable Clocks



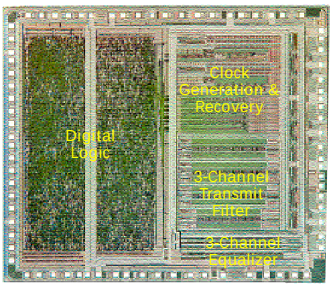
A die photo of Cypress's CY2291 programmable clock chip, which can be used to coordinate the timing of PCs and their peripherals, creating custom clock frequencies for the microprocessor, keyboard, floppy disk drive, and other devices.

Data Communications

The Datacom Division is one of our fastest growing and most profitable businesses. Our team specializes in creating products that move bits of information from one system to another. Although Ethernet is the most widely accepted datacom protocol, linking PC users together in local area networks (LANs), our Datacom division has focused historically on high-performance niche products, such as HOTLink™, a point-to-point transmitter and receiver (transceiver) capable of moving data at a rate of 330 Mbps via the Fibre Channel standard.

Last year, we redirected our Datacom group to move into two high-volume, medium-priced areas: 100 Mbps Ethernet and 155 Mbps ATM (Asynchronous Transfer Mode, a way to move data at high speeds over telephone lines). Both chips are now sampling and are expected to provide significant revenue in 1997.

100 Mbps Ethernet



A die photo of Cypress's Ethernet chip, one of two in the market that allows new Fast Ethernet signals to run on older wiring installed for 10 Mbps Ethernet. Other products require buildings to be rewired with a newer five-wire standard in order to upgrade to 100 Mbps.

CONCLUSION

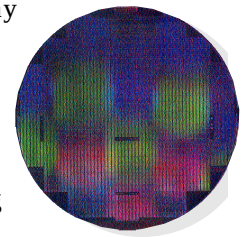
SRAMs historically have represented half of Cypress's sales. In 1996, the SRAM market collapsed after more than one year of SRAM undersupply, during which time high prices attracted new suppliers that glutted the market, dropping prices to historical lows. Cypress was the only SRAM-intensive supplier to plow through the troubled year with no quarterly losses. We will continue to reduce costs in the SRAM business as we strive to recover historical profit levels and to gain market share.

The 1996 SRAM recession did take its toll on our plans for revenue growth. We have already initiated an attack on that problem by introducing several new non-SRAM product families, which should produce significant revenue in 1997. Cypress's 1997 target is to get back on the growth track with record sales.

T.J. Rodgers
President and CEO

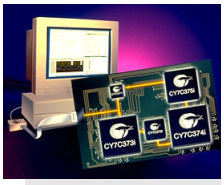
BUSINESS HIGHLIGHTS

Q1



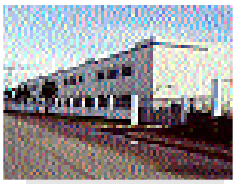
- Cypress posts record earnings per share of $0.39 during a quarter in which many memory-intensive companies showed EPS declines.
- Cypress breaks ground on Fab V in Round Rock, Texas. The eight-inch wafer fab will be a 225,000-square-foot facility with a 35,000-square-foot clean room.
- Cypress opens its 10th design center in Bangalore, India, as part of a strategic initiative to employ distributed design resources around the world, effectively enabling 24-hour-a-day design activity.

Q2



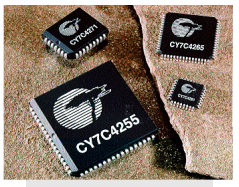
- Cypress announces Release 4.0 of its $99 *Warp2*® programmable logic design tools, adding increased capability rivaling tools costing tens of thousands of dollars.
- Cypress announces Qualified Manufacturer List (QML) certification from the Defense Electronics Supply Center, exempting the company from certain testing criteria and enabling it to reduce the cost of processing military products.
- Cypress debuts its FLASH370i™ CPLD family, which offers customers the ability to reprogram the devices after they have been installed in systems. This capability, known as In-System Reprogrammability (ISR™), is a clear competitive edge for Cypress in the CPLD market.

Q3



- Cypress opens its assembly and test facility in the Philippines, a state-of-the-art, 162,000-square-foot plant that will reduce costs, improve cycle times, and process some 300 million semiconductor devices a year by 1998.
- Cypress announces that its *Warp*® software has surpassed 10,000 installed seats, giving Cypress the opportunity to design-in programmable logic in a wide variety of customer locations.
- Cypress transforms its Fab I in San Jose to an R&D-only facility, reducing costs and speeding development of new products by providing increased fab access for R&D engineers.

Q4

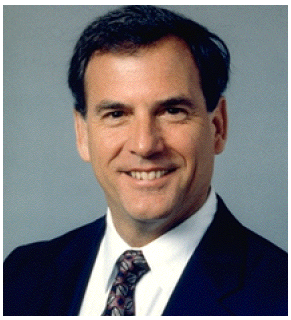


- Cypress introduces Deep Sync™ FIFOs, the first FIFO family to provide the highest density and performance available for synchronous FIFOs while maintaining industry-standard architecture.
- "VHDL for Programmable Logic," a textbook on programmable logic design written by a Cypress senior applications engineer, gains acceptance at the university level.
- Cypress enters the Universal Serial Bus (USB) market with a line of microcontrollers for USB PC peripherals ranging from mice and keyboards to printers and digital cameras. USB allows users to "plug and play" peripherals, eliminating the need to make troublesome configuration adjustments.

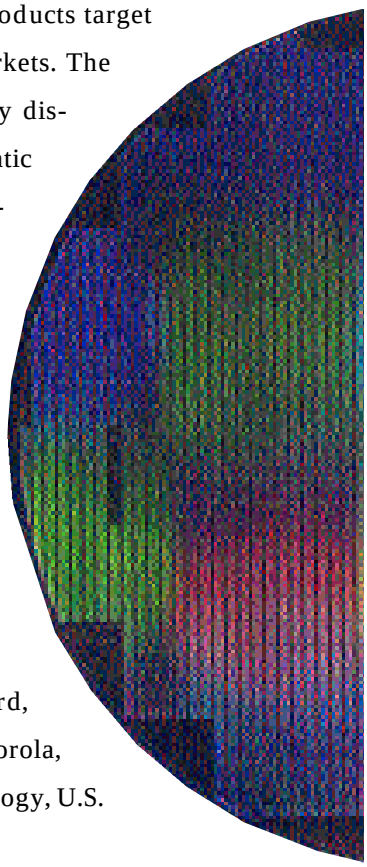
MARKETING PERSPECTIVE

BUILDING A COMPETITIVE ADVANTAGE

Total semiconductor consumption dipped 11% in 1996 to $129 billion from $144.4 billion, marking the industry's first contraction since 1985 (see chart on opposite page). But end-market demand remains strong, and market shifts represent significant new opportunities for Cypress as we prepare to harvest what we believe will be our most promising crop of new products in years. Many of these products target the high-growth communications and consumer electronics markets. The critical silicon for these markets integrates what were previously discrete components and incompatible technologies, such as static memory, digital logic, microcontroller logic, and analog phase-locked loops (PLLs).



J. Daniel McCranie, vice president, sales and marketing.



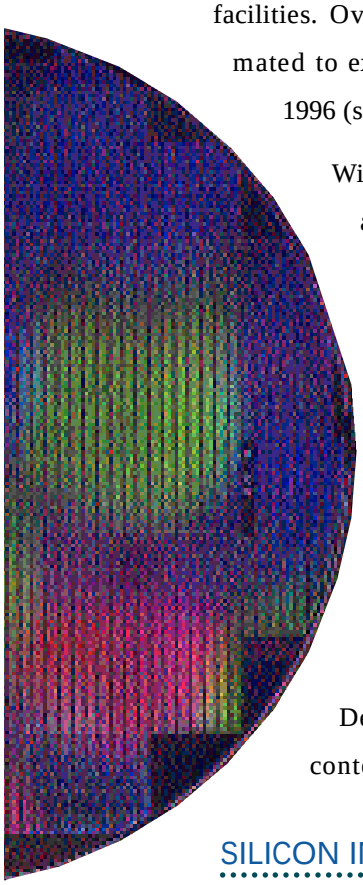
Such integration can best be accomplished by larger semiconductor companies that have developed core processes in unison with their own wafer manufacturing facilities. Over the last 14 years, Cypress has painstakingly built an organization with precisely these capabilities. In the process, we have transformed our company into a leading supplier of both commodity and high-value-added semiconductors for major customers in a wide range of mature and emerging markets. Cypress strategic customers include Alcatel, Cisco, Compaq, Ericsson, Hewlett-Packard, IBM, Intel, Lucent Technologies, Motorola, NEC, Northern Telecom, Seagate Technology, U.S. Robotics, and 3Com.

Cypress products enable high-performance datacom systems. Lucent Technologies uses Cypress FLASH370i CPLDs in its DEFINITY® Enterprise Communications server (above), and 3Com uses Cypress SRAMs in its Etherlink® family of network interface cards (right).

We will continue to leverage our efficient manufacturing and world-class technology as we expand our product offerings, generate integrated products, penetrate new markets, and advance toward our next milestone—$1 billion in sales.

CHARTING A RETURN TO PROSPERITY

The past decade has been characterized by a systemic extension of semiconductor products into virtually every facet of our business and personal lives. In previous decades, semiconductors had been relegated largely to "shared systems" that provided services collectively to individuals but were neither owned nor operated by particular individuals. Examples of such systems are large mainframe computers, military weapons systems, telecommunications station equipment, and industrial-control systems.

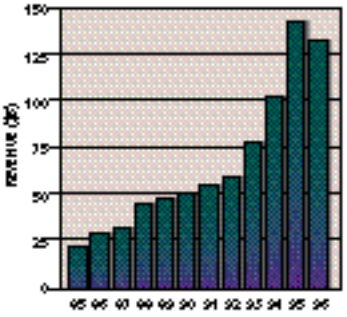


Beginning in the mid-1980s, however, the low cost of semiconductors fostered innovation in personal electronics products. This innovation, in turn, fueled a decade-long growth spurt for the semiconductor industry. Starting in 1994, growth prompted an industrywide wave of capital spending, including allocations for new wafer manufacturing facilities. Overall, the semiconductor industry spent an amount estimated to exceed $90 billion on capital equipment between 1994 and 1996 (see chart below right).

With supply outstripping demand last year, prices declined and revenues suffered. Longer term, our industry should return to healthy expansion, driven by both explosive growth in the electronic products markets and increased semiconductor penetration of those markets. By the year 2000, semiconductors are expected to comprise 28% of electronic equipment sales, up from 12% at the beginning of this decade, according to industry analyst In-Stat (see chart below right).

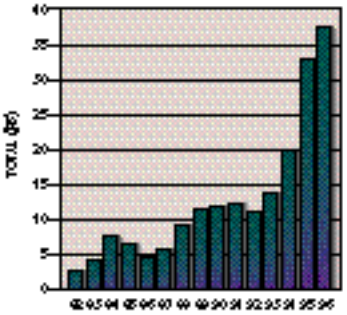
Our plan to capitalize on this steady penetration has remained the same for much of our corporate existence: Develop products and processes that have strong proprietary content and address the needs of our target markets.

Semiconductor Consumption



Total semiconductor consumption dipped 11% in 1996, but demand remains strong, representing significant opportunities for Cypress.

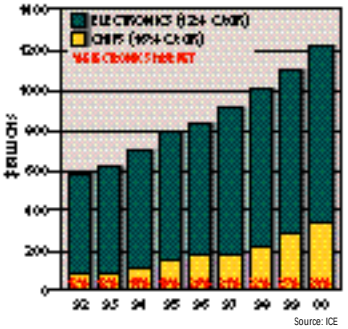
Capital Spending



Source: SIA, ICE, Dominick & Dominick

The semiconductor industry spent over $90 billion on capital equipment between 1994 and 1996, leading to overcapacity and declining product prices.

Semiconductor Component of Global Electronics Revenues



Source: ICE

The semiconductor industry's share of total world electronic sales is projected to increase.

SILICON INTEGRATION: A GATEWAY TO NEW MARKETS

The increasing use of semiconductors in electronic products accelerates the need to integrate previously discrete semiconductor elements into a single, less-expensive piece of silicon. In this way, product manufacturers can enhance features for users—without increasing product size or cost—and semiconductor companies can decrease costs for customers and themselves.

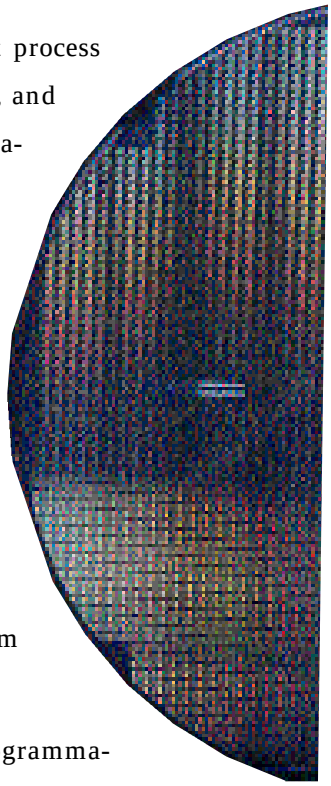
Previously, for cost reasons, companies tended to integrate "like" technologies. SRAMs, for example, were joined to SRAM-like technologies, such as digital logic, but rarely to "incompatible" technologies, such as analog or programmable-memory technology. It was possible to integrate dissimilar technologies, for example, in small, stand-alone microcontrollers, which combine very small memory and analog elements. For large

system or high-speed designs, however, the processing and design trade-offs usually resulted in a cost premium.

The design and production of large “mixed-signal” silicon systems is accomplished most effectively by semiconductor companies with superior manufacturing and technology capabilities. Leveraging our strengths in these areas, we are rolling out our first generation of integrated products. We expect these products to make a substantial contribution to Cypress revenues in the years ahead.

Timing Technology Market

Cypress’s EPROM-programmable clock circuit family combines three different process and cell technologies—digital logic, programmable read only memory (PROM), and analog PLLs. The PROM elements are used to customize the clock to user specifications. By programming different elements of the PROM, the base frequency, slew rate, and output characteristics can be independently modified with maximum flexibility.



Cypress programmable clocks, produced by our Computation Products Division (CPD), are used by customers in applications ranging from motherboards to hard disk drives. But these devices also enlarge Cypress’s stake in the consumer electronics market, targeting home video games, digital video disks (DVD), and video CD players. Samsung and Daiwa have designed our programmable chips into their latest-generation DVD players, while Sega uses them in its game systems.

The Sega Saturn™ game machine uses Cypress programmable clock chips to bring the excitement of advanced games to the home.

Programmability expands Cypress’s served available market (SAM). Because programmable clocks are no longer semicustom parts requiring costly time-consuming mask modifications, our sales force can service accounts with smaller volume requirements.

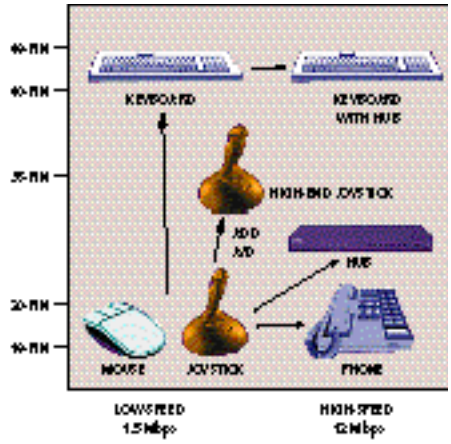
USB Microcontroller Market

Cypress is also serving new markets with another CPD product: a USB microcontroller. USB is expected to become the standard interface between a PC and its peripherals, and we expect the silicon that facilitates this interface to be very much in demand.

Cypress will introduce a family of USB microcontrollers in 1997. Integrating digital logic, analog, PROM, SRAM, and microcontroller logic, these devices represent our entrée into the microcontroller market, our ongoing penetration of the PC peripheral and consumer elec-

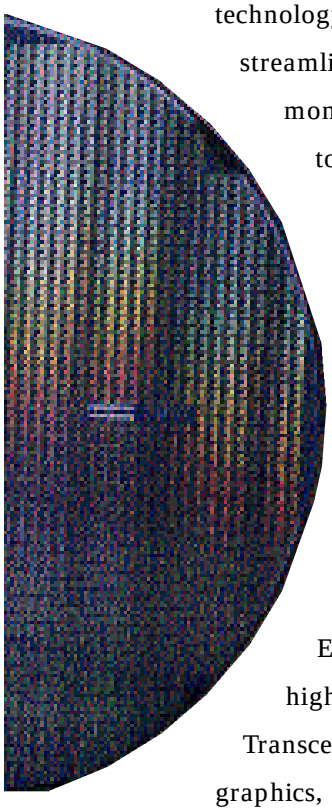
tronics markets, and a possible springboard into other microcontroller markets. Some Cypress USB microcontrollers are designed for use in peripherals, while others are designed for hub products. The rough equivalent of a line-splitting circuit, USB root hubs will increase the number of peripherals a PC can accept, expanding Cypress's SAM and helping to build overall market demand for USB.

USB Product Roadmap



Cypress plans to introduce a family of microcontrollers in 1997 to enable the fast-growing USB market.

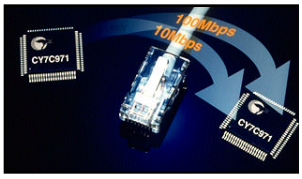
The potential market for USB is huge, partly because of the benefits manufacturers and equipment vendors derive from the technology. In standardizing the PC–peripheral interface, USB streamlines the manufacturing and design process. The common USB standard also makes it easier for manufacturers to bundle proprietary PC/peripheral/software packages, in line with the overall integration trend.



Because we designed our dedicated USB chips from scratch—unlike other manufacturers who chose to adapt much larger, general-purpose microcontrollers for USB—we aim to sell our microcontroller chips at an extremely competitive price. Industry analysts agree that price will be a key factor in the emerging USB market.

Data Communications Market

A third example of product and process integration is Cypress's 10/100 Mbps Ethernet transceiver, a data communications product that combines digital logic, high-speed analog, and first-in/first-out (FIFO) memory technologies. Transceivers are an essential element in Ethernet, enabling users to share graphics, voice, and video over LANs. Compatible with 10 Mbps and 100 Mbps standards, our product offers a performance advantage to a distinct market segment: networks running on the older, copper wiring prevalent in buildings constructed before 1990. Other 100 Mbps solutions run only on newer, coaxial cable. Without the ability to run Fast Ethernet on older wiring, the only upgrade path open to users would be an expensive, disruptive wiring overhaul.



The CY7C971 Fast Ethernet transceiver allows both 10 Mbps and 100 Mbps transmissions over standard copper wiring.

The market for Ethernet boards is expected to expand by an estimated 30 million units, and Ethernet products will remain a key revenue source for semiconductor manufacturers for the remainder of this decade. Cypress produces a range of datacom products, including devices for the higher-speed ATM communications standard, and specialty memories

including dual-port SRAMs and FIFOs. The ATM market alone is expected to increase nearly tenfold in the next five years from $1.07 billion in 1996 to $10.14 billion in 2001, according to In-Stat.

CYPRESS 2000: CAPITALIZING ON MARKET TRENDS

For the balance of this decade, the semiconductor market will be defined by two trends. The rapid growth of personal electronics, coupled with the explosion of applications in consumer, digital, and wireless communications, will continue to fuel increased demand for semiconductor products. On the supply side, probably for most of 1997, the industry will continue to have some excess capacity.

The result will be an industry rewarding suppliers that develop innovative, hard-to-replicate products and processes. Cypress has worked hard to fashion an organization capable of such innovation.

In the past decade, we have broadened our technology base beyond basic SRAMs to include programmable logic, programmable memory, high-performance analog and mixed-signal, high-density digital logic, and microcontrollers, attaining key supplier status with corporate leaders in high-profile markets. Last year, we began to leverage these basic technologies to create integrated silicon products.

The integration of core technologies, and the new generation of products this approach has generated, represents a landmark for Cypress. We expect silicon integration to continue to provide us with new market opportunities—and to increase our penetration of existing markets—as we look toward the year 2000 and beyond.

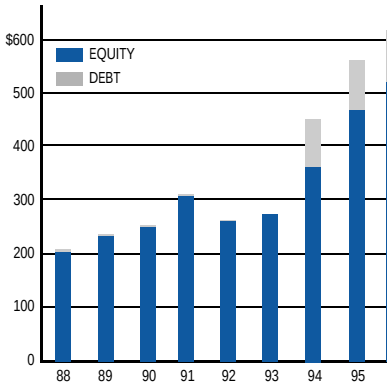
J. Daniel McCranie
Vice President, Sales and Marketing

SELECTED CONSOLIDATED FINANCIAL DATA

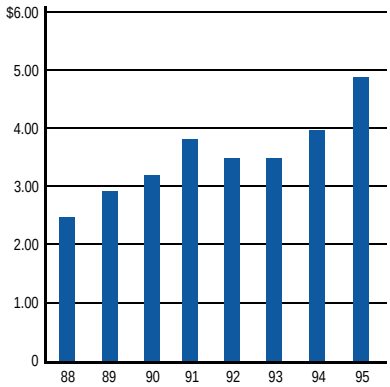
(Dollar and share amounts in thousands, except per-share amounts)
(Unaudited)

	1996	1995	1994	1993	1992
For the year:					
Revenues	$528,385	$596,071	$406,359	$304,512	$272,242
Acquisition-related non-recurring charges	—	—	—	18,271	—
Restructuring and other non-recurring costs (benefits)	(7,018)	17,800	—	(408)	39,700
Operating income (loss)	81,594	159,171	77,792	10,686	(35,636)
Income (loss) before tax	83,505	161,384	80,115	12,567	(32,928)
Net income (loss)	53,029	102,477	50,472	8,043	(21,010)
Net income (loss) per share:					
Primary	$ 0.63	$ 1.15	$ 0.61	$ 0.11	$ (0.28)
Fully diluted	0.62	1.09	0.60	—	—
Weighted average common and common equivalent shares outstanding:					
Primary	83,661	89,347	82,313	76,218	74,514
Fully diluted	92,016	97,583	88,602	—	—
At year-end:					
Cash and short-term investments	$ 93,786	$161,618	$193,275	$ 80,590	$ 82,046
Working capital	126,006	190,580	225,952	124,651	133,966
Total assets	794,047	750,728	555,699	340,648	320,504
Long term debt and other long-term obligations (excluding current portion)	127,895	117,572	111,538	7,776	8,468
Stockholders' equity	510,746	472,099	352,999	271,685	262,061

Capitalization
(Millions)



Book Value per Share



MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS AND FINANCIAL CONDITION

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Actual results could differ materially from those projected in the forward-looking statements as a result of the factors set forth on the inside front cover, in "Factors Affecting Future Results" and elsewhere.

OVERVIEW

In 1996, the Company's revenues decreased to $528.4 million compared to the $596.1 million recorded in 1995. This was a decrease of 11.4% over last year and a 30.0% increase over the $406.4 million recorded in 1994. The decline in revenues resulted in lower profits of $53.0 million or $0.62 per share, compared to $102.5 million, or $1.09 per share in 1995 and $50.5 million, or $0.60 per share in 1994. The revenue decline was primarily due to a significant drop in the Company's average selling prices ("ASPs"), particularly in its largest product line, Memory Products, which includes Static Random Access Memory products ("SRAMs"). As a result of lower ASPs, the Company's gross margin dropped to 42.2% in 1996, compared with 53.7% in 1995 and 45.2% in 1994. The Company projects that ASPs will decrease across many of its product lines in 1997, but at a reduced rate from that experienced in 1996. As a result of this projection, the Company will continue its plan to offset the effects of lower ASPs by introducing new products with higher margins and by redesigning its existing products and manufacturing processes to lower manufacturing costs.

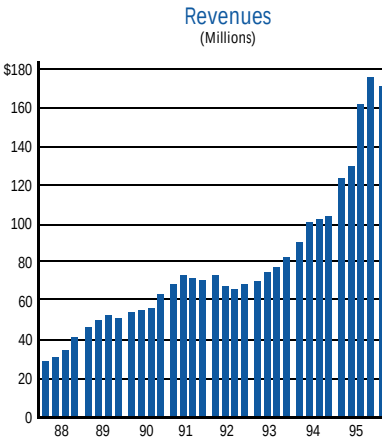
In October 1996, the Company began production in its new assembly and test manufacturing facility in the Philippines. Although the new plant is expected to generate cost savings for the Company in the future, under absorption due to ramping a new facility adversely impacted the Company's cost of revenues during the last quarter of 1996. At the end of 1996, less than 50% of the plant's capacity was being utilized. Fully utilized, the Philippines plant is expected to increase assembly and test manufacturing capacity by 300 million units per year. Should the need for additional back-end manufacturing capacity not materialize, the expected cost savings may not be realized. The Company also began construction of a new fab in Texas ("Fab V"). However, in the third quarter, the Company decided to put on hold construction of Fab V due to market conditions.

In the third quarter of 1996, the Company recorded a pre-tax restructuring and other non-recurring benefit of $7.0 million. A majority of the benefit was derived from the reversal of the $17.8 million reserve established in 1995 related to the Texas Instruments ("TI") patent infringement lawsuit. In July 1996, the Federal Circuit Court of Appeals affirmed the earlier decision of the trial court that the Company did not infringe on either of the patents in the suit. In September 1996 the Court decided that it would not hear any appeal filed by the plaintiff regarding this matter. In December 1996, TI filed a petition of certiorari in the United States Supreme Court. If the petition is granted, the Supreme Court would review on appeal the decision of the Federal Circuit Court of Appeals. Litigation counsel for the Company considers the possibility that the Supreme Court will grant the petition and hear the appeal to be remote, given the small percentage of such petitions that are granted and the fact that the case does not appear to present issues of significant national interest. During the same quarter, the Company also announced a restructuring of its San Jose wafer fabrication facility from a production wafer fabrication plant to predominantly a research and development wafer fabrication facility. As a result of this restructuring, the Company recorded a pre-tax charge of $9.1 million, $5.9 million relating to the write-down of certain excess equipment and the transfer of certain other equipment to its Texas and Minnesota production wafer fabrication facilities and $3.2 million relating to severance and other cash related restructuring charges. In September, the Company also recorded a one-time, pre-tax credit of $3.3 million related to the insurance reimbursement of defense costs incurred in conjunction with the securities class-action lawsuit. This credit was approximately offset by other non-recurring charges related to agreements with certain companies regarding cross-licensing and other matters.

In February 1997, the Company signed a letter of intent with QuickLogic Corporation ("Quick Logic") involving termination of an existing joint development, licensing and foundry agreement for antifuse Field Programmable Gate Array ("FPGA") products and the execution of a new foundry agreement. Under the new agreement, the Company will cease to develop, market and sell antifuse-based FPGAproducts. In return, the Company's equity position in the privately held QuickLogic will grow to greater than 20%. The Company also entered into a five-year wafer-supply agreement to provide FPGAproducts to QuickLogic. The agreement is subject to the completion of definitive documentation and obtaining necessary consents and approvals. The agreement is expected to be finalized in March 1997.

In February 1997, the Company called for redemption of all of the 3.15% Convertible Subordinated Notes that are due in 2001. The redemption will be effective March 26, 1997. Approximately $110.0 million aggregate principal amount at maturity of the notes were outstanding at the time the notes were called for redemption with the aggregate redemption price of approximately $99.0 million. Prior to 5:00 P.M. EST, on March 25, 1997, holders have the option to convert their notes into shares of Cypress common stock at a conversion rate of 72.1746 shares of stock per $1,000 principal amount at maturity of the note. Alternatively, holders may have their notes redeemed at a total redemption price of $900.25 per $1,000 amount at maturity of the notes. The redemption price consists of: (a) an issue price of $839.03, plus (b) $60.26 of accrued original issue discount, plus (c) accrued interest of $0.96, per $1,000 principal amount at maturity of the notes. Any notes that are not converted on or before 5:00 P.M. EST, March 25, 1997 will automatically be redeemed on March 26, 1997.

RESULTS OF OPERATIONS



In 1996, the Company recorded revenues of $528.4 million, a decrease of 11.4% from the $596.1 million recorded in 1995 and a 30.0% increase over the $406.4 million recorded in 1994. The decline in revenues was primarily due to a significant decrease in average selling prices experienced in each of the Company's four major product lines, particularly in the Memory Products Division ("MPD"), which includes the sale of Static Random Access Memory ("SRAM") products. ASPs for SRAM products dropped 22.5% in comparing 1996 to 1995. The Company projects SRAM prices to continue to fall in 1997, but at a reduced rate from that experienced in 1996. Unit sales of SRAM products in 1996 were 2.4% greater than in 1995 even though the number of units sold in the second half of 1996 was significantly less than in the first half of the year. A majority of the decline in sales volume towards the end of 1996 can be attributed to the 256K and 1 meg line of products, where an over supply of product and resulting inventory corrections by most customers slowed down demand for the Company's products. The increase in number of units of SRAM products sold in 1996 in comparison to 1995, was not enough to offset the effects of the declining ASPs. A majority of the SRAM products are sold to the telecommunication and data communication markets. Due to the decline in revenues from its SRAM line of products, MPD's percentage of the Company's revenue decreased to 51.3%, a 10.4% decrease from 1995 and a 0.6% decrease from 1994.

The Programmable Products Division ("PPD"), the Company's second largest revenue producing product line, recorded 19.0% of the Company's revenue in 1996. PPD's contribution to total revenue increased from the 14.9% recorded in 1995. Although total Company revenues decreased 11.4% in comparing 1996 to 1995, PPD's revenues remained relatively constant year-to-year. Like MPD, PPD also experienced pressure from declining ASPs in 1996, dropping 10.7% in 1996 compared to 1995. Offsetting the drop in ASPs was increased sales volume as the number of units sold grew 12.4% in 1996. Revenue growth in Non-Volatile Memory ("NVM") products, formerly the Programmable Read-Only Memory ("PROM") line of products, offset revenue declines in other PPD products as NVM's revenues grew 14.0% in 1996 compared to 1995. Even though ASPs for the sale of NVM products decreased 24.9% in comparing 1996 to 1995, the 51.7% increase in sales volume more than offset the effects of declining ASPs. NVM products are primarily sold to the personal computer and telecommunication markets.

Revenues generated by the Data Communications Division ("DCD") grew 13.8% comparing 1996 to 1995. The growth was primarily in the Division's Channel line of products where several products, including the HOTLink™ point-to-point communication devices and Programmable Skew Clock Buffers ("RoboClock™"), all made significant contributions to revenues. The Channel product line's revenues grew 37.8% in 1996 compared to 1995. Although ASPs decreased 13.7% year-to-year, the sales volume increase of 59.6% more than offset the decline in the average selling price. Specialty Memory products, which include Clocked First-in, First-out ("FIFOs") and Dual Port products, remained relatively stable growing 3.2% in 1996 compared to 1995. Sales volume of such products increased 9.7% over last year, which offset the 5.9% decline in ASPs. A majority of DCD products are sold to the personal computer, telecommunication, and data communication markets.

Last year, the Computation Products Division's ("CPD") revenues were primarily generated from its Timing Technology line of products, which were acquired through the acquisition of IC Designs, Inc. in 1993. In 1996, the Company moved its Fast CMOS Technology ("FCT") Logic Device line of products from PPD and its VME Communication-bus Device line of products from DCD into CPD. CPD's revenues increased in 1996, growing 8.1% from 1995. The revenue growth was primarily a result of increased volume as unit sales grew 41.3% over last year, which more than offset the decrease in average selling price. The revenue growth in CPD was primarily attributed to the Timing Technology line of products as revenues from the sale of such products grew 19.4% in 1996. Like the Company's other divisions, Timing Technology's ASPs in 1996 dropped, falling 32.6% in comparison to 1995; however, sales volume grew 77.0% comparing the same periods. Timing Technology products are primarily sold to the personal computer and PC peripheral markets.

As noted above, the Company continued to experience reductions in ASPs, particularly in its SRAM products. The decrease in ASPs was caused by overall market demand softness, mainly attributable to over supply in the industry and the resulting inventory corrections by customers, particularly in the telecommunication and data communication markets which are the Company's primary markets. Even though end consumption continues to grow in these two markets, the Company believes some customers have built above normal levels of inventory which they are in the process of drawing down. The greater availability of products due to excess supply has also shortened the ordering cycle of customers due to their expectation of product availability. The Company continues to build certain levels of inventory for select core products despite the overall market softness because the Company wants to position itself to have sufficient levels of inventory of these products for the anticipated demand improvements. The Company's inventory levels have increased and may continue to increase in the future resulting in potential exposure to obsolescence, excess quantities, aged inventory, and lower-of-cost-or-market write-down if demand were to not improve as expected by the industry and the Company. The continuation of these factors, which have adversely impacted the industry and the Company, in the future, could have a material adverse effect on the Company's results of operations.

The Company's cost of revenues as a percentage of revenues for 1996 increased to 58% compared with 46% in 1995 and 55% in 1994. The increase in manufacturing costs as a percent of revenues was a reflection of falling ASPs, particularly in the SRAM market. Although revenues declined steadily throughout most of 1996, unit sales increased in many of the Company's product lines. For the sale of SRAM products, the Company recorded a decrease in revenues of over 20% in comparing 1996 to 1995. Even though revenue generated from the sale of SRAM products decreased significantly, the Company sold approximately 2.4 million more units in 1996. The PPD product line's revenue in 1996 remained relatively constant from 1995; however, unit sales increased over 12%. Future ASP erosion could have a material adverse effect on the Company's gross margin, and drive cost of revenues as a percentage of revenues higher. The Company is continuing to explore new methods of reducing manufacturing costs in order to mitigate the effects of declining ASPs. In the fourth quarter of 1996, the Company began production in its new assembly and test manufacturing plant in the Philippines. As expected, the

Philippines plant recorded a loss in its first quarter of operations due to the under utilization of the facility and other costs in excess of those normally incurred due to its start-up status. At the end of 1996, the Philippines plant was operating at less than 50% of capacity. Once fully utilized, this new plant is expected to increase assembly and test manufacturing capacity by 300 million units per year and is expected to assist in lowering the Company's backend manufacturing costs in the future.

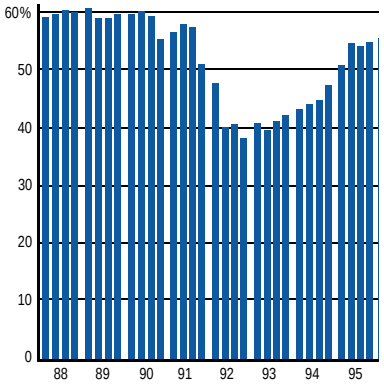
Research and development ("R&D") expenses increased to 16% of revenues in 1996 compared to 12% in 1995 and 13% in 1994. Actual spending in R&D increased significantly in 1996, growing to $84.3 million compared to $71.7 million and $53.2 million in 1995 and 1994, respectively. The growth in R&D expenses as a percent of revenues is the result of both an increase in actual R&D spending and a decrease in revenues. The Company made a conscious decision to increase spending in R&D in order to accelerate the development of new products and enhance its design and process technologies. With the Company's enhanced design capabilities from its worldwide design centers and the transformation of its San Jose wafer fabrication facility into a predominantly R&D wafer facility, actual R&D spending may continue to increase in the future as the Company explores new markets and improves its design and process technologies in an effort to increase revenues and lower costs.

Selling, general and administrative ("SG&A") expenses in 1996 were 12% of revenues. This was comparable to 1995 and 1994 when the Company recorded SG&Aexpenses of 12% and 13% of revenues, respectively. Absolute spending for SG&A expenses for 1996 was $64.3 million, a decrease from the $71.3 million spent in 1995 and an increase from the $52.8 million spent in 1994. The decease in actual sales and marketing expenses in 1996 in comparison to 1995 was primarily a result of lower revenues. Variable costs, such as commission expense, decreased significantly in 1996 due to the decline in revenues. General and administrative expenses also decreased in 1996 compared to 1995. In 1995, the Company recorded legal expenses in excess of those normally incurred due to the Texas Instruments ("TI") patent infringement lawsuit and a securities class-action lawsuit.

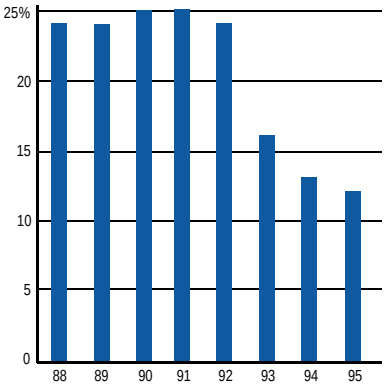
In the third quarter of 1996, the Company recorded a one-time, pre-tax restructuring and other non-recurring benefit of $7.0 million. A majority of the benefit was derived from the reversal of the $17.8 million reserve established in 1995 related to the Texas Instruments ("TI") patent infringement lawsuit. In July 1996, the Federal Circuit Court of Appeals affirmed the earlier decision of the trial court that the Company did not infringe on either of the patents in suit. In September 1996 the Court decided that it would not hear any appeal filed by the plaintiff regarding this matter. In December 1996, TI filed a petition of certiorari in the United States Supreme Court. If the petition is granted, the Supreme Court would review on appeal the decision of the Federal Circuit Court of Appeals. Litigation counsel for the Company considers the possibility that the Supreme Court will grant the petition and hear the appeal to be remote, given the small percentage of such petitions that are granted and the fact that the case does not appear to present issues of significant national interest. During the same quarter, the Company also announced a restructuring of its San Jose wafer fabrication facility, from a production wafer fabrication plant to predominantly a research and development wafer fabrication facility. As a result of this restructuring, the Company recorded a one-time, pre-tax charge of $9.1 million, $5.9 million relating to the write-down of certain excess equipment and the transfer of certain other equipment to its Texas and Minnesota production wafer fabrication facilities and $3.2 million relating to severance and other cash related restructuring charges. In September, the Company also recorded a one-time, pre-tax credit of $3.3 million related to the insurance reimbursement of defense costs incurred in conjunction with the securities class-action lawsuit. This credit was approximately offset by other non-recurring charges related to agreements with certain companies regarding cross-licensing and other matters.

Income from operations in 1996 was $81.6 million, a significant decrease from the $159.2 million recorded in 1995, and slightly better than the $77.8 million, recorded in 1994. The decrease in operating income, compared to 1995, can be attributed to the significant decrease in revenues

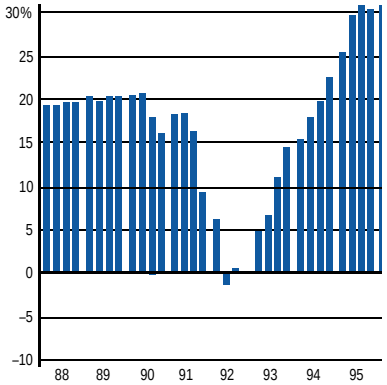
Gross Margin as a Percent of Reven



R&D Expenditures as a Percent of Reve

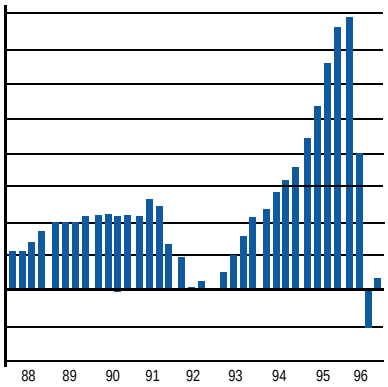


Operating Profit as a Percent of Rever



* Excludes extraordinary credits, restructuring, acquisition related, and other non-recurring charges.

Earnings per Share*



* Excludes extraordinary credits, restructuring, acquisition-related, and other non-recurring charges.

and gross margin resulting from lower ASPs in 1996. Partially offsetting the effects of lower revenues and lower margins was the $7.0 million one-time, pre-tax benefit from restructuring and other non-recurring costs related to the reversal of the $17.8 million TI lawsuit reserve and the recording of the $9.1 million fab restructuring.

Net interest and other income in 1996 was $1.9 million, a slight decrease from the $2.2 million recorded in 1995 and the $2.3 million recorded in 1994. In 1996, the Company recorded $6.9 million in interest expense, an increase of $0.7 million from 1995 and $2.9 million from 1994. Higher interest expense related to the convertible bonds, coupled with interest expense recorded on the $49.0 million borrowing from the short-term line of credit, increased interest expense in 1996.

The Company recorded income tax expense of $30.5 million in 1996, compared to $58.9 million in 1995 and $29.6 million in 1994. The effective tax rates in 1996, 1995, and 1994 were 36.5%, 36.5%, and 37.0%, respectively.

In 1996, the Company's net income decreased to $53.0 million, a significant decline from the $102.5 million recorded in 1995 and slightly better that the $50.5 million recorded in 1994.

FACTORS AFFECTING FUTURE RESULTS

The Company believes that, notwithstanding the various objectives, projections, estimates, and other forward-looking statements set forth in this Annual Report, its future operating results will continue to be subject to variations based on a wide variety of factors, which could lead the Company's operating results to be materially different from those projected in such forward-looking statements. Such factors include, but are not limited to: general economic conditions, the cyclical nature of both the semiconductor industry and the markets addressed by the Company's products such as the networking, computer, and telecommunications markets, failure of expected growth in demand for, or areas of expected new demand for, semiconductor products to materialize, the availability and extent of utilization of manufacturing capacity, fluctuations in manufacturing yields, price erosion, competitive factors, the timing of new product introductions, product obsolescence, the successful ramp up of the Philippines plant, and the ability to develop and implement new technologies including the ramp of our 0.5 micron process to full commercial production. The Company is also dependent on subcontract vendors for a portion of the assembly and test manufacturing of its products, which presents risks including the lack of guaranteed production capacity, delays in delivery, susceptibility to disruption in supply, and reduced control over product costs, adverse weather conditions, and manufacturing yields. The Company's operating results could also be impacted by sudden fluctuations in customer requirements, currency exchange rate fluctuations, and other economic conditions affecting customer demand and the cost of operations in one or more of the global markets in which the Company does business. Typically, the Company requires new orders, in addition to its existing backlog, to meet each quarter's revenue plan.

As a participant in the semiconductor industry, the Company operates in a technologically advanced, rapidly changing and highly competitive environment. While the Company cannot predict what effect these and other factors will have on the Company, they could result in significant volatility in the Company's future performance. To the extent the Company's performance may not meet expectations published by external sources, public reaction could result in a sudden and significantly adverse impact on the market price of the Company's securities, particularly on a short-term basis.

The Company's corporate headquarters and some manufacturing facilities are located near major earthquake faults. As a result, in the event of a major earthquake, the Company could suffer damages that could materially and adversely affect the operating results and financial condition of the Company.

Current pending litigation and claims are set forth in Note 6 of the Notes to Consolidated Financial Statements. The Company will vigorously defend itself in these matters and, subject to the inherent uncertainties of litigation and based upon discovery completed to date, man-

agement believes that the resolution of these matters will not have a material adverse impact on the Company's financial position or results of operations. However, should the outcome of any of the actions be unfavorable, the Company may be required to pay damages and other expenses, which could have a material adverse effect on the Company's financial position or results of operations. In addition, the Company could be required to alter certain of its production processes or products as a result of these matters.

LIQUIDITY AND CAPITAL RESOURCES

The Company's cash, cash equivalents, and short-term investments totaled $93.8 million at the end of fiscal year 1996, a $67.8 million decrease from the end of fiscal year 1995. The decrease in cash, cash equivalents, and short-term investments was primarily a result of lower revenues and lower net income recorded in fiscal year 1996 compared to fiscal year 1995.

Cash from operating activities decreased to $112.2 million in 1996 compared to $190.3 million in 1995. This decrease of $78.1 million was primarily due to the decline in net income from $102.5 million in 1995 to $53.0 million recorded this year. The decline in net income was primarily a result of lower revenues caused by a drop in the Company's ASPs.

Cash used for investing activities in 1996 was $116.8 million, a $70.2 million decrease from the $187.0 million used for investing activities in 1995. In 1996, the Company's investment in short-term securities decreased $78.5 million. Cash was required to fund operations, repurchase the Company's common stock in the open market, and purchase capital equipment. The Company purchased $195.3 million in capital equipment, which was comparable to the $194.9 million purchased the year before. The Company continued to purchase capital equipment in order to increase capacity and capability in its domestic wafer fabrication facilities in Texas and Minnesota, and to bring its new assembly and test facility in the Philippines into production. The Company expects to invest approximately $134.0 million in capital expenditures in 1997 and had committed approximately $57.0 million as of December 30, 1996.

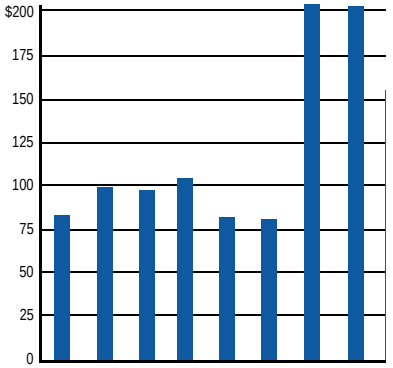
In 1996, the Company recorded cash generated from financing activities of $15.2 million compared to cash used for financing activities of $27.1 million in 1995. During the first quarter of 1996, the Company completed its stock repurchase program that began at the end of 1995 by repurchasing 2.8 million shares of treasury stock for $32.9 million. This was in comparison to the $37.9 million of treasury stock purchased in 1995. The shares repurchased will be used for the Company's 1994 Stock Option Plan and its Employee Stock Purchase Plan.

In September 1996, the Company borrowed $49.0 million against its revolving line of credit established in July 1996. This agreement, with certain banks, is for a three-year, unsecured, $100.0 million line of credit. The applicable interest rate for usage under this agreement will be over a graduated scale of LIBOR, plus a spread. The agreement contains certain financial and other restrictive covenants.

In 1994 and 1995, the Company entered into three operating lease agreements with respect to its office and manufacturing facilities in San Jose and Minnesota, respectively. In April 1996, the Company entered into an additional lease agreement related to two office facilities in San Jose. These agreements require that the Company maintain a specific level of restricted cash or investments to serve as collateral for these leases and maintain compliance with certain financial covenants. In 1996, the Company recorded $22.4 million in restricted investments compared to $20.7 million in 1995. All restricted investments are classified as non-current assets on the balance sheet.

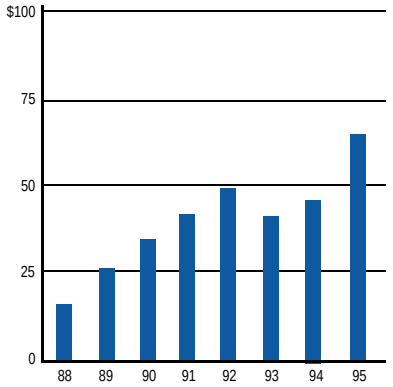
In February 1997, the Company called for redemption of all of the 3.15% Convertible Subordinated Notes that are due in 2001. The redemption will be effective March 26, 1997. Approximately $110.0 million aggregate principal amount at maturity of the notes were outstanding at the time the notes were called for redemption with the aggregate redemption price of approximately $99.0 million. Prior to 5:00 P.M. EST, on March 25, 1997, holders have the option to convert their notes into shares of Cypress common stock at a conversion rate of

Cash, Cash Equivalents, and Short-Ter
Investments (Millions)*



* Includes restricted investments of $62 million in 1996, $
million in 1995, and $19 million in 1994.

Depreciation and Amortization
(Millions)



72.1746 shares of stock per $1,000 principal amount at maturity of the note. Alternatively, holders may have their notes redeemed at a total redemption price of $900.25 per $1,000 amount at maturity of the notes. The redemption price consists of: (a) an issue price of $839.03, plus (b) $60.26 of accrued original issue discount, plus (c) accrued interest of $0.96, per $1,000 principal amount at maturity of the notes. Any notes that are not converted on or before 5:00 P.M. EST, March 25, 1997 will automatically be redeemed on March 26, 1997. The Company is reviewing different alternatives for funding should a majority of the bondholders elect not to convert to equity.

Although the Company believes that existing cash together with cash from operations, supplemented as necessary with borrowing under its revolving line of credit agreement, will provide sufficient resources to meet present and future working capital requirements and other cash needs for the next year, in the event that ASPs continue to decline at rates above normal industry levels and increased demand continues to be insufficient to offset the effects of such declines, the Company may be required to raise additional capital through a debt or equity financing. Although additional funding may be required, there can be no assurance that it would be available at terms the Company deems satisfactory.

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except share and per-share amounts)

	December 30, 1996	January 1, 1996
ASSETS		
Current assets:		
Cash and cash equivalents	$ 20,119	$ 9,487
Short-term investments	73,667	152,131
Total cash, cash equivalents, and short-term investments	93,786	161,618
Accounts receivable, net of allowances for doubtful accounts and customer returns of $3,887 in 1996 and $2,828 in 1995	71,440	108,587
Other receivables	11,971	8,335
Inventories	53,107	28,978
Other current assets	51,108	44,119
Total current assets	**281,412**	**351,637**
Property, plant and equipment, net	437,566	336,593
Other assets, including restricted investments of $61,612 in 1996 and $39,257 in 1995	75,069	62,498
	$ 794,047	**$ 750,728**
LIABILITIES AND STOCKHOLDERS'EQUITY		
Current liabilities:		
Accounts payable	$ 72,309	$ 82,315
Accrued compensation and employee benefits	14,374	21,353
Other accrued liabilities	4,821	25,447
Line of credit	49,000	—
Deferred income on sales to distributors	14,902	13,190
Income taxes payable	—	18,752
Total current liabilities	**155,406**	**161,057**
Convertible subordinated notes	98,241	95,879
Deferred income taxes	21,288	15,653
Other long-term liabilities	8,366	6,040
Total liabilities	**283,301**	**278,629**
Commitments and contingencies (Note 6)		
Stockholders' equity:		
Preferred stock, $.01 par value, 5,000,000 shares authorized; none issued and outstanding	—	—
Common stock, $.01 par value, 250,000,000 shares authorized; 91,358,000 and 88,924,000 issued; 81,098,000 and 81,501,000 outstanding	914	889
Additional paid-in capital	311,184	292,713
Retained earnings	315,491	262,462
	627,589	556,064
Less shares of common stock held in treasury, at cost; 10,260,000 shares at December 30, 1996 and 7,423,000 shares at January 1, 1996	(116,843)	(83,965)
Total stockholders'equity	**510,746**	**472,099**
	$ 794,047	**$ 750,728**

See accompanying notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in thousands, except share and per-share amounts)	Year Ended		
	December 30, 1996	**January 1, 1996**	**January 2, 1995**
Revenues	$528,385	$ 596,071	$406,359
Cost of revenues	305,174	276,160	222,620
Research and development	84,334	71,667	53,188
Selling, general and administrative	64,301	71,273	52,759
Restructuring and other non-recurring costs (benefits)	(7,018)	17,800	—
Total operating costs and expenses	**446,791**	**436,900**	**328,567**
Operating income	81,594	159,171	77,792
Interest expense	(6,895)	(6,239)	(4,041)
Interest income and other	8,806	8,452	6,364
Income before income taxes	83,505	161,384	80,115
Provision for income taxes	(30,476)	(58,907)	(29,643)
Net income	**$ 53,029**	**$ 102,477**	**$ 50,472**
Net income per share:			
Primary	**$ 0.63**	**$ 1.15**	**$ 0.61**
Fully diluted	**0.62**	**1.09**	**0.60**
Weighted average common and common equivalent shares outstanding:			
Primary	**83,661,000**	**89,347,000**	**82,313,000**
Fully diluted	**92,016,000**	**97,583,000**	**88,602,000**

See accompanying notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(Shares and dollars in thousands)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Total Stockholders' Equity
Balances at January 3, 1994	**72,401**	**$772**	**$207,484**	**$109,513**	**$ (46,084)**	**$ 271,685**
Issuance of common stock under employee stock plans and other	5,420	54	24,448			24,502
Tax benefit resulting from stock option transactions			6,340			6,340
Net income for the year				50,472		50,472
Balances at January 2, 1995	**77,821**	**826**	**238,272**	**159,985**	**(46,084)**	**352,999**
Issuance of common stock under employee stock plans and other	6,330	63	31,460			31,523
Tax benefit resulting from stock option transactions			22,981			22,981
Repurchase of common stock under share repurchase program	(2,650)				(37,881)	(37,881)
Net income for the year				102,477		102,477
Balances at January 1, 1996	**81,501**	**889**	**292,713**	**262,462**	**(83,965)**	**472,099**
Issuance of common stock under employee stock plans and other	2,434	25	14,577			14,602
Tax benefit resulting from stock option transactions			3,894			3,894
Repurchase of common stock under share repurchase program	(2,837)				(32,878)	(32,878)
Net income for the year				53,029		53,029
Balances at December 30, 1996	**81,098**	**$914**	**$311,184**	**$315,491**	**$(116,843)**	**$ 510,746**

See accompanying notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)	Year Ended		
	December 30, 1996	**January 1, 1996**	**January 2, 1995**
Cash flow from operating activities:			
Net income	$53,029	$ 102,477	$50,472
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	97,606	64,733	45,039
Non-cash interest and amortization of debt issuance costs	2,774	2,639	1,639
Provision for restructuring and other non-recurring costs	(12,943)	17,800	—
Deferred income taxes	6,216	(8,464)	1,258
Changes in operating assets and liabilities:			
Receivables	36,811	(46,733)	(15,985)
Inventories	(24,129)	(606)	913
Other assets	(7,130)	(20,407)	(3,909)
Accounts payable and accrued liabilities	(28,604)	32,644	31,999
Deferred income	1,712	3,502	837
Income taxes payable and deferred income taxes	(13,117)	42,738	9,885
Net cash flow generated from operating activities	**112,225**	**190,323**	**122,148**
Cash flow from investing activities:			
Decrease (increase) in short-term investments	78,464	7,836	(117,034)
Acquisition of property, plant, and equipment	(195,280)	(194,878)	(112,370)
Sale of equipment	—	—	7,918
Other	—	—	(969)
Net cash flow used for investing activities	**(116,816)**	**(187,042)**	**(222,455)**
Cash flow from financing activities:			
Borrowing from line of credit	49,000	—	—
Issuance of convertible subordinated notes, net of issuance costs	—	—	89,443
Restricted investments related to building lease agreements	(22,355)	(20,744)	(18,513)
Repurchase of common stock	(32,878)	(37,881)	—
Issuance of capital stock	18,496	31,523	24,502
Other long-term liabilities, including minority interest	2,960	—	526
Net cash flow generated (used) for financing activities	**15,223**	**(27,102)**	**95,958**
Net increase (decrease) in cash and cash equivalents	10,632	(23,821)	(4,349)
Cash and cash equivalents, beginning of year	9,487	33,308	37,657
Cash and cash equivalents, end of year	**$20,119**	**$ 9,487**	**$33,308**
Supplemental disclosures:			
Cash paid during the year for:			
Interest	$ 4,982	$ 4,014	$ 1,677
Income taxes	$45,271	$ 30,744	$24,214

See accompanying notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: THE COMPANY AND ITS SIGNIFICANT ACCOUNTING POLICIES

The Company

Cypress Semiconductor Corporation (the "Company" or "Cypress") was incorporated in California in December 1982, commenced business activities on April 7, 1983, and reincorporated in Delaware in February 1987. The Company designs, develops, and manufactures a broad range of high-performance integrated circuits. The Company sells to the networking, military, computer, telecommunications, and instrumentation application markets.

The Company's operations outside the U.S. expanded in 1996 with the addition of its new test and assembly plant in the Philippines. The Company's other foreign operations include several sales offices and design centers located in various parts of the world. Export revenues, principally to customers in Europe and Japan, were 27%, 34%, and 32% of total revenues in 1996, 1995, and 1994, respectively. As of December 30, 1996, all of the Company's subsidiaries are wholly owned, except for Cypress Semiconductor (Texas), Inc. ("CTI"), the Company's wafer fabrication facility in Texas, which is approximately 17% owned by Altera Corporation ("Altera"). Altera receives a fixed amount of wafer fab capacity for its investment.

No one customer accounted for greater than 10% of revenues in 1996, 1995, or 1994. Sales to one distributor accounted for 10% of total revenues in 1994. No one distributor accounted for greater than 10% of revenues in 1996 or 1995.

Summary of Significant Accounting Policies

Fiscal Year—Fiscal years 1996, 1995, and 1994 ended December 30, 1996, January 1, 1996, and January 2, 1995, respectively. The Company operates on a 52- or 53-week fiscal year, ending on the Monday closest to December 31. Fiscal years 1996, 1995 and 1994 each comprised 52 weeks. Certain prior year amounts have been adjusted to conform to current year presentation.

Management Estimates—The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Principles of Consolidation—The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated.

Revenue Recognition—Revenue from product sales direct to customers is recognized upon shipment. Certain of the Company's sales to domestic distributors are made under agreements allowing certain rights of return and price protection on merchandise unsold by the domestic distributors. Accordingly, the Company defers recognition of sales and profit on such sales until the merchandise is sold by the domestic distributors. In 1997, the Company will sell to certain international distributors on certain select parts, under agreements having rights of return and price protections, which are substantially similar to those contained in agreements with domestic distributors.

The Company also has inventory at certain customers on a consignment basis. Revenue is not recorded until the time the title transfers per the consignment agreement.

Fair Value of Financial Instruments—The Company measures its financial assets and liabilities in accordance with generally accepted accounting principles. For certain of the Company's financial instruments, including cash and cash equivalents, trade accounts receivable, accounts payable, and accrued expenses, the carrying amounts approximate fair value due to their short maturities. The amounts shown for long-term debt also approximate fair value.

Cash Equivalents and Short-Term Investments—The Company accounts for investments in accordance with Statement of Financial Accounting Standards No. 115 ("SFAS 115"), "Accounting for Certain Investments in Debt and Equity Securities." All highly liquid investments purchased with an original maturity of three months or less are considered to be cash equivalents. The Company classifies all investments as available for sale, based upon the Company's intention to use these investments to fund working capital needs. The investments, which all have contractual maturities of less than two years, are carried at

cost plus accrued interest, which approximated market for the entire fiscal year. A summary of the carrying amounts of the investments are as follows:

(Dollars in thousands)

	December 30, 1996	January 1, 1996
Corporate debt securities	$ 2,000	$ 6,125
State and municipal obligations	50,171	130,606
Other	21,496	15,400
Total	**$ 73,667**	**$152,131**

Concentration of Credit Risk—Financial instruments that potentially subject the Company to significant concentration of credit risk consist principally of cash equivalents, short-term investments, long-term restricted cash, and trade accounts receivable. The Company places its cash equivalents, short-term investments and long-term restricted cash in a variety of financial instruments such as municipal securities and U.S. Government securities. The Company further limits its exposure to these investments by placing such investments with various financial institutions. The Company routinely performs credit evaluations of these financial institutions.

The Company sells its product to original equipment manufacturers and distributors throughout the world. The Company performs ongoing credit evaluations of its customers' financial condition and, generally, requires no collateral from its customers. The Company maintains an allowance for uncollectible accounts receivable based upon expected collectibility of all accounts receivable.

Inventories—Inventories are valued at standard costs that approximate actual costs, but not in excess of market. Cost is determined on a first-in, first-out basis. Market is based on estimated net realizable value. The components of inventories are as follows:

(Dollars in thousands)

	December 30, 1996	January 1, 1996
Raw materials	$ 12,214	$ 9,859
Work-in-process	27,765	12,682
Finished goods	13,128	6,437
Total	**$ 53,107**	**$ 28,978**

Property, Plant, and Equipment—Property, plant, and equipment are stated at cost. Depreciation and amortization are computed for financial reporting purposes using the straight-line method over the estimated useful lives of the assets, or lease term if less than useful life. Accelerated methods of computing depreciation are used for tax purposes. The components of property, plant, and equipment are as follows:

(Dollars in thousands)

	Useful Lives in Years	Dec 30, 1996	Jan 1, 1996
Land		$ 12,546	$ 8,850
Machinery and equipment	3 to 5	641,612	501,377
Buildings and leasehold improvements	7 to 10	70,673	38,821
Furniture and fixtures	5	7,568	5,384
		732,399	**554,432**
Accumulated depreciation and amortization		(294,833)	(217,839)
Total		**$437,566**	**$336,593**

Preproduction Costs—Incremental costs incurred in connection with developing major production capability at new manufacturing plants, including depreciation, amortization, and cost of qualification of equipment and production processes, are capitalized.

Preproduction costs totaling $4.1 million and $3.1 million, which are net of accumulated amortization of $1.4 million and $1.2 million in 1996 and 1995, respectively, are included in other assets at December 30, 1996 and January 1, 1996, respectively. Such costs are being amortized over five years at a rate based on estimated units to be manufactured during that period. Costs charged to operations for amortization of preproduction costs were $217,000 in 1996, $142,000 in 1995, and $567,000 in 1994.

Income Taxes—The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109 ("SFAS 109"), "Accounting for Income Taxes." The statement requires that the Company follow the liability method of accounting for income taxes which requires recognition of deferred tax liabilities and assets for the expected future tax consequences of temporary differences between the financial statement carrying amounts and the tax bases of assets and liabilities.

Net Income per Share—Net income per share is computed using the weighted average number of shares of outstanding common stock and common equivalent shares, when dilutive. Common equivalent shares include shares issuable under the Company's stock option plans as determined by the treasury stock method. Fully diluted earnings per share assumes full conversion of the convertible subordinated notes into common shares and the elimination of the related interest requirements (net of income taxes).

Translation of Foreign Currencies—The Company accounts for foreign currency translation under Statement of Financial Accounting Standards No. 52 ("SFAS 52"), "Foreign Currency Translation." In accordance with SFAS 52, the Company's new test and assembly operation in the Philippines uses the Philippine peso as its functional currency, while the Company's other operations use the U.S. dollar as its functional currency. Sales to customers are primarily denominated in U.S. dollars, and foreign currency translation gains and losses have not been material in any year.

Accounting for Stock-Based Compensation—The Company accounts for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. The Company's policy is to grant options with an exercise price equal to the quoted market price of the Company's stock on the grant date. Accordingly, no compensation cost has been recognized in the Company's statements of operations. The Company provides additional pro forma disclosures as required under Statement of Financial Accounting Standards No. 123 ("SFAS 123"), "Accounting for Stock-Based Compensation." See Note 4.

NOTE 2: RESTRUCTURING AND OTHER NON-RECURRING COSTS

In the third quarter of 1996, the Company recorded a pre-tax restructuring and other non-recurring benefit of $7.0 million. A majority of the benefit was derived from the reversal of the $17.8 million reserve established in 1995 related to the Texas Instruments ("TI") patent infringement lawsuit. In July 1996, the Federal Circuit Court of Appeals affirmed the earlier decision of the trial court that the Company did not infringe on either of the patents in the suit. In September 1996 the Court decided that it would not hear any appeal filed by the plaintiff regarding this matter. In December 1996, TI filed a petition of certiorari in the United States Supreme Court. If the petition is granted, the Supreme Court would review on appeal the decision of the Federal Circuit Court of Appeals. Litigation counsel for the Company considers the possibility to be remote that the Supreme Court will grant the petition and hear the appeal, given the small percentage of such petitions that are granted and the fact that the case does not appear to present issues of significant national interest. During the same quarter, the Company also announced a restructuring of its San Jose wafer fabrication facility, from a production wafer fabrication plant to predominantly a research and development wafer fabrication facility. As a result of this restructuring, the Company recorded a pre-tax charge of $9.1 million, $5.9 million relating to the write-down of certain excess equipment and the transfer of certain other equipment to its Texas and Minnesota production wafer fabrication facilities, and $3.2 million relating to severance and other cash related restructuring charges. Costs charged against the restructuring reserve in the fourth quarter of 1996 were immaterial. In September, the Company also recorded a one-time, pre-tax credit of $3.3 million related to the insurance reimbursement of defense costs incurred in conjunction with the securities class-action lawsuit. This credit was approximately offset by other non-recurring charges related to agreements with certain companies regarding cross-licensing and other matters.

NOTE 3: CONVERTIBLE SUBORDINATED NOTES

On March 31, 1994, the Company completed a $110 million private placement of 7-year discounted convertible subordinated notes. The notes are due in the year 2001, with a coupon rate of 3.15 percent and a yield-to-maturity of 6.04 percent. The notes are convertible into approximately 7,940,000 shares of common stock and are callable by the Company three years after the date of issuance. Net proceeds were $89.4 million, after issuance costs of $2.9 million. The discount is being amortized using the effective interest rate method over the life of the notes. At year-end, the amount of the convertible subordinated notes required to be reflected as a liability on the Company's balance sheet totaled $98.2 million, which approximates fair market value. See Note 8 for related subsequent events.

NOTE 4: COMMON STOCK OPTION AND OTHER EMPLOYEE BENEFIT PLANS

1994 Stock Option Plan

In 1994, the Company adopted the 1994 Stock Option Plan, which replaced the Company's 1985 Incentive Stock Option Plan and the 1988 Directors' Stock Option Plan (the "Terminated Plans") with respect to future option grants. Under the terms of the 1994 Stock Option Plan, options may be granted to qualified employees, consultants, officers and directors of the Company or its majority-owned subsidiaries. Options become exercisable over a vesting period as determined by the Board of Directors and expire over terms not exceeding ten years from the date of grant. The option price for shares granted under the 1994 Stock Option Plan is typically equal to the fair market value of the common stock at the date of grant. The 1994 Stock Option Plan includes shares that remained available under the Terminated Plans and provides for an annual increase in shares available for issuance pursuant to nonstatutory stock options equal to 4.5% of the Company's outstanding common stock at the end of each fiscal year.

In October 1996, substantially all outstanding options with a share price in excess of $11.00 were canceled and repriced with new options having an exercise price of $11.00 per share, the fair market value as of the date the repricing was announced. A total of 7,083,312 options were repriced. The following table summarizes the Company's shares available for grant and stock option activity for the years ended December 30, 1996, January 1, 1996, and January 2, 1995. The weighted average exercise price for each catagory presented is also shown in the table below.

Shares Under Option and Available for Grant

		Outstanding Options	
	Shares Available for Grant	Number of Shares	Weighted Average Exercise Price
Balance, January 3, 1994	911,582	18,705,510	$ 4.79
Options authorized	6,000,000	—	—
Options granted	(5,548,722)	5,548,722	$ 8.71
Options exercised	—	(3,915,126)	$ 4.61
Options cancelled	1,367,318	(1,367,318)	$ 5.29
Balance, January 2, 1995	2,730,178	18,971,788	$ 5.92
Options authorized	3,502,026	—	—
Options granted	(7,504,204)	7,504,204	$16.82
Options exercised	—	(5,735,670)	$ 4.81
Options cancelled	1,292,221	(1,292,221)	$16.05
Balance, January 1, 1996	20,221	19,448,101	$ 9.81
Options authorized	3,680,864	—	—
Options granted	(12,202,297)	12,202,297	$11.23
Options exercised	—	(1,781,980)	$ 5.38
Options cancelled	8,855,197	(8,855,197)	$14.71
Balance, December 30, 1996	353,985	21,013,221	$ 8.94
Options exercisable on December 30, 1996		9,375,526	$ 7.03

All options were granted at an exercise price equal to the market value of the Company's stock at the date of grant. The weighted average estimated fair value at the date of grant, as defined by SFAS 123, for options granted in 1996 and 1995 was $11.23 and $16.82 per option, respectively. The estimated grant date fair value disclosed by the Company is calculated using the Black-Scholes model. The Black-Scholes model, as well as other currently accepted option valuation models, was developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which significantly differ from the Company's stock option awards. These models also require highly subjective assumptions, including future stock price volatility and expected time until exercise, which greatly affect the calculated grant date fair value.

The following weighted average assumptions are included in the estimated grant date fair value calculations for the Company's stock option awards.

	1996	1995
Expected life	6 years	6 years
Risk-free Interest Rate	6.04%	6.28%
Volatility	.5582	.5559
Dividend Yield	0.00%	0.00%

Significant option groups outstanding as of December 30, 1996 and the related weighted average exercise price and contractual life information are as follows (share information in thousands):

Options with exercise prices range from	Outstanding Shares	Outstanding Price	Exercisable Shares	Exercisable Price	Remaining life (years)
$ 1.00 - $4.75	3,188	$ 4.41	3,150	$ 4.41	3.98
$ 4.76 - $7.13	2,731	$ 5.52	2,149	$ 5.44	6.56
$ 7.14 - $9.25	3,544	$ 8.40	1,922	$ 8.44	7.33
$ 9.26 - $10.88	1,978	$10.45	95	$10.28	9.66
$10.89 - $17.75	9,572	$11.32	2,060	$11.22	9.02

Employee Qualified Stock Purchase Plan

In 1986, the Company approved an Employee Qualified Stock Purchase Plan ("ESPP"), which allows eligible employees of the Company and its subsidiaries to purchase shares of common stock through payroll deductions. The ESPP consists of consecutive 24-month offering periods composed of four 6-month exercise periods. The shares can be purchased at the lower of 85% of the fair market value of the common stock at the date of commencement of this two-year offering period or at the last day of each 6-month exercise period. Purchases are limited to 10% of an employee's eligible compensation, subject to a maximum annual employee contribution limited to a $25,000 market value (calculated as employee's enrollment price multiplied by purchased shares). Of the 7,600,000 shares authorized under the ESPP, 5,889,091 shares were issued through 1996 including, 652,157, 582,432, and 900,496 shares in 1996, 1995, and 1994, respectively.

Compensation costs (included in pro forma net income and net income per share amounts) for the grant date fair value, as defined by SFAS 123, of the purchase rights granted under the ESPP were calculated using the Black-Scholes model. The following weighted average assumptions are included in the estimated grant date fair value calculations for rights to purchase stock under the ESPP:

	1996	1995
Expected life	6 months	6 months
Risk-free Interest Rate	5.98%	5.45%
Volatility	.5882	.5275
Dividend Yield	0.00%	0.00%

The weighted average estimated grant date fair value, as defined by SFAS 123, or rights to purchase stock under the ESPP granted in 1996 and 1995 were $ 12.96 and $ 16.12 per share, respectively.

Pro Forma Net Income and Net Income Per Share

Had the Company recorded compensation costs based on the estimated grant date fair value, as defined by SFAS 123, for awards granted under its 1994 Stock Option Plan and its Employee Stock Purchase Plan, the Company's pro forma net income and earnings per share for the years ended December 30, 1996 and January 1, 1996 would have been as follows:

	1996	1995
Pro forma net income:		
Primary	$ 33,243	$ 92,814
Fully Diluted	$ 32,561	$ 92,814
Pro forma net income per share:		
Primary	$ 0.40	$ 1.06
Fully diluted	$ 0.37	$ 1.00

The pro forma effect on net income and net income per share for 1996 and 1995 is not representative of the pro forma effect on net income in the future years because it does not take into consideration pro forma compensation expense related to grants prior to 1995.

Treasury Stock

In November 1995, the Board of Directors authorized the repurchase of $50.0 million of the Company's common stock. In the first quarter of 1996, the Board approved to increase the amount authorized to approximately $70.0 million. The Company completed the stock purchase program by purchasing 2.8 million shares for $32.9 million in 1996 and 2.7 million shares for $37.9 million in 1995. The shares purchased are expected to be used in conjunction with the Company's 1994 Stock Option Plan and ESPP.

Other Employee Benefit Plans

The Company also maintains a Section 401(k) Plan, Profit Sharing Plan, and Key Employee Bonus Plan. The 401(k) Plan provides participating employees with an opportunity to accumulate funds for retirement and hardship. Eligible participants may contribute up to 20% of their eligible earnings to the Plan Trust.

Under the Profit Sharing Plan, all qualified employees are provided an equal share of bonus payments, which are based on the Company achieving a targeted level of earnings per share. In 1995 and 1994, $7,575,000 and $5,241,000 respectively, were charged to operations in connection with the Profit Sharing Plan. In 1996, no charges to operations were made in connection with the profit sharing plan.

In 1994, a Key Employee Bonus Plan was established, which provides for bonus payments to selected employees upon achievement of certain Company and individual performance targets. In 1995 and 1994, $4,937,000 and $1,902,000, respectively, were charged to operations in connection with this Plan. In 1996, there were no charges to operations in connection with this plan.

NOTE 5: INCOME TAXES

The components of the provision for income taxes are summarized below. Income before taxes is principally attributed to domestic operations.

Components of the Provision for Income Taxes

(Dollars in thousands)

	Year Ended		
	December 30, 1996	**January 1, 1996**	**January 2, 1995**
Income before provision for taxes	$ 83,505	$161,384	$ 80,115
Current tax expense:			
U.S. Federal	$ 21,481	$ 60,163	$ 24,998
State and local	1,706	6,988	3,286
Foreign	1,073	220	101
Total current	**24,260**	**67,371**	**28,385**
Deferred tax expense (benefit):			
U.S. Federal	5,559	(7,849)	709
State and local	657	(615)	549
Total deferred	**6,216**	**(8,464)**	**1,258**
Total	**$ 30,476**	**$ 58,907**	**$ 29,643**

The tax provision differs from the amounts obtained by applying the statutory U.S. Federal Income Tax Rate to income before taxes as shown below.

Tax Provision Difference

(Dollars in thousands)

	Year Ended		
	December 30, 1996	**January 1, 1996**	**January 2, 1995**
Statutory rate	35%	35%	35%
Tax at U.S. statutory rate	$29,227	$56,487	$28,040
State income taxes, net of federal benefit	1,536	4,142	2,492
Tax credits	—	(1,013)	(300)
Net Foreign Sales Corporation (FSC) benefit	(1,548)	(479)	(427)
Benefit of tax free investments	(998)	(2,259)	(1,324)
Other, net	2,259	2,029	1,162
Total	**$30,476**	**$58,907**	**$29,643**

The components of the net deferred tax assets at December 30, 1996, and January 1, 1996, under SFAS 109 were as follows:

(Dollars in thousands)

	December 30, 1996	**January 1, 1996**
Deferred tax assets:		
Deferred income on sales to distributors	$ 9,667	$ 5,654
Inventory reserves and basis differences	13,794	7,677
Restructuring and legal reserves	1,167	11,027
Asset valuation and other reserves	13,511	10,822
State tax, net of federal tax	522	455
Other, net	1,472	2,388
Total deferred tax assets	**40,133**	**38,023**
Deferred tax liabilities:		
Excess of tax over book depreciation	(25,568)	(17,294)
Other, net	(1,184)	(1,271)
Total deferred tax liabilities	**(26,752)**	**(18,565)**
Net deferred tax assets	**$13,381**	**$19,458**

The net deferred tax asset at December 30, 1996, is substantially realizable through carry-back to prior years' taxable income. Other current assets include current deferred tax assets of $34,900,000 at December 30, 1996, and $35,111,000 at January 1, 1996, respectively.

The tax benefits associated with disqualifying dispositions of stock options or employee stock purchase plan shares reduce taxes currently payable by $3.9 million.

NOTE 6: COMMITMENTS AND CONTINGENCIES

Operating Lease Commitments

The Company leases most of its manufacturing and office facilities under noncancelable operating lease agreements that expire at various dates through 2004. These leases require the Company to pay taxes, insurance, and maintenance expenses, and provide for renewal options at the then fair market rental value of the property.

In 1994 and 1995, the Company entered into three operating lease agreements with respect to its office and manufacturing facilities in San Jose and Minnesota, respectively. In April 1996, the Company entered into an additional lease agreement related to two office facilities in San Jose. These agreements require quarterly payments that vary based on the London interbank offering rate ("LIBOR"), plus a spread. All leases pro-

vide the Company with the option of either acquiring the property at its original cost or arranging for the property to be acquired at the end of the respective lease terms. The Company is contingently liable under certain first-loss clauses for up to $55.5 million at December 30, 1996. Based on management's estimate of the fair value of the properties, no liability was recorded at December 30, 1996. Furthermore, the Company is required to maintain a specific level of restricted cash or investments to serve as collateral for these leases and maintain compliance with certain financial covenants. As of December 30, 1996, the amount of restricted cash or investments recorded was $61.6 million, which is in compliance with these agreements. These restricted cash or investments are classified as non-current assets on the balance sheet.

The aggregate annual rental commitments under noncancelable operating leases as of December 30, 1996, are:

(Dollars in thousands)

Fiscal Year	
1997	$ 7,432
1998	6,046
1999	5,100
2000	4,555
2001	2,848
2002 and thereafter	7,313
Total	**$33,294**

Rental expense was approximately $7,708,000 in 1996, $5,995,000 in 1995, and $4,954,000 in 1994.

Line of Credit

In July 1996, the Company established a three-year, $100-million unsecured revolving credit facility with Bank of America National Trust and Savings Association as agent on behalf of certain banks. The applicable interest rate for usage under this agreement is a graduated scale of LIBOR, plus a spread. The agreement contains certain financial and other covenants including limitation on indebtedness, liens, disposition of assets, consolidations and mergers, investments and contingent obligations, and maintenance of a leverage ratio, consolidated tangible net worth, quick ratio and adjusted EBIT/fixed charge coverage ratio. In September 1996, the Company borrowed $49.0 million against the line of credit which remained outstanding at year end. The balance borrowed will be due three years from the date of the agreement. The borrowings from the line of credit are recorded on the balance sheet as current liabilities.

Litigation and Asserted Claims

In the normal course of business, the Company receives and makes inquiries with regard to possible patent infringement. Where deemed advisable, the Company may seek or extend licenses or negotiate settlements.

In May 1995, in a case before the U.S. District Court in Dallas, Texas, a jury delivered a verdict of $17.8 million against the Company in a patent infringement lawsuit filed by Texas Instruments ("TI"). In August 1995, the judge reversed the decision stating that TI failed to prove that Cypress infringed on TI's patents covering the plastic encapsulation process used to package semiconductor devices. In July 1996, the Federal Court of Appeals affirmed the decision of the trial court that the Company did not infringe on either of the patents in the suit. In September 1996 the Court denied TI's motion for reconsideration, and as a result of that ruling, Cypress reversed the $17.8 million reserve recorded in March 1995 with respect to this lawsuit. In December 1996, TI filed a petition of certiorari in the United States Supreme Court. If the petition is granted, the Supreme Court would review on appeal the decision of the Federal Circuit Court of Appeals. Litigation counsel for the Company considers the possibility that the Supreme Court will grant the petition and hear the appeal to be remote, given the small percentage of such petitions that are granted and the fact that the case does not appear to present issues of significant national interest.

In June 1995, Advanced Micro Devices ("AMD") charged the Company with patent infringement and filed suit in the U.S. District Court in Delaware. The suit claimed that the Company infringed on several of AMD's Programmable Logic Patents. In November 1995, the Company filed a patent infringement action against AMD in the U.S. District Court for the District of Minnesota. The Company alleged infringement by AMD of a number of the Company's patents in this action. In April 1996, the Company and AMD signed a cross-licensing agreement terminating the patent litigation between the two companies. The agreement allows each company to continue to produce its own products with no threat of future patent lawsuits by the other company.

In June 1995, the U.S. District Court of Northern California dismissed by a summary judgement a class-action lawsuit filed against the Company and certain of its officers. The suit filed was for alleged violations of the Securities Exchange Act of 1934 and certain provisions of state law regarding disclosure of short-term business prospects. The plaintiffs have filed an appeal. The Company will vigorously defend itself in this matter and, subject to the inherent uncertainties of litigation and based upon discovery completed to date, management believes that the resolution of this matter will not have a material adverse impact on the Company's financial position or results of operations. However, should the outcome of this action be unfavorable, the Company may be required to pay damages and other expenses, which could have a material adverse effect on the Company's financial position and results of operations.

Purchase Commitments

At December 30, 1996, the Company had purchase commitments aggregating $57.0 million, principally for manufacturing equipment and facilities. These commitments were made for purchases in 1997.

NOTE 7: RELATED PARTIES

During 1990, the Company made a cost-basis investment of $1.0 million in Vitesse Semiconductor Series E Preferred Stock (which has been converted to common stock since Vitesse's initial public offering) and guaranteed an equipment lease line of credit for Vitesse, of $3.5 million, maturing on August 31, 1997. There was no outstanding principal balance related to the lease line as of December 30, 1996. In May 1996, the Company recorded a gain on the sale of 25% of its investment in Vitesse. As of December 30, 1996, the Company's cost-basis investment is $750,000. The Company's chairman, a board member, and its president are members of the Vitesse Board of Directors.

Between 1992 and 1995, the Company made cost-basis investments totaling $3.2 million in QuickLogic Series D and E preferred stock. No additional investment was made in 1996. The Company also recorded sales to QuickLogic of $8,206,000, $5,769,000, and $1,972,000 in 1996, 1995, and 1994, respectively, and at fiscal year-end 1996, 1995, and 1994, the Company had a receivable due from QuickLogic of $1,374,000, $717,000, and $787,000, respectively. In the second quarter of 1996, QuickLogic exercised its right under the 1993 agreement to receive additional wafer capacity by paying the Company $4.5 million. Subsequent to year end, the Company and QuickLogic signed a letter of intent to terminate this agreement and enter into a new agreement. See Note 8 for related subsequent events. Under certain circumstances, the Company may make additional investments in QuickLogic. The Company's chairman's venture capital firm is an investor in QuickLogic and is represented on the Board of Directors.

NOTE 8: SUBSEQUENT EVENTS

In February 1997, the Company signed a letter of intent with QuickLogic to terminate an existing joint development, licensing, and foundry agreement for antifuse Field Programmable Gate Array ("FPGA") products and planned to execute a new foundry agreement. Under the new agreement, Cypress will cease to develop, market, and sell antifuse-based FPGAproducts. In return, the Company's equity position in the privately held QuickLogic will grow to greater than 20%. The Company also entered into a five-year wafer-supply agreement to provide FPGAproducts to QuickLogic. The agreement is subject to the completion of definitive documentation and necessary consents and approvals. The agreement is expected to be finalized in March 1997.

In February 1997, the Company called for redemption of all of the 3.15% Convertible Subordinated Notes that are due in 2001. The redemption will be effective March 26, 1997. Approximately $110.0 million aggregate principal amount at maturity of the notes were outstanding at the time the notes were called for redemption with the aggregate redemption price of approximately $99.0 million. Prior to 5:00 P.M. EST, on March 25, 1997, holders have the option to convert their notes into shares of Cypress common stock at a conversion rate of 72.1746 shares of stock per $1,000 principal amount at maturity of the note. Alternatively, holders may have their notes redeemed at a total redemption price of $900.25 per $1,000 amount at maturity of the notes. The redemption price consists of: (a) an issue price of $839.03, plus (b) $60.26 of accrued original issue discount, plus (c) accrued interest of $0.96, per $1,000 principal amount at maturity of the notes. Any notes that are not converted on or before 5:00 P.M. EST, March 25, 1997 will automatically be redeemed on March 26, 1997.

In February 1997, the Company sold its remaining $750,000 investment in Vitesse Semiconductor. The Company sold 83,333 shares and recorded a gain of $3.8 million.

SUMMARY ANNUAL AND QUARTERLY FINANCIAL DATA

(Amounts in thousands, except per-share data and employee headcount)

(Unaudited) **Year Ended**

	Dec 30 1996	Jan 1 1996	Jan 2 1995	Jan 3 1994	Dec 28 1992	Dec 30 1991	Dec 31 1990	Jan 1 1990
Revenues	$528,385	$596,071	$406,359	$304,512	$272,242	$286,829	$225,232	$199,339
Costs and expenses:								
Cost of revenues	305,174	276,160	222,620	179,821	158,159	128,149	93,947	81,963
Research and development	84,334	71,667	53,188	49,798	64,951	71,750	55,553	47,604
Selling, general and administrative	64,301	71,273	52,759	46,344	45,068	42,171	33,437	29,261
Acquisition-related non-recurring charges	—	—	—	18,271	—	—	—	—
Restructuring and other non-recurring costs (benefits)	(7,018)	17,800	—	(408)	39,700	—	—	—
Total costs and expenses	446,791	436,900	328,567	293,826	307,878	242,070	182,937	158,828
Operating income (loss)	81,594	159,171	77,792	10,686	(35,636)	44,759	42,295	40,511
Interest expense	(6,895)	(6,239)	(4,041)	(289)	(440)	(1,000)	(1,088)	(1,786)
Interest income and other	8,806	8,452	6,364	2,170	3,148	8,012	9,142	7,900
Income (loss) before income taxes	83,505	161,384	80,115	12,567	(32,928)	51,771	50,349	46,625
(Provision) benefit for income taxes	(30,476)	(58,907)	(29,643)	(4,524)	11,918	(17,600)	(17,119)	(15,911)
Net income (loss)	$ 53,029	$102,477	$ 50,472	$ 8,043	$ (21,010)	$ 34,171	$ 33,230	$ 30,714
Net income (loss) per share:								
Primary	$ 0.63	$ 1.15	$ .61	$ .11	$ (.28)	$ .42	$ .43	$ .40
Fully diluted	$ 0.62	$ 1.09	$ .60	—	—	—	—	—
Weighted average shares used in computation of EPS:								
Primary	83,661	89,347	82,313	76,218	74,514	80,668	76,502	76,524
Fully diluted	92,016	97,583	88,602	—	—	—	—	—
Depreciation / amortization expense	97,606	64,733	45,039	41,245	47,634	41,538	33,503	25,828
Cash and short-term investments	93,786	161,618	193,275	80,590	82,046	103,703	91,650	96,641
Stockholders' equity	510,746	472,099	352,999	271,685	262,061	298,612	242,208	219,422
Number of employees	2,171	1,859	1,423	1,262	1,529	1,945	1,595	1,388
Percent of revenue								
Cost of revenue	58%	46%	55%	59%	58%	44%	42%	41%
Research & development	16%	12%	13%	16%	24%	25%	25%	24%
Selling, general & administrative	12%	12%	13%	15%	17%	15%	15%	15%
Total costs and expenses	85%	73%	81%	96%	113%	84%	81%	80%
Operating income (loss)	15%	27%	19%	4%	(13%)	16%	19%	20%

	Three Months Ended							
	Dec 30 1996	Sep 30 1996	July 1 1996	Apr 1 1996	Jan 1 1996	Oct 2 1995	July 3 1995	Apr 3 1995
	$113,103	$109,647	$135,464	$170,171	$177,279	$161,155	$134,273	$123,365
	75,223	81,075	72,015	76,861	80,567	73,860	60,899	60,834
	21,103	19,826	21,989	21,416	21,300	18,305	16,392	15,671
	15,661	14,998	15,502	18,140	20,568	17,908	17,506	15,291
	—	—	—	—	—	—	—	—
	—	(7,018)	—	—	—	—	—	17,800
	111,987	108,881	109,506	116,417	122,435	110,073	94,797	109,596
	1,116	766	25,958	53,754	54,844	51,082	39,476	13,769
	(2,149)	(1,617)	(1,482)	(1,647)	(1,530)	(1,560)	(1,415)	(1,733)
	3,089	1,769	2,075	1,873	2,677	1,215	2,255	2,303
	2,056	918	26,551	53,980	55,991	50,737	40,316	14,339
	(752)	(335)	(9,686)	(19,703)	(20,441)	(18,518)	(14,714)	(5,234)
	$ 1,304	$ 583	$ 16,865	$ 34,277	$ 35,550	$ 32,219	$ 25,602	$ 9,105
	$ 0.02	$ 0.01	$ 0.20	$ 0.41	$ 0.40	$ 0.35	$ 0.29	$ 0.11
	—	—	$ 0.20	$ 0.39	$ 0.38	$ 0.33	$ 0.27	$ 0.11
	84,911	83,028	83,285	83,418	88,926	91,681	89,557	87,223
	—	—	91,227	91,358	96,860	99,621	98,244	95,607
	27,257	25,455	23,290	21,604	20,300	17,533	13,609	13,291
	93,786	95,557	65,453	111,073	161,618	183,654	175,541	196,200
	510,746	502,231	497,715	477,864	472,099	449,680	410,177	373,446
	2,171	2,124	2,093	1,971	1,859	1,750	1,605	1,477
	67%	74%	53%	45%	45%	46%	45%	49%
	19%	18%	16%	13%	12%	11%	12%	13%
	14%	14%	11%	11%	12%	11%	13%	12%
	99%	99%	81%	68%	69%	68%	71%	89%
	1%	1%	19%	32%	31%	32%	29%	11%

REPORT OF INDEPENDENT ACCOUNTANTS

To the Stockholders and Board of Directors of Cypress Semiconductor Corporation:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, stockholders' equity, and of cash flows present fairly, in all material respects, the financial position of Cypress Semiconductor Corporation and its subsidiaries at December 30, 1996 and January 1, 1996, and the results of its operations and its cash flows for each of the three years in the period ended December 30, 1996, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

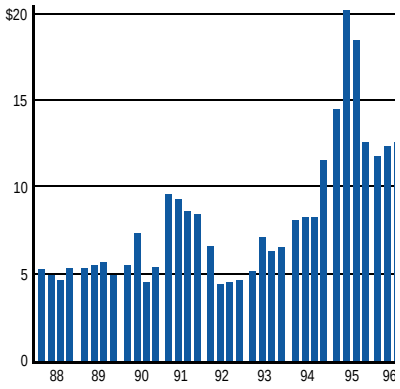
Price Waterhouse LLP
San Jose, California
January 20, 1997, except as to Note 8, which is as of February 25, 1997

ABOUT YOUR INVESTMENT

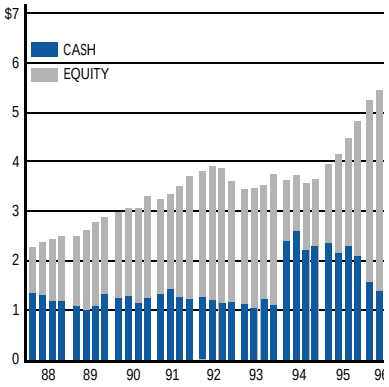
The Company's Common Stock trades on the New York Stock Exchange under the trading symbol "CY." The following table sets forth, for the periods indicated, the low, the high, and closing sales prices for the Common Stock. The Company has not paid cash dividends and has no present plans to do so. At December 30, 1996 there were approximately 3,579 holders of record of the Company's Common Stock.

	Price Range of Common Stock ($)		
	Low	**High**	**Close**
Fiscal year ended			
December 30, 1996:			
First Quarter	10.00	16.25	11.75
Second Quarter	11.38	15.00	12.25
Third Quarter	9.13	13.63	12.63
Fourth Quarter	10.50	16.63	14.50
Fiscal year ended			
January 1, 1996:			
First Quarter	10.75	16.13	14.31
Second Quarter	13.06	21.63	20.13
Third Quarter	17.06	27.75	18.81
Fourth Quarter	11.50	19.19	12.63

Closing Share Price



Stockholders' Equity per Share
And Cash per Share



GLOSSARY

Analog As opposed to digital, signals that are "on" or "off," or "1" or a "0." Analog signals vary in a continuous manner, like the Dow Jones Industrial Average.

ATM Asynchronous Transfer Mode. A high-speed transmission standard whereby information of various types—voice, video, and data—is conveyed as a sequence of small, fixed-length packets of data.

ASP The average selling price, per-unit, of a class of components (e.g., SRAMs).

Back-end A reference to the final suite of semiconductor manufacturing operations that comprises assembly, packaging, package marking, and final electrical testing of the devices.

Baseband communications In general, communications in which the information-carrying signal is placed directly on the transmission medium without use of a carrier signal. In particular, Ethernet is an example of a digital, networked baseband system.

Bit The minimum piece of digital information, a "1" or a "0," typically represented as a "high" or "low" voltage state in electronic circuits. A numeral, letter, or other symbol can be represented by a combination of eight bits, which is called a "byte."

Broadband communications Traditionally, communication using an analog carrier signal modulated by (made to vary in accordance with) the information signal (whether analog or digital). More recently, also a reference to communication across a network having wide-bandwidth (broad frequency response) channels.

Cache A small, very fast memory made from SRAM chips, used to "feed" microprocessors at their maximum rate (DRAM memory is too slow). Cache SRAM on the microprocessor chip is called primary, or Level 1, cache; SRAMs on the motherboard are called secondary, or Level 2, cache. See **DRAM**, **SRAM**.

Cellular base station A fixed node, or location, in a cellular telephone system, which transmits to and receives from the individual mobile cellular phones operating within the cell controlled by the base station. The various technologies used in digital cellular telephony are CDMA(Code Division Multiple Access); AMPS (Advanced Mobile Phone System); TDMA(Time Division Multiple Access); PHS (Personal Handyphone System); and GMS (Global Mobile System standard).

Chip A single, monolithic integrated circuit (IC), one of many identical such ICs fabricated simultaneously on a (usually silicon) wafer. Also called a die. See **integrated circuit**.

Chipset In general, a group of ICs that work together to perform a defined set of functions. A PC chipset connects, or bridges, a PC's central processor unit (e.g., a Pentium processor) to the system's secondary cache (SRAM) memory, main (DRAM) memory, and peripherals buses (e.g., PCI and ISAbuses).

Clean room Dust and other particles in the air we breathe are frequently larger than the features fabricated on modern ICs and can damage the ICs while they are being built. Thus, the fabrication of IC chips on wafers is carried out in a room with a highly controlled, filtered atmosphere—a "clean" room.

CMOS Complementary Metal Oxide Semiconductor. The silicon IC technology of choice for the 1990s, the CMOS process produces complementary (p-channel and n-channel) Metal Oxide Semiconductor (MOS) transistors on the same wafer, which permits the design of very low power ICs. Cypress was one of the first companies to produce a modern, very fast version of CMOS, achieved by reducing transistor feature size to the sub-micron region.

Core competency Also, core technology. A company's special expertise upon which its competitive advantage is based. Cypress's core competencies include the design and volume manufacture of high-quality and high-reliability ICs, and EPROM, SRAM, PLL, and digital- and programmable-logic technologies.

Core logic IC products that provide all the logic needed in a personal computer (excluding the microprocessor). Compare **glue logic**.

CPLD Complex Programmable Logic Device. An integrated circuit consisting of a limited number of relatively large, user-programmable logic blocks. Each logic block is roughly equivalent to a small programmable logic device (PLD). The logic blocks and the CPLD's input/output points communicate with each other across an interconnect matrix that is a defining feature of CPLD architecture. CPLDs are well-suited to fast, complex, single-pass logic, such as state machines, decoders, and counters. See **PLD**.

Data communications The transmission and reception of digitally coded information.

Die See **chip**.

Digital A signal or function the amplitude (voltage or current level) of which, at any given time, is characterized by a discrete value. A binary digital signal varies between two discrete levels called "1" and "0" or "high" and "low." Compare analog.

Digital logic A methodology (also called Boolean algebra) for dealing with expressions containing two-state variables (i.e., binary, "1" or "0", "high" or "low") that describe the behavior of a circuit or system. Also, the hardware (components and circuits) in which such expressions are implemented.

Discrete device A single semiconductor device, such as a transistor, fabricated, packaged, and tested for individual use in a circuit design. Compare **integrated circuit**.

DRAM Dynamic Random Access Memory. The main memory in almost all computers and the highest-volume chip manufactured. Compare **SRAM**.

Dual-Port RAM An SRAM that can be accessed by two different computers simultaneously. See **SRAM**.

Dynamic RAM See **DRAM**.

EPROM Erasable Programmable Read Only Memory. A form of PROM that uses special MOS transistors to store charge (to represent a "1" or "0") for tens of years, even without power. An EPROM can be erased (using ultraviolet light) and reprogrammed. See **PROM**.

ESCON An IBM-proprietary communications **protocol** (see entry) used to connect IBM-compatible computers.

Ethernet A local area network (LAN) technology for carrying data at a 10 Mbps (millions of bits per second) rate. Fast Ethernet, a recent development, extends the data rate to 100 Mbps.

FCT logic Fast CMOS Technology logic. The **"glue logic"** (see entry) integrated circuits used to construct digital electronic systems. See also **bit** and **CMOS**.

Fibre Channel A standard for data communications that prescribes how to interconnect computers and peripherals at specified data rates between 267 and 1065 Mbps (millions of bits per second).

FIFO First-In, First-Out Memory. A FIFO allows data to be inserted at one end and taken out the other in the same sequence and to be added at a different rate than it is removed. Therefore, FIFOs are useful for communicating data between systems operating at different data rates.

Glue logic A general term referencing miscellaneous functions. Specifically, the fixed or programmable logic devices used on a PC motherboard to implement the few functions not already integrated into the **chipset** (see entry).

HOTLink™ The name for Cypress's CY7B923/CY7B933 transmitter/receiver chipset for high-speed data communications over fiberoptic, coaxial, and twisted-pair link media at rates to 400 Mbps (millions of bits per second).

Hub (network hub) A kind of multifunction switching equipment, typically located at the center of a star-topology local area network. (In a star topology, connections radiate out from the center to the peripheral nodes, like the spokes of a wheel.) A hub performs a variety of duties, such as signal routing and switching. It also acts as a repeater; i.e., a hub can receive signals and resend them to other hubs. A LAN hub is sometimes loosely referred to as a central switch.

Hub (USB hub) The connection point for one or more peripherals in a PC's **USB** (see entry) peripherals-connection system. USB uses multiple hubs, which connect to each other across a tiered-star topology. The chain of hubs ultimately terminates in a so-called root hub embedded in the host PC; through the root hub, the host PC can "talk" to any of the up to 127 peripherals connected to the USB. A hub consists of a controller, a packet repeater, a single root-port to the upstream direction (towards the host PC), and multiple ports for downstream transfers. A hub may be embedded in a peripheral or it may be a dedicated, external USB box that functions as an expansion hub.

Integrated circuit (IC) The implementation of an electronic function or many functions as a monolithic structure on a substrate, usually silicon. IC fabrication technology now permits several million transistors to be deposited on a small substrate, or "chip," allowing very large memories, and even complete systems, to be built in a single IC.

ISDN Integrated Services Digital Network. A single communications vehicle that supports all forms of signal traffic—low- and high-speed data, audio, and video—across a standardized interface and on a single hardware platform.

Local area network (LAN) A communications network linking nodes (interconnection points) in the same "local" area—within a building, or within some limited radius (e.g., 0.5 mile), etc. Compare **Wide Area Network**.

Mainframe A large computer system, archetypically one occupying a number of equipment cabinets, and known colloquially as "big iron."

MAU Medium Attachment Unit. In a local area network (LAN), the device used at a node to couple the data terminal equipment to the transmission medium (e.g., coaxial cable).

Microcontroller A single integrated-circuit chip containing all the elements of a complete computer—central processor, RAM and ROM memory, and associated logic. Although sometimes loosely called a "microcomputer," a microcontroller, as its name implies, is a device for control applications; e.g., Cypress's CY7C63000 family is a group of microcontrollers intended specifically for use with the Universal Serial Bus, or **USB** (see entry).

Mixed signal A reference to a circuit requiring both analog and digital techniques and components. A phase-locked loop (PLL) is an example of a circuit using mixed-signal techniques.

Modem Short for modulator-demodulator. A modem is used to connect digital devices across analog transmission lines by converting an incoming digital data stream into an outgoing analog signal, and vice versa.

Motherboard The main printed-circuit board in any electronic equipment. Most widely associated today with the personal computer, the motherboard carries almost all the ICs and other semiconductors that make up a PC.

Network interface card (NIC) The connection between an Ethernet network and a personal computer. A NIC integrates a controller and a transceiver onto a single printed-circuit card, which plugs into the computer's backplane.

Packet A group of binary bits defined in terms of their format and maximum allowable number. A packet is switched and transmitted as a composite whole through a packet-switching, data communications network or other packet-handling device, such as a **USB hub** (see entry).

PCI bus Peripheral Component Interface bus. The backbone of a modern PC design, the PCI bus is the PC industry's de facto standard interface between the central processor and its associated cache and main memories and all the other devices that connect to them (video card, LAN adapter, controllers, etc.).

PCMCIA card The Personal Computer Memory Card International Association helps standardize credit-card-sized modules ("cards") capable of storing a variety of functionalities (e.g., software in ROM, fax/modem) needed by portable PCs and other small, processor-based portable equipment.

Phase-locked loop (PLL) A circuit that uses both analog and digital (i.e., mixed signal) techniques to produce multiple frequencies of high accuracy and precision from a single reference-frequency input. Cypress uses PLLs of its own design in its programmable clock and data communications products.

Physical layer A communications technology is defined by a standardized seven-layer model in which the top layer—Layer 7, called the Application Layer—is the user's interface to the network. The layers proceed downward to the bottom layer—Layer 1, or the Physical Layer—which specifies the electrical and mechanical characteristics of the **protocol**

(see entry) used to transfer data between a pair of adjacent points on the network; the Physical Layer also interfaces to the transmission medium itself. Cypress's CY7C971 is a physical layer transceiver for Ethernet and Fast Ethernet running on a twisted-pair medium.

PLD Programmable Logic Device. An integrated circuit that is shipped blank to customers and can be field programmed into a custom logic circuit, such as a counter or an adder. The circuit is fabricated using an EPROM or Flash core connected to logic circuitry. The custom logic function is created by programming the core into a custom pattern of "1"s and "0"s.

PLL See **phase-locked loop**.

Plug-and-play For PC users, the ability to connect a peripheral simply by plugging it in, without opening the computer or turning it off, and without having to think about any settings. The peripheral is detected, characterized, configured, and otherwise made ready for use automatically, without user interaction. Plug-and-play capability is a major feature of **USB** (see entry).

Protocol In general, a set of rules. In particular here, the rules that govern networked communications. Low-level protocols define such detailed characteristics as transmission rates, data encoding schemes, physical interfaces, network addressing schemes, and the method by which nodes contend to send data over the network. High-level protocols deal with user-related issues, such as file sharing and printing.

PROM Programmable Read Only Memory. A "Read Only Memory" (ROM) is a memory in which the data is fixed even when the power is off. ROMs are needed in applications such as "bootstrapping" computers (providing start-up data) when they are first turned on. Programmable ROMs are shipped blank to customers and customized in their facilities. See **EPROM**.

RAM3™ An advanced, Cypress-proprietary fabrication technology with 0.5-micron feature geometry and a six-transistor memory cell having very low power demand and very high data integrity. Cypress is the first company able to build a six-transistor cell in a reduced die size.

Root hub (USB root hub) See **hub (USB)**.

Routers Equipment in a packet-switching network that determine the path through the network of any given packet.

Semiconductor A solid, crystalline material having electrical properties intermediate between a metal and an insulator. The controlled introduction of impurities ("doping") into the semiconductor material during device fabrication sets the material's electrical conductivity. Semiconductor materials of different conductivities, when brought together, form junctions having certain electronic properties that form the basis of transistor action. The term, semiconductor, also refers to the finished device itself.

Served available market Also, SAM. For a given company, the portion of the **total available market** (see entry) that the company's products are able to be sold into.

SONET Synchronous Optical Network. The SONET standard defines a very-high-speed data transport mechanism and in part forms the basis of the so-called Physical Layer of the Broadband Integrated Services Digital Network (B-ISDN). A SONET network can carry **ATM** (see entry) data packets, for example. In Europe, SONET is known as Synchronous Digital Hierarchy, or SDH.

SRAM Static Random Access Memory. A Random Access Memory allows the user to store and retrieve data at a high rate of speed. The term "static" means that, so long as the power is on, the memory will retain its data. This feature contrasts with Dynamic Random Access Memories (DRAMs), in which the data fades away every few milliseconds. Thus, DRAMs must have their data refreshed continuously, even when the power is on. In industry parlance, "slow" SRAMs have access times longer than 45 nanoseconds, "fast" SRAMs have access times shorter than 45 nanoseconds, and SRAMs with access times of 15 nanoseconds or less are "very fast."

Static memory, Static RAM See **SRAM**.

Telecommunications Commonly, the transmission and reception of (analog) information such as voice.

Total available market (TAM) The sum total of the universe of all possible sales for a given type of product or for a range of products.

Transceiver Short for transmitter-receiver. A transceiver combines into a single unit the functionality of a transmitter and a receiver. Cypress's CY7C971 is a Fast Ethernet transceiver for use with unshielded twisted-pair wire transmission media.

Universal Serial Bus (USB) The PC industry's new concept for connecting peripherals, such as a mouse, monitor, printer, modem, etc., to a host PC. USB eliminates the historical PC limitation of "one port, one peripheral" and instead permits up to 127 peripherals to be connected to a single PC. It is also highly "user friendly," in that it facilitates true hands-off, **plug-and-play** (see entry) installation of the peripherals. USB is expected to become the new de facto standard for PC-peripherals connectivity. Cypress's CY7C63000 family of USB microcontrollers is designed specifically for this very large, new market.

USB See **Universal Serial Bus**.

VMEbus VME stands for VERSAmodule Eurocard. The VMEbus is a non-proprietary, high-speed, 32- or 64-bit-wide interface, standardized electrically and mechanically. It simplifies integration of data processing devices, storage devices, and peripheral control devices into a tightly coupled hardware configuration.

Wide area network (WAN) A communications network distinguished from a **LAN** (see entry) mainly by its longer-distance capabilities. A WAN may incorporate several LANs.

Yield The percent of chips on a processed wafer that pass all functional and technical requirements necessary for customer shipment.

CORPORATE INFORMATION

BOARD OF DIRECTORS

Pierre Lamond[1, 2]	Chairman of the Board of Directors, General Partner, Sequoia Capital
T.J. Rodgers[3]	President and Chief Executive Officer
Fred B. Bialek	Merger and Acquisition Specialist
Eric Benhamou[2]	President and CEO, 3Com Corporation
John C. Lewis[1]	Chairman, Amdahl Corporation

EXECUTIVE OFFICERS

T.J. Rodgers, President and Chief Executive Officer
Antonio Alvarez, Vice President, Research and Development
Emmanuel Hernandez, Vice President, Finance and Administration, and Chief Financial Officer
Jim Kupec, Vice President, Product Divisions
Lothar Maier, Vice President, Worldwide Wafer Manufacturing
J. Daniel McCranie, Vice President, Marketing and Sales

VICE PRESIDENTS AND SUBSIDIARY PRESIDENTS

Dan Barrett, Vice President, European Sales and Marketing
Lou Chetaud, Vice President, Worldwide Manufacturing
Bernard Glasauer, Vice President, Quality and Reliability Assurance
Kirk Johnson, Corporate Controller
Jeff Kaszubinski, Vice President, Memory Products Division
Paul Keswick, Vice President, New Product Development
Jeff Linden, Vice President, Non-Volatile Memory Division
Christopher Norris, Vice President, Programmable Logic Division
Rich Parker, Vice President, North American Distribution
Sean Salehi, Vice President, Management Information Systems, Chief Information Officer
R. Michael Starnes, Vice President, Process Technology[3]
Joyce Sziebert, Vice President, Human Resources
John Ramacciotti, Vice President, Procurement
Bruce Threewitt, Vice President, Systems Development
John Torode, Vice President, Computer Products Division
Ron Treadway, Vice President, Data Communications Division
William Verdi, Vice President, Strategic Accounts
Michael Villott, Vice President, North American Sales
Neil Weiss, Vice President, Tax and Treasury

LEGAL MATTERS

Questions regarding legal matters should be directed to:
Emmanuel Hernandez, Vice President, Finance and Administration, and Chief Financial Officer

LEGAL COUNSEL

Wilson, Sonsini, Goodrich & Rosati
650 Page Mill Road
Palo Alto, California 94303-1050
(415) 493-9300

INDEPENDENT ACCOUNTANTS

Price Waterhouse LLP
150 Almaden Boulevard
San Jose, California 95113
(408) 537-1200

CORPORATE HEADQUARTERS

Cypress Semiconductor Corporation
3901 North First Street
San Jose, California 95134-1599

Tel.: (408) 943-2600
FAX: 408-943-2796
Internet: http://www.cypress.com

REGISTRAR AND TRANSFER AGENT

BancBoston State Street Investor Services, L.P.
150 Royall Street
Canton, Massachusetts 02021
(617) 575-2000

[1] Member of the Audit Committee
[2] Member of the Compensation Committee
[3] Founder

ANNUAL MEETING

The annual meeting of stockholders for Cypress Semiconductor Corporation will be held on Tuesday, May 13, 1997, 10:00 a.m., local time, at the Company's offices at 4001 North First Street, San Jose, California 95134.

COMMON STOCK

Cypress Semiconductor Corporation's common stock is traded on the New York Stock Exchange under the symbol "CY."

FORM 10K

A copy of the Corporation's Annual Report on Form 10K, as filed with the Securities and Exchange Commission, will be made available without charge to all stockholders upon written request to the Company. Direct requests to the attention of the Chief Financial Officer at the corporate office listed above.

THE RIGHT PRODUCTS FOR THE RIGHT MARKETS

Cypress's broad product lines target the telecommunications, data communications, and personal computer markets, providing top-tier companies worldwide with solutions for their leading-edge systems.

WESTERN DIGITAL

The Western Digital Caviar, 2.1 gigabyte, 3.5-inch Low-Profile Enhanced IDE hard drive combines enhanced electronics with new head and read-channel technology to provide a high-performance solution for today's powerful systems. It uses Cypress SRAMs.

MOTOROLA

Using Cypress ultra-low-power SRAMs, Motorola's ADVISOR GOLD™ Word Message Pager provides a four-line, 80-character display, and offers up to five months of battery life.

ADAPTEC

Adaptec's ATM155 family of ATM LAN adapters uses Cypress's physical-layer (PHY) chip to enable high-speed, two-way simultaneous movement of voice, video, and data, eliminating network bottlenecks.

ASCEND COMMUNICATIONS

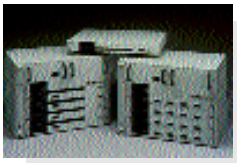
Ascend Communications MAX TNT multiprotocol WAN Access Switch lets network service providers and corporations build customized, high-density networks according to specific application and bandwidth requirements. It incorporates Cypress SRAMs, FCT Logic, and Dual-Ports, and FIFOs.

KYOCERA

Kyocera's second-generation PHS cellular base station, with Cypress high-speed SRAMs, FIFOs, clock generators, CPLDs, and 16V8 PLDs, connects millions of cell phone users in Japan.

3COM

The 3Com CELLplex 7000 Switch is a full-featured, flexible solution for switching voice, video, and data on a mission-critical ATM-based network. It uses Cypress Deep Sync™ FIFOs.



CYPRESS

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