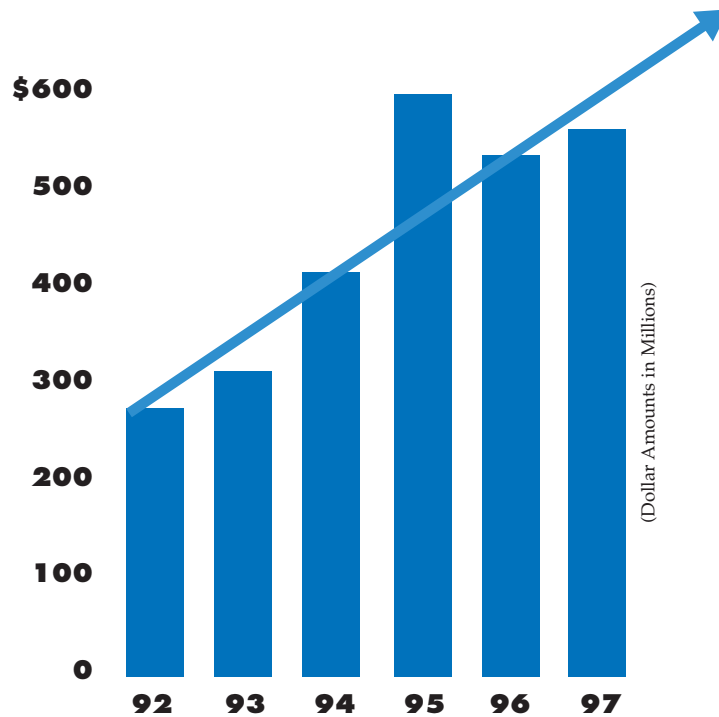


CYPRESS

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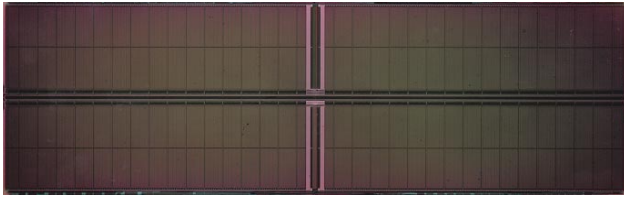
"Cypress's 1997 target is to get back on the growth track with record sales."

T.J. Rodgers, 1996 Annual Report



New Products, New Markets

4-MEGABIT SRAM: 26,239,686 TRANSISTORS



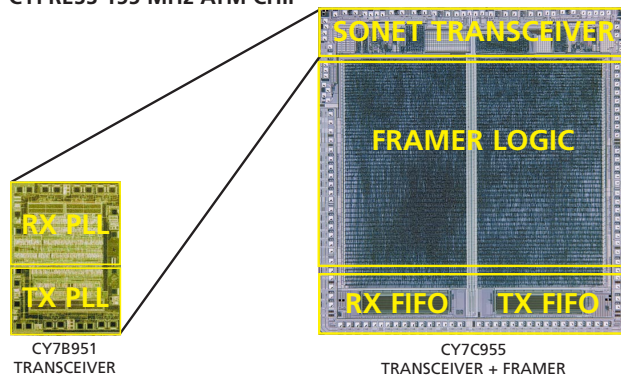
In 1997, Cypress introduced the most complicated chip it has ever manufactured. Our new 4-megabit SRAM contains a record 26,239,686 transistors—3.5 times that of Intel's Pentium II® microprocessor. It is a high-performance SRAM designed for data communications and military applications.

"ROAM"™ — SRAM & ROM (READ-ONLY MEMORY)



The "ROAM"™ is a combination of an SRAM and a ROM (Read-Only Memory) which contains fixed bits of information to drive displays. In addition to its specialized dual-memory function, the ROAM is also designed for extremely low power, an outgrowth of our work on pagers and cell phones, and represents a new, special, value-added function.

CYPRESS 155 MHz ATM CHIP



ATM (Asynchronous Transfer Mode) is one way data is transmitted over the telephone system. Several years ago, Cypress introduced the CY7B951, a device that could launch and receive data off the phone system. Given our new ability to integrate logic, FIFO memory, and analog circuitry, we now have a more highly integrated solution that not only transmits and receives data, but buffers it with FIFOs and creates "frames" of data in the proper format for the telephone system.

UNIVERSAL SERIAL BUS

CYPRESS
MOUSE

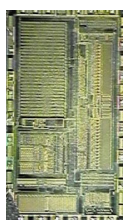
MOTOROLA
MOUSE

CYPRESS
KEYBOARD
HUB

INTEL HUB



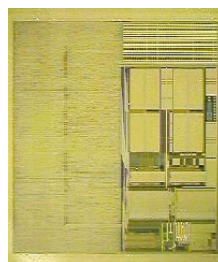
4.19 sq. mm



26.5 sq. mm



7.10 sq. mm



86.5 sq. mm

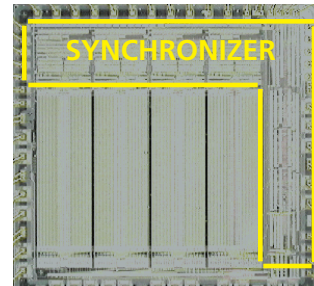
Starting mid-year, personal computers will be connected to their peripherals using USB (Universal Serial Bus). Cypress invented a special microcontroller and computer language to create the most efficient possible solution for implementing USB. It is estimated there will be five USB chips needed for every personal computer. Our special architecture gives us a great cost advantage over competitors who have modified older architectures to perform the USB function.

NoBL™ DATA COMMUNICATIONS SRAM

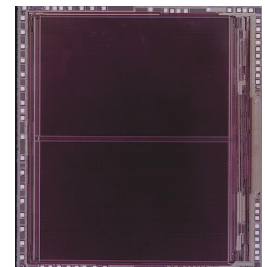


Our NoBL™ SRAM has "No Bus Latency," a special architectural feature that allows data to pass through the RAM at twice the speed of the SRAMs used in personal computers. The NoBL SRAM is specifically designed for the routers and switches used in the Internet and corporate intranets.

FIRST-IN FIRST-OUT MEMORY



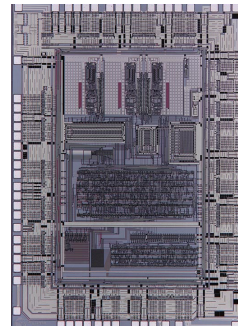
MARKET SHARE LEADER
256 KBIT



CYPRESS
1 MEGABIT

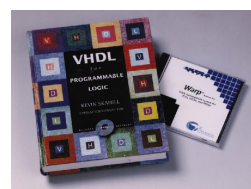
FIFO (First-In First-Out) memory is a special memory which receives data from the sending system at its speed and provides data to the receiving system at its speed, compensating for the difference in speed between systems. FIFOs are required every time data is transmitted from one system to another. Last year, Cypress invented a new FIFO architecture that allows us to use a simple memory array, rather than memory plus a large block of logic called a synchronizer. This patented architectural advantage has allowed us to start taking market share from the industry leader. Cypress is currently No. 2 in FIFOs.

CY228X SPREAD-SPECTRUM CLOCK



Cypress ships 10 million clock chips for personal computers every quarter. These chips synchronize all the various functions within the PC (processor, keyboard, disk drive, etc.). One of the major problems with clocks is the creation of electromagnetic noise, which can interfere with radio and television. This next-generation spread spectrum clock dramatically reduces that noise, a major benefit to personal computer manufacturers who must pass government electronic noise testing before shipping product.

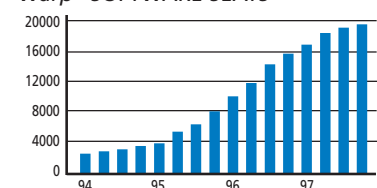
WE WROTE THE BOOK ON VHDL



VHDL is the design language of programmable logic. A Cypress applications engineer wrote a college text that is so popular it has been translated into numerous languages. The VHDL language is the basis for *Warp*™, our programmable logic design software.

Cypress's programmable logic design software was ranked second in a recent survey of engineers. We have now sold almost 20,000 design "seats," which our customers use to design our chips into their end products.

Warp™ SOFTWARE SEATS



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 include static random access memories (SRAMs), programmable logic devices (PLDs), data communications products, timing devices, and Universal Serial Bus (USB) 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. In 1997, exports increased to 36% of total revenues, a company record.

Cypress manufactures its products at four wafer manufacturing plants in California, Minnesota, and Texas. In 1996, the Company opened a new 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>.

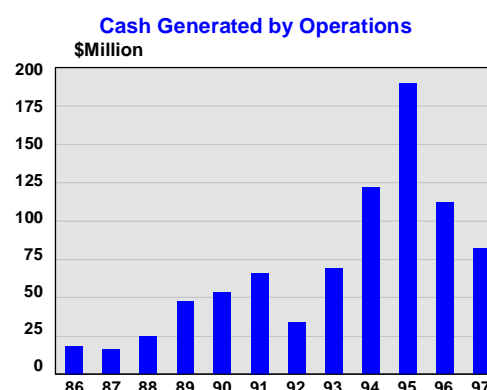
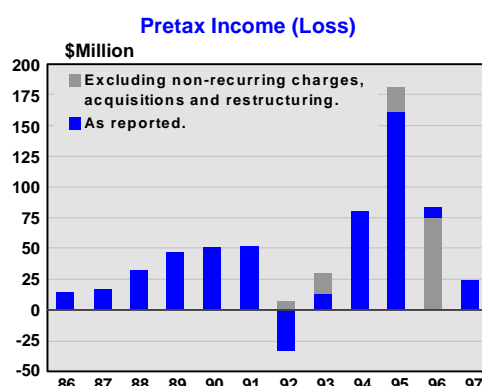
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FINANCIAL HIGHLIGHTS

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

	1997	1996	Change
For the year:			
Revenues	\$ 544,356	\$ 528,385	3%
Operating income	18,313	81,594	(78%)
Net income	18,419	53,029	(65%)
Net income per share:			
Basic	\$ 0.21	\$ 0.66	(68%)
Diluted	0.21	0.62	(66%)
At year-end:			
Total assets	\$ 956,270	\$ 794,047	20%
Cash and short-term investments	201,561	93,786	115%
Stockholders' equity	643,476	510,746	26%
Stockholders' equity per share	\$ 6.80	\$ 5.58	22%
Weighted average common and common equivalent shares:			
Basic	87,888	80,241	10%
Diluted	94,648	91,604	3%

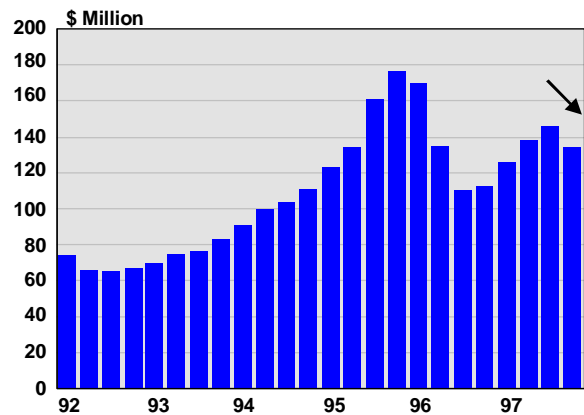


TO OUR SHAREHOLDERS

Our 1997 revenue of \$544.4 million grew 3.0% relative to last year's figure of \$528.4 million, in line with the semiconductor industry's sluggish growth in 1997. Nevertheless, we were disappointed that the SRAM slump continued unexpectedly for another full year. When writing the 1996 Shareholder Letter, I believed that the SRAM slump had bottomed out in the third quarter of 1996, and I wrote, "Cypress's 1997 target is to get back on the growth track with record sales." The SRAM market did bottom out in Q3 1996, and Cypress did record a year of quarterly sequential revenue growth, but then we were set back by a broad industry slowdown in the fourth quarter that ended our string of improving quarters. We now believe that the slowdown will continue into Q1 1998 before we begin growing again.

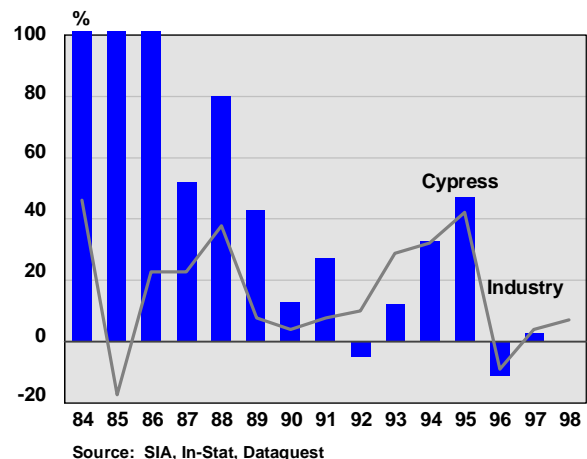
Despite the modest revenue growth, our customers are consuming our chips in record unit volumes. We shipped 257 million units in 1997 vs. 179 million units in 1996, a unit growth of over 40%. The combination of record unit volume and sluggish revenue growth—i.e., rapid price decline—squeezed 1997 profit to \$0.21 per share vs. the \$0.62 per share recorded last year. The problem became acute in the fourth quarter, when earnings per share declined to breakeven.

Cypress Revenue



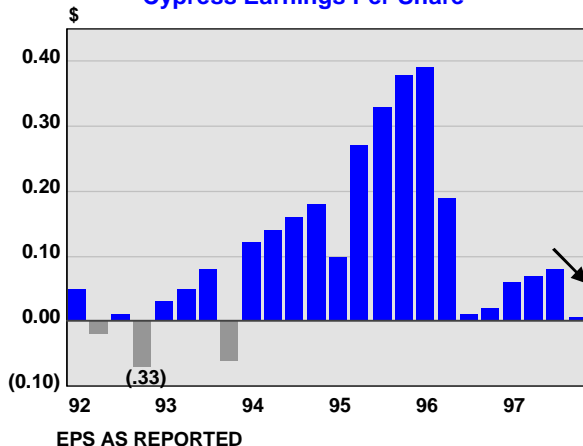
Cypress's quarterly revenue peaked at \$177 million in late 1995. During 1996, SRAM prices were cut in half. The SRAM market bottomed out in the third quarter of 1996, after which Cypress increased its revenue for four straight quarters. We endured a disappointing setback in the fourth quarter of 1997 as industry sales softened again.

Annual Growth Rate vs. Industry



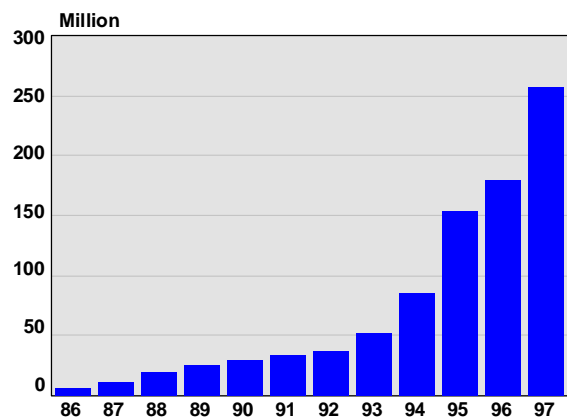
Over the last four years, Cypress has grown at a rate similar to that of the semiconductor industry at large. The problem has been that after very rapid growth in the '90s, the industry contracted in 1996 and grew little in 1997. The forecast is for growth in 1998, but only 7%-8%, according to industry watchers.

Cypress Earnings Per Share



With dramatically higher unit shipments but only slightly higher revenue, Cypress's earnings dropped to breakeven in the fourth quarter of 1997. We decided to restructure to regain solid profitability.

Units Shipped



Despite Cypress's recent slow revenue growth, its unit output has increased dramatically to record levels. Cypress shipped over a quarter-billion units in 1997, up 44% from 1996.

This market situation is the new reality for Cypress, and we have decided to restructure the company so that we can regain solid profitability in 1998, whether or not robust market growth resumes.

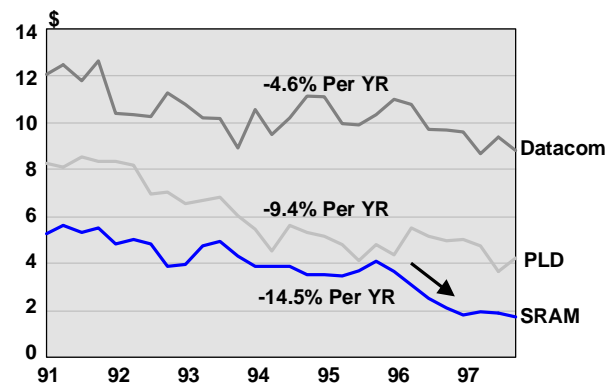
SRAM BUSINESS: SHORT-TERM AND LONG-TERM VIEWS

Making the SRAM business profitable again is our primary challenge. For the last seven years, our data communications chips have sold for approximately \$10 with only modest 4.6% yearly price attrition. The price attrition of our PLD chips averaged 9.4% per year, but our PLD prices have been stable in the \$4 range for the last three years. In contrast, SRAM prices have been dropping at a high annual rate of 14.5%, including a precipitous halving of prices in 1996, a decline caused by over-investment and product dumping by several Korean and Taiwanese companies that have recently been penalized by the U.S. government with import duties as high as 100%. These duties, combined with the normal improvements in the SRAM business cycle, should drive SRAM margins back toward normal, but not until late 1998.

The 1996-7 SRAM price recession is the most severe that I have seen in my 22 years in the SRAM business. The seven-year trend for Cypress SRAM revenue growth is still a respectable 19% per year, but the boom of 1994-5 and the crash of 1996-7 show extreme excursions in SRAM sales, compared with Cypress's other businesses. For example, the annual growth rate of our data communications division is higher at 34%—and much more stable. This raises the question among some investors, "Why not just get out of the SRAM business and focus on your most profitable business segments?"

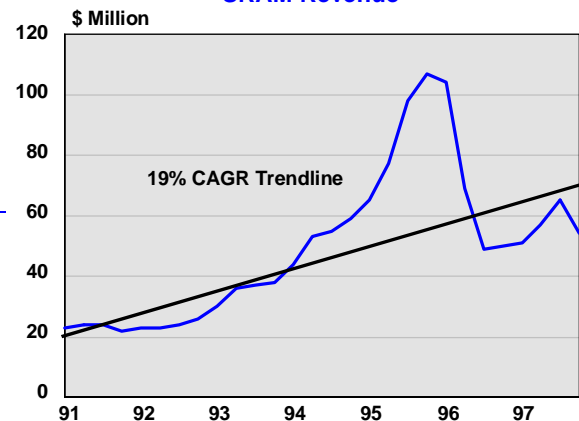
Dropping SRAMs might be advantageous for Cypress shareholders over a one-year period, but it would be a big mistake in even a three-year time frame. Cypress's retained earnings (a balance sheet

Average Unit Selling Price



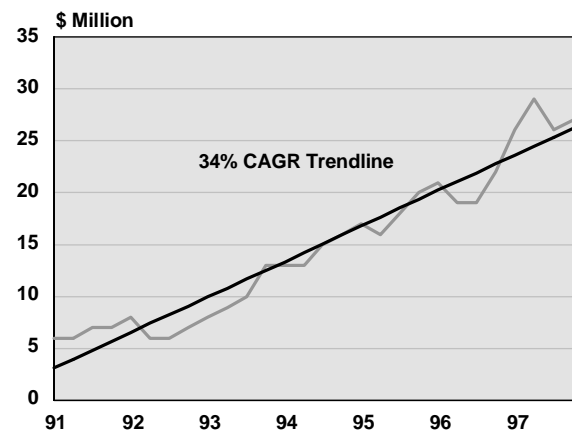
Cypress's non-SRAM divisions sell high-margin products in stable markets. SRAM prices dropped by a factor of two in 1996, becoming the main impediment to increased profitability.

SRAM Revenue



Over the last seven years, Cypress's SRAM revenue has grown at a reasonable 19% compound annual growth rate. There was a huge SRAM boom in 1994-5 followed by an SRAM recession in 1996-7.

Data Communications Revenue

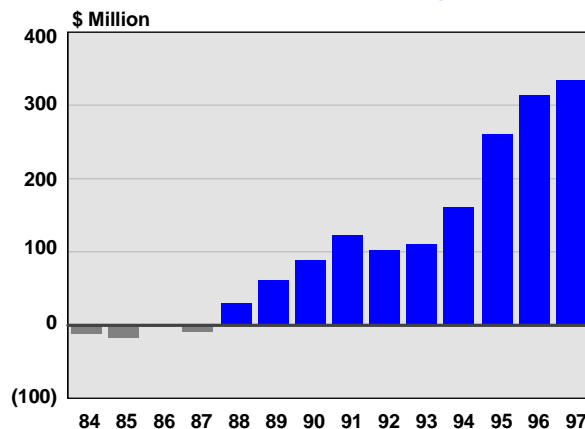


The Data Communications Division's 34% revenue growth rate exceeds that of SRAMs—and its growth is much less erratic.

report of cumulative lifetime profits) stood at \$334 million at the end of 1997. These earnings represent a 9.2% cumulative after-tax profit on Cypress's \$3.65 billion of cumulative lifetime revenue. That level of long-term, sustained profitability ranks us in the top 15, all-time most profitable American semiconductor companies. The point here about SRAMs is that over our lifetime, SRAMs have accumulated \$331 million dollars of pre-tax profit, equivalent to \$215 million after-tax, or approximately 60% of Cypress's lifetime profit. Although it is true that the SRAM business was frustratingly unprofitable in 1997 and, before that, in 1992 (the only year Cypress recorded a loss), it is also true that when the SRAM business makes money, it makes a lot of money. For example, in 1994-6, Cypress made \$281 million in pre-tax profit in the SRAM business (\$183 million after-tax), about as much as all the cash we currently have.

Our efforts to diversify the company into other product areas have actually been funded by profits from the SRAM group. Currently, Cypress's revenue breakout is 41% SRAM, 21% datacom, 20% computer products, and 18% programmable products. The SRAM and Programmable Products divisions were part of Cypress's original 1983 business

Cypress Retained Earnings

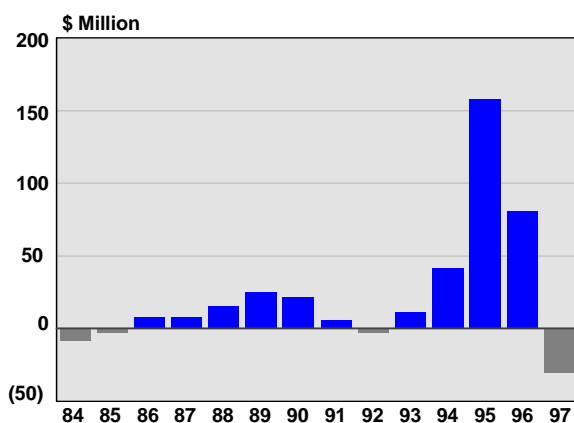


Top 15 U.S. Semiconductor Retained Earnings (97)

Intel	\$16,557
Motorola	\$9,202
Texas Inst.	\$4,806
Micron	\$2,379
AMD	\$1,031
Analog Devices	\$781
National	\$673
LSI Logic	\$581
Adaptec	\$559
Atmel	\$547
Linear Tech	\$453
Xilinx	\$442
Altera	\$392
Maxim	\$374
Cypress	\$334

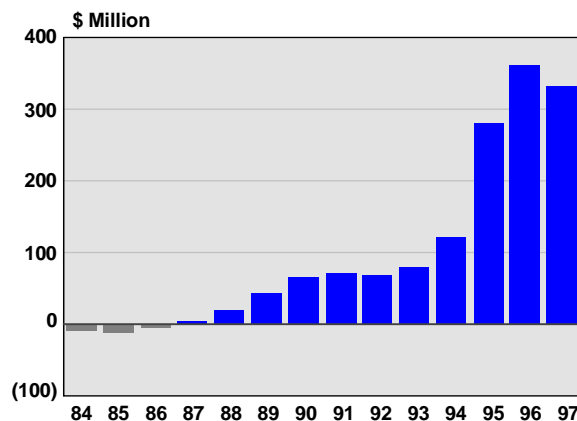
Cypress's retained earnings (cumulative lifetime profit) reached \$334 million in 1997, ranking it in the top 15 in all-time profit for American semiconductor companies. Cypress, Altera, and Maxim are young companies on the list—less than half the age of Intel, Motorola, and Texas Instruments.

SRAM Pre-Tax Profit



Although the SRAM business is profitable over a long period of time, in troubled years like 1992 and 1997 SRAMs can subtract from the profit of other divisions.

SRAM Cumulative Pre-Tax Profit



The cumulative pre-tax profit of Cypress's SRAM group is \$331 million, or \$215 million after-tax. That figure represents more than 60% of our lifetime profit, and virtually all of our current cash on hand. The SRAM business is very profitable in the long haul.

plan, but our new divisions, computer products (bought outright) and datacom (funded internally), were both funded with SRAM profits.

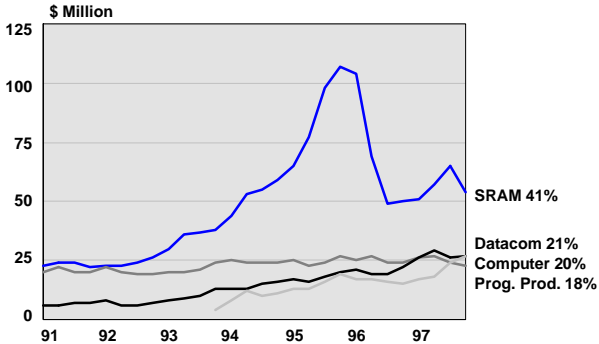
These diversification efforts have been successful: Cypress is no longer an “SRAM” company, as we now ship 1.5 times more non-SRAM than SRAM revenue. Nonetheless, SRAMs are an important part of our product portfolio—the only product type we ship to every one of our 13 strategic accounts. Furthermore, our very diversified, 70-product SRAM offering allows us to number among our Top 25 accounts some of the most potent SRAM manufacturers in the world, including Nippon Electric Corporation, Motorola, Fujitsu, Toshiba, and Samsung. SRAMs have been an integral part of Cypress since its inception and will again be generating profit this year for our shareholders. We are striving to regain SRAM profitability by the third quarter.

TWO CYPRESSES

In the fourth quarter of 1997, our three non-SRAM divisions—data communications, computer products, and programmable products—accounted for \$81 million, or 59% of sales. These divisions recorded pre-tax profitability in excess of 20%, yet the company broke even. Cypress currently looks like two companies, a profitable non-SRAM company with 59% of sales, and an unprofitable SRAM company with 41% of sales. Two imperatives jump out: 1) return the SRAM division to profit as quickly as possible, and 2) grow the highly profitable non-SRAM businesses as quickly as possible. My 1996 Shareholder Letter outlined actions taken to drive down SRAM costs:

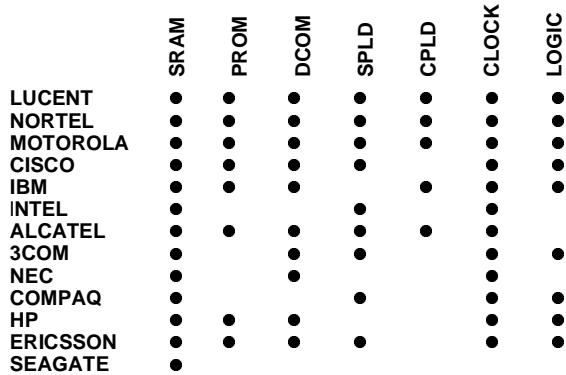
- Process improvements. The 256K SRAM, our highest-volume product (20 million units per quarter), has been redesigned more than 20 times to reduce cost since its introduction in 1988. The original product was made with a 0.8-micron process that produced a relatively large chip with only 400 SRAMs per 6-inch

Revenue by Division



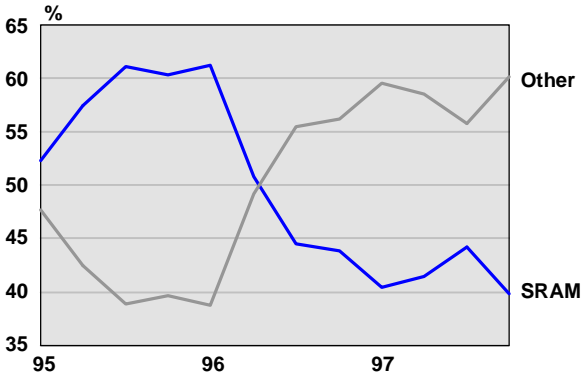
Cypress has diversified to the point that SRAMs are now less than half of sales. The Memory Products Division and the Programmable Products Division were part of the original Cypress business plan. Cypress bought the Computer Product Division in 1993 and internally funded the Data Communications Division, our second-largest and fastest-growing division. Profits from the SRAM group paid for this diversification.

Strategic Account Sales



The SRAM group ships significant revenue into every Cypress strategic account. Our customers see us as a key SRAM supplier.

SRAM % Total Revenue



Cypress’s three non-SRAM divisions have recently grown more rapidly than the SRAM division and now comprise 59% of sales. The SRAM division has amounted to less than half of our sales for the last 1½ years.

wafer. Our most advanced 256K SRAM today uses 0.35-micron geometries to pack 3,200 SRAMs on a 6-inch wafer.

- Move to 8-inch wafers. Our newest wafer fabrication facility, Fab 4 in Bloomington, Minnesota, produces 8-inch wafers with 1.78 times more chips per wafer than the 6-inch wafers manufactured in Minnesota Fab 3 and Fab 2 in Round Rock, Texas.
- Automated offshore assembly and test. Our new, fully automated Manila assembly and test plant now produces approximately 50% of our output with record low “back-end” costs.

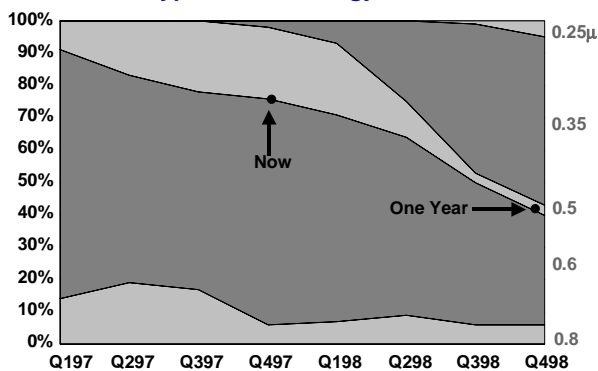
Given these improvements, why is the SRAM group not yet profitable?

Although we do have multiple 0.35-micron and even 0.25-micron SRAM products running in both Fab 1 and Fab 4, these advanced processes—which offer the lowest possible cost—did not represent an economically significant fraction of our manufacturing capacity in 1997. In the fourth quarter of 1997, only 21% of our wafers were manufactured using our most advanced 0.5-micron or less technologies. Although our more advanced technologies are ready to ramp in manufacturing, the barrier to complete conversion has been not technical, but

structural, based on the current deployment of our existing wafer fabrication plants.

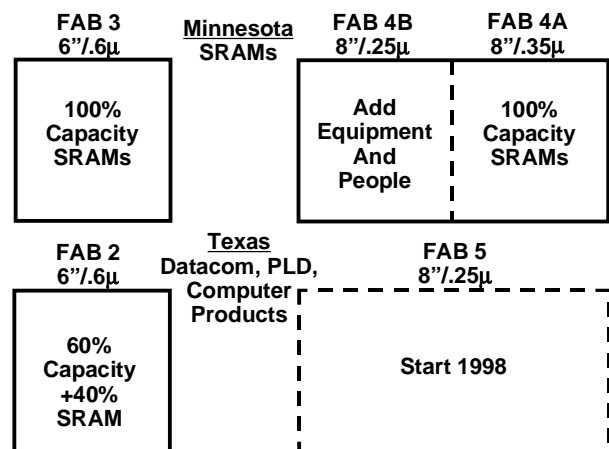
Cypress’s primary production facilities are Texas Fab 2 and Minnesota Fabs 3 and 4. Fabs 2 and 3 produce 6-inch wafers primarily with 0.6-micron processes. Prior to the restructuring announced on March 9, 1998, our plan was to ramp production of sub-0.5-micron processes in Fab 4, our newest facility. We planned to devote the Minnesota facility to SRAMs with Fab 3 running at 100% of installed capacity, and to grow by ramping Fab 4 with new equipment and new people. We also planned to make SRAMs in Texas Fab 2 because even though Fab 2 manufactures our non-SRAM products, those products only consumed 60% of its capacity and we needed more SRAMs than Minnesota could make. The cost of ramping SRAM products in Fab 2 in the fourth quarter of 1997 hurt earnings in a breakeven quarter. Furthermore, the addition of new equipment and people to Fab 4 to turn on our newest technologies also drove up total costs. We have decided our old plan to keep our legacy fabs full and to ramp up new fabs for new technologies will not work in today’s environment.

Cypress Technology Mix



Although Cypress has 0.35-micron technology in production now, and 0.25-micron processes yielding in two different fabs, advanced technologies (0.5-micron or less) represented only 21% of Cypress’s manufacturing in the fourth quarter of 1997. This year, by shutting down part of our older wafer fabrication facilities, we plan to move 50%-plus of our wafers to advanced technologies. We also expect to achieve revenue on our new 0.25-micron process this year. The remaining 0.6- and 0.8-micron wafers will be used to manufacture analog and mixed-signal circuits for which 0.6-micron technology is optimum.

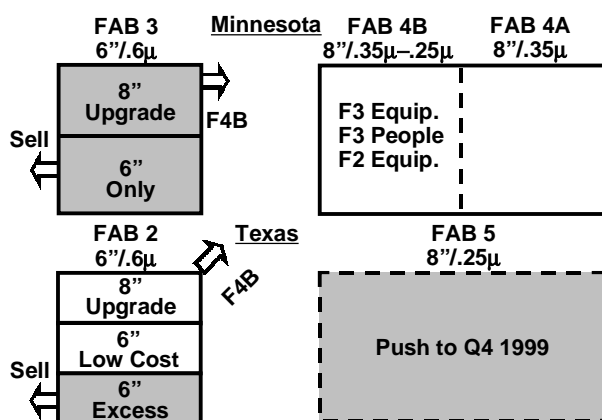
Old Fab Plan



Cypress manufactures SRAMs in Minnesota and non-SRAM products in Texas. Texas Fab 2 and Minnesota Fab 3 are older 6-inch/0.6-micron plants. We are ramping our newest technologies in Minnesota Fab 4. When Fab 4 reaches its capacity, we will start Fab 5 in Texas. We have decided to restructure our wafer fabrication plants to meet the challenges of today’s markets and to convert to our newest process technologies.

We have decided to restructure our fabs to become fundamentally more efficient. Instead of buying new equipment and hiring new people to ramp up Fab 4b, we will upgrade existing 6-inch equipment in Fab 3 to 8-inch and use much of it to build out Fab 4b. Much of the equipment in Fab 2 and Fab 3 is modern and completely capable of 0.35-micron production when upgraded to handle larger wafers. Fab 3 employees will move across to Fab 4 with their equipment. Thus, we will be using the same people and much of the same equipment to produce 8-inch wafers rather than 6-inch wafers. There are 1,224 one-megabit SRAM chips on an 8-inch/0.35-micron wafer, but only 294 on a 6-inch/0.6-micron wafer—a dramatic efficiency improvement. To further cut costs, the 6-inch equipment in Fab 3 that cannot be upgraded will be sold, and Fab 3 will be shut down. The Minnesota plant will reorganize into a single, highly efficient SRAM factory with advanced technologies manufactured on 8-inch wafers.

New Fab Plan



Our fab restructuring plan calls for:

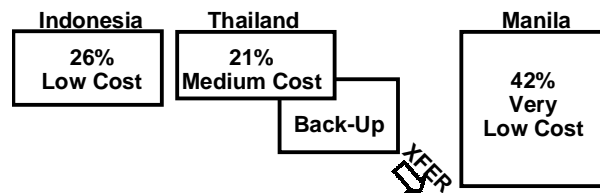
- Fab 3 equipment will be upgraded from 6- to 8-inch and will be used to build Fab 4b, in lieu of buying new equipment. Fab 3 employees will move to Fab 4.
- The 6-inch equipment in Fab 3 that cannot be upgraded will be sold.
- Fab 3 will be closed down as a cost saving.
- Fab 4 will make SRAMs much more productively than Fab 3 did.
- Some Fab 2 equipment will be upgraded to 8-inch and moved to Fab 4.
- Fab 2 will stop making SRAMs.
- Excess Fab 2 equipment will be sold, and the fab will concentrate on making highly profitable non-SRAM wafers at the lowest possible cost.
- Fab 5 will be pushed out to the fourth quarter of 1999.

With the Minnesota plant producing 0.35-micron SRAMs in high volume, the need for extra 0.6-micron SRAMs in Fab 2 will vanish. By mid-year, Fab 2 will downsize and focus on making our highly profitable non-SRAM products at the lowest possible cost. To reduce costs in Fab 2, the advanced SRAM equipment that is upgradable to 8-inch will be shipped to Fab 4. The equipment that is not upgradable, or that is not needed for the downsized Fab 2, will be sold.

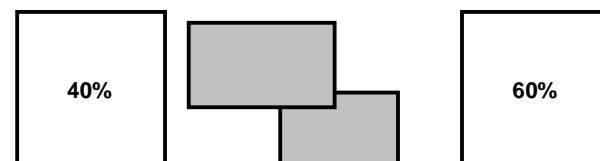
Prior to this restructuring, Cypress ran its two older facilities, Fabs 2 and 3, at full capacity, while it ramped its new technologies in Fab 4 and faced the need to complete Texas Fab 5 soon to meet demand. After the restructuring, we are left with two more-effective plants: Minnesota Fab 4 with the 0.35/0.25-micron, 8-inch wafers demanded by the SRAM business, and Texas Fab 2 with the very-low-cost 0.6-micron, 6-inch wafers optimized for analog circuits common in non-SRAM products. Fab 5 can now be deferred until late 1999.

We are also restructuring our product final test areas. Currently, Cypress tests its products offshore in three Asian locations: Indonesia; Thailand; and Manila, the Philippines. Our new Manila facility is the most cost-efficient plant and produces about 50% of our output. We rent test space at a low-cost Indonesian plant, which produces 26% of our out-

1997 Test MFG



1998 Test MFG



Our test area will also be restructured to reduce costs. Our most expensive plants in Thailand will be shut down by moving their production to our fully automated Manila plant, which produces at our lowest manufacturing costs.

put. We also rent a test area in Thailand, a problem for us during the current Asian economic crisis. Our Thai partner's plant is facing bankruptcy, which forced us to fund a second, back-up facility. We have also recently ramped down our Thai test production from 33% to 21% of output, making the plant much less efficient. We are now going to shut down both Thailand facilities and transfer production to Manila.

The fab and test restructuring described above will reduce our costs dramatically. The one-time charge to earnings associated with plant shutdowns, severance costs, and other charges is \$85.5 million, to be taken in the first quarter of 1998. We expect Cypress to return to profitability in the second quarter of 1998 and the SRAM group to return to profitability in the third quarter of 1998. Barring further anomalous degradation in our markets, Cypress profit in the fourth quarter of 1998 should exceed that of any quarter in 1997.

We are also planning to increase SRAM profitability by adding value with advanced products, rather than just cutting costs. Some of these new products are shown on the inside front cover. Our largest SRAM to date, a 4-megabit version for military and data communications applications, represents a record for Cypress: 26,239,686 transistors on one chip—3.5 times more than Intel's Pentium II® microprocessor. Another new SRAM innovation is the NoBL™ (No Bus Latency) SRAM architecture, specifically designed for routers and other data communications systems. In SRAMs designed for computers, a cycle of operation is wasted between reading from and writing into the SRAM. NoBL eliminates that wasted cycle to provide dramatic performance improvements.

In last year's report, I wrote about our micropower SRAMs, capable of both high speed and extended battery life in cell phones and pagers. The gain comes from our new SRAM cell, a 6-transistor (6T) cell, that features 100-times lower power consumption than our older 4-transistor (4T) cell—the

dominant type of cell shipped in the industry (more than 95% of volume). Using advanced process technology and a unique, patented cell architecture, we have been able to pack our 6T cell into an area one-quarter that of our older 4T cell. Last year, we announced important portable equipment design wins at Motorola and Nippon Electric Corporation. This year, those products will commence volume production. In addition, we have been asked by our customers to create more micropower products with special features; for example, a combination SRAM and ROM memory with both fixed and read/write memory on one chip. The "ROAM™" as we call it, is also shown on the inside front cover. It will ramp into volume production this year. An advanced Motorola pager and digital cellular phone using these new products are shown on the back cover of this report.

DATAKOM PRODUCTS

Data communications chips handle the "bits" that travel on the Internet and other media. The Datacom Division is our fastest growing group, primarily because of the explosion of the Internet. Datacom chips contain three different types of circuitry: logic to control transmission, specialty memory to buffer incoming and outgoing signals, and analog circuitry to drive the physical medium through which the bits flow (optical fiber, coaxial cable, twisted pair, etc.). Over the last three years we have built analog design capability to match our logic and specialty memory strengths. Currently, Cypress has four centers of excellence with analog and "mixed-signal" (analog and digital together) capability: San Jose; Austin; Woodinville, Washington; and Cork, Ireland. These centers are currently designing numerous products for data communications applications with transmission speeds from 50 million bits per second to 2.5 billion bits per second (equivalent to 250,000 typed pages per second). The fastest chips are designed with our newest 0.35-micron BiCMOS

technology, the fastest technology we have ever produced, with transistors capable of operation at frequencies higher than 20 billion cycles per second.

Whenever one system transmits data to any other system, the resultant transmission requires the use of a FIFO (First-In, First-Out) memory to complete the data transfer. One can think of a FIFO as a pipeline that takes in data at the frequency of the transmitting system, stores it, and releases it from the other end of the pipeline at the frequency of the receiving system. FIFOs are needed for ordinary telephone conversations, for personal computer transmissions, and even faxes. Cypress is the world's second-largest producer of FIFOs. Recently, we invented a new FIFO architecture that gives us a significant competitive advantage. The 1-megabit version of this product is shown on the inside front cover, alongside the 256K version of the largest manufacturer. Despite the fact that the Cypress product is four times as dense as the competition's product, it is actually *smaller*.

With the ability to combine digital circuits, specialty memories, and analog design on one chip, Cypress has introduced the first in a series of multi-function chips for the Internet. Our 155-mega-bit-per-second ATM data communications chip is pictured on the inside front cover. "ATM" (Asynchronous Transfer Mode) is one way data is transmitted over normal telephone lines. Our ATM chip is just now ramping in revenue.

COMPUTER PRODUCTS

Our Computer Products Division in Woodinville, Washington, a Seattle suburb, produces two primary products: clock chips for personal computers, and chips to support the new USB (Universal Serial Bus) technology for PCs. PC clock chips, like our new CY228X device, shown on the inside front cover, create multiple clock signals that coordinate the various parts of the PC (keyboard, microprocessor, disk drive, etc.). PC clock chips

must pass a government test for EMI (ElectroMagnetic Interference). Every oscillating electronic system emits electronic radiation that can interfere with radio and television. All new PC models must go through extensive EMI testing and receive government certification before they can be marketed. A hang-up in EMI testing can be a disaster for new PC models that have lifetimes measured in months. Cypress's newest clock uses a technology called "spread spectrum" to dramatically improve EMI performance. The clock chip is designed to drive the PC at many, very slightly different frequencies, rather than just one frequency. The result is that the electronic noise created by the PC is spread out over several potential radio or television interference frequencies, lowering the amount of noise in any one channel. Over the next year, virtually all new PCs that use the newest, high-performance microprocessor chips will switch over to the new spread-spectrum clocks.

In last year's report, I described the new USB standard for PCs in detail. Microsoft® and Intel® have supported a new standard for connecting a PC with its peripherals (keyboard, mouse, joystick, printer, etc.) with a new, simple, universal four-wire plug—instead of the maze of plugs on the back of current PCs. The new computers, in addition to being cheaper to manufacture and physically simpler, will also be guaranteed to "plug and play," an industry phrase meaning that peripherals hooked up with the USB interface are guaranteed to work without the tinkering that annoys PC users today.

What's simple for the PC user ends up being complicated for the USB chip designer. In order to sort out the 127 possible peripherals that can be simultaneously plugged into the two USB sockets on all new PCs, the USB chip ends up being a small system, incorporating logic, two different kinds of memory, and analog circuitry. Our USB chips will ramp this year, after the scheduled May release of Microsoft Windows 98®. Cypress developed its USB mouse and keyboard chips in conjunction

with Microsoft specifically to make them plug and play with Windows 98®. To solve the USB problem, our Seattle engineers invented an entirely new computer language and a microcontroller with a small size and efficiency unprecedented in the market (see comparison of our USB chips with those of our competitors on the inside front cover). Our USB chips already have been used in a Microsoft mouse and keyboard, which are shown on the back cover. We expect USB to ramp to multimillion-unit volume in the third and fourth quarters of this year. Just the prototype volumes for USB chips are nearing the million-unit mark in Q1 1998.

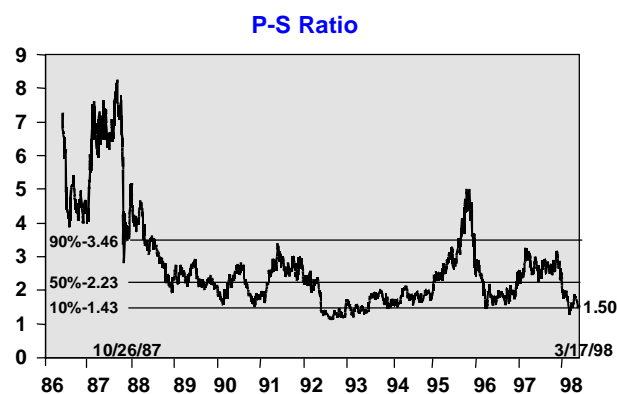
PROGRAMMABLE PRODUCTS

Programmable products represent 18% of our sales. The division enjoys excellent gross margin, but it has not grown as rapidly as we would have liked. Last year, we began to invest much more heavily in product development to increase sales as rapidly as possible. Programmable logic device (PLD) sales depend on more than just the chips, which are configurable in the field by customers to perform a wide variety of functions. Today's PLDs are so complicated that the vendor must also provide a software design system for using them. This software, which takes millions of dollars and years to produce, has been one of our barriers to growth. We have now broken through that barrier. In a market survey by *Electronic Design*, a top electronics trade periodical, Cypress's design software for programmable logic rated second to that of Altera and way ahead of other competitors. We literally wrote the book on programmable logic synthesis: "VHDL for Programmable Logic," a college textbook written by a Cypress engineer, has become the standard for teaching the very popular VHDL "language" used to design PLDs. Our software has been a great success, with 19,483 seats sold as of the end of 1997, and our VHDL book is so popular it has already been translated into French and Chinese.

This year, we plan to take some big steps forward on the PLD chip side by introducing the first product in our new Ultra37000™ family. The Ultra37256 is twice as complex as any programmable logic device we have ever made. It is faster than the comparable device from any of our competitors. Prototype samples are due in March 1998. Later in the year, we will take a bigger step forward by introducing our Ultra39000™ family. This family will be manufactured in our 0.25-micron SRAM technology, the most advanced technology we have ever used on a PLD, allowing us to introduce the largest complex PLD ever manufactured. Cypress was the first company to introduce programmable logic devices manufactured in CMOS, based on our license from the inventor of the PLD, Monolithic Memories. This year we plan to regain a share of technology leadership by introducing our new Ultra37000 and Ultra39000 families.

BUYBACK PROGRAM

In a 1996 booklet, "Thinking About Cypress Stock," I analyzed the ratio of the price of Cypress shares to our sales per share, the P-S ratio, a ratio similar to the P-E ratio, but for sales. Over the entire public trading history of our company, the median Cypress valuation was a share price 2.23 times the annualized sales per share. When the P-S ratio drops to 1.43, Cypress is valued at the



The P-S (price-to-sales) ratio of Cypress stock is calculated by taking the price of Cypress shares divided by the annualized sales per share; it's like a P-E ratio, only for sales. Over the last decade, Cypress stock has traded at a median multiple of 2.23 times sales. The stock is historically highly valued (90th percentile) when it trades at 3.46 times sales and lowly valued (10th percentile) when it trades at 1.43 times sales. The Cypress P-S ratio is currently at a low value, triggering our buyback program.

10th-percentile low point relative to its decade-long trading history. As of March 17, 1998, Cypress's shares were trading at \$8.56, a P-S ratio of 1.50, near the 10th-percentile low point. In our model that's a "buy," and we have acted to buy back our shares using both direct purchases and the sale of put options. As of March 17, 1998, we had bought outright or contracted to buy 5.2 million shares at an average price of \$8.79 for a total of \$45.8 million.

Share Buyback

METHOD	#SHARES	@	\$/SHARE = TOTAL
PURCHASE	706,000	\$9.85	\$ 6,952,000
PUT CONTRACT	4,500,000	\$9.97	\$44,875,000
- PREMIUMS			\$ (6,075,00)
	5,206,000	\$8.79	\$45,752,000

Cypress buys back its shares by outright purchase or by the sale of "put" contracts to repurchase shares in the future, for which the company receives a premium that effectively lowers buyback costs. Currently, Cypress has bought directly or contracted to buy 5.2 million shares at an average price of \$8.79, for a total of \$45.8 million.

CONCLUSION

Today, there are two Cypresses: the SRAM Cypress—which has made the lion's share of our profit over the last 15 years, but which is currently losing money. And the other Cypress, comprising three non-SRAM divisions with 59% of corporate revenue and 20% pre-tax profit. I expect the SRAM group will return to profitability—with no excuses—in the third quarter, and Cypress to achieve solid profitability after the first quarter of 1998. During the year, the non-SRAM Cypress divisions will be driving singlemindedly toward expanding their sales with new product introductions.

We have made the tough decision to restructure to make Cypress competitive in today's market. Our new-product pipeline is more full than ever before. We plan to show our investors substantial, sequential improvements in both revenue and profit in 1998.

T.J. Rodgers
President and CEO

BUSINESS HIGHLIGHTS

Q1

- Cypress enters the huge market for slow SRAMs with the introduction of a family of SRAMs based on a 6-transistor cell that offers significant power savings and extends battery life in mobile applications.
- Cypress becomes the first programmable logic vendor to sell its design software over the worldwide web, offering the popular *Warp2*® program for \$99.
- Cypress focuses solely on programmable logic devices that can be reprogrammed after they have been inserted in systems, ending an agreement under which Cypress marketed one-time-programmable antifuse FPGAs.

Q2

- Cypress enters the high-end video market with the introduction of the SMPTE-259M Chipset. The chipset uses Cypress HOTLink™ technology to deliver digital video communications without expensive external filters.
- Cypress expands its market-leading line of Universal Serial Bus (USB) microcontrollers, introducing new products for keyboards with integrated pointing devices and gamepads.
- Cypress announces the availability of a new 100 MHz, RoboClock™ programmable buffer for communications systems. RoboClock assures that signals within a system all arrive exactly when and where they are needed.

Q3

- Cypress introduces NoBL™ SRAMs. NoBL devices eliminate read/write “wait states” that can cause performance bottlenecks in high-speed networking systems.
- Cypress sells \$175 million of 6% convertible subordinated notes, with the cash raised intended for general corporate purposes, including capital expenditures, working capital, and potential strategic acquisitions or investments.
- Cypress unveils its 4-megabit SRAM with more than 26.2 million transistors. Even at 4 million bits, it offers standby power usage less than 1 mA.

Q4

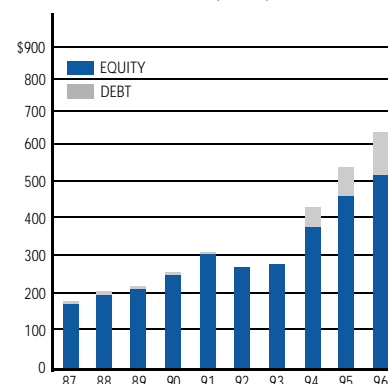
- Cypress introduces the 1-megabit Deep Sync™ FIFO, the world’s largest FIFO. It holds four times more data than the closest competing device yet still fits into the industry-standard package.
- Cypress introduces the company’s first production 0.35-micron product, the CY7C1021 SRAM aimed at applications using digital signal processors and microcontrollers.
- Cypress opens a new design center in Cork, Ireland, continuing its strategy of deploying design resources around the world to reduce development cycles.

Selected Consolidated Financial Data

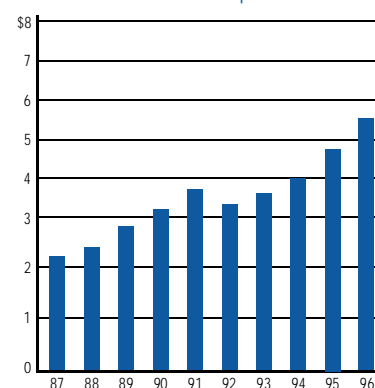
(In thousands, except per-share amounts)
(Unaudited)

	1997	1996	1995	1994	1993
For the year:					
Revenues	\$544,356	\$528,385	\$596,071	\$406,359	\$304,512
Acquisition-related non-recurring charges	—	—	—	—	18,271
Restructuring and other non-recurring costs (benefits)	—	(7,018)	17,800	—	(408)
Operating income	18,313	81,594	159,171	77,792	10,686
Income before tax	24,032	83,505	161,384	80,115	12,567
Net income	18,419	53,029	102,477	50,472	8,043
Net income per share:					
Basic	\$0.21	\$0.66	\$1.25	\$0.67	\$0.11
Diluted	0.21	0.62	1.09	0.60	0.11
Weighted average common and common equivalent shares outstanding:					
Basic	87,888	80,241	81,748	75,618	71,785
Diluted	94,648	91,604	97,309	88,311	76,241
At year-end:					
Cash and short-term investments	\$201,561	\$93,786	\$161,618	\$193,275	\$80,590
Working capital	305,027	126,006	190,580	225,952	124,651
Total assets	956,270	794,047	750,728	555,699	340,648
Long term debt and other long-term obligations (excluding current portion)	219,741	127,895	117,572	111,538	7,776
Stockholders' equity	643,476	510,746	472,099	352,999	271,685

Capitalization
(Millions)



Book Value per Share



The Letter to Shareholders 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 profitability goals, 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 and the Management's Discussion and Analysis section, particularly "Factors Affecting Future Results," 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, or to transition existing capacity to new uses; (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.

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 1997, the Company's revenues increased to \$544.4 million compared to the \$528.4 million recorded in 1996, but decreased in comparison to the \$596.1 million recorded in 1995. Revenues increased 3.0% over last year, but were 8.7% lower than in 1995. Even with the increase in revenues comparing 1997 to 1996, profits in 1997 decreased to \$18.4 million, or \$0.21 per share, on a diluted basis, compared to \$53.0 million, or \$0.62 per share in 1996. Earnings Per Share ("EPS") have been restated for all periods presented in compliance with Statement of Financial Accounting Standard No. 128 ("FAS 128"), "Earnings Per Share". Profits in 1995 were significantly higher than in 1997 as the Company recorded profits of \$102.5 million, or \$1.09 per share. The Company continued to be adversely affected by decreasing average selling prices ("ASPs"), particularly in its largest product line, Memory Products, which includes Static Random Access Memory products ("SRAMs"). Also in the latter part of the year, the Company was adversely impacted by lower yields caused by the conversion of certain capacity to 0.35 micron resulting in shortage in manufacturing output and missed sales opportunities. As a result of lower ASPs, the Company's gross margin decreased to 34.4% in 1997, compared to 42.2% in 1996 and 53.7% in 1995. ASPs in 1998 are expected to continue to decrease, but at a reduced rate from that experienced in 1997. In order to offset the effects of lower ASPs, the Company will continue its efforts to introduce new products with higher margins and to lower manufacturing costs by redesigning its existing products and transition its manufacturing processes from 0.65 micron to 0.5, 0.35 and 0.25 micron geometries.

In February 1997, the Company called for redemption of all of the 3.15% Convertible Subordinated Notes which was effective as of March 26, 1997. At the time of conversion, approximately 85% of the holders elected to convert their notes into the Company's common stock, increasing the amount of common stock outstanding by 6,789,013 shares. As a result of holders electing the cash settlement, the Company paid out \$14.3 million.

In March 1997, the Company signed a definitive agreement with QuickLogic Corporation ("QuickLogic") involving the 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 FPGA products. In return, Quicklogic paid \$4.5 million, which represented \$3.5 million of Non-Recurring Engineering ("NRE") revenue related to the sale of technology rights and \$1.0 million of compensation for inventory and other assets, and issued shares of Quicklogic common stock that increased the Company's equity position in the privately-held QuickLogic to greater than 20%. The \$4.5 million cash consideration represented the payment the Company received in June 1996. The Company also entered into a five-year wafer-supply agreement to provide FPGA products to QuickLogic. Revenues and net income contributed by the FPGA product line during 1997, 1996 and 1995 were not significant. The Company is using the equity method of accounting to record its investment in Quicklogic. The loss recorded in 1997 was not significant.

In September 1997, the Company completed a \$175.0 million private placement of 5-year Convertible Subordinated Notes. The notes are due in the year 2002, with a coupon rate of 6.00% and an initial conversion premium of 48.2%. The notes are convertible into approximately 7,408,000 shares of common stock and are callable by the Company three years after the date of issuance. Net proceeds were \$170.2 million, after issuance costs of \$4.8 million.

In October 1997, the Board of Directors authorized the repurchase of up to 2.0 million shares of the Company's common stock. In December 1997, the Board of Directors authorized the

repurchase of an additional 2.0 million shares. As of December 29, 1997, the Company had repurchased 515,800 shares of its common stock for \$5.3 million. The shares purchased are expected to be issued in conjunction with the Company's 1994 Stock Option Plan and ESPP. In conjunction with the authorized stock repurchase program, the Company sold put warrants through private placements for which it received \$2.8 million. The Company has a maximum potential obligation to purchase 3.0 million shares of its common stock at an aggregate price of \$32.4 million as of December 29, 1997. The puts have various expiration periods from January 1998 through October 1998. The Company has the right to settle the put warrants with cash or settle the difference between the exercise price and the fair market value at the exercise date with stock or cash. The intent of the Company is to settle these put warrants with stock, and therefore, no amount was classified out of stockholders' equity in the accompanying consolidated balance sheet.

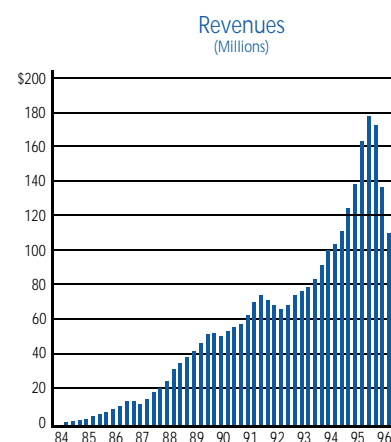
In December 1997, the Company announced its plans to exit the commodity Erasable Programmable Read-Only Memory business ("EPROM"). The remaining, high-margin EPROM business was merged with the Company's memory products division in order to serve the Company's EPROM customers in the future without the heavy cost of maintaining a product line. The Company also announced plans to discontinue its Chipset business, which was served by the Company's PC Logic product line. This included the closure of the Company's Germany Design Center, which specialized in designing chipsets. Costs associated with the change in the Company's business described above, were not material and were taken as period expenses in 1997.

In December 1997, the Company announced it was shutting down its San Jose test facility. In 1992, the Company moved a majority of its backend manufacturing to Bangkok, Thailand, but maintained a small test area in San Jose to support new products. In 1996 the Company began operations in its new assembly and test facility located in the Philippines. In 1997, as the Company began ramping up production in the Philippines plant, it was decided that the Company no longer needed to maintain the small, but expensive test facility in San Jose. As such, the plant was shut down. Costs associated with this shutdown were not material and were taken as period expenses in 1997.

In January 1998, substantially all outstanding stock options with an exercise price in excess of \$9.75 per share were cancelled and replaced with new options having an exercise price of \$9.75 per share, the fair market value on the date that the employees accepted the repricing. A total of 10,463,688 shares were repriced. This repricing excluded the Board of Directors, the Chief Executive Officer and the Executive staff of the Company.

On March 9, 1998, the Company announced a restructuring plan for which it will incur charges in the quarter ended March 30, 1998, for the write-down and write-off of manufacturing facilities, equipment and improvements; operating costs attributable to the closure and consolidation of manufacturing facilities; consolidation of test facilities; write-down of non-usable assembly inventory in the Thai test facility; the severance of manufacturing and other personnel and other costs.

The Company plans to shut down its six-inch, 0.6 micron wafer fabrication plant, Fab III, in Bloomington, Minnesota and move all production to its eight-inch, 0.35 micron fab, Fab IV, also in Minnesota. The adjustments from this decision relate primarily to the carrying value of manufacturing assets. As a result of developments in the semiconductor industry, such as decreasing average selling prices, particularly in its largest product line, Memory Products, the Company has accelerated the use of more advanced manufacturing processes to produce its products. The use of these more advanced processes indicated that the carrying value of these selected older assets may not be recoverable. The fair value of such manufacturing assets was based primarily upon third party estimates of fair value. The impairment charge relates to those assets that cannot be upgraded to eight-inch capability for use in Fab IV.



Fab II, located in Round Rock, Texas has been used in the manufacture of wafers for the Datacommunication, Programmable Logic and Computer Products divisions. A decision has been made to discontinue producing SRAMs in Texas. Costs associated with this decision include severance payments for approximately 100 employees, a write-down in the valuation of equipment which cannot be used elsewhere and related costs.

The Company uses a third party subcontractor, located in Thailand, for a portion of its test manufacturing. The Company plans to consolidate the Thai test manufacturing operation into its subsidiary operation located in the Philippines. Costs associated with this include severance payments, write-off of non-usable assembly inventory and the write-down of equipment that the Company will not be able to use in its Manila plant.

The decision to centralize most of the wafer production in an eight-inch fab caused the Company to make a decision to upgrade its R&D wafer fab, Fab I, located in San Jose, California, from six-inch to eight-inch to ensure compatibility. The charges associated with this move include facility write-downs and disposal of certain six-inch manufacturing equipment.

Costs associated with all the above decisions amount to approximately \$63.0 million.

Separately, the Company will record charges of approximately \$22.0 million relating to the write-off of certain equity investments and additional inventory reserves relating to the ongoing industry over-supply and continued inventory corrections by end user customers.

Results Of Operations

In 1997, the Company recorded revenues of \$544.4 million, an increase of 3.0% compared to the \$528.4 million recorded in 1996, but an 8.7% decrease in comparison to the \$596.1 million recorded in 1995. Even though revenues in 1997 increased slightly compared to 1996, ASPs continued to decline, particularly in the Memory Products Division ("MPD"), which includes the Static Random Access Memory ("SRAM") line of products. The ASPs for SRAM products continued to decline dropping 38.9% during 1997. The Company expects SRAM ASPs to decrease in 1998, but at a rate slower than experienced in the two previous years. The revenue decline in SRAM products caused by decreasing ASPs in 1997 was primarily in the 1 meg family of products where the ASPs at the end of 1997 dropped 37.6% in comparison to the end of 1996. Although unit sales volume of SRAM products increased significantly, growing 36.6% comparing 1997 to 1996, the increase in unit sales volume was not significant enough to offset the decline in ASPs. Consequently, SRAM revenues decreased 16.4% from 1996. In 1997, the Company moved its Non-volatile Memory ("NVM") line of products from the Programmable Products Division ("PPD") to MPD. Revenues generated from the sale of NVM products decreased 20.0% in 1997 compared to 1996, due to lower revenues recorded for EPROM products. As a result of the continued decline in the EPROM business, management decided to exit the commodity EPROM business and concentrate its efforts on products expected to yield higher margins. MPD's percentage of the Company's total revenues decreased 11.9% largely due to the decline in SRAM revenues and the revenue growth in the Company's other divisions.

Revenues generated by the Data Communications Division ("DCD") grew 34.3% comparing 1997 to 1996. Similar to last year, the growth in DCD's revenues was primarily the result of increased revenues in the division's Channel line of products, which recorded 45.7% more revenue in 1997 than in 1996. Significant contributions to revenue were made by the product line's two primary products, HOTLink point-to-point communication devices and Programmable Skew Clock Buffers ("RoboClock"). While ASPs decreased 9.7% during 1997, the 61.5% increase in unit sales volume more than offset the decline. Revenues in the Specialty Memory line of products, which include Clocked First-in, First-out ("FIFOs") and Dual Port products, also increased 27.4% comparing 1997 to 1996. The 42.3% increase in unit sales volume comparing 1997 to 1996 more than offset the 10.7% decrease in ASPs comparing the same time periods. As a result of the increase in revenues, DCD's percentage of the Company's total revenues increased 4.7%, growing to 20.0% in 1997.

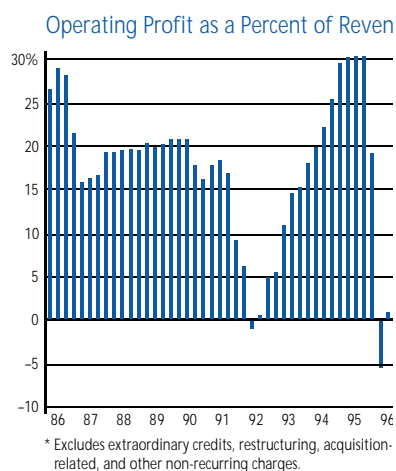
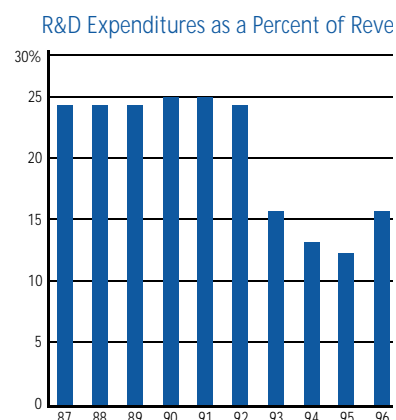
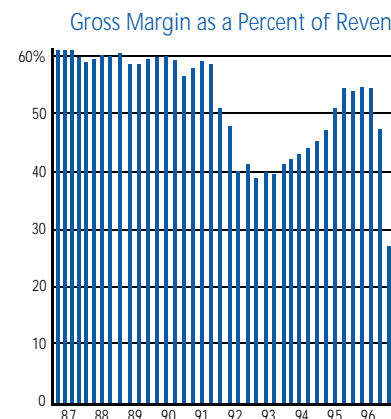
Revenues for the Programmable Logic Division (“PLD”) increased 21.9% comparing 1997 to 1996. PLD, along with NVM, formed the Company’s Programmable Products Division in 1996. PLD revenues in 1997 benefited by \$3.5 million from non-recurring engineering revenue (“NRE”) related to the sale of its FPGA technology rights to QuickLogic. Without the \$3.5 million NRE, revenues for PLD products grew 14.7% year to year. The increase in revenues was primarily due to increased sales volume which grew 26.9% in 1997. This increased sales volume more than offset the decline in ASPs comparing 1997 to 1996. During that period, PLD’s percentage of the Company’s total revenues increased 1.7% growing to 10.9%.

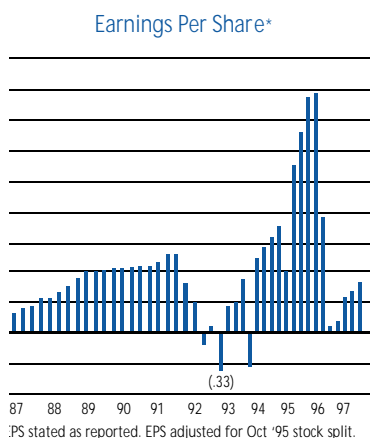
The Computer Products Division (“CPD”), the primary products of which include the Company’s Clock line of products, the VME Communication-bus Device line of products, the Universal Serial Bus (“USB”) line of products and the Fast CMOS Technology (“FCT”) Logic Device line of products increased revenues by 30.9% when comparing 1997 to 1996. The increase in revenues was experienced across all of CPD’s product lines, particularly in the Division’s Clock line of products. In the second half of 1997, the sale of Clock products increased significantly due to sales generated from its 227X family of clocks which service Intel Corporation and other personal computer-related manufacturers. Revenues generated from the sale of Clock products increased 32.1% comparing 1997 to 1996. Although the average selling price of Clock products decreased 25.4% comparing 1997 to 1996, the 86.1% increase in unit sales volume more than offset the effects of lower ASPs. With the increase in revenues, CPD’s percentage of the Company’s total revenue increased 3.3% to 15.7%.

As noted above, the Company continued to experience reductions in ASPs during 1997, particularly in its SRAM products. The decrease in ASPs continued to be caused by industry over-supply and continued inventory corrections by end user customers, particularly evident in the telecommunication and data communication markets that the Company principally serves. Even though ASPs in several markets continued to decline throughout 1997, the rate of decline was for the most part less than the rate of decline experienced throughout 1996. ASPs in 1998 are expected to continue to decline, but at a reduced rate from that experienced in 1997.

The Company’s cost of revenues as a percentage of revenues for 1997 increased to 65.6% compared to 57.8% in 1996 and 46.3% in 1995. As occurred in 1996, the increase in manufacturing costs as a percentage of revenues in 1997 continued to be a reflection of falling ASPs, particularly in the SRAM market. Unit volume increased significantly throughout a majority of the Company’s product lines in 1997 even though revenues increased only slightly compared to 1996. Unit volume increased to 252.4 million units in 1997, a 42.4% increase over 1996. Continued ASP erosion in the future could have a material adverse effect on the Company’s gross margin, and drive cost of revenues as a percentage of revenues higher. In 1997, cost of revenues benefited from certain changes in accounting estimates, primarily related to excess inventory reserves no longer required. The Company continues to introduce new products and new methods to reduce 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. The Philippines plant is expected to generate cost savings for the Company in the future, however in 1997, the cost savings were not fully realized due to the ramping of the facility. At the end of 1997, the Philippines facility produced over 40.0% of the Company’s backend manufacturing production compared to approximately 20.0% in 1996. The Company plans to continue to ramp up production at the Philippines plant in 1998 in order to lower its fixed cost per unit produced and take further advantage of potential cost savings including related tax holidays. Once fully-utilized, the Philippines plant is expected to increase assembly and test manufacturing capacity by 300 million units per year.

Alphatec Electronics Pcl (“Alphatec”), one of the Company’s primary backend manufacturing subcontract vendors, missed a number of deadlines to repay debt through 1997, including a repayment of \$43.7 million of third party international bonds during the second quarter of 1997. Although Alphatec has experienced recent financial difficulties, the assembly and test





operations, with which the Company currently does business, continue to operate under normal operating conditions. At December 29, 1997, the Company has consigned approximately \$15.3 million, net book value, of capital assets to Alphatec and Alphatec's production represents approximately 17% of the Company's backend manufacturing capacity. In March 1998, the Company decided to exit Alphatec's test manufacturing facility and to move all of its equipment to its Philippines plant.

Research and development ("R&D") expenses increased to 17.2% of revenues compared to 16.0% in 1996 and 12.0% in 1995. Actual spending in R&D increased significantly in 1997, growing to \$93.8 million compared to \$84.3 million and \$71.7 million in 1996 and 1995, respectively. The increase in R&D expenses in 1997 was in process technology and to a larger extent in new product development resources. The Company expects to continue to allocate resources to R&D in an effort to accelerate the development of new products and develop its 0.35 and 0.25 micron process technologies. With the Company's commitment to increase design capabilities in its design centers and the transformation of the San Jose wafer manufacturing facility into a research and development wafer facility, actual R&D spending is projected to grow 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 1997 were 13.8% of revenues. This was an increase from the 12.2% and 12.0% recorded in 1996 and 1995, respectively. Actual spending in SG&A expenses was \$75.3 million in 1997, an \$11.0 million increase over the \$64.3 million recorded in 1996 and a \$4.0 million increase over the \$71.3 million recorded in 1995. Selling and marketing expenses increased primarily as a result of additional headcount and increased expenditures resulting from increased efforts in strategic marketing and customer service. In 1997, the Company added headcount, particularly Field Application Engineers, in order to enhance its ability to expand its market share in existing markets and explore other opportunities in new markets. General and administrative expenses also increased from 1996 primarily as a result of increased headcount and the implementation of system enhancements. The Company plans to continue its efforts to control general and administrative expenditures in the future.

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 March 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 filed by Texas Instruments. As a result of this decision, the Company reversed the \$17.8 million reserve (See Note 7) in the third quarter of 1996. Also during the third quarter of 1996, the Company announced a restructuring of its San Jose wafer fabrication facility. As a result, the Company recorded a one-time, pre-tax charge of \$9.1 million principally related to the write-down of certain excess equipment and the transfer of certain other equipment to its Texas and Minnesota production wafer fabrication plants. The Company also recorded a one-time, pre-tax credit of \$3.3 million related to the 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 1997, substantially all the reserve was used for the purpose for which they were originally intended resulting in a remaining balance of \$1.7 million at December 29, 1997. There was no restructuring or other one-time, non-recurring costs charged to the Company in 1997.

Income from operations in 1997 was significantly lower in comparison to 1996 and 1995. Operating income in 1997 was \$18.3 million compared to \$81.6 million in 1996 and \$159.2 million in 1995. The decrease in operating income in 1997 can be attributed to a significant increase in cost of revenues and declining ASPs throughout 1997. The Company is continuing its efforts to develop new products that typically command higher margins and to reduce manufacturing costs through the development of and the conversion to new manufacturing

processes and the redesign of existing products in order to improve gross margin and operating income.

Net interest and other income in 1997 was \$5.7 million, an increase from the \$1.9 million and \$2.2 million recorded in 1996 and 1995, respectively. Interest and other income increased by \$4.1 million to \$12.9 million in 1997 from the \$8.8 million recorded in 1996 and was \$4.4 million higher than the \$8.5 million recorded in 1995. The majority of the increase can be attributed to the \$3.8 million gain recorded from the sale of the Company's remaining investment in Vitesse Corporation in 1997. Interest expense in 1997 was \$7.2 million, a slight increase in comparison to the \$6.9 million and \$6.2 million recorded in 1996 and 1995, respectively. In 1997, interest expense was primarily from the convertible bond that was redeemed in March 1997, the new convertible bond issued in September 1997 and the Company's revolving line of credit.

The Company recorded income tax expense of \$5.6 million in 1997, compared to \$30.5 million in 1996 and \$58.9 million in 1995. The effective tax rate for 1997 was 23.4% compared to 36.5% in both 1996 and 1995. In 1997, the decrease in the effective tax rate was primarily a result of R&D tax credits and certain tax benefits related to the Company's operations in the Philippines.

The Company's net income decreased significantly in 1997 in comparison to 1996 and 1995. In 1997, net income recorded was \$18.4 million, compared to \$53.0 million in 1996 and \$102.5 million in 1995.

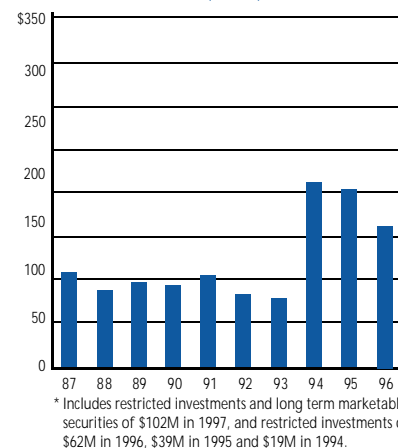
Factors Affecting Future Results

Risk Factors

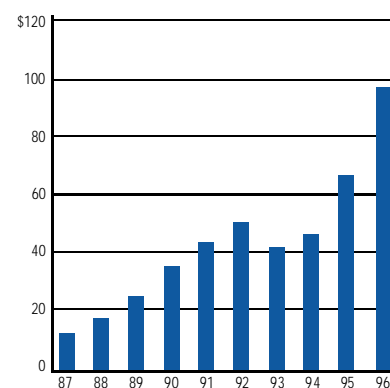
Except for the historical information contained herein, the discussion in this annual report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, including, but not limited to, statements as to the future operating results and business plans of the Company, that involve risks and uncertainties. The Company's actual results could differ materially from those discussed herein. Factors that could cause or contribute to such differences 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 networking, computer, and telecommunications markets, the effects of competition, characterized by price erosion, rapid technological change and heightened foreign competition in many markets, slower than expected growth in demand for semiconductor products, the availability and extent of utilization of manufacturing capacity, dependence on independent subcontract vendors, dependence on limited sources of supplies, fluctuation in manufacturing yields, the successful development and timing and market acceptance of new product introductions, product obsolescence, costs associated with future litigation, costs associated with protecting the Company's intellectual property, the successful ramp up of the Company's Philippines back-end manufacturing plant, the ability to develop and implement new technologies including the continued transition to full commercial production of the Company's new 0.5, 0.35 and 0.25 micron processes, dependence on key personnel, risk of international operations and the effects of environmental regulations.

The Company's quarterly and annual results of operations are affected by a variety of factors that could materially and adversely affect revenues, gross profit and income from operations. These factors include, among others, demand for the Company's products; changes in product mix; competitive pricing pressure (particularly in the static RAM market); fluctuations in manufacturing yields; cost and availability of raw materials; unanticipated delays or problems in the introduction or performance of the Company's new products; the Company's ability to introduce new products that meet customer requirements; market acceptance of the Company's products; product introduction by competitors; availability and extent of utilization of manufacturing capacity; product obsolescence; successful ramp up of the Company's Philippines back-end manufacturing plant, resolution of Alphatec's financial

Cash, Cash Equivalents, and Investments
(Millions)*



Depreciation and Amortization
(Millions)



situation; ability to develop and implement new technologies, including the transition of the Company's new 0.5, 0.35 and 0.25 micron process and continued migration to smaller geometries; conversion and upgrade of existing equipment base to these technologies including transfer of equipment and capability among sites; conversion and upgrade of the existing equipment set from 6-inch to 8-inch capability; level of expenditures for research and development and sales, general and administrative functions of the Company; costs associated with future litigation; and costs associated with protecting the Company's intellectual property. Any one or more of these factors could result in the Company failing to achieve its expectations as to future revenues, gross profit and income from operations. Additionally, risks inherent in the cyclical nature of the semiconductor industry may cause the Company's quarterly and annual results of operations to vary significantly. Moreover, as is common in the semiconductor industry, the Company frequently ships more products in the third month of each quarter than in either of the first two months of the quarter, and shipments in the third month are higher at the end of that month. The concentration of sales in the last month of the quarter contributes to the difficulty in predicting the Company's quarterly revenues and results of operations.

Since the Company recognizes revenues from sales to domestic distributors only upon the distributors' sale to end customers, the Company is highly dependent on the accuracy of distributors' estimates on their resale which could be materially different from the actual amounts finally reported. This also contributes to the difficulty in predicting the Company's quarterly revenue and results of operations, particularly in the last month of the quarter.

Additionally, the Company's headquarters and some manufacturing facilities are located near major earthquake faults. In the event of a major earthquake, the Company could suffer damages that could materially and adversely affect the Company's business, financial conditions and results of operations.

For further discussion of risk factors, refer to the Company's filing on Form 10-K with the Securities and Exchange Commission.

Year 2000 Disclosure

In the next two years, most companies will face a potentially serious information systems problem because many software application and operational programs written in the past may not properly recognize calendar dates beginning in the year 2000. This problem could force computers to either shut down or provide incorrect data or information. The Company began the process of identifying the changes required to its computer programs and hardware, in consultation with software and hardware providers in late 1996. Efforts are being made to modify or replace any non-compliant software, systems and equipment by the year 1999. In 1997, the Company began the process of replacing certain software by implementing a new accounting software system that is year 2000 compliant. Further, the Company is aware of the risks to third parties and the potential adverse impact on the Company resulting from the failure by these parties to adequately address the year 2000 problem. In response to this, the Company is inquiring of strategic suppliers and large customers to determine the extent to which the Company is vulnerable to these third parties failure to remediate their own year 2000 issues. The Company has expended and will continue to expend appropriate resources to address this issue on a timely basis. However, no estimate of the expected total cost of this effort can be made at this time, nor can any assurance be given that the year 2000 problem will not have an adverse impact on the Company's earnings. The Company has determined it has no exposure to contingencies related to the year 2000 issue for the products it has sold.

Liquidity And Capital Resources

The Company's cash, cash equivalents and short-term investments totaled \$201.6 million at the end of fiscal year 1997, a \$107.8 million increase from the end of 1996.

In February 1997, the Company called for redemption of all of the 3.15% Convertible Subordinated Notes which was effective as of March 26, 1997. At the time of conversion, approximately 85% of the holders elected to convert their notes into the Company's common stock, increasing the amount of common stock outstanding by 6,789,013 shares. As a result of holders electing the cash settlement, the Company paid out \$14.3 million.

In April 1997, the Company sold capital equipment located in its Minnesota wafer fabrication facility to Fleet Capital Leasing ("Fleet") in a sale-leaseback agreement. In October 1997, the Company entered into a similar agreement with Comdisco, Inc. ("Comdisco") for other capital equipment located in Minnesota. The Company received a total of \$28.2 million from Fleet and Comdisco in exchange for the capital equipment and as a result of the transactions, recorded an immaterial gain that will be amortized over the life of the leases.

In September 1997, the Company completed a \$175.0 million private placement of 5-year Convertible Subordinated Notes. The notes are due in the year 2002, with a coupon rate of 6.00% and an initial conversion premium of 48.2%. The notes are convertible into approximately 7,408,000 shares of common stock and are callable by the Company three years after the date of issuance. Net proceeds were \$170.2 million, after issuance costs of \$4.8 million.

In October 1997, the Board of Directors authorized the repurchase of up to 2.0 million shares of the Company's common stock. In December 1997, the Board of Directors authorized the repurchase of an additional 2.0 million shares. As of December 29, 1997, the Company had repurchased 515,800 shares of its common stock for \$5.3 million. The shares purchased are expected to be issued in conjunction with the Company's 1994 Stock Option Plan and ESPP. In conjunction with the authorized stock repurchase program, the Company sold put warrants through private placements for which the Company received \$2.8 million. The Company has a maximum potential obligation to purchase 3.0 million shares of its common stock at an aggregate price of \$32.4 million as of December 29, 1997. The puts have various expiration periods from January 1998 through October 1998. The Company has the right to settle the put warrants with cash or settle the difference between the exercise price and the fair market value at the exercise date with stock or cash. The intent of the Company is to settle these put warrants with stock, and therefore, no amount was classified out of stockholders' equity in the accompanying consolidated balance sheet.

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 specified leverage ratio, consolidated tangible net worth, quick ratio and adjusted EBIT/fixed charge coverage ratio. In December 1997, the Company repaid the \$49.0 million it borrowed from the revolving line of credit in September 1996.

In 1997, the Company purchased \$142.3 million in capital equipment, a significant decrease from the \$195.3 million purchased in 1996. The Company continued to purchase capital equipment for its domestic wafer fabrication plants to improve wafer manufacturing capacity and capabilities as the Company implements new technologies, including its 0.5, 0.35 and 0.25 micron processes. Equipment purchased for the Company's Philippines plant and its offshore subcontractors was used to improve backend manufacturing capacity and tool certain packaging capabilities. Capital equipment was also purchased for the Company's technology group in order to enhance its research and development capabilities. Capital expenditures in 1998 are expected to be approximately \$100.0 million as the Company continues its efforts to increase its manufacturing capabilities and capacity and to enhance its research and development capabilities.

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 for 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. The Company's restricted investment balance as of December 29, 1997 and December 30, 1996 was \$60.1 million and \$60.6 million, respectively, and is recorded as Other Assets on the balance sheet.

The Company believes that existing cash, cash from operations and borrowings under its revolving line of credit agreement, will be sufficient to meet present and anticipated working capital requirements and other cash needs for at least the next twelve months. In the event that ASPs continue to decline at rates above normal industry levels and demand continues to be insufficient to offset the effects of such declines, the Company may be required to raise additional capital through debt or equity financing. Although additional financing may be required, there can be no assurance that it would be available to the Company or available at terms the Company deems satisfactory.

Consolidated Balance Sheets

(In thousands, except share and per-share amounts)

	December 29, 1997	December 30, 1996
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 151,725	\$ 20,119
Short-term investments	<u>49,836</u>	<u>73,667</u>
Total cash, cash equivalents and short-term investments	201,561	93,786
Accounts receivable, net of allowances for doubtful accounts and customer returns of \$3,524 in 1997 and \$3,887 in 1996	67,854	71,440
Inventories	76,925	53,107
Other current assets	51,740	63,079
Total current assets	398,080	281,412
Property, plant and equipment, net	442,661	437,566
Other assets, including restricted investments of \$60,112 and long-term marketable securities of \$42,146 in 1997 and restricted investments of \$61,612 in 1996	115,529	75,069
	\$ 956,270	\$ 794,047
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 60,857	\$ 72,309
Accrued compensation and employee benefits	15,967	14,374
Other accrued liabilities	5,505	4,821
Line of credit	—	49,000
Deferred income on sales to distributors	9,636	14,902
Income taxes payable	1,088	—
Total current liabilities	93,053	155,406
Convertible subordinated notes	175,000	98,241
Deferred income taxes	36,070	21,288
Other long-term liabilities, including minority interest	8,671	8,366
Total liabilities	312,794	283,301
Commitments and contingencies (Note 7)		
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; 98,147,000 and 91,358,000 issued; 90,684,000 and 81,098,000 outstanding	1,015	914
Additional paid-in capital	430,682	311,184
Retained earnings	<u>333,910</u>	<u>315,491</u>
	765,607	627,589
Less shares of common stock held in treasury, at cost; 7,463,000 shares at December 29, 1997 and 10,260,000 shares at December 30, 1996	(122,131)	(116,843)
Total stockholders' equity	643,476	510,746
	\$ 956,270	\$ 794,047

See accompanying notes to Consolidated Financial Statements.

Consolidated Statements Of Operations

(In thousands, except per-share amounts)	Year Ended		
	December 29, 1997	December 30, 1996	January 1, 1996
Revenues	\$544,356	\$528,385	\$596,071
Cost of revenues	356,919	305,174	276,160
Research and development	93,842	84,334	71,667
Selling, general and administrative	75,282	64,301	71,273
Restructuring and other non-recurring costs (benefits)	—	(7,018)	17,800
Total operating costs and expenses	526,043	446,791	436,900
Operating income	18,313	81,594	159,171
Interest expense	(7,197)	(6,895)	(6,239)
Interest income and other	12,916	8,806	8,452
Income before income taxes	24,032	83,505	161,384
Provision for income taxes	(5,613)	(30,476)	(58,907)
Net income	\$ 18,419	\$ 53,029	\$102,477
Net income per share:			
Basic	\$ 0.21	\$ 0.66	\$ 1.25
Diluted	0.21	0.62	1.09
Weighted average common and common equivalent shares outstanding:			
Basic	87,888	80,241	81,748
Diluted	94,648	91,604	97,309

See accompanying notes to Consolidated Financial Statements.

Consolidated Statements Of Stockholders' Equity

(In thousands)

	<u>Common Stock</u>		<u>Additional</u>	<u>Retained</u>	<u>Treasury</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>	<u>Paid-In</u>	<u>Earnings</u>	<u>Stock</u>	<u>Stockholders'</u>
			<u>Capital</u>			<u>Equity</u>
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
Issuance of common stock under employee stock plans and other from treasury stock	3,313	33	29,503			29,536
Tax benefit resulting from stock option transactions			6,959			6,959
Issuance of common stock from the conversion of the convertible debt	6,789	68	83,036			83,104
Repurchase of common stock under share repurchase program	(516)				(5,288)	(5,288)
Net income for the year				18,419		18,419
Balances at						
December 29, 1997	90,684	\$1,015	\$430,682	\$333,910	\$(122,131)	\$ 643,476

See accompanying notes to Consolidated Financial Statements.

Consolidated Statements Of Cash Flows

(In thousands)	Year Ended		
	December 29, 1997	December 30, 1996	January 1, 1996
Cash flow from operating activities:			
Net income	\$ 18,419	\$53,029	\$102,477
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	111,361	97,606	64,733
Non-cash interest and amortization of debt issuance costs	3,978	2,774	2,639
Restructuring and other non-recurring costs	—	(12,943)	17,800
Deferred income taxes	14,782	6,216	(8,464)
Changes in operating assets and liabilities:			
Receivables	9,035	36,811	(46,733)
Inventories	(23,818)	(24,129)	(606)
Other assets	(50,385)	(7,130)	(20,407)
Accounts payable and accrued liabilities	(11,946)	(28,604)	32,644
Deferred income	(5,266)	1,712	3,502
Income taxes payable and deferred income taxes	15,870	(13,117)	42,738
Net cash flow generated from operating activities	82,030	112,225	190,323
Cash flow from investing activities:			
Decrease (increase) in short-term investments	23,831	78,464	7,836
Acquisition of property, plant, and equipment	(142,305)	(195,280)	(194,878)
Sale of equipment	28,183	—	—
Net cash flow used for investing activities	(90,291)	(116,816)	(187,042)
Cash flow from financing activities:			
Borrowing from (repayment of) line of credit	(49,000)	49,000	—
Issuance of convertible subordinated notes, net of issuance costs	170,187	—	—
Redemption of convertible debt	(14,331)	—	—
Restricted investments related to building lease agreements	—	(22,355)	(20,744)
Repurchase of common stock	(5,288)	(32,878)	(37,881)
Issuance of capital stock	36,495	18,496	31,523
Other long-term liabilities, including minority interest	1,804	2,960	—
Net cash flow generated (used) for financing activities	139,867	15,223	(27,102)
Net increase (decrease) in cash and cash equivalents	131,606	10,632	(23,821)
Cash and cash equivalents, beginning of year	20,119	9,487	33,308
Cash and cash equivalents, end of year	\$151,725	\$20,119	\$ 9,487
Supplemental disclosures:			
Cash paid during the year for:			
Interest	\$4,585	\$ 4,982	\$ 4,014
Income taxes	\$1,550	\$45,271	\$30,744

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, to international customers were 36%, 27%, and 34% of total revenues in 1997, 1996, and 1995, respectively. As of December 29, 1997, 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 end user accounted for greater than 10% of revenues in 1997, 1996, or 1995. Sales to one distributor accounted for 10% of total revenues in 1997. No one distributor accounted for greater than 10% of revenues in 1996 or 1995.

Summary Of Significant Accounting Policies

FISCAL YEAR-Fiscal years 1997, 1996, and 1995 ended December 29, 1997, December 30, 1996, and January 1, 1996, respectively. The Company operates on a 52- or 53-week fiscal year, ending on the Monday closest to December 31. Fiscal years 1997, 1996 and 1995 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 Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated.

INVESTMENTS-Investments where the Company has an equity position of greater than 20% are accounted for using the equity method.

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 domestic distributors. The Company sells to certain European distributors on certain select parts, under agreements having price protection. Revenue from sales to European distributors is recognized upon shipment. The Company reserves all anticipated price adjustments stemming from its European 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-For certain of the Company's financial instruments, including cash and cash equivalents, short-term investments, restricted investments, trade accounts receivable, accounts payable, and accrued expenses, the carrying amounts approximate fair value. The amounts shown for long-term marketable securities and long-term debt also approximate fair value.

CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS-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 requirements. The investments, which all have contractual maturities of less than one year, are carried at cost plus accrued interest, which approximated market for the entire fiscal year. Cash and cash equivalents and short-term investments included the following debt and equity securities at December 29, 1997 and December 30, 1996:

(In thousands)

	Dec 29, 1997	Dec 30, 1996
Corporate debt securities	\$ 75,634	\$ 2,000
State and municipal obligations	78,084	50,171
Other	47,843	41,615
Total	\$201,561	\$ 93,786

CONCENTRATION OF CREDIT RISK-Financial instruments that potentially subject the Company to significant concentration of credit risk consist principally of cash equivalents, short-term and long-term investments, long-term restricted cash, and trade accounts receivable. The Company places its cash equivalents, short-term and long-term investments and long-term restricted cash in a variety of financial instruments such as, corporate bonds, municipal securities and U.S. Government securities. The Company further limits its exposure to these investments by placing such investments with various issuers and 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:

(In thousands)

	Dec 29, 1997	Dec 30, 1996
Raw materials	\$ 17,900	\$ 12,214
Work-in-process	35,281	27,765
Finished goods	23,744	13,128
Total	\$ 76,925	\$ 53,107

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:

(In thousands)

	Useful Lives in Years	Dec 29, 1997	Dec 30, 1996
Land		\$ 12,922	\$ 12,546
Equipment	3 to 5	726,363	641,612
Buildings and leasehold improvements	7 to 10	69,340	70,673
Furniture and fixtures	5	6,543	7,568
		815,168	732,399
Accumulated depreciation and amortization		(372,507)	(294,833)
Total		\$442,661	\$437,566

LONG-LIVED ASSETS-Long-lived assets held and used by the Company are reviewed for impairment whenever events or circumstances indicate that the carrying amount of an asset may not be recoverable. In addition, all long-lived assets to be disposed of are reported at the lower of carrying amount or fair market value, less selling costs.

INCOME TAXES-The Company follows 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.

EARNINGS PER SHARE-The Company adopted Statement of Accounting Standard No. 128 ("FAS 128), Earnings Per Share ("EPS"), which was issued in February 1997. FAS 128 requires presentation of both basic and diluted EPS on the income statement. For all periods presented, Basic EPS is computed by dividing net income available to common stockholders (numerator) by the weighted average number of common shares outstanding (denominator) during the period. In computing diluted EPS, the average stock price for the period is used in determining the number of shares assumed to be purchased from the exercise of stock options. Diluted EPS is computed using the weighted average number of common and potential common stock equivalent shares outstanding during the period.

TRANSLATION OF FOREIGN CURRENCIES-The Company uses the U.S. dollar as its functional currency for all foreign subsidiaries. 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 5.

RECENT ACCOUNTING PRONOUNCEMENTS-In June 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 130 ("FAS 130"), "Reporting Comprehensive Income". FAS 130 establishes standards for the reporting of comprehensive income and its components in a full set of general-purpose financial statements for periods beginning after December 15, 1997. Comprehensive income as defined includes all changes in equity (net assets) during the period from non-owner sources. Reclassification of financial statements for earlier periods for comparative purposes is required. The Company will adopt FAS 130 in its 1998 annual report.

In June 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 131 ("FAS 131"), "Disclosure About Segments of An Enterprise and Related Information". FAS 131 revises information regarding the reporting of certain operating segments for periods beginning after December 15, 1997. It also establishes standards for related disclosures about products and services, geographic areas and major customers. The Company will adopt FAS 131 in its 1998 annual report.

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 and as a result of this ruling, the Company reversed the \$17.8 million reserve it established in 1995. In December 1996, TI filed a petition of certiorari in the United States Supreme Court. In June 1997, the United States Supreme Court denied TI's petition of certiorari. Accordingly, adjudication of the case is now final. During the third quarter of 1996, 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 1996, 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 1997, substantially all the reserve was used for the purpose for which they were originally intended resulting in a remaining balance of \$1.7 million at December 29, 1997. For discussion of restructuring activity subsequent to year end, see Note 9.

Note 3: Convertible Subordinated Notes

In February 1997, the Company called for redemption of all of the 3.15% Convertible Subordinated Notes which was effective as of March 26, 1997. At the time of conversion, approximately 85% of the holders elected to convert their notes into the Company's common stock, increasing the amount of common stock outstanding by 6,789,013 shares. As a result of holders electing the cash settlement, the Company paid out \$14.3 million.

In September 1997, the Company completed a \$175.0 million private placement of 5-year Convertible Subordinated Notes. The notes are due in the year 2002, with a coupon rate of 6.0% and an initial conversion premium of 48.2%. The notes are convertible into approximately 7,408,000 shares of common stock and are callable by the Company three years after the date of issuance. Net proceeds were \$170.2 million, after issuance costs of \$4.8 million.

Note 4: Earnings Per Share

FAS 128 requires the reconciliation of the numerators and the denominators of the basic and diluted per share computation as follows:

(In thousands, except per-share amounts)

	1997			1996			1995		
	Income	Shares	Per-Share Amount	Income	Shares	Per-Share Amount	Income	Shares	Per-Share Amount
Basic EPS:									
Net income	\$18,419	87,888	<u>\$0.21</u>	\$53,029	80,241	<u>\$0.66</u>	\$102,477	81,748	<u>\$1.25</u>
Effects of Dilutive Securities:									
Stock Options		4,885			3,423			7,621	
Convertible debentures	1,130	1,875		3,700	7,940		3,614	7,940	
Diluted EPS:									
Net income	<u>\$19,549</u>	<u>94,648</u>	<u>\$0.21</u>	<u>\$56,729</u>	<u>91,604</u>	<u>\$0.62</u>	<u>\$106,091</u>	<u>97,309</u>	<u>\$1.09</u>

Options to purchase \$5,696,000 shares of common stock were outstanding at December 29, 1997, but were not included in the computation of diluted EPS as their average exercise price was higher than the average market price of the stock. Convertible debentures outstanding at December 29, 1997 convertible to 7,408,000 shares of common stock were also excluded from diluted EPS as their effect was anti-dilutive.

Note 5: 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 non-statutory 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 per share were cancelled and replaced 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. In January 1998, substantially all outstanding stock options with an exercise price in excess of \$9.75 per share were cancelled and replaced with new options having an exercise price of \$9.75 per share, the fair market value on the date that the employees accepted the repricing. A total of 10,463,688 shares were repriced. This repricing excluded the Board of Directors, the Chief Executive Officer and the Executive staff of the Company.

The following table summarizes the Company's stock option activity and related weighted average exercised price for each category for the years ended December 29, 1997, December 30, 1996 and January 1, 1996. The weighted average exercise price for each category presented is also shown in the table below.

Shares Under Option and Available for Grant

(Share information in thousands)

	1997		1996		1995	
	Shares	Price	Shares	Price	Shares	Price
Options outstanding, beginning of year	21,013	\$ 8.94	19,448	\$ 9.81	18,972	\$ 5.92
Options cancelled	(1,461)	\$11.13	(8,855)	\$ 14.71	(1,292)	\$16.05
Options granted	5,497	\$12.64	12,202	\$11.23	7,504	\$16.82
Options exercised	(2,772)	\$ 7.62	(1,782)	\$ 5.38	(5,736)	\$ 4.81
Options outstanding, end of year	<u>22,277</u>	<u>\$ 9.86</u>	<u>21,013</u>	<u>\$ 8.94</u>	<u>19,448</u>	<u>\$ 9.81</u>
Options exercisable at December 1997	<u>10,447</u>	<u>\$ 7.88</u>				

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 1997, 1996 and 1995 was \$6.07, \$3.14 and \$7.49 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;

	1997	1996	1995
Expected life	6 years	6 years	6 years
Risk-free Interest Rate	6.63%	6.04%	6.28%
Volatility	.5529	.5582	.5559
Dividend Yield	0.00%	0.00%	0.00%

Significant option groups outstanding as of December 29, 1997 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 - \$6.75	4,472	\$ 4.87	4,416	\$ 4.85	4.23
\$ 6.76 - \$10.75	4,695	\$ 9.10	2,725	\$ 8.61	7.13
\$10.76 - \$11.00	7,243	\$11.00	2,973	\$11.00	8.04
\$11.01 - \$11.56	3,287	\$11.56	84	\$11.55	9.78
\$11.57 - \$17.56	2,580	\$14.56	250	\$14.98	9.14

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 the enrollment price multiplied by purchased shares). Of the 7,600,000 shares authorized under the ESPP, 6,430,146 shares were issued through 1997 including, 541,055, 652,157 and 582,432, shares in 1997, 1996, and 1995, 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:

	1997	1996	1995
Expected life	6 months	6 months	6 months
Risk-free Interest Rate	5.80%	5.98%	5.45%
Volatility	.5861	.5882	.5275
Dividend Yield	0.00%	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 1997, 1996 and 1995 were \$5.49, \$5.37 and \$10.15 per share, respectively.

Pro Forma Net Income (Loss) and Net Income (Loss) 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 (loss) and earnings per share for the years ended December 29, 1997, December 30, 1996 and January 1, 1996 would have been as follows:

(In thousands, except per-share amounts)

	1997	1996	1995
Pro forma net income (loss):			
Basic	\$ (6,431)	\$32,490	\$92,814
Diluted	\$ (6,431)	\$36,190	\$96,427
Pro forma net income (loss) per share:			
Basic	\$ (0.07)	\$ 0.40	\$ 1.14
Diluted	\$ (0.07)	\$ 0.40	\$ 1.01

The pro forma effect on net income (loss) and net income (loss) per share for 1997, 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 October 1997, the Board of Directors authorized the repurchase of up to 2.0 million shares of the Company's common stock. In December 1997, the Board of Directors approved the repurchase of an additional 2.0 million shares. As of December 29, 1997, the Company repurchased 515,800 shares of its common stock for \$5.3 million. The shares purchased are expected to be issued in conjunction with the Company's 1994 Stock Option Plan and ESPP.

In conjunction with the authorized stock repurchase program, the Company sold put warrants through private placements for which the Company received \$2.8 million which has been recorded as additional paid in capital. The Company has a maximum potential obligation to purchase 3.0 million shares of its common stock at an aggregate price of \$32.4 million as of December 29, 1997. The puts have various expiration periods from January 1998 through October 1998. The Company has the right to settle the put warrants with cash or settle the difference between the exercise price and the fair market value at the exercise date with stock or cash. The intent of the Company is to settle these put warrants with stock, and therefore, no amount was classified out of stockholders' equity in the accompanying consolidated balance sheet.

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 being 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, New Product Bonus 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 New Product Bonus Plan effective for 1997, all qualified employees are provided bonus payments, which are based on the Company attaining certain levels of new product revenue, plus attaining certain levels of profitability. In 1997, \$475,000 was charged to operations in connection with the New Product Bonus Plan. In 1996 and 1995, under the Profit Sharing Plan, all qualified employees were provided an equal share of bonus payments which were based on the Company achieving a targeted level of earnings per share. In 1995, \$7,575,000 was charged to operations in connection with the Profit Sharing Plan. There were no charges to operations in connection with the Profit Sharing Plan in 1996.

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, \$4,937,000 was charged to operations in connection with this Plan. In 1997 and 1996, there were no charges to operations in connection with this Plan.

Note 6: 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

(In thousands)

	Year Ended		
	December 29, 1997	December 30, 1996	January 1, 1996
Income before provision for taxes	\$ 24,032	\$ 83,505	\$161,384
Current tax expense:			
U.S. Federal	\$(10,483)	\$21,481	\$ 60,163
State and local	1,418	1,706	6,988
Foreign	500	1,073	220
Total current	(8,565)	24,260	67,371
Deferred tax expense (benefit):			
U.S. Federal	16,033	5,559	(7,849)
State and local	(1,855)	657	(615)
Total deferred	14,178	6,216	(8,464)
Total	\$ 5,613	\$30,476	\$ 58,907

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

(In thousands)

	Year Ended		
	December 29, 1997	December 30, 1996	January 1, 1996
Statutory rate	35%	35%	35%
Tax at U.S. statutory rate	\$ 8,411	\$ 29,227	\$56,487
Foreign Earnings	(1,151)	—	—
State income taxes, net of federal benefit	922	1,536	4,142
Tax credits	(2,274)	—	(1,013)
Net Foreign Sales Corporation (FSC) benefit	(78)	(1,548)	(479)
Benefit of tax free investments	(482)	(998)	(2,259)
Other, net	265	2,259	2,029
Total	\$5,613	\$ 30,476	\$58,907

The components of the net deferred tax assets at December 29, 1997 and December 30, 1996, under SFAS 109 were as follows:

(In thousands)

	December 29, 1997	December 30, 1996
Deferred tax assets:		
Deferred income on sales to distributors	\$ 9,773	\$ 9,667
Inventory reserves and basis differences	12,596	13,794
Restructuring and legal reserves	9	1,167
Asset valuation and other reserves	12,670	13,511
State tax, net of federal tax	421	522
R & D tax credits	4,177	—
Other, net	1,122	1,472
Total deferred tax assets	40,768	40,133
Deferred tax liabilities:		
Excess of tax over book depreciation	(40,355)	(25,568)
Other, net	(1,210)	(1,184)
Total deferred tax liabilities	(41,565)	(26,752)
Net deferred tax assets (liabilities)	\$ (797)	\$ 13,381

Other current assets include current deferred tax assets of \$35,573,000 at December 29, 1997, and \$34,900,000 at December 30, 1996, respectively.

The tax benefits associated with disqualifying dispositions of stock options or employee stock purchase plan shares reduced taxes currently payable by \$7.0 million in 1997.

Note 7: Commitments And Contingencies

Operating Lease Commitments

The Company leases most of its manufacturing and office facilities under non-cancelable 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 April 1997, the Company sold capital equipment located in its Minnesota wafer fabrication facility to Fleet Capital Leasing ("Fleet") in a sale-leaseback agreement. In October 1997, the Company entered into a similar agreement with Comdisco, Inc. ("Comdisco") for other capital equipment located in Minnesota. The Company received a total of \$28.2 million from Fleet and Comdisco in exchange for the capital equipment and as a result of the transactions, recorded an immaterial gain that will be amortized over the life of the leases.

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 provide 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 \$52.9 million at December 29, 1997. Based on management's estimate of the fair value of the properties, no liability was recorded at December 29, 1997. 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 29, 1997, the amount of restricted cash or investments recorded was \$60.1 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 non-cancelable operating leases as of December 29, 1997, are:

(In thousands)

Fiscal Year	
1998	\$16,251
1999	14,734
2000	8,274
2001	4,165
2002	3,232
2003 and thereafter	7,420
Total	\$54,076

Rental expense was approximately \$13,936,000 in 1997, \$7,708,000 in 1996, and \$5,995,000 in 1995.

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 certain 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 that remained outstanding until November 1997. At December 29, 1997 there were no borrowings against the line of credit. Any balance borrowed will be due three years from the date of the agreement.

Litigation And Asserted Claims

The semiconductor industry has experienced a substantial amount of litigation regarding patent and other intellectual property rights. The Company is currently and may in the future be involved in litigation with respect to alleged infringement by the Company of another party's patents, or may in the future be involved in litigation to enforce its patents or other intellectual property rights, to protect its trade secrets and know-how, to determine the validity or scope of the proprietary rights of others, or to defend against claims of infringement or invalidity. Such litigation has in the past and could in the future result in substantial costs and diversion of management resources and payment of substantial damages and/or royalties or prohibitions against utilization of essential technologies, and could have a material adverse effect on the Company's business, financial condition and results of operations. From time to time the Company has received, and may receive in the future, communications alleging that its products or its processes may infringe on product or process technology rights held by others.

In June 1997, the Company commenced a declaratory judgement action in the United States District Court for the District of Nevada against the Li Second Family Trust (the "Trust") asking for declaratory relief to the effect that a U.S. patent relating to a portion of the process for manufacturing semiconductors is unenforceable, invalid and not infringed by the Company. The Trust has counterclaimed for patent infringement on the same patent alleging such patent covers oxide-isolated integrated circuits. In correspondence, attorneys for the Trust have argued that such patent "is applicable to NMOS, CMOS, Bipolar, BiCMOS and other technologies". In December 1997, in a related case, the Federal Court for the Eastern District of Virginia preliminarily ruled that Dr. Li's patent is unenforceable due to inequitable conduct by Dr. Li and his attorneys in obtaining the patent. Dr. Li has the right to file an appeal, although no such appeal as been filed as of March 17, 1998. The Company believes it has meritorious defenses to the counterclaim and intends to defend itself vigorously. However, should the outcome of this action be unfavorable, the Company's business, financial condition and results of operations could be materially and adversely affected.

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 TI failed to prove that the Company infringed on TI's patents covering the plastic encapsulation process used to package semiconductor devices. In July 1996, the Federal Circuit 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, the Company reversed the \$17.8 million reserve recorded in March 1995 with respect to this lawsuit. In December 1996, TI filed a petition of certiorari with the United States Supreme Court. In June 1997, the United States Supreme Court denied TI's petition of Certiorari. Accordingly, adjudication of the case is now final.

In January 1998, the Company was contacted by the attorneys representing the estate of Mr. Jerome Lemelson charging that the Company infringed on certain patents registered by Mr. Lemelson. The attorneys for the estate have not filed suit, but have urged the Company to enter into a licensing agreement with the estate in order to avoid litigation. The Company is in the process of reviewing the charges to determine the validity of the suit. Should the estate file suit, the Company will vigorously defend itself in this matter and based upon the inherent uncertainties of litigation, 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 29, 1997, the Company had purchase commitments aggregating \$71.4 million, principally for manufacturing equipment and facilities. These commitments were made for purchases in 1998.

Note 8: Related Parties

During 1990, the Company made a cost-basis investment of \$1.0 million in Vitesse Semiconductor ("Vitesse") stock. In February 1997, the Company sold its remaining investment and recorded a gain of \$3.8 million in other income. 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 in QuickLogic Corporation ("QuickLogic") Series D and E preferred stock. In June 1996, the Company received \$4.5 million from QuickLogic, the original intent of which was to obtain a minority interest in CTI and to secure guaranteed fab capacity. The Company classified the \$4.5 million as other long-term liabilities in 1996 awaiting final negotiation of the terms and transaction approval from Altera, an existing minority interest shareholder. In March 1997, the Company signed a definitive agreement with QuickLogic Corporation 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 ceased development, marketing and selling of antifuse-based FPGA products. In return, QuickLogic paid \$4.5 million, which represented \$3.5 million of NRE revenue related to the sale of technology rights and \$1.0 million of compensation for inventory and other assets, and issued shares of QuickLogic common stock that increased the Company's equity position in the privately-held QuickLogic to greater than 20%. The \$4.5 million cash consideration represented the payment the Company received in June 1996. The Company also entered into a five-year wafer-supply agreement to provide FPGA products to QuickLogic. Revenues and net income contributed by the FPGA product line during 1997, 1996 and 1995 were not significant. The Company is using the equity method of accounting to record its investment in QuickLogic. The Company's share of QuickLogic's loss recorded in 1997 was not significant.

The Company recorded sales to QuickLogic of \$11.7 million, \$8.2 million, and \$5.8 million in 1997, 1996, and 1995, respectively, and at fiscal years-end 1997, 1996, and 1995, the Company had a receivable due from QuickLogic of \$1.5 million, \$1.4 million, and \$0.7 million, respectively. 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 9: Subsequent Events

On March 9, 1998, the Company announced a restructuring plan for which it will incur charges in the quarter ended March 30, 1998, for the write-down and write-off of manufacturing facilities, equipment and improvements; operating costs attributable to the closure and consolidation of manufacturing facilities; consolidation of test facilities; write-down of non-usable assembly inventory in the Thai test facility; the severance of manufacturing and other personnel and other costs.

The Company plans to shut down its six-inch, 0.6 micron wafer fabrication plant, Fab III, in Bloomington, Minnesota and move all production to its eight-inch, 0.35 micron fab, Fab IV, also in Minnesota. The adjustments from this decision relate primarily to the carrying value of manufacturing assets. As a result of developments in the semiconductor industry, such as decreasing average selling prices, particularly in its largest product line, Memory Products, the Company has accelerated the use of more advanced manufacturing processes to produce its products. The use of these more advanced processes indicated that the carrying value of these selected older assets may not be recoverable. The fair value of such manufacturing assets was based primarily upon third party estimates of fair value. The impairment charge relates to those assets that cannot be upgraded to eight-inch capability for use in Fab IV.

Fab II, located in Round Rock, Texas has been used in the manufacture of wafers for the Datacommunication, Programmable Logic and Computer Products divisions. A decision has been made to discontinue producing SRAMs in Texas. Costs associated with this decision include severance payments for approximately 100 employees, a write-down in the valuation of equipment which cannot be used elsewhere and related costs.

The Company uses a third party subcontractor, located in Thailand, for a portion of its test manufacturing. The Company plans to consolidate the Thai test manufacturing operation into its subsidiary operation located in the Philippines. Costs associated with this include severance payments, write-off of non-usable assembly inventory and the write-down of equipment that the Company will not be able to use in its Manila plant.

The decision to centralize most of the wafer production in an eight-inch fab caused the Company to make a decision to upgrade its R&D wafer fab, Fab I, located in San Jose, California, from six-inch to eight-inch to ensure compatibility. The charges associated with this move include facility write-downs and disposal of certain six-inch manufacturing equipment.

Costs associated with all the above decisions amount to approximately \$63.0 million.

Separately, the Company will record charges of approximately \$22.0 million relating to the write-off of certain equity investments and additional inventory reserves relating to the ongoing industry, over-supply and continued inventory corrections by end user customers.

The Company sold additional put warrants through private placements through February 26, 1998. As of March 17, 1998, the Company has a maximum potential obligation to purchase 4.5 million shares of its common stock at an aggregate price of \$44.9 million.

Summary Annual And Quarterly Financial Data

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

(Unaudited)

	Year Ended							
	Dec 29 1997	Dec 30 1996	Jan 1 1996	Jan 2 1995	Jan 3 1994	Dec 28 1992	Dec 30 1991	Dec 31 1990
Revenues	\$ 544,356	\$ 528,385	\$ 596,071	\$ 406,359	\$ 304,512	\$ 272,242	\$ 286,829	\$ 225,232
Costs and expenses:								
Cost of revenues	356,919	305,174	276,160	222,620	179,821	158,159	128,149	93,947
Research and development	93,842	84,334	71,667	53,188	49,798	64,951	71,750	55,553
Selling, general and administrative	75,282	64,301	71,273	52,759	46,344	45,068	42,171	33,437
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	526,043	446,791	436,900	328,567	293,826	307,878	242,070	182,937
Operating income (loss)	18,313	81,594	159,171	77,792	10,686	(35,636)	44,759	42,295
Interest expense	(7,197)	(6,895)	(6,239)	(4,041)	(289)	(440)	(1,000)	(1,088)
Interest income and other	12,916	8,806	8,452	6,364	2,170	3,148	8,012	9,142
Income (loss) before income taxes	24,032	83,505	161,384	80,115	12,567	(32,928)	51,771	50,349
(Provision) benefit for income taxes	(5,613)	(30,476)	(58,907)	(29,643)	(4,524)	11,918	(17,600)	(17,119)
Net income (loss)	\$ 18,419	\$ 53,029	\$ 102,477	\$ 50,472	\$ 8,043	\$ (21,010)	\$ 34,171	\$ 33,230
Net income (loss) per share:								
Basic	\$ 0.21	\$ 0.66	\$ 1.25	\$ 0.67	\$ 0.11	\$ (0.28)	\$ 0.46	\$ 0.45
Diluted	\$ 0.21	\$ 0.62	\$ 1.09	\$ 0.60	\$ 0.11	\$ (0.28)	\$ 0.42	\$ 0.43
Weighted average shares used in computation of EPS:								
Basic	87,888	80,241	81,748	75,618	71,785	74,481	74,428	73,585
Diluted	94,648	91,604	97,309	88,311	76,241	74,481	80,838	76,503
Depreciation/amortization expense	111,361	97,606	64,733	45,039	41,245	47,634	41,538	33,503
Cash and short-term investments	201,561	93,786	161,618	193,275	80,590	82,046	103,703	91,650
Stockholders' equity	643,476	510,746	472,099	352,999	271,685	262,061	298,612	242,208
Number of employees	2,770	2,171	1,859	1,423	1,262	1,529	1,945	1,595
Percent of revenue								
Cost of revenue	66%	58%	46%	55%	59%	58%	44%	42%
Research & development	17%	16%	12%	13%	16%	24%	25%	25%
Selling, general & administrative	14%	12%	12%	13%	15%	17%	15%	15%
Total costs and expenses	97%	85%	73%	81%	96%	113%	84%	81%
Operating income (loss)	3%	15%	27%	19%	4%	(13%)	16%	19%

Three Months Ended

Dec 29 1997	Sept 29 1997	June 30 1997	March 31 1997	Dec 30 1996	Sep 30 1996	July 1 1996	Apr 1 1996
\$134,134	\$ 146,081	\$ 138,142	\$125,999	\$113,103	\$109,647	\$ 135,464	\$170,171
94,538	93,345	86,687	82,349	75,223	81,075	72,015	76,861
23,833	24,560	24,426	21,023	21,103	19,826	21,989	21,416
19,606	18,977	19,135	17,564	15,661	14,998	15,502	18,140
—	—	—	—	—	—	—	—
—	—	—	—	—	(7,018)	—	—
137,977	136,882	130,248	120,936	111,987	108,881	109,506	116,417
(3,843)	9,199	7,894	5,063	1,116	766	25,958	53,754
(3,154)	(948)	(779)	(2,316)	(2,149)	(1,617)	(1,482)	(1,647)
3,095	2,756	2,238	4,826	3,089	1,769	2,075	1,873
(3,902)	11,007	9,353	7,573	2,056	918	26,551	53,980
4,010	(3,797)	(3,213)	(2,613)	(752)	(335)	(9,686)	(19,703)
\$ 108	\$ 7,210	\$ 6,140	\$ 4,960	\$ 1,304	\$ 583	\$ 16,865	\$ 34,277
\$ 0.00	\$ 0.08	\$ 0.07	\$ 0.06	\$ 0.02	\$ 0.01	\$ 0.21	\$ 0.43
\$ 0.00	\$ 0.08	\$ 0.07	\$ 0.06	\$ 0.02	\$ 0.01	\$ 0.19	\$ 0.39
90,890	90,054	88,768	81,838	80,821	80,409	79,787	79,946
93,923	96,084	94,096	94,489	92,865	83,037	91,239	91,337
28,804	28,056	26,862	27,639	27,257	25,455	23,290	21,604
201,561	302,397	123,133	131,225	93,786	95,557	65,453	111,073
643,476	637,245	615,443	602,866	510,746	502,231	497,715	477,864
2,770	2,672	2,537	2,299	2,171	2,124	2,093	1,971
70%	64%	63%	65%	67%	74%	53%	45%
18%	17%	18%	17%	19%	18%	16%	13%
15%	13%	14%	14%	14%	14%	11%	11%
103%	94%	94%	96%	99%	99%	81%	68%
(3%)	6%	6%	4%	1%	1%	19%	32%

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 29, 1997 and December 30, 1996, and the results of its operations and its cash flows for each of the three years in the period ended December 29, 1997, 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

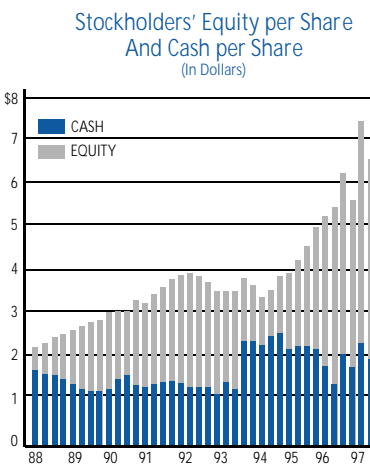
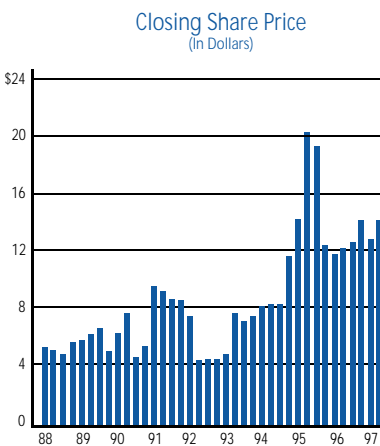
San Jose, California

January 20, 1998, except as to Note 9, which is as of March 6, 1998

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 29, 1997 there were approximately 3,032 holders of record of the Company’s Common Stock. Prior shares and stock prices have been restated to reflect a two-for-one stock split which was effected in October 1995.

Price Range of Common Stock (\$)			
	Low	High	Close
Fiscal year ended			
December 29, 1997:			
First Quarter	11.62	15.25	12.50
Second Quarter	11.62	15.88	14.50
Third Quarter	14.19	18.94	15.50
Fourth Quarter	7.37	15.94	8.63
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



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

Communications in which the information-carrying signal is placed directly on the transmission medium without use of a carrier signal.

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 mother board 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**.

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 and into the next millennium, 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.

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.

Flash

An electrically programmable and erasable, non-volatile technology that provides users with the programmability and data storage of **EPROMs** (see entry), plus in-system erasability. Non-volatile means that an **integrated circuit** (see entry) holds data when power is off. Cypress uses flash technology in its **FLASH370i™** family of **CPLDs** (see entry).

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 elsewhere on the board.

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 many millions of transistors to be deposited on a small substrate, or **chip**, (see entry) 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."

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 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.

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.).

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 CY7C955 is a physical layer transceiver for SONET/SDH on ATM (see entries).

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** (see entry) 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.

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 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 Consultant
 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, Memory Products Division and Research and Development
 Emmanuel Hernandez, Vice President, Finance and Administration and Chief Financial Officer
 Jim Kupec, Vice President, Business Development
 Lothar Maier, Vice President, Worldwide Manufacturing
 J. Daniel McCranie, Vice President, Marketing and Sales

VICE PRESIDENTS AND SUBSIDIARY PRESIDENTS

Dan Barrett, Vice President, European Sales and Marketing
 Jagdish Belani, Vice President, Packaging Technology
 Anthony Cantu, Vice President, Quality
 Louis Chetaud, Vice President, Worldwide Assembly and Test Manufacturing
 Gerald Cummings, Vice President, Central Manufacturing Operations
 David Fleischer, Vice President, Asia Pacific
 Bernard Glasauer, Vice President, Product Engineering
 Jeff Kaszubinski, Vice President, Manufacturing Operations
 Paul Keswick, Vice President, New Product Development
 Thomas Kneuppel, Vice President and Corporate Controller
 Jeff Linden, Vice President, Computer Products Division
 Christopher Norris, Vice President, Programmable Logic Division
 Rich Parker, Vice President, North American Distribution
 John Ramacciotti, Vice President, Procurement
 Edward Rodriguez, Vice President, Data Communications Division
 Christopher Seams, Vice President, Worldwide Wafer Manufacturing
 R. Michael Starnes, Vice President, Process Technology⁽³⁾
 Joyce Sziebert, Vice President, Human Resources
 John Torode, Vice President and Chief Technical Officer
 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

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 (617) 575-2000

⁽¹⁾ Member of the Audit Committee

⁽²⁾ Member of the Compensation Committee

⁽³⁾ Founder

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.

Warp2 is a registered trademark, and Cypress, Cypress Semiconductor, the Cypress logotype, Deep Sync, FLASH370i, HOTLink, ISR, NoBL, RAM3, RAM4, RAM5, ROAM, RoboClock, Ultra37000, Ultra39000, and *Warp* are trademarks of Cypress Semiconductor Corporation.

Other names may be service marks or trademarks of their respective holders and may be registered in certain jurisdictions.

Customer photographs used in this report were provided by Ascend Communications, Divicom, Hewlett-Packard, Microsoft, Motorola, Northern Telecom, Psion Dacom, Seagate, Sierra Design Labs, and 3Com and are used by permission. The product names are trademarks or registered trademarks of the respective companies.

ANNUAL MEETING

The annual meeting of stockholders for Cypress Semiconductor Corporation will be held on Friday, May 15, 1998 10:00 a.m., local time, at the Company's offices at 3939 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 Customers

Cypress's customers are industry leaders in the data communications, telecommunications, networking, and personal computer markets. Cypress's broad product line allows us to provide extra value to customers by shipping a wide variety of products to each of them.



3Com's U.S. Robotics™ 56K Faxmodem offers the fastest communication available over standard analog phone lines. It incorporates Cypress SRAMs.

Hewlett-Packard's HP Colorado™ 5GB tape drive sets a new standard for desktop and portable PC backup, offering outstanding performance and high capacity at a low price. It uses Cypress EPROM-programmable clock chips.



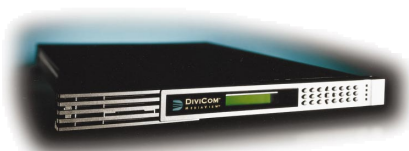
Seagate's Medalist 8641 disc drive offers a capacity of 8.6 Gbytes and transfers data at a rate up to 33 Mbytes/second. It uses the Cypress CY7C1021 SRAM, the company's first production 0.35-micron product.

Sierra Design Labs' Quickframe™ family of high-performance, uncompressed digital video disk recorders offers the world's leading long-format, uncompressed digital video disk recording. It incorporates the Cypress SMPTE-259M Chipset.



Psion Dacom's Gold Card™ Global PC series connects notebook computers worldwide with conventional and wireless digital communications. Gold Card incorporates Cypress SRAMs and features outstanding upgradability – a major advantage to mobile computer users.

Ascend Communications' MAX 4000™ Series high-powered, multiprotocol WAN access switches enhance call performance by maximizing line utilization and minimizing equipment problems. They use Cypress SRAMs and FCT logic.



DiviCom's MediaView MV40™ digital video encoder for broadcast applications delivers increased channel count and improved video quality. It uses Cypress SRAMs, FCT logic, and specialty memories.

The Right Products For The Right Markets

Cypress designs and manufactures a broad range of products for the fast-growing communications market, including high-performance silicon for networking standards such as ATM and Fibre Channel, digital cellular base stations, routers that form the backbone of the Internet, and professional-quality digital video systems. Cypress also offers products for the personal computer market, including clock chips, FCT logic, and chips to support Universal Serial Bus (USB) technology, a new connection standard for PCs and their peripherals that enables users to "plug and play" devices without annoying configuration hassles.



Microsoft's® innovative USB Intellimouse™ and Natural® Keyboard elite use the Cypress CY7C63001 and CY7C63412 USB microcontrollers, respectively.

Motorola's i600™ digital handset for the iDEN® (Integrated Digital Enhanced Network) system offers an expanded feature set with customizable options in the smallest, lightest integrated digital handset available. It uses Cypress micropower SRAMs.



3Com's CoreBuilder™ 3500 Layer 3 switch leads the industry by providing 10 times the performance for as low as one-tenth the cost of a traditional backbone router. It uses Cypress micropower SRAMs.

Hewlett-Packard's HP ScanJet™ 5100Cxi color scanner delivers scanning resolution as high as 1200 dots per inch and speeds up to 2 ms/line. It uses Cypress SRAMs.



Nortel's Meridian 1™ PBX holds the largest worldwide market share of any PBX brand line with more than 25 million lines installed in more than 150 countries. It uses Cypress SRAMs, memory modules, FIFOs, programmable logic, PROMs, and clocks.

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

