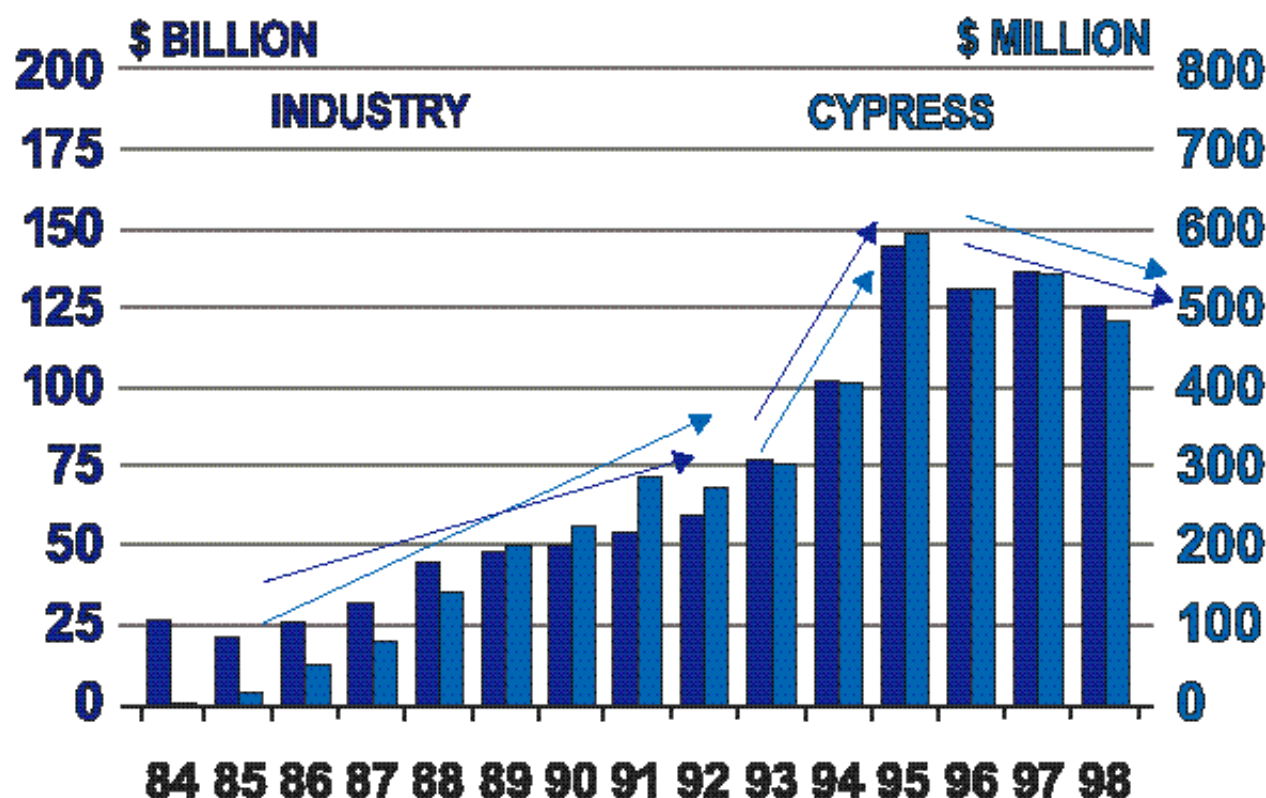


CYPRESS

1 9 9 8 A N N U A L R E P O R T



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. Cypress's product line includes static random access memories (SRAMs) and SRAM modules, specialty memories (first-in first-out, or FIFO, memories and dual-port RAMs), programmable logic devices (PLDs) and PLD design tools, data communications products (for ATM, SONET, and very-high-speed serial/parallel links), clock and timing devices, and Universal Serial Bus (USB) microcontrollers.

Cypress markets its products through direct sales offices in North America, Europe, and Asia and a worldwide network of distributors and sales representatives. In 1998, exports accounted for 39% of total revenues.

Cypress manufactures its products at wafer manufacturing plants in California, Minnesota, and Texas. The company operates an advanced 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 on the worldwide web at <http://www.cypress.com>.

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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 increases in gross margin, rate of growth of research and development expenditures as a percent of revenues, rate of growth of selling, general and administrative expenses, 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:

- (1) increased competition which could result in lost sales or price erosion;
- (2) 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 keep pace with or meet those rapidly changing needs;
- (3) 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;
- (4) failure of expected growth in demand for, or areas of expected new demand for, semiconductor products to materialize;
- (5) failure to successfully bring on line and utilize additional manufacturing capacity, or to transition existing capacity to new uses;
- (6) inability to develop and/or adopt more advanced manufacturing technology;
- (7) inability of Cypress's patents or other proprietary rights to ensure adequate protection against encroachment on Cypress's technology by competitors; and
- (8) failure to attract and/or retain key personnel.

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

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

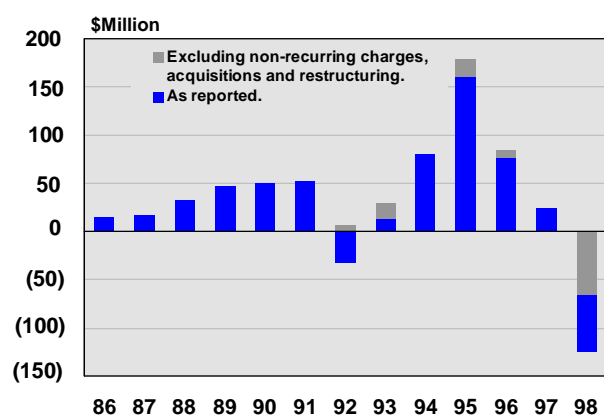
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FINANCIAL HIGHLIGHTS

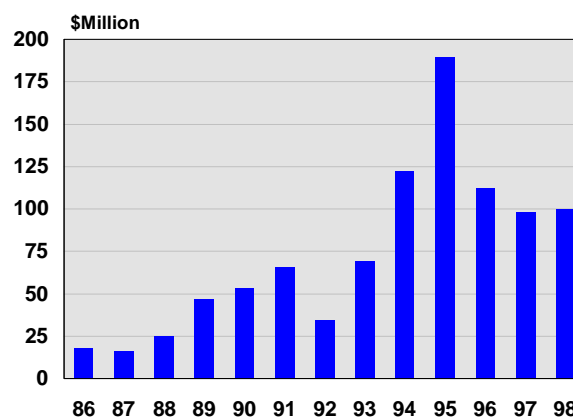
(In thousands, except per-share data)

	1998	1997
For the year:		
Revenues	\$ 486,841	\$544,356
Operating income (loss)	(127,308)	18,313
Net income (loss)	(110,850)	18,419
Net income (loss) per share:		
Basic	\$ (1.24)	\$ 0.21
Diluted	\$ (1.24)	\$ 0.21
At year-end:		
Total assets	\$ 756,299	\$ 956,270
Cash, cash equivalents, and short-term investments	152,231	201,561
Stockholders' equity	489,101	643,476
Stockholders' equity per share	\$ 5.76	\$ 7.10
Weighted average common and common equivalent shares outstanding:		
Basic	89,338	87,888
Diluted	89,338	94,648

Pretax Income (Loss)



Cash Generated by Operations



TO OUR SHAREHOLDERS

In the 1997 shareholder letter, I concluded, “We plan to show our investors substantial, sequential improvements in both revenue and profit in 1998.” That did not happen at Cypress or in the semiconductor industry at large. In this letter, I will outline what happened in the industry in 1998, the details of Cypress’s 1998 performance, and what we plan to achieve in 1999, our 16th year.

THE SEMICONDUCTOR INDUSTRY IN 1998

The front cover of this report shows Cypress’s first 15 years of revenue side-by-side with the revenue of the semiconductor industry. Three distinct time periods are evident:

- 1984-1992. Cypress exploits the high-performance niches outlined in its original business plan and grows to \$300 million in revenues with a growth rate exceeding that of the industry.
- 1993-1995. Cypress doubles in size to \$600 million in revenues in only two years at a growth rate equal to that of the industry.
- 1996-1998. Cypress revenue declines to \$500 million, shrinking at the same rate as the industry.

In the last five years, Cypress has grown or contracted at a rate nearly identical to that of the industry at large. Some mid-sized semiconductor companies have outperformed the market. They usually engage in a specialized area of the semiconductor business, such as programmable logic (Xilinx, Altera), linear circuits (Maxim, Linear Technology), or data/telecommunications (Vitesse). Growing faster than the industry continues to be a primary Cypress objective that we and the top 20 semiconductor companies in the world found very difficult to meet in 1998 (*Figure 1*).

Cypress’s quarterly revenue peaked in 1995 during our unprecedented boom in static random access memory (SRAM) sales (*Figure 2*). That boom encouraged overproduction of semiconductor memories in general, particularly among newcomers in Taiwan and Korea. Japan also overinvested in manufacturing capability in the late 1980s. In the early 1990s, that poor investment strategy caught up with Japan and its semiconductor industry, pushing them into a tailspin from which they have yet to recover. (When the U.S. started to copy the Japanese strategy of destructive “government-industry partnerships,” I testified three

Top 20 Semiconductor Companies 1998 Revenue Growth

	1997	1998	Growth
1 Intel	21,746	22,675	4.3%
2 NEC	10,222	8,271	-19.1%
3 Motorola	8,067	6,918	-14.2%
4 Toshiba	7,253	6,055	-16.5%
5 Texas Instruments	7,352	6,000	-18.4%
6 Samsung	5,856	4,752	-18.9%
7 Hitachi	6,298	4,649	-26.2%
8 Philips	4,440	4,502	1.4%
9 STMicroelectronics N.V.	4,019	4,300	7.0%
10 Siemens	3,441	3,866	12.4%
10 Fujitsu	4,622	3,866	-16.4%
12 Mitsubishi	3,925	3,733	-4.9%
13 IBM	3,391	3,245	-4.3%
14 Lucent Technologies	2,762	3,100	12.2%
15 Matsushita	2,847	2,645	-7.1%
16 Advanced Micro Devices	2,341	2,364	1.0%
17 National Semiconductor	2,759	2,226	-19.3%
18 SANYO	2,471	2,225	-10.0%
19 Rohm	2,053	1,967	-4.2%
20 Sony	1,974	1,829	-7.3%
	Average		-8.0%
	Average w/o Intel		-11.1%

Figure 1. Fourteen of the top 20 semiconductor companies in the world lost revenue in 1998 (Source: Dataquest, December 1998).

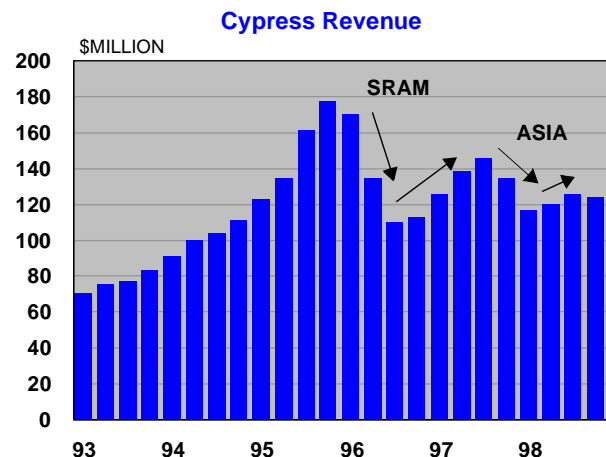


Figure 2. Cypress revenue peaked during the SRAM boom of 1995 and then was hit hard by two recessions: the 1996 SRAM recession, and the 1998 Asian recession, from which we are currently recovering.

times before the U.S. House and Senate between 1989 and 1993. I warned legislators to stick with Silicon Valley’s free-market formula, which I believed would prevail in the long run over Japan’s managed economy. I testified because some of the proposals floated at that time would have been very harmful to Silicon Valley and to Cypress specifically. In the 1990s, the Korean chip industry followed the Japanese strategy and is now in turmoil because of it.)

Our revenue graph shows the impact of memory overproduction as the SRAM recession of 1996 (*Figure 2*). We had begun to recover from that recession in 1997

when the Asian recession surprised the industry, and us, with a second dip.

Our November 1997 analyst conference was attended by 30 semiconductor industry analysts. I asked the analysts to predict Cypress's 1998 revenue (*Figure 3*). Even the most pessimistic of the analysts overestimated our revenue by 30%, because at that time no one fully comprehended the impact on pricing of the escalating Asian recession. The Semiconductor Industry Association (SIA) also overestimated 1998 industry growth in its October 1997 forecast, which predicted 16.8% growth. The industry's revenue ended up shrinking by 8.4% year-on-year.

Surprises are typical in the semiconductor industry. While our industry averaged 17% annual growth over the 1978-1998 period, no single year was in line with that average growth rate. Each year's growth rate fell into one of two brackets—10% and less, or 23% and greater, meaning that for each of the last 20 years, the semiconductor industry has had a boom or a bust relative to its long-term average growth, but never an average year. What is different about the 1996-1998 period is that worldwide semiconductor average selling prices (ASPs) declined three years in a row. That never happened before. During the 1978-1998 period, there was never more than a *single* down year for ASPs before a recovery, making the 1996-1998 period the worst price recession in semiconductor history, particularly for memory products.

CREATING GROWTH

Our objective, to exceed the industry's growth rate, means that we must continue to ride the upturns, and to create and/or buy strategic revenue growth during the downturns. To that end, we recently announced the acquisition of IC Works, an approximately \$80-million semiconductor company specializing in computer clocks. The acquisition will double our revenue in that attractive market.

We also chose to increase 1998 research and development spending (*Figure 4*) despite the downturn. And we improved the efficiency of each R&D dollar spent. For example, our process R&D dollars are producing new technologies much more quickly. In the past, a new process technology took three years to invent and put into production. Today, our newest technologies go into full production in one year (*Figure 5*). We have also begun to use wafer foundries to stretch our R&D dollars: Our Programmable Products Division (PPD) needed a 0.18-micron logic technology to develop its

Analysts' 1998 Cypress Revenue Estimates

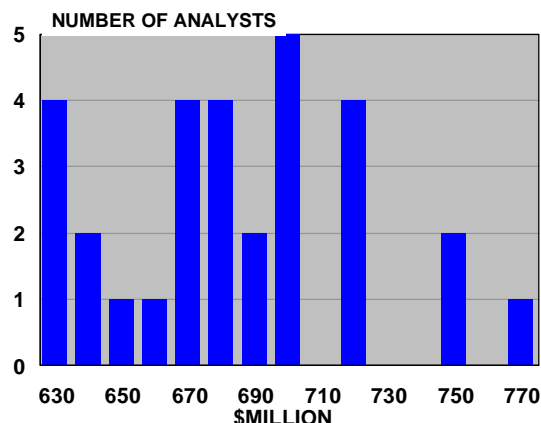


Figure 3. Thirty analysts guessed in November 1997 that Cypress's 1998 revenue would be \$630-\$770 million, 35% to 65% higher than the final result. The error came from not yet understanding how the Asian recession would affect the semiconductor industry—by dropping prices dramatically.

Cypress R&D Expenses

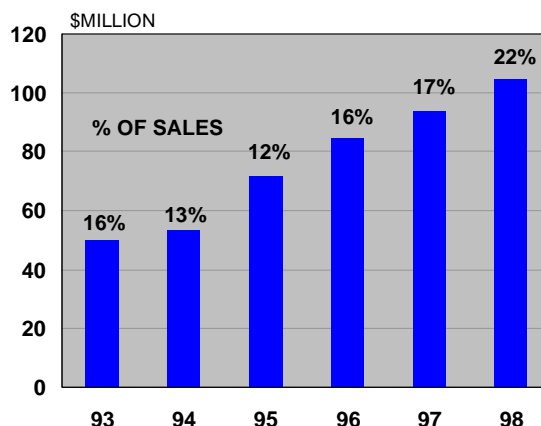


Figure 4. Despite a tough year in 1998, Cypress increased its R&D expenditure to a record \$105 million, or 22% of sales.

Production Wafer Starts

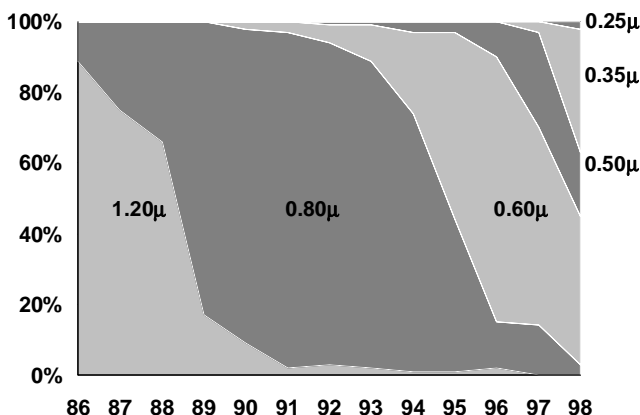


Figure 5. Historically, process technologies were developed over three-year cycles. Now Cypress deploys a new process technology almost every year.

new Ultra39000™ complex programmable logic device (CPLD) family, so we partnered with Taiwan Semiconductor Manufacturing Company (TSMC), rather than stretching our process-R&D dollars thinner. When PPD stopped paying for internal process development, it was able to focus its entire R&D budget on chip design to make its greatest progress ever, as I will report later in this letter.

The combination of more R&D dollars, each spent more efficiently, has produced record new-product revenue for Cypress (*Figure 6*). We count “new products” as those which provide a new function during their first 18 months of shipment. Using a more traditional measure, 34% of Cypress’s 1998 revenue came from products less than three years old.

TWO CYPRESSES

The revenue stall Cypress is experiencing is not due to end-market demand, which is at an all-time high for us (*Figure 7*). The brunt of both the SRAM recession of 1996 and the Asian recession of 1998 fell on Cypress’s memory segment, which saw its average SRAM unit selling price reduced by more than half with three consecutive yearly price declines (*Figure 8*). Meanwhile, the three divisions in our non-memory segment enjoyed stable pricing typical for their markets.

Despite the fact that the memory segment made \$172 million in pre-tax profit in 1995-1996, it lost money in 1998—while the divisions in the non-memory segment (datacom, programmable products, and computer products) made over 20% pre-tax profit on 58% of our 1998 revenue, not counting the first quarter of restructuring. As I described in last year’s annual

New-Product Revenue
(Products less than 18 months old)

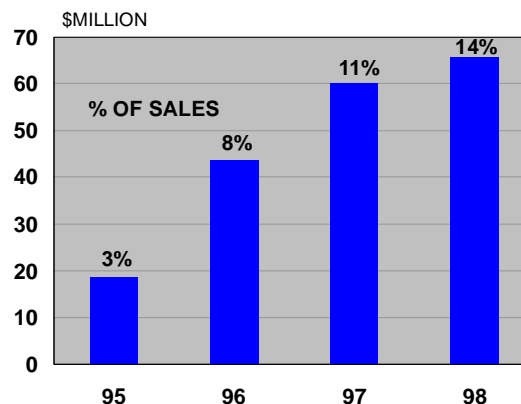


Figure 6. The combination of increased R&D spending and increased R&D efficiency pushed Cypress’s 1998 new-product sales to all-time record levels, more than triple the boom year of 1995.

Units Shipped

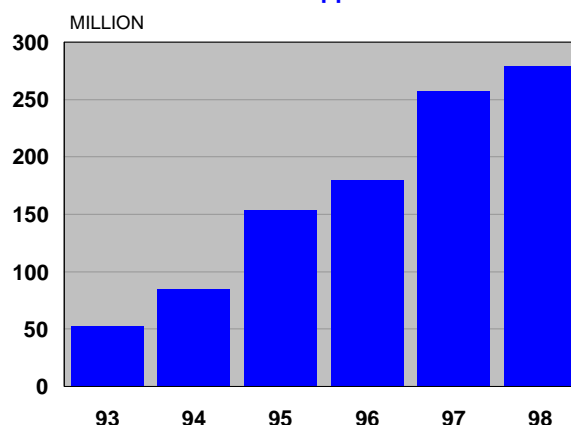


Figure 7. The SRAM and Asian recessions did not reduce end-market demand, they actually stimulated it with low prices. Cypress shipped a record 280 million units in 1998.

Two Cypresses

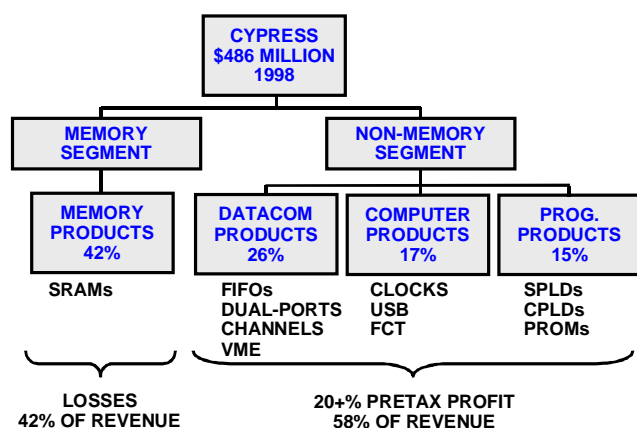


Figure 9. Cypress has two segments: a memory segment that is currently unprofitable and a non-memory segment that produces a majority of Cypress’s revenue, and makes excellent profits.

Average Selling Prices By Division

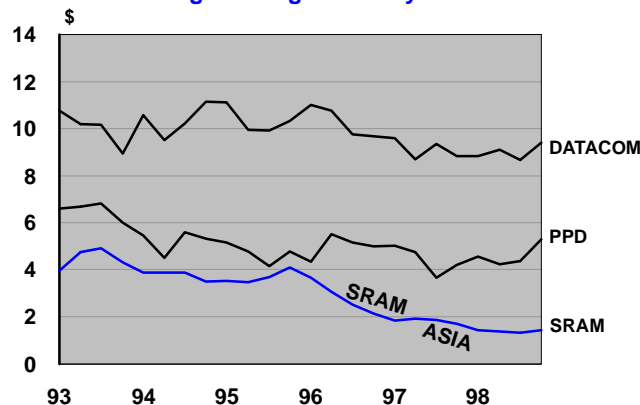


Figure 8. The SRAM and Asian recessions hurt the SRAM business, rapidly cutting selling prices by a factor of 2.5. The selling prices in Cypress’s non-memory Datacom and PPD divisions remained high and stable.

report, right now there are two Cypresses: the memory segment, which has yet to return to profitability, and the non-memory segment, which is nicely profitable (Figure 9). Another imperative for Cypress is to return the memory segment to profitability, a task that will take until Q499, one year longer than I forecasted in the 1997 shareholder letter. The delay is due to the unanticipated pricing effects of the Asian recession, which triggered Asian chip makers to drop their prices to subsistence levels to keep their factories running.

I will now outline the 1999 product strategies for each of the three divisions in our non-memory segment.

PROGRAMMABLE PRODUCTS DIVISION (PPD)

The strategy for PPD is simple: add new product families as quickly as possible to grow revenue in a healthy business that makes 60%+ gross margin (Figure 10).

At the beginning of 1998, Cypress's CPLD offering ended with our FLASH370™ line, which topped out at 128 macrocells, the basic unit of CPLD size, each roughly equivalent to 30 gates of logic (Figure 11). We trailed the density of the top CPLD competitor by a factor of four. To achieve parity, we needed to design and bring to market quickly our new Ultra37000™ family, which expanded our CPLD offering to the 512-macrocell level.

Ordinarily, a new CPLD family takes two years to design and put into production. To beat that schedule, we increased the R&D budget for PPD and focused all of those R&D dollars on design by partnering with the TSMC foundry to do process development, as I described earlier. Our San Jose and U.K. design centers teamed up to bring out the entire new 14-member Ultra37000 family in 1998 (Figure 12), beating the goal I set in the 1997 shareholder letter of "introducing the first product in the Ultra37000 family [in 1998]."

Our next step will be to introduce in 1999 the largest CPLD available—a feat that requires an architectural breakthrough. Figure 13 (following page) shows one section, or a "block" of our new Ultra39000™ family. Each block looks just like an advanced CPLD. Each block contains eight simple programmable logic devices (SPLDs), which connect to one another through a Programmable Interconnect Matrix™ (PIM™). Each block also contains two SRAMs with more bits than competing programmable-logic devices, including field-programmable gate arrays (FPGAs), as well as a large dual-port RAM. The tim-

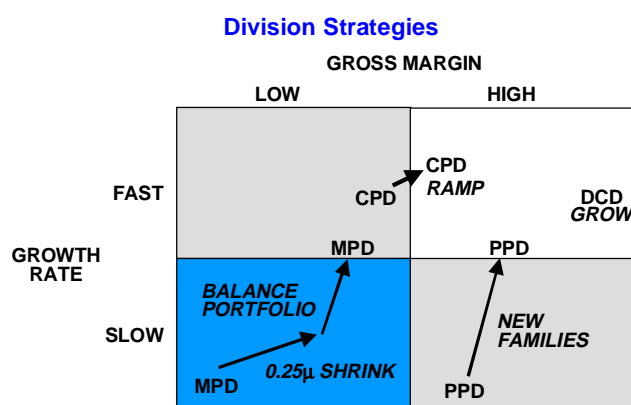


Figure 10. This map divides the semiconductor business into four quadrants. The slow-growth/low-margin quadrant is to be avoided. The quadrants with fast-growth/low (but OK) margin, and slow-growth/high-margin, are good business areas, but the goal is to drive toward fast growth and high margins. The current and planned 1999 year-end positions of each of our divisions is plotted along with the actions we are taking to improve these businesses.

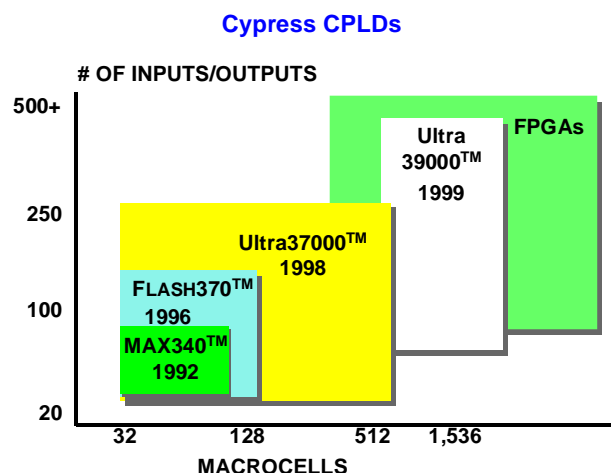


Figure 11. The entire Ultra37000 family was introduced in 1998, increasing our CPLD size by a factor of four, from 128 to 512 macrocells. This year, we will introduce the Ultra39000, a CPLD of unprecedented size, 1536 macrocells.

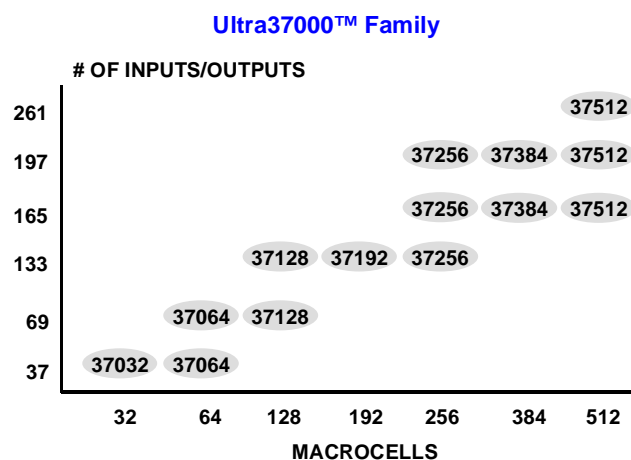


Figure 12. The 14-member Ultra37000 family was brought to market in 1998, ahead of schedule. Prior to these product introductions, Cypress's largest CPLD was 128 macrocells.

Ultra39000™ Block

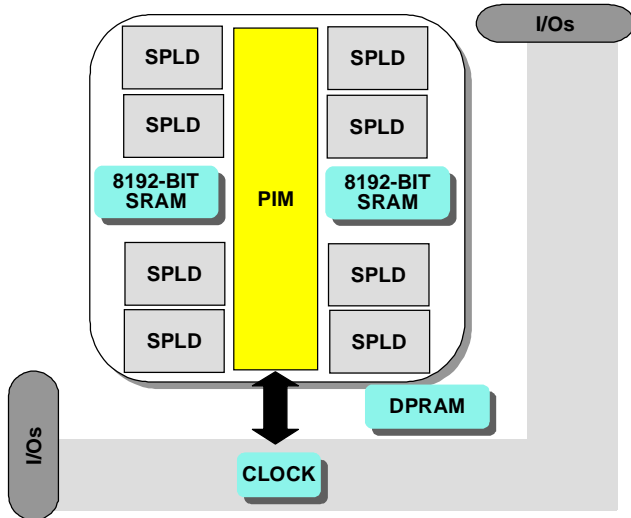


Figure 13. Cypress's new Ultra39000™ CPLD family is constructed of "blocks," each of which contains eight simple PLDs, two SRAM blocks, a dual-port RAM block, and an internal clock for precise timing. One block in the Ultra39000 family has the function of an entire CPLD of the prior generation, along with a lot of memory and precise timing.

ing of the Ultra39000 block is controlled by an internal clock circuit. A block in the Ultra39000 is therefore equivalent to an advanced CPLD with large SRAM and dual-port RAM memories and precise timing. Note that the design of the Ultra39000 draws on the core competencies of three Cypress divisions:

MPD (SRAM), DCD (dual-port RAM), and CPD (clocks).

Figure 14 shows how multiple blocks like the one just described connect via a programmable busing system to create a single, large Ultra39000 chip with multiple embedded CPLDs. This new CPLD family will scale to unprecedented densities—well beyond current CPLD territory into the 100,000-gate range currently the exclusive domain of FPGAs. Furthermore, we expect the Ultra39000 family to be significantly faster than any FPGA it competes against.

DATA COMMUNICATIONS DIVISION (DCD)

The Datacom Division is our most profitable division. It focuses on chips that transmit and receive data, and on special memories to store and manipulate data, such as dual-port RAMs. Dual-port RAMs allow two systems—for example, a system sending and a system receiving data—to store and retrieve data simultaneously from the same shared memory. Traditionally, dual-port RAMs have been built with bulky eight-transistor cells, which make them large and expensive. For years, specialty-memory manufacturers sought to make a dual-port RAM with ordinary, simple, cheap SRAM cells. In 1994, one of our Mississippi design center engineers patented a breakthrough method for using an ordinary SRAM cell to build a dual-port RAM. The result: Our new one-megabit dual-port

Ultra39000 Architecture

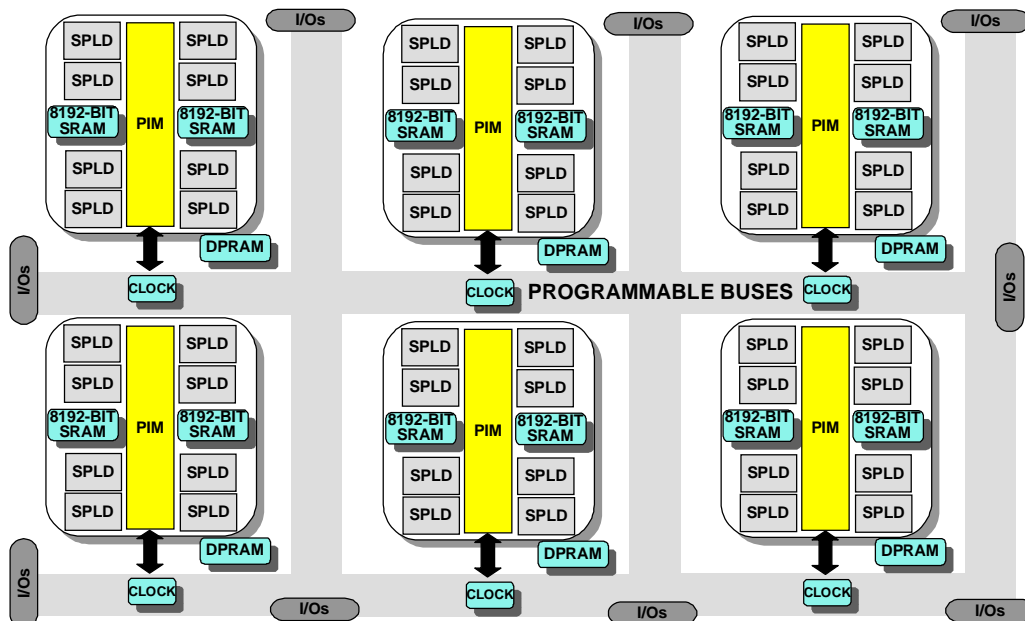


Figure 14. The Ultra39000 CPLD uses programmable buses to hook up several blocks into a large CPLD structure of unprecedented size.

RAM chip is smaller than the leading competitor's half-megabit chip (*Figure 15*). In addition, our new dual-port RAM provides a "parity" function, an extra, ninth bit of information for every eight bits of data stored. The parity feature is used to detect when data transmission errors occur in zero-tolerance applications, such as automatic teller machines.

In the data transmission and reception area, Cypress has prospered with its HOTLink™ family, which I introduced to shareholders in the 1992 shareholder letter (*Figure 16*). HOTLink proliferated into a family of products that handle data transmission at rates from 155 to 400 megabits per second in applications such as digital video broadcasting, asynchronous transfer mode (ATM) data transfer, and proprietary communications channels such as IBM's "ESCON," short for Enterprise Systems Connection. The most important market served by HOTLink turned out to be the internal backplane of data routers and switches. This year, we will introduce HOTLink II™, an advanced product that will increase data transmission rates to 400 to 2,500 megabits per second (equivalent to transmitting 10,000 to 62,500 typed pages per second). To achieve that level of performance, we have developed a new, 0.25-micron BiCMOS process technology that features special bipolar transistors that can amplify signals up to a frequency of 25 gigahertz. In addition, the HOTLink II family will feature architectural innovations inspired by our new division vice president and general manager, Ed Rodriguez, a 17-year National Semiconductor veteran, who ran a \$250-million data communications division at that company.

We intend to grow DCD into a leader in datacommunications. As the strategy map (*Figure 10*) shows, DCD is growing and profitable—we simply need to invest more to grow faster.

COMPUTER PRODUCTS DIVISION (CPD)

In the 1996 shareholder letter, I announced that Microsoft contracted Cypress to design and manufacture a new Universal Serial Bus (USB) chip for their new Windows® 98 software. USB is the new industry standard, a four-pin plug used to connect peripherals to personal computers (*Figure 17*). USB is the connector of choice because with one inexpensive cable type, an intelligent USB network will make PC peripherals truly plug-and-play, while eliminating the cost of the current awkward and expensive plugs and cords. With an estimated five USB connections per PC, times 100 million PCs shipped per year, the USB market is growing rapidly—and Cypress is the market-share

Dual-Port RAMs

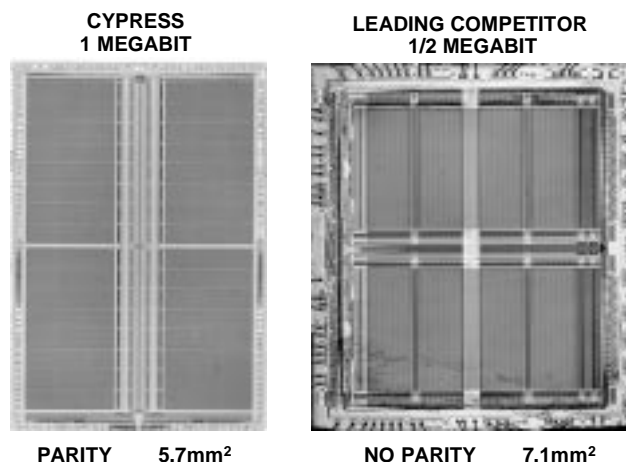


Figure 15. Cypress's patented dual-port RAM cell is smaller than that of our competitors, allowing us to pack a larger dual-port RAM on a smaller chip. In addition, we offer at no premium a parity bit, a ninth bit for every eight bits of data, to provide more-error-free data storage by detecting data-transmission errors.

HOTLink

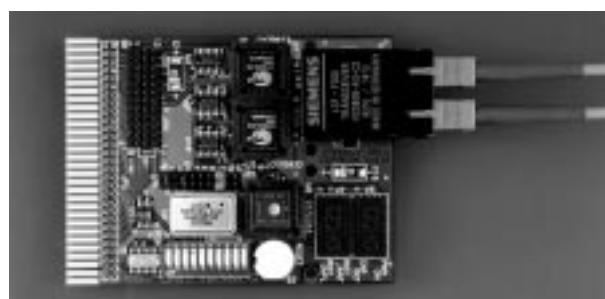


Figure 16. HOTLink was discussed in the 1992 Shareholder's Letter. The pair of Cypress chips in the center of the board transmit and receive data from the system the card is plugged into. That data is exchanged with another system in serial form along the optical fibers (on the left side of the picture) at speeds of up to 400 megabits per second. In 1999, we will introduce HOTLink II, which will run at 2.5 gigabits per second, equivalent to transmitting 62,500 typed pages per second.

Universal Serial Bus (USB) Computer Peripheral Plug-and-Play

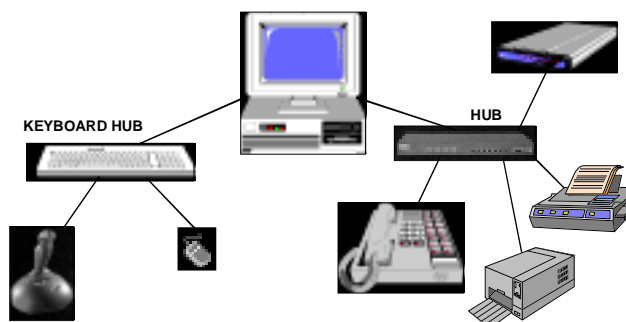


Figure 17. The Universal Serial Bus (USB) uses a common, four-pin connector to hook up peripherals to a personal computer. The advantage is ease of use (plug-and-play) and low cost.

leader, having shipped 8.0 million units in 1998 (*Figure 18*).

The primary reason for our success in the USB market is a new microcontroller Cypress invented to perform the USB function (which requires an intelligent chip to keep track of the numerous peripherals that could be connected to a PC). Our microcontroller is specifically designed to handle the USB data link chore without any of the unnecessary overhead that would be found on a general-purpose microcontroller, such as the Intel 8051 or the Motorola 6805, which can be programmed to perform the USB function. The result: Our USB chips are very small and cost effective, including our new 1998 family addition, a USB hub chip (*Figure 19*).

The other major part of our CPD business, clocks for PCs and other systems, comprised about 73% of CPD’s 1998 business, or about \$60 million.

We expect the IC Works acquisition to receive government approval and become effective in the first quarter of 1999, approximately doubling the size of our clock business. The deal was a good one for Cypress shareholders: 13.7 million shares times \$9.50 per share (our share price when the deal was signed), equals a sale price of \$130 million, valuing IC Works at 1.63 times its annual revenue. At the same \$9.50 per share, Cypress is valued at 1.65 times its annualized Q498 revenue. Consequently, we added approximately \$80 million of annual revenue with 20% pre-tax profit to the non-memory segment of Cypress for a price that reflects Cypress’s aggregate valuation, including the memory segment.

USB Unit Shipments

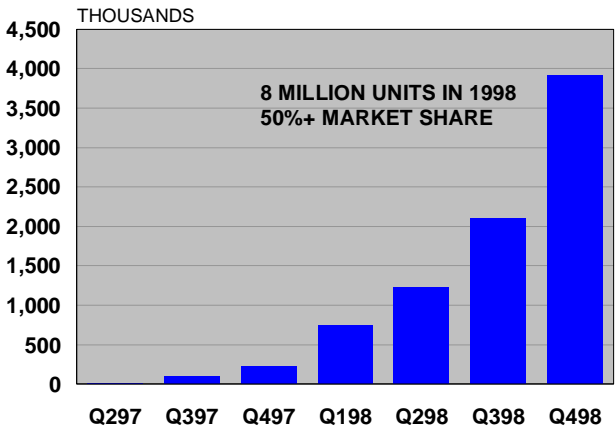


Figure 18. Cypress shipped eight million USB chips in 1998, accounting for more than 50% of the market.

Ilbok Lee—IC Works’ president and a 25-year industry veteran of National Semiconductor, Intel and Samsung—will run the clock businesses in Seattle and San Jose, while Jeff Linden, the current vice president of CPD, will focus on our rapidly growing USB business.

I will now outline the 1999 product strategy for our memory segment.

MEMORY PRODUCTS DIVISION (MPD)

Achieving MPD profitability requires two things: ramping 0.25-micron production to over 50% of revenue and balancing the SRAM product portfolio with two new, value-added product families. Combined, we believe these moves will push our SRAM success into faster-growing, higher-margin business areas (*Figure 10*).

Superior USB Solutions

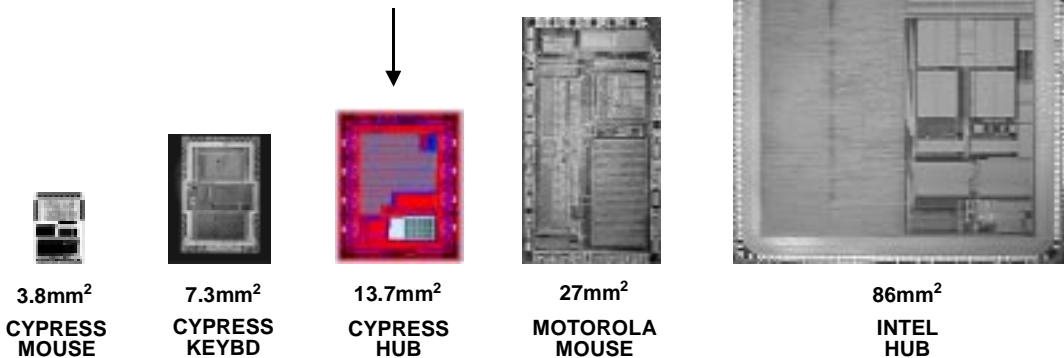


Figure 19. Cypress’s 1998 addition to its USB family, its hub chip, allows four peripherals to be plugged into one USB port. Because of our proprietary RISC microcontroller, we have the smallest USB chips in the industry.

The majority of Cypress's SRAM business is in high-speed asynchronous SRAMs, a niche area when Cypress was founded but now a competitive commodity market. Cypress is the market-share leader in this area, shipping over 100 million high-speed asynchronous SRAMs per year. In commodity SRAMs, the mandate is to “shrink” products, to migrate them as quickly as possible to next-generation technology.

Last year, when I outlined a plan to shut down Minnesota Fab 3 and ramp our new 8-inch Minnesota Fab 4, the goal was to move our SRAM production onto our more advanced technologies. We exceeded that plan: In the fourth quarter, 67% of our SRAM wafer starts were in 0.35-micron technologies or better, and we shipped first revenue on our 0.25-micron technology (Figure 20). Last year, we expected the conversion to 0.35-micron technology to bring our SRAM business to the break-even point, but the price reductions brought on by the Asian recession mean that ramping our 0.25-micron technology will now be required to reach that milestone.

In 1998, we introduced two new value-added product families—MoBL™ and NoBL™. These products address, respectively, two of our three focus markets—mobile communications and networking.

MoBL is short for More Battery Life™, our trademarked name for a new family of products designed for the wireless market (cell phones, pagers, etc.), in which low-power translates into all-important battery life. Our second value-added SRAM family is dubbed NoBL, for No Bus Latency™, a family of six SRAMs, in 2- to 8-megabit densities, designed especially for the routers and switches used in data networks.

For the last two decades, SRAM cells generally have been of the four-transistor (4T) variety. 4T SRAM cells are very small and inexpensive to manufacture but they consume significant power merely to hold their data (in the so-called “standby” mode). Alternative six-transistor (6T) cells were used less frequently because of their size and cost. 6T SRAM cells burn almost no power in standby mode. In my 1995 shareholder letter, I introduced a new Cypress 6T SRAM cell that is even less expensive to build than our 4T SRAM cell. The new cell was made possible by a Cypress process innovation, the “self-aligned contact,” which a Cypress engineer in San Jose invented and patented in 1994. Since then, we have converted over 89% of our SRAM production to our patented 6T, low-standby-power technology.

SRAM Wafer Production

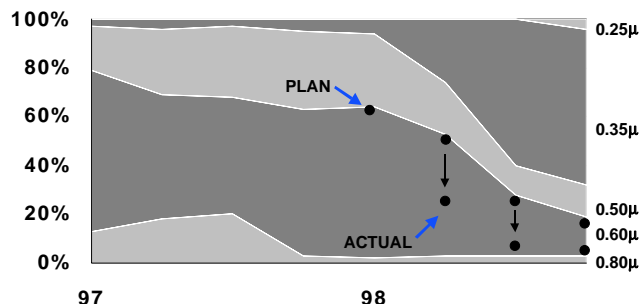


Figure 20. Cypress's 1998 plan was to turn the majority of our production to 0.35-micron or better technology. We beat that plan and began ramping our 0.25-micron technology.

MoBL™ = More Battery Life™

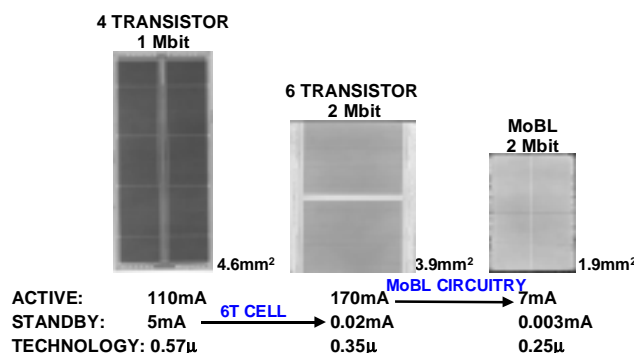


Figure 21. Relative to industry-standard SRAMs made with 4T cells, Cypress has taken two steps forward. In 1996, we introduced a novel 6T cell, which cut down standby current by a factor of 100. In 1998, we added special MoBL™ circuitry to cut down active current by a factor of 20, dramatically increasing mobile phone talk time.

The 6T cell innovation reduces the standby current in our SRAMs to less than 1% of the standby current of our older 4T-based SRAMs (Figure 21). Our family of 6T, low-standby-current SRAMs targets a new market for Cypress and represents a new, growing \$20-million business for us.

This year, we took the next step beyond low standby current—to low active current—which translates into longer talk time on cellular telephones. By applying new MoBL circuit design techniques, we were able to reduce the active current of a 2-megabit SRAM by a factor of 20 (Figure 21). Our new MoBL SRAM family has grown rapidly, and we expect a significant revenue ramp in 1999.

Our second major SRAM development—NoBL—targets data networks and switches. A switch in a data network serves the function of moving data from one “port” (e.g., your PC) to another port (e.g., the group server). One common method for moving the data is to store the input-port data in SRAM and retrieve the

SRAMs for Network Switches

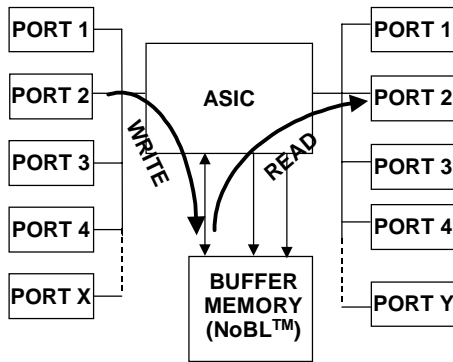


Figure 22. A switch in a corporate data network moves data from the input port to the destination port through a buffer memory. Our new NoBL™ SRAM family is optimized to do this switch function better than any other type of SRAM.

output-port data from that memory (*Figure 22*). The architectures of both commodity asynchronous SRAMs and personal computer SRAMs make them non-optimum for the switch function. In our NoBL family, we have added special logic to interface with the switch efficiently. The result is an architecture with a higher data throughput for a given SRAM size and speed. We expect our NoBL SRAMs to make significant inroads into the datacom and telecom markets in 1999.

In conclusion, the combination of (1) cost reductions from advanced technologies, (2) higher ASPs for the new NoBL and MoBL families, (3) revenue increases due to a more stable SRAM market, and (4) revenue increases due to the sales of new products are expected finally to bring the Memory Products Division to profitability in 1999.

BUY-BACK PROGRAM

Cypress measures its market valuation by its P/S ratio, its price per share divided by sales per share, or equivalently, the ratio of its market capitalization to its last-quarter revenue, annualized.¹ That metric stayed below its median historical value throughout 1998 (*Figure 23*). Consequently, our buy-back program remained active during the year: Since the fourth quarter of 1997, we bought back 8.1 million Cypress shares at an average price of \$8.31. As a result, our weighted average shares outstanding dropped from 93.9 million in Q497 to 85.1 million in Q498. In order to meet one of the requirements for pooling accounting on our IC Works acquisition, the buyback program was terminated by the board of directors in February 1999.

1. Call 408-943-2911 to receive a copy of "Thinking About Cypress Stock," a detailed analysis of Cypress's P/S ratio, or access our website at <http://www.cypress.com/investor>.

P/S Ratio

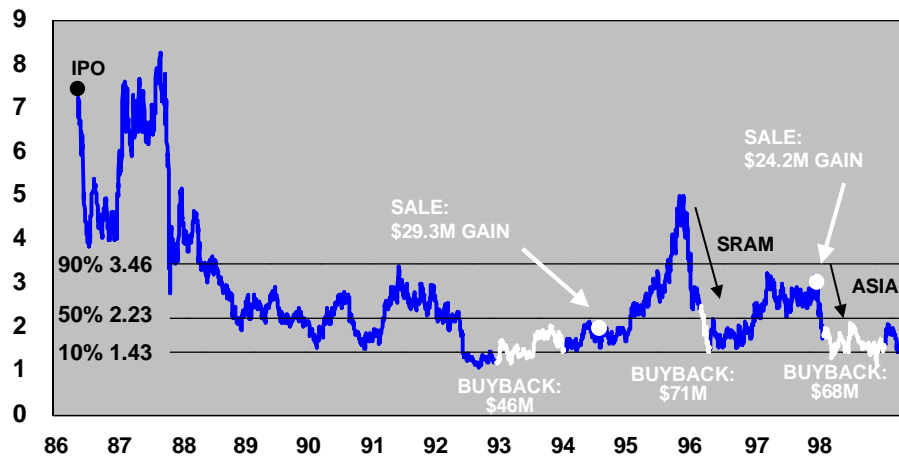


Figure 23. Cypress's P/S ratio, a measure of our market value, has historically averaged 2.23. In tough times, it drops to 1.43, and in good times it rises to 3.46. Last year, we stayed near the 1.43 mark, which we believe represents undervalued shares. Consequently, we bought back 8.1 million shares. Similarly, when our valuation was low in prior cycles, we bought back shares and resold them to provide a capital gain for the company.

CONCLUSION

Cypress's 1998 revenue performance was in line with the market. But the market was down, and our performance was therefore not good enough. We have increased R&D spending and improved R&D efficiency, causing our new-product revenue to increase to record levels. In addition to the growth the new product revenue will provide, we have signed agreements to make two acquisitions, which should also add significantly to 1999 revenue.

After restructuring in the first quarter of 1998, our earnings results achieved breakeven in the third quarter, before a manufacturing slip-up caused a loss in the fourth quarter. The restructuring dramatically increased our efficiency by consolidating three wafer fab plants into two and three back-end assembly plants into two. In addition, we moved the bulk of the company's production into 0.35-micron-or-better technology. We expect that the restructuring and technology advances, as well as our accelerated new-product introductions, will propel Cypress to solid operating

profitability in Q199 and throughout the rest of the year. Fifty-eight percent of our revenue, the non-memory segment of Cypress, achieves consistent 20%+ pre-tax profitability, and that profit will fall through to the bottom line as we achieve our plan to bring SRAMs to breakeven.

Cypress's priorities for 1999 are clear:

- Grow faster than the industry;
- Achieve breakeven in the Memory Products Division to regain solid overall profitability; and,
- Quickly and efficiently integrate our IC Works acquisition.

T.J. Rodgers
President and CEO

1998 BUSINESS HIGHLIGHTS

Q1

- Cypress signs a worldwide distribution franchise agreement with Montreal-based Future Electronics, under which Future will sell Cypress's complete product line. Future is the world's fourth-largest industrial distributor of electronic components, employing over 5,200 people in more than 100 major market centers around the world.
- Cypress announces NoBL™ (No Bus Latency™) SRAMs optimized for very-high-speed, next-generation networking applications. NoBL eliminates traditional memory speed bottlenecks.
- Cypress introduces families of very-high-speed clocks and memory buffers in support of the most advanced PC processors (CPUs) and PC technologies such as AGP, SDRAM, and USB.
- Cypress offers a complete line of 3.3-V first-in first-out (FIFO) memories, including the industry's largest, reinforcing the company's technical and product leadership role in the synchronous FIFO memory market.

Q2

- Cypress expands its CPLD product line with the Ultra37000™ family, offering unparalleled speed. The world's fastest CPLDs, they provide dramatically increased density, to 512 macrocells, and ease-of-use.
- Cypress extends its line of Universal Serial Bus (USB) microcontrollers with new high-speed families aimed at standalone USB hubs and hubs integrated into keyboards and monitors.
- Cypress adds to its programmable clock chip line a lower-power, 3.3-V version of its popular RoboClock® offering the same industry-leading features—programmable skew and zero propagation delay—as the original 5-V device.

Q3

- Cypress's new Field-Programmable Clock Generators (FPCG™)—the industry's first—eliminate the usual weeks or months of waiting by allowing immediate customization of multiple clock frequencies for PCs and other digital systems.
- Cypress debuts over 60 new synchronous and asynchronous dual-port SRAMs in densities up to 1 Mbit—twice the density of any other true dual-ported SRAM.
- Cypress extends its relationship with Taiwan Semiconductor Manufacturing Co. (TSMC) with an agreement to manufacture Cypress's next-generation CPLDs: 0.18-micron feature size, and competitive with FPGAs in density and speed.

Q4

- Cypress takes a price leadership position in ATM and spurs ATM growth by offering its 3.3-V, quad-port CY7B9514V SONET/ATM transceiver at \$2.49/port, compared with industrywide per-port pricing of \$13.
- Cypress reconfigures its web site, <http://www.cypress.com>, to give engineers faster, easier access to a wider array of technical information, reducing their time-to-design, time-to-market, and time-to-money.
- Cypress introduces MoBL™ (More Battery Life™) micropower SRAMs that use up to 90% less active power than standard, low-power SRAMs, dramatically increasing battery life in new-generation mobile products.
- Cypress and IC Works (ICW) arrive at an agreement under which privately-held ICW will merge into Cypress. ICW specializes in timing-generation ICs, highly complementary to Cypress's clock and timing products, and inn wireless radio-frequency ICs, a new business area for Cypress and a fast-growing one.

Selected Consolidated Financial Data

(In thousands, except per-share data)

(Unaudited)

	1998	1997	1996	1995	1994
For the year:					
Revenues	\$ 486,841	\$ 544,356	\$ 528,385	\$ 596,071	\$ 406,359
Restructuring and other non-recurring costs (benefits)	58,940	—	(7,018)	17,800	—
Operating income (loss)	(127,308)	18,313	81,594	159,171	77,792
Income (loss) before tax	(124,856)	24,032	83,505	161,384	80,115
Net income (loss)	(110,850)	18,419	53,029	102,477	50,472
Net income (loss) per share:					
Basic	\$ (1.24)	\$ 0.21	\$ 0.66	\$ 1.25	\$ 0.67
Diluted	\$ (1.24)	\$ 0.21	\$ 0.62	\$ 1.09	\$ 0.60
Weighted average common and common equivalent shares outstanding:					
Basic	89,338	87,888	80,241	81,748	75,618
Diluted	89,338	94,648	91,604	97,309	88,311
At year-end:					
Cash, cash equivalents and short-term investments	\$ 152,231	\$ 201,561	\$ 93,786	\$ 161,618	\$ 193,275
Working capital	184,080	305,027	126,006	190,580	225,952
Total assets	756,299	956,270	794,047	750,728	555,699
Long-term debt and other long-term obligation (excluding current portion)	167,589	219,741	127,895	117,572	111,538
Stockholders' equity	489,101	643,476	510,746	472,099	352,999

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

Revenues for Cypress Semiconductor Corporation ("Cypress") decreased 10.6% to \$486.8 million in fiscal 1998 from \$544.4 million in fiscal 1997. The net loss for fiscal 1998 was \$110.8 million compared to net income of \$18.4 million in fiscal 1997. The net loss for fiscal 1998 included a restructuring charge of \$58.9 million and other non-recurring charges totaling \$27.3 million. Excluding the restructuring and non-recurring charges, the net loss for fiscal 1998 was \$24.6 million. Cypress incurred a net loss of \$1.24 per share, on a diluted basis, during fiscal 1998 compared to diluted earnings per share of \$0.21 per share in fiscal 1997.

On January 21, 1999, Cypress announced the signing of a definitive agreement to acquire privately held IC Works, Inc. (ICW). The agreement provides for Cypress to issue up to 13.7 million shares in exchange for all outstanding stock and options of ICW. The merger is intended to be accounted for as a pooling of interests. Completion of the merger is subject to ICW shareholder approval and other closing conditions. Revenues for ICW during fiscal years ending March 31, 1998, 1997 and 1996, were \$54.1 million, \$41.6 million and \$40.0 million, respectively. Net income (loss) for ICW during fiscal years ending March 31, 1998, 1997 and 1996, was \$(10.9) million, \$(27.9) million and \$2.5 million, respectively.

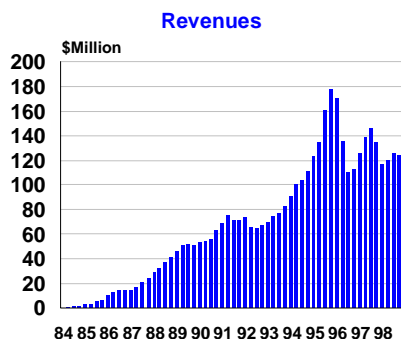
In response to a review by the staff of the Securities and Exchange Commission, Cypress is revising previously reported financial statements. The Management's Discussion and Analysis of Operations and Financial Condition and the consolidated financial statements have been adjusted to reflect adjustments related to restructuring activity.

On November 16, 1998, Cypress filed a universal shelf registration statement with the Securities and Exchange Commission (SEC). The registration statement, when effective, will allow Cypress to market and sell up to \$300 million of its securities. Cypress intends to issue shares in relation to the ICW acquisition once the registration statement is effective. The shelf registration statement will allow Cypress flexibility regarding the type of securities it can sell, including common stock, preferred stock and various forms of debt securities in the future.

Beginning with its 1998 fiscal year end, Cypress ended its fiscal months, quarters and years on Sundays, rather than Mondays, bringing its fiscal period ends in line with predominant industry practice. For the year ended January 3, 1999, Cypress had a 53-week year, while fiscal years 1997 and 1996 each had 52-week years. Operating results for this additional week were considered immaterial to Cypress's consolidated operating results for the year ended January 3, 1999.

Results of Operations

Revenues



Revenues for fiscal 1998 were \$486.8 million, a decrease of \$57.5 million or 10.6% versus revenues for fiscal 1997. This compares with a decrease of \$41.5 million or 7.9% from fiscal 1996 to fiscal 1998. Cypress derives its revenues from the sale of Memory Products and Non-memory Products.

Sales from Memory Products include Static Random Access Memories ("SRAMs") and multichip modules. Revenues from the sale of Memory Products for 1998 decreased \$30.6 million or 13.5% over revenues from the sale of these products for fiscal 1997. This compares with a decrease of \$75.3 million or 27.8% from fiscal 1996 to fiscal 1998. From fiscal 1997 to fiscal 1998, sales of SRAMs declined \$22.6 million or 10.9% and multichip module sales decreased \$8.0 million or 43.9%. Revenues from SRAMs during fiscal 1998 decreased \$63.6 million or 25.5% compared to fiscal 1996. Sales of multichip modules declined \$11.7 million or 53.4% from fiscal 1996 to fiscal 1998. The decline in Memory Product revenues, as compared to fiscal 1997, resulted from both lower average selling prices ("ASPs") and a decline in unit sales. ASPs and unit sales decreased

11.9% and 1.9%, respectively, from fiscal 1997 to fiscal 1998. Although ASPs for Memory Products have decreased compared to fiscal 1997, they have been stable during the last three quarters of fiscal 1998. Unit sales volume of Memory Products increased 34.6% comparing fiscal 1998 to fiscal 1996. However, the increase in unit sales volume was not enough to offset the decline in ASPs.

Non-memory Products include programmable logic products, data communication devices, computer products and non-volatile memory products. Non-memory products also include foundry revenues. Foundry revenue represents sales of wafers to customers. Revenues from the sale of Non-memory Products declined \$26.9 million or 8.5% comparing 1998 to 1997. The decrease related primarily to declines in the sale of programmable logic products of \$18.0 million or 30.3% and data communication devices of \$2.8 million or 2.2% and a decrease in foundry revenue of \$9.1 million or 39.0%. An increase in the sale of computer products of \$15.2 million or 22.5% partially offset the decrease. Also contributing to the decrease was Cypress's decision to cease selling certain non-volatile memory devices, Erasable Programmable Read-only Memory ("EPROM") at the end of 1997. The end of revenues from the sale of EPROMs combined with an overall decrease in the sale of other non-volatile memory products contributed to a decrease of \$12.2 million or 29.6% from fiscal 1998 to fiscal 1997. Revenues from the sale of Non-memory Products during fiscal 1998 increased \$33.7 million or 13.1% compared to fiscal 1996. The increase related to the rise in the sale of data communication devices of \$33.5 million or 37.1% and computer products of \$33.2 million or 67.1% and an increase in foundry revenue of \$3.4 million or 31.2%. The increase was offset by a decrease in the sale of non-volatile memory of \$22.3 million or 43.4% and a decline in the sale of programmable logic products of \$14.1 million or 25.4%.

As is typical in the semiconductor industry, ASPs of products generally decline over the lives of such products. The decreases in ASPs continue to be caused by industry over-supply, particularly with the semiconductor companies that service the telecommunication and data communication markets, that Cypress principally serves. To increase revenues, Cypress seeks to expand its market share in the markets it currently serves and to introduce and sell new products. Cypress will remain competitive with respect to its pricing to prevent a further decline in sales.

Cost of Revenues

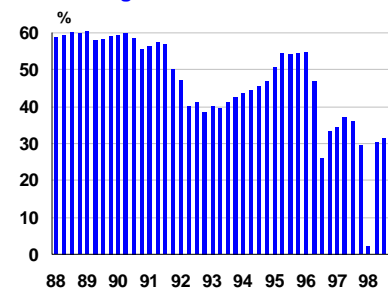
Cost of revenues for fiscal 1998 were 75.5% of revenues, compared to 65.6% of revenues for fiscal 1997 and 57.8% of revenues during fiscal 1996. Cost of revenues for fiscal 1998 included one-time non-recurring charges totaling \$21.7 million. These charges included \$15.8 million related to the write-down of inventory, \$3.8 million for the write-off of pre-operating costs and \$2.1 million for the write-off of certain equipment. The \$15.8 million charge for incremental inventory reserves arose due to market conditions resulting in the ongoing, over-supply and continued inventory corrections by end-user customers.

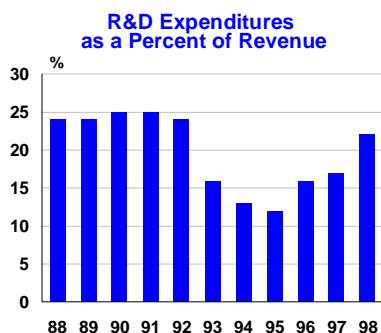
The write-off of pre-operating costs included \$2.9 million related to Cypress's wafer fabrication operation in Bloomington, Minnesota and \$0.9 million related to its assembly and test operations in the Philippines. As a result of the restructuring activities, Cypress wrote off its previously capitalized pre-operating costs as an impaired asset due to uncertainties surrounding their future economic benefits. The pre-operating costs totalling \$3.8 million, net of accumulated amortization were included in other assets at December 29, 1997.

The write-off of equipment was related to equipment identified as obsolete during Cypress's periodic review of equipment and was no longer considered usable. Excluding these one-time non-recurring charges, cost of revenues as a percent of revenues for fiscal 1998 would have been 71.0%. The increase in manufacturing costs as a percent of revenues from fiscal 1996 through to fiscal 1998 continued to be a reflection of lower revenues due to a combination of declining ASPs and lower unit sales volumes.

Revenues have continued to decline due primarily to lower ASPs. Should ASPs continue to erode at a rate greater than anticipated, gross margins could be materially adversely affected. Cypress continues to introduce new products and new methods of reducing manufacturing costs in order to mitigate the effects of declining ASPs on its gross margin. In March 1998, Cypress announced restructuring activities for its domestic wafer fabrication facilities and offshore back-end manufacturing operations. Activities completed to date have increased Cypress's manufacturing efficiencies and as a result, its gross margin has been increasing since the first quarter of fiscal 1998. Cypress expects to benefit from these restructuring activities in the future.

Gross Margin as a Percent of Revenue





Research and Development

Research and development (“R&D”) expenditures for fiscal 1998 were \$104.9 million or 21.5% of revenues, compared with \$93.8 million or 17.2% of revenues for fiscal 1997 and \$84.3 million or 16.0% of revenues for fiscal 1996. R&D expenditures in fiscal 1998 increased \$11.0 million or 11.8% compared to fiscal 1997 and \$20.6 million or 24.4% compared to fiscal 1996. \$5.4 million of the R&D spending increase in 1998 from 1997 pertains to incremental depreciation incurred to reflect the revised useful lives of certain assets impacted by the decision to upgrade Fab 1 to an eight-inch facility. Increased salaries, benefits and maintenance expenses account for the rest of the R&D spending increase. The increase in R&D costs from fiscal 1996 to fiscal 1998 related to increases in salary and benefit costs, expenses incurred for supplies, equipment repair and maintenance expenses and amortization and depreciation charges.

R&D expenditures increased from fiscal 1996 through fiscal 1998 as Cypress continued its effort to accelerate the development of new products and migration to more advanced process technologies. During 1998, Cypress began utilizing the 0.25 micron process technology for manufacturing purposes and started development of the 0.18 micron process technology. Even with Cypress’s commitment to increase design capabilities in its design centers, R&D spending as a percent of revenues is projected to remain relatively constant in the future. Cypress is continuing to explore new markets and improve its design and process technologies in an effort to increase revenues and reduce costs.

Selling, General and Administrative

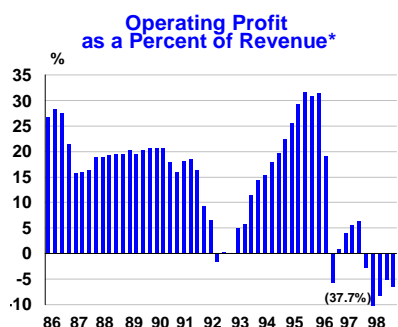
Selling, general and administrative (“SG&A”) expenses for fiscal 1998 were \$83.0 million or 17.0% of revenues, compared to \$75.3 million or 13.8% of revenues for fiscal 1997 and \$64.3 million or 12.2% of revenues for fiscal 1996. SG&A expenses for fiscal 1998 increased by \$7.7 million or 10.2% as compared to fiscal 1997 and by \$18.7 million or 29.1% when compared to fiscal 1996. SG&A spending increased from fiscal 1997 to fiscal 1998 principally because of \$2.5 million in costs incurred to reimburse a customer for certain product expenses incurred, a new sales force training program and higher marketing communication expenditures. The increase in SG&A spending from fiscal 1996 to fiscal 1998 was due primarily to additional headcount, increased expenditures resulting from increased efforts in strategic marketing and customer service and the implementation of system enhancements. With the exception of variable spending, such as incentive bonuses and commissions, Cypress expects to keep SG&A spending relatively constant.

1998 Restructuring and Other Non-recurring Costs

The semiconductor industry has experienced a significant downturn as a result of over-capacity from sharply higher manufacturing efficiencies, large capital investments in production capacity and semiconductor customers moving towards a “just in time” mode of operating. Cypress has experienced a severe price-oriented recession, which resulted in declining sales for most of 1996 and during the fourth quarter of 1997, although demand showed signs of recovery. In the first quarter of 1998, Cypress experienced a further decline in demand and eventually posted a drop in revenues as well as a significant decrease in unit shipments. During this first quarter, the semiconductor industry overall recorded its first quarterly revenue decline after several quarters of improving demand. Cypress had also experienced a decline in its capacity utilization. In view of these developments, Cypress determined that a major and rapid move away from six-inch to eight-inch manufacturing capability was required, as well as consolidation of its manufacturing operations.

During 1998, Cypress implemented an overall cost reduction plan and recorded a \$58.9 million restructuring reserve. The restructuring entailed:

- The shutdown of Fab 3, located in Bloomington, Minnesota and consolidation of parts of Fab 3 operations with other operations of Cypress.
- The discontinuance of the 0.6 micron 256k SRAM production in Fab 2 located in Texas.
- The conversion of an existing research and development fab located in San Jose (Fab 1) to eight-inch capability in order to be compatible with the state of the art eight-inch Minnesota manufacturing facility.
- The transfer of Cypress’s test operations from its subcontractor, Alphatec, in Thailand to Cypress’s production facility in the Philippines.
- The restructuring activities described above include the termination of approximately 850 personnel, primarily from manufacturing both at Cypress and at Alphatec.



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

FAB 3 — The charge related to the shutdown of Fab 3 was \$30.2 million. Of this amount, \$26.0 million related to the write-down of equipment held for sale, \$1.7 million related to incremental third party costs expected to be incurred in the eventual physical removal of the written down assets (“other fixed asset related charges”), \$1.1 million related to severance and other employee related costs and \$1.4 million related to inventory.

Fab 3 assets which were not upgradable to 8-inch capability were written down based on the estimated useful lives of the assets and the salvage value of the assets. The estimated useful lives were generally two months as a result of the decision to discontinue production in Fab 3 and the salvage value was determined based on the estimated sales value of used semiconductor equipment. Non-upgradable Fab 3 assets were depreciated to their salvage value during the production phase-down period. Fab 3 assets, which were upgradable to 8-inch capability, were transferred to Fab 4 production during the third quarter of 1998.

Beginning in the second quarter of 1998, production was phased down in Fab 3 and in accordance with the restructuring plan, production ceased in July 1998. From this time, Cypress has held the non-upgradable equipment for sale. However, due to the over-supply of used semiconductor equipment, a substantial amount of the equipment remains on hand. Cypress expects to recover the originally determined salvage value for such equipment, however, no assurance can be given as to the amount of proceeds which will ultimately be collected.

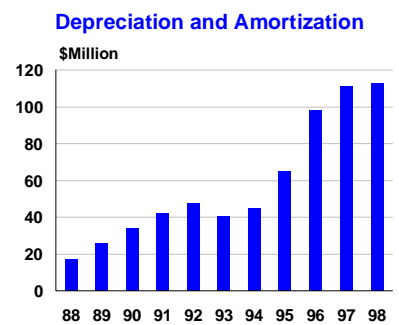
FAB 2 — The decision to discontinue manufacturing SRAM products on Cypress’s 0.6 micron 256K SRAM process in Texas resulted in excess equipment and employee redundancy. Charges related to this decision totaled \$21.3 million, of which \$18.0 million related to the write-down of equipment held for sale, \$0.3 million related to the write-down of inventory, \$1.7 million related to severance and other employee related costs and \$1.3 million of other fixed asset related charges for incremental third party costs expected to be incurred in the eventual physical removal of the written down assets and the resolution of certain related tax matters.

Excess equipment in Fab 2 was written down based on the estimated useful lives of the assets and the estimated salvage value of the assets. The salvage value was determined based on the estimated sales value of used semiconductor equipment. Cypress had the ability and intention to sell all the equipment immediately, but due to the semiconductor industry slow-down, Cypress recognized immediate sale of the equipment would be difficult. The equipment was kept in the fab, ready for demonstration and testing by a willing buyer. Cypress used the equipment during the production phase-down period through May 1998.

Similar to Fab 3 equipment, some of this equipment remains on hand due to the over-supply of used semiconductor equipment on the market. Cypress expects to recover the originally determined salvage value for such equipment, however, no assurance can be given as to the amount of proceeds which will ultimately be collected.

FAB 1 AND SAN JOSE OPERATIONS — The restructuring plan included the upgrade of Fab 1 to an eight-inch facility to ensure compatibility with Cypress’s Fab 4 manufacturing facility in Minnesota. Fab 1 is used for research and development purposes. The plan assumed commencement of Fab 1 restructuring activities during the middle of 1998 with completion by the end of January 1999. The plan included the disposal of six-inch manufacturing equipment in January 1999 which was not upgradable to eight-inch capability. The remaining net book value of \$6.1 million of such assets is being written off over the estimated useful life through January 1999. Incremental depreciation charges of \$5.4 million, to reflect the revised useful lives of this equipment were included in research and development costs for 1998 and will continue through January 1999. Cypress also reserved \$1.0 million to write-down the value of certain other equipment and assets and reserved \$1.3 million related to severance and other employee related costs.

ALPHATEC — Cypress reserved \$5.1 million to provide for the consolidation of Thailand test activities from Alphatec, Cypress’s subcontractor, with Cypress’s Philippines facility. Of this \$5.1 million reserve, \$1.5 million was related to production inventories which were no longer usable as a result of this consolidation, \$1.3 million was related to severance costs at the subcontractor, \$1.3 million related to excess equipment and leasehold improvements which are no longer used and \$1.0 million for other fixed asset related charges for incremental third party costs expected to be incurred in the eventual physical removal of the written down assets. The assets were considered held for sale and were written down to their revised carrying value. The transfer of production from



Alphatec to the Philippines facility began during the second quarter of 1998 and was completed in January 1999, one month later than originally planned.

RESTRUCTURING STATUS — Fabs 2 and 3 restructuring activities were completed in May and July 1998, respectively, consistent with our restructuring schedule except for the disposal of the equipment. Fab 1 restructuring was not completed in January 1999 as originally planned. Cypress is evaluating alternatives to achieve its eight-inch conversion plan and should have resolution in the first half of 1999. The Alphatec consolidation and transfer activity was completed in January 1999, one month later than originally planned. Cypress continues its effort to dispose of assets held for sale, impacted by these restructuring activities, and expects to recover the originally determined salvage value for those assets.

OTHER — Separate from the restructuring charge, Cypress recorded an additional \$27.3 million, which were recorded as operating expenses. These charges resulted from changes in market conditions and were considered as part of ongoing operations. They included inventory reserves (\$15.8 million), the write-off of pre-operating costs (\$3.8 million), the write-off of an equity investment (\$3.1 million), costs incurred to reimburse a customer for certain product expenses incurred (\$2.5 million) and the write-off of obsolete equipment in Fab 4 (\$2.1 million). These charges are discussed under the respective captions (“Cost of Sales”, “Selling, General and Administrative” and “Interest and Other Income”), where the charges were recorded.

1996 Restructuring and Other Non-recurring Charges

During the third quarter of 1996, Cypress announced a restructuring of its San Jose, California wafer fabrication facility, from a production wafer fabrication plant to predominantly a research and development wafer fabrication facility. As a result of this restructuring, Cypress recorded a pre-tax charge totaling \$9.1 million. The charge included \$5.9 million for the write-down of certain excess equipment and \$3.2 million for severance and other related restructuring charges. Substantially all of the reserve has been used as of the end of 1998.

In the third quarter of 1996, Cypress recorded a non-recurring benefit of \$17.8 million. The benefit was derived from the reversal of the reserve established in 1995 related to the Texas Instruments (“TI”) patent infringement lawsuit. In July 1996, the Federal Circuit Court of Appeals (“Court”) affirmed the earlier decision of the trial court that Cypress 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, Cypress reversed the reserve established in 1995. In 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 was determined to be final.

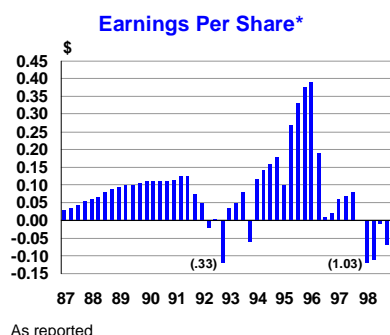
In September 1996, Cypress recorded a one-time, pre-tax credit of \$3.3 million related to the insurance reimbursement of defense costs incurred in conjunction with the securities class-action lawsuit. This credit was offset by \$5.0 million of other non-recurring charges related to agreements with certain companies regarding cross-licensing and other matters.

Interest Expense

Interest expense was \$10.9 million for fiscal 1998, compared to \$7.2 million for fiscal 1997 and \$6.9 million for fiscal 1996. Interest expense incurred during fiscal 1998 is primarily associated with the 6.0% Convertible Subordinated Notes (“Notes”), which were issued in September 1997 and are due in 2002. The increase in fiscal 1998 is primarily attributable to a full year of interest related to the Notes during fiscal 1998 compared to three months of interest incurred during fiscal 1997. Interest incurred during fiscal 1997 also included expenses from the convertible bond redeemed in March 1997 and the revolving line of credit. Interest incurred during fiscal 1996 comprised primarily of interest costs related to the 3.15% Convertible Subordinated Notes redeemed March 1997 and the revolving line of credit.

Interest and Other Income

Net interest and other income was \$13.3 million for fiscal 1998 compared to \$12.9 million for fiscal 1997 and \$8.8 million for fiscal 1996. Net interest and other income for fiscal 1998 includes interest income of \$15.2 million, a \$1.7 million pre-tax net gain related to the retirement of \$15.0 million of Cypress’s 6.0% Convertible Subordinated Notes and foreign exchange gains of \$0.5 million. The amount is offset by a non-recurring, pre-tax charge of \$3.1 million recorded to reflect the decline in value of a certain investment and \$1.0 million in amortization of bond issuance costs.



Net interest and other income for fiscal 1997 relates primarily to interest income and a \$3.8 million gain from the sale of Cypress's remaining investment in Vitesse Corporation. Net interest and other income for fiscal 1996 comprises of interest income of \$7.2 million, a credit for minority interest of \$1.5 million, gain from the sale of a portion of Cypress's investment in Vitesse Corporation of \$0.6 million and other miscellaneous credits and charges.

Taxes

Cypress's effective tax rates for fiscal years 1998, 1997 and 1996 were 11.2%, 23.4% and 36.5%, respectively. A tax benefit of \$14.0 million was realized during fiscal 1998 compared to expenses of \$5.6 million and \$30.5 million during fiscal 1997 and fiscal 1996, respectively. The benefit was attributable primarily to the utilization of loss carrybacks, the utilization of research and development tax credits and non-U.S. income taxed at lower tax rates compared to U.S. tax rates, principally related to Cypress's operations in the Philippines. The decrease in the effective tax rate from fiscal 1996 to fiscal 1997 was primarily as a result of R&D tax credits and certain tax benefits related to Cypress's operations in the Philippines.

During 1998, the United States Internal Revenue Service began an examination of tax returns for fiscal years 1994 through 1996. The examination is expected to continue through December 1999. Management believes that no potential adjustments will ultimately result from this examination.

Stock Based Compensation

Pro forma information regarding net income (loss) and earnings (loss) per share is required by Statement of Accounting Standards No. 123 (SFAS 123). As permitted by SFAS 123, Cypress discloses pro-forma net income (loss) and pro-forma net income (loss) per share as if it had recorded compensation cost. The pro-forma effect on net income (loss) and net income (loss) per share is based on the estimated grant date fair value, as defined by SFAS 123 for awards granted under the Cypress's 1994 Stock Option Plan and its Employee Stock Purchase Plan. Inclusive of the pro-forma effect, basic and diluted net loss was \$(141,536) and \$(6,431) for 1998 and 1997, respectively. For 1996, pro-forma basic and diluted net income was \$32,490 and \$36,190, respectively. Pro-forma basic and diluted net income (loss) per share was \$(1.58), \$(0.07) and \$0.40 for fiscal years 1998, 1997 and 1996, respectively. The pro forma net income (loss) reported for fiscal years 1998, 1997 and 1996 were impacted by a variety of factors including the number of options granted and the exercise price associated with these options. The pro forma effect on fiscal year 1998 was also impacted by the repricing of existing options. The repricing and the option grants caused an increase in pro forma net loss for fiscal 1998 over the actual loss reported for fiscal 1998.

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 10,464,000 shares were repriced. This repricing excluded the Board of Directors, the Chief Executive Officer and the Executive staff of Cypress.

Factors Affecting Future Results

Risk Factors

The risks and uncertainties described below are not the only ones Cypress faces. Additional risks and uncertainties not presently known to us or that we currently deem immaterial also may impair Cypress's business operations. If any of the following risks actually occur, our business financial condition and operating results could be materially adversely affected, the trading price of our common stock could decline and you might lose all or part of your investment.

Following is a summary of the risk factors:

- Cypress's future operating results are very likely to fluctuate and therefore may fail to meet expectations.
- Cypress faces periods of industry-wide semiconductor over-supply which harm its results.
- Cypress's financial results could be adversely impacted if the markets in which it sells its products do not grow.
- Cypress is affected by a general pattern of product price decline and fluctuations which can adversely impact our business.

- Cypress may be unable to adequately protect its intellectual property rights, and may face significant expenses as a result of ongoing, or future, litigation.
- Cypress's financial results could be adversely impacted if it fails to develop, introduce and sell new products or fails to develop and implement new manufacturing technologies.
- Interruptions in the availability of raw materials can adversely impact Cypress's financial performance.
- Operational problems experienced by assembly and test subcontractors used by Cypress can adversely impact its financial performance.
- The complex, essential nature of Cypress's manufacturing activities make the company highly susceptible to manufacturing problems and these problems can have substantial negative impact when they occur.
- Cypress may not be able to use all of its existing or future manufacturing capacity, which can negatively impact its business.
- Cypress's operations and financial results could be severely harmed by certain natural disasters.
- Cypress's business, results of operations and financial condition will be adversely impacted if it fails to compete in its highly competitive industry and markets.
- Cypress must build semiconductors based on its forecasts of demand, and can end up with large amounts of unsold product if its forecasts are wrong.
- Cypress must spend heavily on equipment to stay competitive, and will be adversely impacted if it is unable to secure financing for such investments.
- Cypress competes with others to attract and retain key personnel, and any loss of, or inability to attract such personnel would hurt Cypress.
- Cypress faces additional problems and uncertainties associated with international operations that could adversely impact it.
- Cypress must comply with many different environmental regulations, which can be expensive.
- Cypress depends on third parties to transport its products and could be harmed if these parties experience problems.

For a complete detailed discussion of risk factors, refer to Cypress's filing on Form 10-K with the Securities and Exchange Commission.

Year 2000 Readiness Disclosure

In less than a year, most companies will face a potentially serious problem because many software applications, operational systems and equipment with embedded chips or processors may not properly recognize or accurately process calendar dates beginning in the year 2000, due to the prevalent use of two digits to represent the year in these systems and equipment.

Like many other companies, the year 2000 issue poses a risk for Cypress. The year 2000 problem could affect our computers, software and other equipment we use and operate. This could result in system failures causing disruptions in operations, including among other things, interruptions in manufacturing, design and process development operations; temporary disruptions in processing business transactions; and disruptions in other normal business operations.

Cypress has taken company-wide actions to assess the nature and extent of work required to prepare its products, systems, equipment and infrastructure for January 1, 2000. In addition, we have engaged in the process of evaluating our key suppliers and customers to determine the extent to which our operations are vulnerable based upon third parties' failure to address their own year 2000 issues. These activities represent our ongoing efforts to address the year 2000 problem that we commenced with the implementation of a year 2000-compliant accounting software system in 1997.

Cypress's president and executive staff have assumed the responsibility of managing the impact of the year 2000 problem on all aspects of our operations, including programs for identification, inventory taking, risk assessment and cost estimates of problems associated with the year 2000; the plans, remediation effort and testing methodology to correct those problems; and the development of contingency plans if some of the corrective actions fail to correct the problem or do not get implemented in a timely manner. These activities, in varying phases, are currently in process.

It is our objective to ensure that our internal business (MIS) systems are compliant by March 1999 and that the rest of our systems, equipment and infrastructure are compliant by June 1999. Our efforts over the past three months have shifted in focus from inventory taking and assessment to remediation, testing and contingency planning activities. All mission critical systems, equipment and infrastructure elements are being tested for year 2000 readiness by June 1999. We have also begun contingency planning efforts, considering Cypress's entire supply chain and external infrastructure, to ensure plans will be in place to address any unforeseen year 2000 failures.

Through 1998, Cypress has incurred little cost in addressing the year 2000 problem. In 1999 we expect to incur between two and three million dollars of expense and capital outlays for remediation, testing and contingency planning efforts.

In the event Year 2000 issues relating to key customers and suppliers are not successfully resolved, based on information available to us at present, we believe that the most reasonably likely worst case scenario is a temporary disruption in infrastructure service, particularly power and telecommunications, which could adversely impact supplier deliveries or customer shipments. If severe disruptions occur in these areas and are not corrected in a timely manner, a revenue or profit shortfall may result in fiscal year 2000.

Cypress Year 2000 contingency planning efforts are guided by three elements and specifically expressed in our Year 2000 Mission: (1) Cypress serves its customers continuously, (2) Cypress maintains continuous employment, and (3) Cypress increases shareholder value relative to its competitors. The executive staff of Cypress is directly responsible for developing and approving Cypress's Year 2000 contingency planning efforts, and the team is led by the CEO. The operating assumption that external infrastructure may be down for up to 2-4 weeks has been used in order to create a suitable framework for contingency planning efforts, and as a result, Cypress expects to have plans in place to address any unforeseen year 2000 failures. Our contingency planning efforts will continue through June 1999, at which time these activities will be documented and implemented accordingly. A number of business responses are being actively considered and all should be viewed as likely for some segment of our customer/supplier base:

- developing second/alternate source suppliers for critical raw materials and subcontract operations,
- work-in-process inventory "build ahead" in Cypress wafer fab locations,
- finished goods inventory "build ahead" in Cypress/subcontractor assembly locations,
- increased consignment inventory programs for strategic customers (up to 3 months on customer premises),
- higher year-end 1999 stocking levels for primary Cypress distributors,
- partial/full company shutdown for up to 14 days,
- facility "safe state" plans, including plans to preserve equipment and the controlled environment of manufacturing facilities (i.e., temperature and humidity controls) for a period of 2 weeks using self-generated power in the event of infrastructure shutdown, and
- early payment/collection as well as delayed payment/collection for Cypress suppliers, customers and employees.

Market Risk Disclosure

Cypress is exposed to financial market risks, including changes in foreign currency exchange (FX) rates and interest rates. To mitigate risks associated with FX rates, Cypress utilizes derivative financial instruments. Cypress does not use derivative financial instruments for speculative or trading purposes.

A majority of Cypress's revenue and capital spending is transacted in U.S. dollars. However, Cypress does enter into these transactions in other currencies, primarily Japanese yen and certain other European currencies. Cypress attempts to limit its exposure to changing FX rates through both operational and financial market instruments. Cypress manufactures its products in a number of locations around the world, and hence has a cost base that is well diversified over a number of European and Asian currencies as well as the U.S. dollar (USD). This diverse base of local currency costs serves to partially counterbalance the earnings effect of potential changes in value of Cypress's local currency-denominated revenues. Also, Cypress, denominates its third-party export sales in U.S. dollars, whenever possible.

Short-term exposures to changing FX rates are managed by financial market transactions, principally through the purchase of forward FX contracts (with maturities of three months or less) to offset the earnings and cash-flow impact of the nonfunctional currency-denominated receivables. Forward FX contracts are denominated in the same currency as the receivable being covered, and the term of the forward FX contract matches the term of the underlying receivable. Cypress covers all known and measurable exposed receivables denominated in currencies that have a liquid, cost-effective forward foreign exchange market. The receivables being covered arise from trade transactions and other firm commitments affecting Cypress.

Cypress does not hedge its foreign currency exposure in a manner that would entirely eliminate the effects of changes in FX rates on its operations. Accordingly, Cypress's reported revenues and results of operations have been, and in the future may be, affected by changes in the FX rates. Cypress has utilized a sensitivity analysis for the purpose of identifying its market risk, in relation to underlying transactions that are sensitive to FX rates including foreign currency forward exchange contracts and nonfunctional currency-denominated receivables. The net amount that is exposed to changes in foreign currency rates was subject to a 10% change in the value of the foreign currency versus the U.S. dollar. Cypress believes it has no material sensitivity to changes in foreign currency rates on its net exposed derivative financial instrument position.

A 52 basis-point move in interest rates (10% of Cypress's weighted average interest rate in 1998) affecting Cypress's floating-rate financial instruments as of January 3, 1999 would have an immaterial effect on Cypress's pretax results of operations over the next fiscal year. An increase in interest rates would not significantly increase interest expense due to the fixed nature of Cypress's debt obligation.

All of the potential changes noted above are based on sensitivity analyses performed on Cypress's balances as of January 3, 1999.

Liquidity and Capital Resources

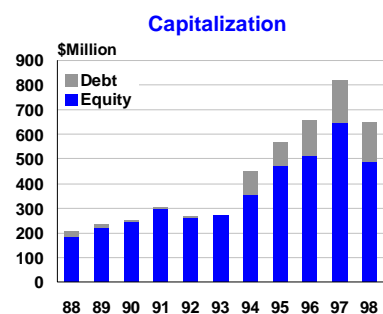
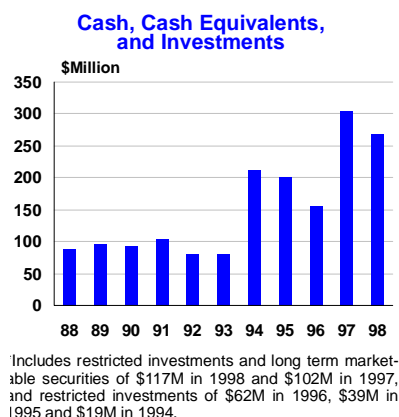
Cypress's cash, cash equivalents and short-term investments totaled \$152.2 million at the end of fiscal year 1998, a \$49.3 million decrease from the end of 1997.

In 1998, Cypress retired a total of \$15.0 million principal of its \$175.0 million, 6.0% Convertible Subordinated Notes ("Notes") for \$12.9 million, resulting in a pre-tax net gain of \$1.7 million. The net gain was recorded as interest and other income. The Notes, which were issued in September 1997, are due October 1, 2002 and contain a coupon rate of 6.0%. The remaining outstanding Notes are convertible into approximately 6,772,000 shares of common stock and are callable by Cypress on or after October 2, 2000.

A portion of the proceeds from the notes were used to repay the \$49.0 million balance outstanding under the revolving credit facility, acquire equipment, purchase a building in Woodinville, Washington and for stock repurchases in 1997. The remaining proceeds have been invested in interest-bearing investment grade securities and have been used for general corporate purposes, including capital expenditures to add manufacturing capacity and capability, development and commercialization of products, working capital and potential strategic acquisitions or investments.

During 1998, Cypress purchased \$82.2 million in capital equipment, a significant decrease from the \$142.3 million purchased in 1997. Cypress purchased equipment for its domestic wafer fabrication plants, its test and assembly facility in the Philippines, its backend manufacturing subcontractors and its San Jose design and technology groups. Equipment purchased for its fabs is expected to improve wafer manufacturing capacity and capabilities as Cypress implements new technologies, including its 0.18 and 0.25 micron processes. A majority of the equipment purchased was for Fab 4 equipment located in Minnesota to increase the capacity and capability of Fab 4. Equipment purchased for the Philippines and its subcontractors was used to increase manufacturing capacity and tool certain packaging capabilities. Capital equipment purchases for the technology group are expected to enhance and accelerate research and development capabilities. Capital expenditures in 1999 are expected to be approximately \$122.0 million as Cypress continues its efforts to increase its manufacturing capabilities and capacity and to enhance its research and development capabilities. Commitments for purchases beyond the year 1999 are not considered to be significant.

During 1997, the Board of Directors authorized the repurchase of up to 4.0 million shares of Cypress's common stock. In September 1998, the Board of Directors authorized the repurchase of up to an additional 10.0 million shares under the stock repurchase program. Through January 3,



1999, 8.1 million shares have been repurchased under this entire program for \$67.5 million. The repurchased shares are expected to be used in conjunction with Cypress's 1994 Stock Option Plan and Employee Stock Purchase Plan. During 1998, Cypress reissued 1,782,000 shares of common stock under such plans. In conjunction with the authorized stock repurchase program, Cypress sold put warrants through private placements for which Cypress received a net amount of \$9.4 million through January 3, 1999. Cypress has a maximum potential obligation to purchase 4.5 million shares of its common stock at an aggregate price of \$44.5 million as of January 3, 1999. The puts have various expiration periods through May 1999. Cypress 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. It is Cypress's intent to settle these put warrants with stock and therefore, no amount was classified out of stockholders' equity in the accompanying consolidated balance sheets. On February 25, 1999, the Board of Directors terminated the stock repurchase program.

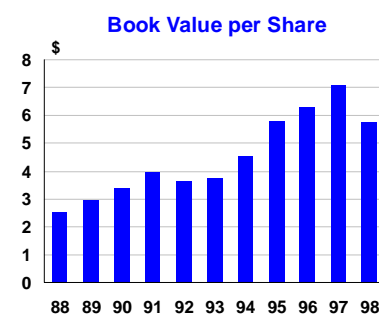
In February 1997, Cypress called for redemption of all of the 3.15% Convertible Subordinated Notes which was effective as of March 26, 1997. At the time of conversion, approximately 85% of the holders elected to convert their notes into Cypress's common stock, increasing the amount of common stock outstanding by 6.8 million shares. As a result of holders electing the cash settlement, Cypress paid out \$14.3 million.

In April 1997, Cypress sold capital equipment located in its Minnesota wafer fabrication facility to Fleet Capital Leasing ("Fleet") in a sale-leaseback agreement. In October 1997, Cypress entered into a similar agreement with Comdisco, Inc. ("Comdisco") for other capital equipment located in Minnesota. Cypress 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 July 1996, Cypress established a three-year, \$100.0 million unsecured revolving credit facility with Bank of America National Trust and Savings Association as agent on behalf of certain banks. During 1998, Cypress cancelled the line of credit.

In 1994 and 1995, Cypress entered into three operating lease agreements with respect to its office and manufacturing facilities in San Jose and Minnesota, respectively. In April 1996, Cypress entered into an additional lease agreement for two office facilities in San Jose. These agreements require that Cypress maintain a specific level of restricted cash or investments to serve as collateral for these leases and maintain compliance with certain financial covenants. Cypress's restricted investment balance as of January 3, 1999 and December 29, 1997 was \$59.7 million and \$60.1 million, respectively, and is recorded as other assets on the Balance Sheet. Cypress was in compliance with its covenants at January 3, 1999.

Cypress believes that existing cash and cash equivalents and cash from operations 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, Cypress's operating results may be adversely impacted causing Cypress 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 Cypress or available at terms Cypress deems satisfactory.



Consolidated Balance Sheets

(In thousands, except per-share amounts)

	January 3, 1999	December 29, 1997
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 133,772	\$ 151,725
Short-term investments	<u>18,459</u>	<u>49,836</u>
Total cash, cash equivalents and short-term investments	152,231	201,561
Accounts receivable, net (Note 2)	58,692	67,854
Inventories (Note 2)	58,823	76,925
Other current assets	13,943	51,740
Total current assets	283,689	398,080
Property, plant and equipment, net (Note 2)	347,746	442,661
Assets held for sale	2,021	—
Other assets (Note 2)	122,843	115,529
	\$ 756,299	\$ 956,270
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 50,172	\$ 60,857
Accrued compensation and employee benefits	19,244	15,967
Other accrued liabilities	4,521	5,505
Deferred income on sales to distributors	12,081	9,636
Income taxes payable	13,591	1,088
Total current liabilities	99,609	93,053
Convertible subordinated notes	160,000	175,000
Deferred income taxes	—	36,070
Other long-term liabilities, including minority interest	7,589	8,671
Total liabilities	267,198	312,794
Commitments and contingencies (Note 8)		
Stockholders' equity:		
Preferred stock, \$.01 par value, 5,000 shares authorized; none issued and outstanding	—	—
Common stock, \$.01 par value, 250,000 shares authorized; 98,147 issued; 84,859 and 90,684 outstanding	981	981
Additional paid-in-capital	437,336	430,716
Retained earnings	<u>215,422</u>	<u>333,910</u>
	653,739	765,607
Less shares of common stock held in treasury, at cost; 13,288 shares at January 3, 1999 and 7,463 shares at December 29, 1997	(164,638)	(122,131)
Total stockholders' equity	489,101	643,476
	\$ 756,299	\$ 956,270

See accompanying notes to Consolidated Financial Statements.

Consolidated Statements of Operations

(In thousands, except per-share amounts)

Year Ended

	January 3, 1999	December 29, 1997	December 30, 1996
Revenues	\$ 486,841	\$ 544,356	\$ 528,385
Cost of revenues	367,352	356,919	305,174
Research and development	104,887	93,842	84,334
Selling, general and administrative	82,970	75,282	64,301
Restructuring and other non-recurring costs (benefits)	58,940	—	(7,018)
Total operating costs and expenses	614,149	526,043	446,791
Operating income (loss)	(127,308)	18,313	81,594
Interest expense	(10,853)	(7,197)	(6,895)
Interest income and other	13,305	12,916	8,806
Income (loss) before income taxes	(124,856)	24,032	83,505
(Provision) benefit for income taxes	14,006	(5,613)	(30,476)
Net income (loss)	\$ (110,850)	\$ 18,419	\$ 53,029
Net income (loss) per share:			
Basic	\$ (1.24)	\$ 0.21	\$ 0.66
Diluted	\$ (1.24)	\$ 0.21	\$ 0.62
Weighted average common and common equivalent shares outstanding:			
Basic	89,338	87,888	80,241
Diluted	89,338	94,648	91,604

See accompanying notes to Consolidated Financial Statements.

Consolidated Statements of Stockholders' Equity

(In thousands)

	Common Shares	Stock Amount	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Total Stockholders' Equity
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 stock 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
Re-issuance of treasury shares under employee stock plans and other	3,313		26,777			26,777
Premiums received from put option issuances			2,760			2,760
Tax benefit resulting from stock option transactions			6,959			6,959
Issuance of common stock from the conversion of the convertible debt	6,789	67	83,036			83,103
Repurchase of common stock under stock repurchase program	(516)				(5,288)	(5,288)
Net income for the year				18,419		18,419
Balances at December 29, 1997	90,684	981	430,716	333,910	(122,131)	643,476
Re-issuance of treasury shares under employee stock plans and other	1,782			(7,638)	19,767	12,129
Premiums received from put option issuances			6,620			6,620
Repurchase of common stock under stock repurchase program	(7,607)				(62,274)	(62,274)
Net loss for the year				(110,850)		(110,850)
Balances at January 3, 1999	84,859	\$ 981	\$ 437,336	\$ 215,422	\$ (164,638)	\$ 489,101

See accompanying notes to Consolidated Financial Statements.

Consolidated Statements of Cash Flows

(In thousands)

Year Ended

	January 3, 1999	December 29, 1997	December 30, 1996
Cash flow from operating activities:			
Net income (loss)	\$ (110,850)	\$ 18,419	\$ 53,029
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	112,702	111,361	97,606
Non-cash interest and amortization of debt issuance costs	1,034	3,978	2,774
Net gain on early retirement of debt	(1,734)	—	—
Loss on sale of fixed assets	1,069	—	—
Restructuring costs	58,940	—	—
Other non-recurring costs	8,827	—	(12,943)
Deferred income taxes	(797)	14,782	6,216
Changes in operating assets and liabilities:			
Receivables	11,166	9,035	36,811
Inventories	18,102	(23,818)	(24,129)
Other assets	35,256	(8,239)	(7,130)
Accounts payable and accrued liabilities	(13,483)	(11,946)	(28,604)
Deferred income	2,445	(5,266)	1,712
Income taxes payable	(22,770)	15,870	(13,117)
Net cash flow generated from operating activities	99,907	124,176	112,225
Cash flow from investing activities:			
Purchase of investments	(110,718)	(112,185)	(198,342)
Sale or maturities of investments	127,195	93,870	276,806
Acquisition of property, plant and equipment	(82,205)	(142,305)	(195,280)
Proceeds from sale of equipment	5,390	28,183	—
Net cash flow used for investing activities	(60,338)	(132,437)	(116,816)
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)	—
Early retirement of debt	(12,916)	—	—
Restricted investments related to building lease agreements	—	—	(22,355)
Repurchase of common stock	(62,274)	(5,288)	(32,878)
Issuance of common stock	—	—	18,496
Re-issuance of treasury shares	12,130	33,735	—
Premiums received from put options	6,620	2,760	—
Other long-term liabilities, including minority interest	(1,082)	1,804	2,960
Net cash flow generated (used) for financing activities	(57,522)	139,867	15,223
Net increase (decrease) in cash and cash equivalents	(17,953)	131,606	10,632
Cash and cash equivalents, beginning of year	151,725	20,119	9,487
Cash and cash equivalents, end of year	\$ 133,772	\$ 151,725	\$ 20,119
Supplemental disclosures:			
Cash paid during the year for:			
Interest	\$ 10,045	\$ 4,585	\$ 4,982
Income taxes	\$ 98	\$ 1,550	\$ 45,271

See accompanying notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

Note 1: Summary of Significant Accounting Policies

Cypress — Cypress Semiconductor Corporation (“Cypress”) designs, develops, manufactures and markets a broad line of high-performance digital and mixed-signal integrated circuits for a range of markets, including computers, data communications, telecommunications and instrumentation systems.

Cypress’s operations outside of the U.S. expanded in 1996 with the addition of its test and assembly plant in the Philippines. Cypress’s other foreign operations include several sales offices and design centers located in various parts of the world. Revenues to international customers were 39%, 36% and 27% of total revenues in 1998, 1997 and 1996, respectively. As of January 3, 1999, all of Cypress’s subsidiaries were wholly owned except for Cypress Semiconductor (Texas) Inc. (“CTI”), Cypress’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.

The consolidated financial statements include the accounts of Cypress and all of its subsidiaries. Intercompany transactions and balances have been eliminated in consolidation.

Fiscal Year — Beginning with its 1998 fiscal year end, Cypress ended its fiscal months, quarters and years on Sundays, rather than Mondays, bringing its fiscal period ends in line with predominant industry practice. Fiscal years 1998, 1997 and 1996 ended January 3, 1999, December 29, 1997 and December 30, 1996, respectively. Fiscal year 1998 was a 53-week year ending on the Sunday closest to December 31 while fiscal years 1997 and 1996 were 52-week years ending on the Monday closest to December 31. Operating results for this additional week were considered immaterial to Cypress’s consolidated operating results for the year ended January 3, 1999.

Management Estimates — The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates, although such differences are not expected to be material to the financial statements.

Reclassifications — Certain prior year amounts have been adjusted to conform to current year presentation.

Financial Instruments — For certain of Cypress’s financial instruments, including cash and cash equivalents, accounts receivable, accounts payable and other current liabilities, the carrying amounts approximate their fair value due to the relatively short maturity of these items. The estimated fair market value of Cypress’s investments reasonably estimate their fair values based on market information. At January 3, 1999, the estimated fair value of the Convertible Subordinated Notes was \$141.8 million.

Cypress has foreign subsidiaries which operate and sell Cypress’s products in various global markets. As a result, Cypress is exposed to changes in foreign currency exchange rates. Cypress utilizes hedge instruments, primarily forward contracts to manage its exposure associated with firm third-party transactions and net asset positions denominated in non-functional currencies. Cypress does not hold derivative financial instruments for speculative purposes. Forward contracts are considered identifiable hedges and realized and unrealized gains and losses are deferred until settlement of the underlying commitments. They are recorded as other gains or losses when a hedged transaction is no longer expected to occur. Deferred gains and losses were not significant at January 3, 1999 and December 29, 1997. Foreign currency transaction gains and losses included in interest and other income were insignificant for the years ended January 3, 1999, December 29, 1997 and December 30, 1996. At January 3, 1999, total outstanding purchased forward contracts were immaterial.

The estimated fair values have been determined by Cypress, using available market information. However, considerable judgement is required in interpreting market data to develop the estimates of fair value. Accordingly, the estimates presented are not necessarily indicative of the amounts that Cypress could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies could have a material effect on the estimated fair value amounts.

Cash Equivalents and Investments — Highly liquid investments purchased with an original maturity of ninety days or less are considered to be cash equivalents. All Cypress investments are classified as available-for-sale. Investments in available-for-sale securities are reported at fair value with unrealized gains and losses net of related tax, if any, included as a component of stockholders’ equity.

Inventories — Inventories are stated at the lower of standard cost (which approximates actual cost on a first-in, first-out basis) or market. Market is based on estimated net realizable value.

Property, Plant and Equipment — Property, plant and equipment are stated at cost. Depreciation is computed for financial reporting purposes using the straight-line method over the estimated useful lives of the assets as presented below. Leasehold improvements and leasehold interests are amortized over the shorter of the estimated useful lives of the assets or the remaining term of the lease. Accelerated methods of computing depreciation are used for tax purposes.

Useful Lives in Years

Equipment	3 to 7
Buildings and leasehold improvements	7 to 10
Furniture and fixtures	5

Pre-operating Costs — Incremental costs incurred in connection with developing major production capability at new manufacturing plants, including depreciation, amortization and cost of qualification of equipment and production processes were capitalized up to December 1997. Pre-operating costs totalling \$3.8 million, net of accumulated amortization were included in other assets at December 29, 1997. Such costs were being amortized over five years at a rate based on estimated units to be manufactured during that period. In fiscal 1998, these costs were written off and at January 3, 1999, no pre-operating costs are remaining.

Long-Lived Assets — Long-lived assets held and used by Cypress 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.

Revenue Recognition — Revenues from product sales are generally recognized upon shipment and a reserve is provided for estimated returns. A portion of Cypress's sales are made to domestic distributors under agreements which allow certain rights of return and price protection on products unsold by domestic distributors. Accordingly, Cypress defers recognition of revenues and profit on such sales until distributors resell the products.

Cypress sells to certain international distributors with a provision for price adjustments on certain products. Cypress reserves for all anticipated price adjustments. No rights of return exist on sales to international distributors. Accordingly, sales are recognized upon shipment.

Cypress also has inventory, which is held by certain customers on a consignment basis. Revenues are recorded when title transfers as defined per the respective consignment agreements.

Income Taxes — Cypress 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 — In accordance with Statement of Accounting Standard No. 128 ("SFAS 128"), Cypress reports Earnings Per Share ("EPS"), both basic and diluted EPS on the income statement. Basic EPS is based upon weighted-average common shares outstanding. Diluted EPS is computed using the weighted average common shares outstanding plus any potentially dilutive securities, except when their effect is anti-dilutive. Dilutive securities include stock options and convertible debt.

Translation of Foreign Currencies — Cypress uses the U.S. dollar as its functional currency for all foreign subsidiaries. Accordingly, gains and losses from translation of foreign currency financial statements into U.S. dollars are included in results of operations. Sales to customers are primarily denominated in U.S. dollars. All foreign currency translation gains and losses have not been material in any year.

Concentration of Credit Risk — Financial instruments that potentially subject Cypress to concentrations of credit risk are primarily investments and trade accounts receivable. Cypress's investment policy requires cash investments to be placed with high-credit quality institutions and to limit the amount of credit from any one issuer.

Cypress sells its products to original equipment manufacturers and distributors throughout the world. Cypress performs ongoing credit evaluations of its customers' financial condition whenever deemed necessary and generally does not require collateral. Cypress maintains an allowance for doubtful accounts receivable based upon the expected collectibility of all accounts receivable.

Accounting for Stock-Based Compensation — Cypress accounts for its stock option plans and its employee stock purchase plan in accordance with provisions of the Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees". In accordance with Statement of Financial Accounting Standards No. 123 ("SFAS 123"), "Accounting for Stock-Based Compensation", Cypress provides additional proforma disclosures in Note 6.

Comprehensive Income — In June 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income" ("SFAS 130"). Cypress adopted this statement as of the first quarter of 1998 and has determined that it does not have any changes in equity (net assets) from non-owner sources.

Segment Reporting — In fiscal 1998, Cypress adopted Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information" ("SFAS 131"). SFAS 131 supersedes Statement of Financial Accounting Standards No. 14, "Financial Reporting for Segments of a Business Enter-

prise.” SFAS 131 establishes standards for disclosures about products and services, geographic areas and major customers (see Note 10).

Recent Accounting Pronouncements — In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, “Accounting for Derivative Instruments and Hedging Activities” (“SFAS 133”). SFAS 133 establishes a new model for accounting for derivatives and hedging activities and supersedes and amends a number of existing accounting standards. SFAS 133 requires that all derivatives be recognized in the balance sheet at their fair market value. In addition, corresponding derivative gains and losses should be either reported in the statement of operations or stockholders equity, depending on the type of hedging relationship that exists with respect to such derivatives. Adopting the provisions of SFAS 133, which will be effective in fiscal year 2000, are not expected to have a material effect on Cypress's consolidated financial statements.

Note 2: Balance Sheet Components

Available-For-Sale Securities

Cypress's portfolio of available-for-sale securities consists of the following:

(In thousands)

	January 3, 1999	December 29, 1997
Corporate debt securities	\$ 101,042	\$ 89,557
State and municipal obligations	73,607	94,675
Other	23,341	48,042
Total available-for-sale securities	\$ 197,990	\$ 232,274

At January 3, 1999 and December 29, 1997, the net unrealized holding gains and losses on securities were immaterial. The securities at January 3, 1999 and December 29, 1997 by contractual maturity are shown below.

(In thousands)

	January 3, 1999	December 29, 1997
Due in one year or less	\$ 140,944	\$ 190,128
Due after one year through two years	57,046	42,146
Total available-for-sale securities	\$ 197,990	\$ 232,274

Accounts Receivable, Net

(In thousands)

	January 3, 1999	December 29, 1997
Accounts receivable, gross	\$ 60,310	\$ 71,378
Allowance for doubtful accounts and customer returns	(1,619)	(3,524)
Accounts receivable, net	\$ 58,692	\$ 67,854

Inventories, Net

(In thousands)

	January 3, 1999	December 29, 1997
Raw materials	\$ 8,939	\$ 17,900
Work-in-process	33,096	35,281
Finished goods	16,788	23,744
Inventories, net	\$ 58,823	\$ 76,925

Property, Plant and Equipment, Net

(In thousands)

	January 3, 1999	December 29, 1997
Land	\$ 13,533	\$ 12,922
Equipment	620,233	726,363
Buildings and leasehold improvements	96,386	69,340
Furniture and fixtures	6,292	6,543
Total property, plant and equipment	740,944	815,168
Accumulated depreciation and amortization	(388,698)	(372,507)
Net property, plant and equipment	\$ 347,746	\$ 442,661

Other Assets

(In thousands)

	January 3, 1999	December 29, 1997
Restricted investments	\$ 59,742	\$ 60,112
Long-term investments	57,046	42,146
Other	6,055	13,271
Total other assets	\$ 122,843	\$ 115,529

Note 3: Restructuring and Other Non-Recurring Costs

1998 Restructuring and Other Non-Recurring Costs

During 1998, Cypress implemented an overall cost reduction plan and recorded a \$58.9 million restructuring reserve. The restructuring entailed:

- The shutdown of Fab 3, located in Bloomington, Minnesota and consolidation of parts of Fab 3 operations with other operations of Cypress.
- The discontinuance of the 0.6 micron 256K SRAM production in Fab 2 located in Texas.
- The conversion of an existing research and development fab located in San Jose (Fab 1) to eight-inch capability in order to be compatible with the state of the art eight-inch Minnesota manufacturing facility.
- The transfer of Cypress's test operations from its subcontractor, Alphatec, in Thailand to Cypress's production facility in the Philippines.
- The restructuring activities described above include the termination of approximately 850 employees primarily from manufacturing both at Cypress and at Alphatec.

The following table sets forth Cypress's 1998 restructuring expense and charges taken from the date the restructuring commenced through January 3, 1999.

(In thousands)

	1998 Restructuring Expense	Utilized	Balance January 3, 1999
Write-down of inventory ⁽¹⁾	\$ 3,250	\$ (3,250)	\$ —
Severance and other employee related charges ⁽¹⁾	5,334	(3,025)	2,309
Other fixed asset related charges ⁽¹⁾	3,030	—	3,030
Provision for phase-down and consolidation of manufacturing facilities ⁽¹⁾	976	(637)	339
Total	\$ 12,590	\$ (6,912)	\$ 5,678

(1) Classified on the Balance Sheet as part of accrued liabilities.

FAB 3 — The charge related to the shutdown of Fab 3 was \$30.2 million. Of this amount, \$26.0 million related to the write-down of equipment held for sale, \$1.7 million of other fixed asset related charges for incremental third party costs expected to be incurred in the eventual physical removal of the written down assets, \$1.1 million related to severance and other employee related costs and \$1.4 million related to inventory.

Fab 3 assets which were not upgradable to 8-inch capability were written down based on the estimated useful lives of the assets and the salvage value of the assets. The estimated useful lives were generally two months as a result of the decision to discontinue production in Fab 3 and the salvage value was determined based on the estimated sales value of used semiconductor equipment. Non-upgradable Fab 3 assets were depreciated down to their salvage value during the production phase-down period. Fab 3 assets, which were upgradable to 8-inch capability, were transferred to Fab 4 production during the third quarter of 1998.

In accordance with the restructuring plan, Fab 3 production was phased down beginning in the second quarter of 1998 and ceased in July 1998. From this time, Cypress has held the non-upgradable equipment for sale. However, due to the over-supply of used semiconductor equipment, a substantial amount of the equipment remains on hand. Cypress expects to recover the originally determined salvage value for such equipment.

FAB 2 — The decision to discontinue manufacturing SRAM products on Cypress's 0.6 micron 256K SRAM process in Texas resulted in excess equipment and employee redundancy. Charges with this decision totaled \$21.3 million, of which \$18.0 million related to the write-down of equipment, \$0.3 million related to the write-down of inventory, \$1.7 million related to severance and other employee related costs and \$1.3 million of other fixed asset related charges for incremental third party costs expected to be incurred in the eventual physical removal of the written down assets and the resolution of certain related tax matters.

Excess equipment in Fab 2 was written down based on the useful lives of the assets and the estimated salvage value of the assets. Cypress had the ability and intention to sell all the equipment immediately but due to the semiconductor industry slow-down, Cypress recognized immediate sale of the equipment would be difficult. The equipment was kept in the fab, ready for demonstration and testing by a willing buyer. Cypress used the equipment during the production phase-down period through May 1998.

Similar to Fab 3 equipment, some of this equipment remains on hand due to the over-supply of used semiconductor equipment on the market. Cypress expects to recover the originally determined salvage value for such equipment, however, no assurance can be given as to the amount of proceeds which will ultimately be collected.

FAB 1 AND SAN JOSE OPERATIONS — The restructuring plan included the upgrade of Fab 1 to an eight-inch facility to ensure compatibility with Cypress's Fab 4 manufacturing facility in Minnesota. Fab 1 is used for research and development purposes. The plan assumed commencement of Fab 1 restructuring activities during the middle of 1998 with completion by the end of January 1999. The plan included the disposal and write-down of six-inch manufacturing equipment which was not upgradable to eight-inch capability. The remaining net book value of \$6.1 million of such assets is being written off over the estimated useful life through January 1999. Incremental depreciation charges of \$5.4 million, to reflect the revised useful lives of this equipment were included in research and development costs for 1998 and will continue through January 1999. Cypress also reserved \$1.0 million to write-down the value of certain other equipment and reserved \$1.3 million related to severance and other employee related costs.

ALPHATEC — Cypress reserved \$5.1 million to provide for the consolidation of Thailand test activities from Alphatec, Cypress's subcontractor, with Cypress's Philippines facility. Of this \$5.1 million reserve, \$1.5 million was related to production inventories which were no longer usable as a result of this consolidation, \$1.3 million was related to severance costs at the subcontractor and \$2.3 million was related to excess equipment and leasehold improvements which were no longer used. The assets were considered held for sale and were written down to their salvage value. The transfer of production from Alphatec to the Philippines facility began during the second quarter of 1998 and was completed in January 1999, one month later than originally planned.

RESTRUCTURING STATUS — Fabs 2 and 3 restructuring activities were completed in May and July 1998, respectively, consistent with our restructuring schedule except for the disposal of the equipment. Fab 1 restructuring was not completed in January 1999 as originally planned. Cypress is evaluating alternatives to achieve its eight-inch conversion plan and should have resolution in the first half of 1999. The Alphatec consolidation and transfer activity was completed in January 1999, one month later than originally planned. Cypress continues its effort to dispose of assets held for sale, impacted by these restructuring activities, and expects to recover the originally determined salvage value for those assets.

OTHER — Separate from the restructuring charge, Cypress recorded an additional charge of \$27.3 million, which were recorded as operating expenses. These charges resulted from changes in market conditions and were considered as part of ongoing operations. They included inventory reserves (\$15.8 million), the write-off of pre-operating costs (\$3.8 million), the write-off of an equity investment (\$3.1 million), costs incurred to reimburse a customer for certain product expenses incurred (\$2.5 million) and the write-off of obsolete equipment in Fab 4 (\$2.1 million). The write-down of inventory was made to establish incremental reserves for excess inventory and was recorded as cost of revenues.

The write-off of pre-operating costs included \$2.9 million related to Cypress's wafer fabrication operation in Bloomington, Minnesota and \$0.9 million related to its assembly and test operation in the Philippines. As a result of restructuring activities, Cypress wrote off its previously capitalized pre-operating costs as an impaired asset due to uncertainties surrounding their future economic benefits and accordingly the costs were written off to cost of sales. There were no capitalized pre-operating costs subsequent to the first quarter of 1998.

The \$3.1 million write-off of the investment was recorded against net interest and other income to reflect the decline in the value of a certain investment. Selling, general and administrative costs included the write-off of \$2.5 million in costs incurred to reimburse a customer for certain product expenses incurred. During Cypress's periodic review of equipment, some equipment was identified as obsolete and \$2.1 million was charged to cost of sales to write-off the obsolete equipment.

1996 Restructuring and Other Non-recurring Costs

During 1996, Cypress recorded a pre-tax restructuring and other non-recurring benefit as detailed below:

	1996
Restructuring	\$ 9,100
Non-recurring benefit	(17,800)
Other	1,682
Total	\$ (7,018)

The \$9.1 million pre-tax charge was a result of Cypress's decision to restructure its San Jose, California wafer fabrication facility, from a production wafer fabrication plant to predominantly a research and development wafer fabrication facility. The charge included \$5.9 million for the write-down of certain excess equipment and \$3.2 million for severance and other related restructuring charges. Substantially all of the reserve has been used as of the end of 1998.

The \$17.8 million benefit was derived from the reversal of the reserve established in 1995 related to the Texas Instruments ("TI") patent infringement lawsuit. In July 1996, the Federal Circuit Court of Appeals ("Court") affirmed the earlier decision of the trial court that Cypress 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, Cypress reversed the reserve established in 1995. In 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 was determined to be final.

In September 1996, Cypress 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 offset by \$5.0 million of other non-recurring charges related to agreements with certain companies regarding cross-licensing and other matters.

Note 4: Convertible Subordinated Notes

In 1998, Cypress retired a total of \$15.0 million principal of its \$175.0 million, 6.0% Convertible Subordinated Notes ("Notes") for \$12.9 million, resulting in a pre-tax net gain of \$1.7 million. The gain was offset by the write-off of bond issuance costs of \$0.4 million (pre-tax). The net gain was recorded as interest and other income. The Notes, which were issued in September 1997, are due October 1, 2002 and contain a coupon rate of 6.0% and an initial conversion premium of 48.2%. The remaining outstanding Notes are convertible into approximately 6,772,000 shares of common stock and are callable by Cypress on or after October 2, 2000. The Notes are unsecured subordinated obligations.

In February 1997, Cypress 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 Cypress's common stock, increasing the amount of common stock outstanding by 6,789,013 shares. As a result of holders electing the cash settlement, Cypress paid out \$14.3 million.

Note 5: Earnings (Loss) Per Share

As required by SFAS 128, following is a reconciliation of the numerators and the denominators of the basic and diluted per share computation:

(In thousands, except per-share amounts)

	1998			1997			1996		
	Loss	Shares	Per-Share Amount	Income	Shares	Per-Share Amount	Income	Shares	Per-Share Amount
Basic EPS:									
Net income (loss)	\$ (110,850)	89,338	<u>\$ (1.24)</u>	\$ 18,419	87,888	<u>\$ 0.21</u>	\$ 53,029	80,241	<u>\$ 0.66</u>
Effects of dilutive securities:									
Stock options	—	—		—	4,885		—	3,423	
Convertible debentures	—	—		1,130	1,875		3,700	7,940	
Diluted EPS:									
Net income (loss)	\$ (110,850)	89,338	<u>\$ (1.24)</u>	\$ 19,549	94,648	<u>\$ 0.21</u>	\$ 56,729	91,604	<u>\$ 0.62</u>

At January 3, 1999 and December 29, 1997, options to purchase 24,774,000 and 5,696,000 shares, respectively, of common stock were outstanding, but were excluded in the computation of diluted EPS as their effect was anti-dilutive. At December 30, 1996, no outstanding options to purchase common stock were excluded in the computation of diluted EPS. Convertible debentures outstanding at January 3, 1999 and December 29, 1997 convertible to 6,772,000 and 7,408,000 shares, respectively, of common stock were also excluded from diluted EPS as their effect was anti-dilutive. No shares related to convertible debentures were excluded at December 30, 1996.

Note 6: Common Stock Option and Other Employee Benefit Plans

1994 Stock Option Plan

In 1994, Cypress adopted the 1994 Stock Option Plan, which replaced Cypress'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 Cypress or its majority-owned subsidiaries. Options become exercisable over a vest-

ing period as determined by the Board of Directors and expire over terms not exceeding twenty 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 Cypress'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. A total of 7,083,000 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 10,464,000 shares were repriced. This repricing excluded the Board of Directors, the Chief Executive Officer and the Executive staff of Cypress.

The following table summarizes Cypress's stock option activity and related weighted average exercise price for each category for the years ended January 3, 1999, December 29, 1997 and December 30, 1996. The weighted average exercise price for each category presented is also shown in the table below.

Shares Under the 1994 Stock Option Plan

(In thousands, except per-share amounts)

	1998		1997		1996	
	Shares	Price	Shares	Price	Shares	Price
Options outstanding, beginning of year	22,277	\$ 9.86	21,013	\$ 8.94	19,448	\$ 9.81
Options cancelled	(13,582)	11.44	(1,461)	11.13	(8,855)	14.71
Options granted	16,971	9.40	5,497	12.64	12,202	11.23
Options exercised	(892)	6.52	(2,772)	7.62	(1,782)	5.38
Options outstanding, end of year	<u>24,774</u>	<u>8.80</u>	<u>22,277</u>	<u>9.86</u>	<u>21,013</u>	<u>8.94</u>
Options exercisable at January 3, 1999	<u>12,984</u>	<u>\$ 8.14</u>				

All options were granted at an exercise price equal to the market value of Cypress'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 1998, 1997 and 1996 was \$3.92, \$6.07 and \$3.14 per option, respectively. The estimated grant date fair value disclosed by Cypress 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 Cypress'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 Cypress's stock option awards:

	1998	1997	1996
Expected life	7 years	6 years	6 years
Risk-free interest rate	5.41%	6.63%	6.04%
Volatility	.5467	.5529	.5582
Dividend yield	0.00%	0.00%	0.00%

Significant option groups outstanding as of January 3, 1999 and the related weighted average exercise price and contractual life information, are as follows:

(In thousands, except per-share amounts)

Options with exercise prices range from	Outstanding		Exercisable		Remaining Life (years)
	Shares	Price	Shares	Price	
\$1.00 — \$ 8.38	7,754	\$ 6.46	4,605	\$ 5.27	6.29
\$8.39 — \$ 9.25	3,673	\$ 8.67	2,294	\$ 8.57	6.89
\$9.26 — \$ 9.75	9,314	\$ 9.75	4,737	\$ 9.75	7.62
\$9.76 — \$17.56	4,033	\$ 11.24	1,348	\$ 11.50	8.32

Employee Qualified Stock Purchase Plan

In 1986, Cypress approved an Employee Qualified Stock Purchase Plan ("ESPP"), which allows eligible employees of Cypress 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 the employee's enrollment price multiplied by the number of purchased shares). Of the 10,100,000 shares authorized under the ESPP, 7,320,000 shares were issued through 1998 including 890,000, 541,000 and 652,000 shares in 1998, 1997, and 1996, 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:

	1998	1997	1996
Expected life	6 months	6 months	6 months
Risk-free interest rate	4.96%	5.80%	5.98%
Volatility	.5371	.5861	.5882
Dividend yield	0.00%	0.00%	0.00%

The weighted average estimated grant date fair value, as defined by SFAS 123, of rights to purchase stock under the ESPP granted in 1998, 1997 and 1996 were \$2.56, \$5.49 and \$5.37 per share, respectively.

Pro Forma Net Income (Loss) and Net Income (Loss) Per Share

If Cypress had 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, Cypress's pro forma net income (loss) and earnings per share for the years ended January 3, 1999, December 29, 1997 and December 30, 1996 would have been as follows:

(In thousands, except per-share amounts)

	1998	1997	1996
Pro forma net income (loss):			
Basic	\$ (141,536)	\$ (6,431)	\$ 32,490
Diluted	\$ (141,536)	\$ (6,431)	\$ 36,190
Pro forma net income (loss) per share:			
Basic	\$ (1.58)	\$ (0.07)	\$ 0.40
Diluted	\$ (1.58)	\$ (0.07)	\$ 0.40

The pro forma effect on net income (loss) and net income (loss) per share for 1998, 1997 and 1996 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

During 1997, the Board of Directors authorized the repurchase of up to 4.0 million shares of Cypress's common stock. In September 1998, the Board of Directors authorized the repurchase of up to an additional 10.0 million shares under the stock repurchase program. Through January 3, 1999, 8.1 million shares have been repurchased under this entire program for \$67.5 million. The repurchased shares are expected to be used in conjunction with Cypress's 1994 Stock Option Plan and Employee Stock Purchase Plan. During 1998, Cypress reissued 1,782,000 shares of common stock under such plans. In conjunction with the authorized stock repurchase program, Cypress sold put warrants through private placements for which Cypress received a net amount of \$9.4 million through January 3, 1999. Cypress has a maximum potential obligation to purchase 4.5 million shares of its common stock at an aggregate price of \$44.5 million as of January 3, 1999. The puts have various expiration periods through May 1999. Cypress 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. It is Cypress's intent to settle these put warrants with stock and therefore, no amount was classified out of stockholders' equity in the accompanying consolidated balance sheets. On February 25, 1999, the Board of Directors terminated the stock repurchase program.

Other Employee Benefit Plans

Cypress also maintains a Section 401(k) Plan, New Product Bonus Plan, Key Employee Bonus Plan and Deferred Compensation Plan. The 401(k) Plan provides participating employees with an opportunity to accumulate funds for retirement and hardship. Eligible participants may contribute up to 15% of their eligible earnings to the Plan Trust. Cypress does not make contributions to the plan.

Under the New Product Bonus Plan effective for 1997, all qualified employees are provided bonus payments, which are based on Cypress attaining certain levels of new product revenue, plus attaining certain levels of profitability. In 1998 and 1997, \$0.7 million and \$0.5 million, respectively were charged to operations in connection with the New Product Bonus Plan. In 1996, under the Profit Sharing Plan, all qualified employees

were provided an equal share of bonus payments, which were based on Cypress achieving a targeted level of earnings per share. In 1996, no charges to operations were made in connection with the profit sharing plan.

In 1994, a Key Employee Bonus Plan was established, which provides for bonus payments to selected employees upon achievement of certain Cypress and individual performance targets. In 1998, \$4.1 million was charged to operations in connection with this Plan. In 1997 and 1996, there were no charges to operations in connection with this Plan. Employees eligible under the Key Employee Bonus Plan can elect to participate in the Deferred Compensation Plan, which allows eligible employees to defer their salary, bonus and other related payments. Costs incurred by Cypress for the Deferred Compensation Plan during fiscal years 1998, 1997 and 1996 were insignificant.

Note 7: 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)

	January 3, 1999	December 29, 1997	December 30, 1996
Income (loss) before provision for taxes	\$ (124,793)	\$ 24,032	\$ 83,505
Current tax expense:			
U.S. Federal	\$ (13,720)	\$ (10,483)	\$ 21,481
State and local	—	1,418	1,706
Foreign	511	500	1,073
Total current	(13,209)	(8,565)	24,260
Deferred tax expense (benefit):			
U.S. Federal	(4,210)	16,033	5,559
State and local	3,413	(1,855)	657
Total deferred	(797)	14,178	6,216
Total	\$ (14,006)	\$ 5,613	\$ 30,476

The tax provision (benefit) 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)

	January 3, 1999	December 29, 1997	December 30, 1996
Statutory rate	35%	35%	35%
Tax at U.S. statutory rate	\$ (42,810)	\$ 8,411	\$ 29,227
Foreign earnings	(4,153)	(1,151)	—
State income taxes, net of federal benefit	3,413	922	1,536
Tax credits	(3,700)	(2,274)	—
Net Foreign Sales Corporation (FSC) benefit	—	(78)	(1,548)
Benefit of tax free investments	(350)	(482)	(998)
Current year loss with no benefit	18,498	—	—
Future benefits not recognized	15,900	—	—
Other, net	(804)	265	2,259
Total	\$ (14,006)	\$ 5,613	\$ 30,476

The components of the net deferred tax assets at January 3, 1999 and December 29, 1997, under SFAS 109 were as follows:

(In thousands)

	January 3, 1999	December 29, 1997
Deferred tax assets:		
Deferred income on sales to distributors	\$ 11,024	\$ 9,773
Inventory reserves and basis differences	13,765	12,596
Restructuring and legal reserves	2,161	9
Asset valuation and other reserves	25,725	12,670
State tax, net of federal tax	420	421
Research and development tax credits	7,377	4,177
Net operating loss	30,015	—
Other, net	903	1,122
Total deferred tax assets	91,390	40,768
Deferred tax liabilities:		
Excess of tax over book depreciation	(40,709)	(40,355)
Other, net	(1,209)	(1,210)
Total deferred tax liabilities	(41,918)	(41,565)
Net deferred tax assets (liabilities)	49,472	(797)
Valuation allowance	(49,472)	—
Net deferred tax assets (liabilities) after valuation allowance	\$ —	\$ (797)

Other current assets include current deferred tax assets of \$35,573,000 at December 29, 1997.

No tax benefits associated with disqualifying dispositions of stock options or employee stock purchase plan shares were realized in 1998.

During 1998, the United States Internal Revenue Service began an examination of tax returns for fiscal years 1994 through 1996. The examination is expected to continue through December 1999. Management believes that no potential adjustments will ultimately result from this examination.

Note 8: Commitments and Contingencies

Operating Lease Commitments

Cypress leases most of its manufacturing and office facilities under non-cancelable operating lease agreements that expire at various dates through 2012. These leases require Cypress 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, Cypress sold capital equipment located in its Minnesota wafer fabrication facility to Fleet Capital Leasing ("Fleet") in a sale-leaseback agreement. In October 1997, Cypress entered into a similar agreement with Comdisco, Inc. ("Comdisco") for other capital equipment located in Minnesota. Cypress 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 is being amortized over the life of the leases.

In 1994 and 1995, Cypress entered into three operating lease agreements with respect to its office and manufacturing facilities, in San Jose and Minnesota, respectively. In April 1996, Cypress 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 Cypress 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. Cypress is contingently liable under certain first-loss clauses for up to \$52.7 million at January 3, 1999. First loss clauses state that Cypress is potentially liable for any decline in the value of the property up to a specified percentage. The purchase option then permits Cypress to acquire the property at the lower value. Based on management's estimate of the fair value of the properties, no liability was required to be recorded at January 3, 1999 or December 29, 1997. Furthermore, Cypress 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 January 3, 1999, the amount of restricted investments recorded was \$59.7 million, which is in compliance with these agreements. These restricted cash or investments are classified as non-current on the balance sheet.

The aggregate annual rental commitments under non-cancelable operating leases as of January 3, 1999 are as follows:

(In thousands)

Fiscal Year	
1999	\$ 16,838
2000	9,522
2001	4,890
2002	3,315
2003	2,720
2004 and thereafter	4,949
Total	\$ 42,234

Rental expense was approximately \$17.7 million in 1998, \$14.0 million in 1997 and \$7.7 million in 1996.

Litigation and Asserted Claims

The semiconductor industry has experienced a substantial amount of litigation regarding patent and other intellectual property rights. From time to time, Cypress 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. Cypress is currently and may in the future be involved in litigation with respect to alleged infringement by Cypress 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 Cypress's business, financial condition and results of operations.

During 1998, EMI Group of North America, Inc. ("EMI") filed suit against Cypress in the Federal Court in Delaware, claiming that Cypress has infringed on four patents owned by EMI. Cypress and EMI have entered into a license agreement in February 1999, for one of the four patents in the lawsuit. In return, EMI has agreed to withdraw two of the four patents from the lawsuit, including the patent related to the licensing agreement. Cypress has reviewed the charges related to the remaining two patents and believes that these charges are without merit, that it does not infringe the patents in question and that the patents are invalid and/or unenforceable. While no assurance can be given regarding the outcome of this action, Cypress believes that the final outcome of the matters will not have a material effect on Cypress's consolidated financial position or results of operations. Cypress will vigorously defend itself in these matters. However, because of the nature and inherent uncertainties of litigation, should the outcome of this action be unfavorable, Cypress may be required to pay damages and other expenses, which could have a material adverse effect on Cypress's financial position and results of operations.

In January 1998, Cypress was contacted by an attorney representing the estate of Mr. Jerome Lemelson, charging that Cypress infringes certain patents owned by Mr. Lemelson. On February 26, 1999, the estate filed suit against Cypress and 87 other companies. Cypress is in the process of reviewing the claims to determine their validity, and at this time, Cypress believes that the patents are invalid and/or unenforceable.

While no assurance can be given regarding the outcome of this action, Cypress believes that the final outcome of the matters will not have a material effect on Cypress's consolidated financial position or results of operations. Cypress will vigorously defend itself in this matter; however, because of the nature and inherent uncertainties of litigation, should the outcome of this action be unfavorable, Cypress may be required to pay damages and other expenses, which could have a material adverse effect on Cypress's financial position and results of operations.

In June 1997, Cypress commenced a declaratory judgment 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 part of the process for manufacturing semiconductors is unenforceable, invalid and not infringed by Cypress. The Trust has counter-claimed for patent infringement on the same patent, alleging such patent covers oxide-isolated integrated circuits. In December 1997, in a related case, the United States District Court for the Eastern District of Virginia preliminarily ruled that the 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 had been filed as of March 12, 1999. Cypress believes it has meritorious defenses to the counter-claim and intends to defend itself vigorously. While no assurance can be given regarding the outcome of this action, Cypress believes that the final outcome of the matters will not have a material effect on Cypress's consolidated financial position or results of operations. However, should the outcome of this action be unfavorable, Cypress's business, financial condition and results of operations could be materially and adversely affected.

On October 2, 1997, Cypress filed an action against Kevin Yourman, Joseph Weiss, and their associated law offices in the Superior Court of California in Santa Clara County for malicious civil prosecution in the underlying securities fraud actions initiated by Messrs. Yourman and Weiss in 1992. The underlying securities fraud actions were dismissed because no officer of Cypress made any actionable false or misleading statements or omissions. An appeal affirmed the lower court's finding that Messrs. Yourman and Weiss failed to put forth evidence showing a genuine issue of fact with regard to any statements by the Cypress's officers. A motion by Messrs. Yourman and Weiss to dismiss Cypress's malicious prosecution action was denied, and was also subsequently denied by the Supreme Court of California. This action has gone forward into discovery and the defendants have offered a settlement, which has been refused by Cypress. Although the results of litigation are unpredictable, Cypress believes it will prevail. Cypress believes that this action, regardless of its outcome, will have little, if any effect on Cypress's consolidated financial position or results of operations.

In June 1998, Cypress was contacted by Lucent Technologies ("Lucent") regarding the infringement of four or more patents owned by Lucent. Subsequently, Cypress has notified Lucent that Lucent has infringed on one of Cypress's patents. Cypress believes that a new cross-licensing agreement will be finalized with Lucent by the end of March 1999. Cypress believes the outcome of this action will have little, if any effect on Cypress's consolidated financial position or results of operations.

Purchase Commitments

At January 3, 1999, Cypress had purchase commitments aggregating \$55.7 million, principally for manufacturing equipment and facilities. These commitments relate to purchases to be made in 1999. Purchase commitments beyond 1999 are not considered to be significant. Commitments for 1999 purchases will be funded through a combination of cash resources, retirement of investments and the \$160.0 million, 6.0% Convertible Subordinated Notes.

Note 9: Related Parties

Between 1992 and 1995, Cypress made cost-basis investments in QuickLogic Corporation ("QuickLogic") Series D and Series E preferred stock. In June 1996, Cypress 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. Cypress 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, Cypress 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, Cypress 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 Cypress's equity position in the privately-held QuickLogic to greater than 20%. The \$4.5 million cash consideration represented the payment Cypress received in June 1996. Cypress 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 and 1996 were not significant.

In the first quarter of 1998, Cypress determined that its investment in QuickLogic had declined in value and the decline in value was not temporary. Accordingly, Cypress wrote-off its investment in QuickLogic to reflect this decline.

Cypress recorded sales to QuickLogic of \$2.3 million, \$11.7 million and \$8.2 million in 1998, 1997 and 1996, respectively. At fiscal year-ends 1998 and 1997, Cypress had a receivable due from QuickLogic of \$0.6 million and \$1.5 million, respectively.

During 1990, Cypress made a cost-basis investment of \$1.0 million in Vitesse Semiconductor stock. Cypress sold its remaining investment in February 1997 and recorded a gain of \$3.8 million in other income.

Note 10: Segment Information

Cypress has two reportable segments, Memory Products and Non-memory Products. The Memory Products segment includes Static Random Access Memories ("SRAMs") and multichip modules. The Non-memory Products segment includes programmable logic products, data communication devices, computer products, non-volatile memory products and wafers manufactured by the foundry.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies (see Note 1). Cypress evaluates the performance of its two segments based on profit or loss from operations before income taxes, excluding nonrecurring gains and losses.

Cypress's reportable segments are strategic business units that offer different products. Products that fall under the two segments differ in nature, are manufactured utilizing different technologies and have a different end-purpose. As such, they are managed separately. Memory Products are characterized as a commodity, which is

depicted by high unit sales volume and lower gross margins. These products are manufactured using more advanced technology. A significant portion of the wafers produced for Memory Products are manufactured at Cypress's technologically advanced, eight-inch wafer production facility located in Minnesota (Fab 4). Memory Products are used by a variety of end-users but the product is used specifically for the storage and retrieval of information. In contrast to Memory Products, unit sales of non-Memory Products are generally lower than Memory Products, but sell at higher gross margins. Some Non-memory Products are manufactured utilizing less technologically advanced processes. A majority of wafers for Non-memory Products are manufactured at Cypress's less technologically advanced six-inch Fab located in Texas (Fab 2). Products in the Non-memory segment perform non-memory functions such as floating-point mathematics, store fixed data that is not to be altered during normal machine operations and data transfer and routing functions of signals throughout a computer system.

The tables below set forth information about the reportable segments for fiscal years 1998, 1997, and 1996. Cypress does not allocate income taxes or non-recurring items to segments. In addition, segments do not have significant non-cash items other than depreciation and amortization in reported profit or loss.

Business Segment Net Revenues

(In thousands)

	1998	1997	1996
Memory	\$ 195,929	\$ 226,566	\$ 271,192
Non-memory	290,912	317,790	257,193
Total consolidated revenues	\$ 486,841	\$ 544,356	\$ 528,385

Business Segment Profit (Loss)

(In thousands)

	1998	1997	1996
Memory	\$ (94,781)	\$ (35,742)	\$ 61,384
Non-memory	26,413	54,055	13,192
Restructuring and other non-recurring (costs) benefits	(58,940)	—	7,018
Interest income and other	13,305	12,916	8,806
Interest expense	(10,853)	(7,197)	(6,895)
Income (loss) before provision for income taxes	\$ (124,856)	\$ 24,032	\$ 83,505

Business Segment Assets

The following illustrates total assets by segment for the respective years.

(In thousands)

	1998	1997	1996
Memory	\$ 301,565	\$ 348,536	\$ 316,369
Non-memory	93,898	146,905	159,844
Corporate and other	360,836	460,829	317,834
Total consolidated assets	\$ 756,299	\$ 956,270	\$ 794,047

The Memory and Non-Memory segment assets include only those assets that are reported to the chief operating decision maker for purposes of making decisions about allocating resources to the segments and assessing their performance. Assets utilized solely by the Memory or Non-memory segments have been recorded under the appropriate segment asset category. Assets utilized jointly by both segments were allocated to the segments based on depreciation charges taken by the respective segments. Assets that could not be attributed directly to either segment have been reported under the Corporate and other category.

Business Segment Depreciation

The following illustrates depreciation by segment for the respective years.

(In thousands)

	1998	1997	1996
Memory	\$ 86,905	\$ 77,420	\$ 63,121
Non-memory	25,797	33,941	34,485
Total consolidated depreciation	\$ 112,702	\$ 111,361	\$ 97,606

Geographic Area

The following illustrates revenues by geographic locations. Revenues are attributed to countries based on the customer location.

(In thousands)

	1998	1997	1996
United States	\$ 295,621	\$ 348,228	\$ 346,200
Europe	87,869	91,203	92,976
Japan	49,384	50,507	51,444
Other foreign countries	53,967	54,418	37,765
Total consolidated revenues	\$ 486,841	\$ 544,356	\$ 528,385

The following illustrates property, plant and equipment by geographic locations.

(In thousands)

	1998	1997	1996
United States	\$ 275,580	\$ 372,155	\$ 380,309
Philippines	69,996	67,629	54,980
Other foreign countries	2,170	2,877	2,277
Total consolidated property, plant and equipment	\$ 347,746	\$ 442,661	\$ 437,566

No one end user accounted for greater than 10% of revenues in 1998, 1997 or 1996. Sales to one distributor accounted for greater than 10% of total revenues in 1998 and 1997. No one distributor accounted for greater than 10% of revenues in 1996.

Note 11: Subsequent Events

On January 21, 1999, Cypress announced the signing of a definitive agreement to acquire privately held IC Works, Inc. (ICW). The agreement provides for Cypress to issue up to 13.7 million shares in exchange for all outstanding stock and options of ICW. The merger is intended to be accounted for as a pooling of interests. Completion of the merger is subject to ICW shareholder approval and other closing conditions. Revenues for ICW during fiscal years ending March 31, 1998, 1997 and 1996, were \$54.1 million, \$41.6 million and \$40.0 million, respectively. Net income (loss) for ICW during fiscal years ending March 31, 1998, 1997 and 1996, were \$(10.9) million, \$(27.9) million and \$2.5 million, respectively. Revenues and net income for ICW during the nine months ended December 26, 1998 were \$52.8 million and \$7.6 million, respectively.

Report of Independent Accountants

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

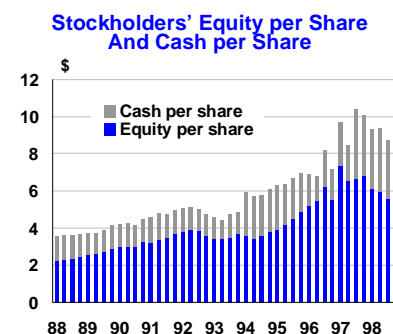
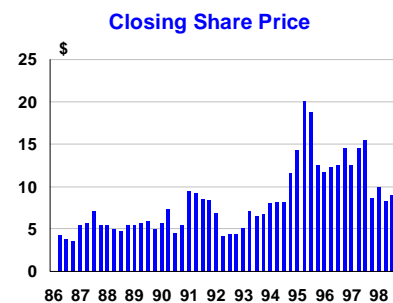
In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, stockholders' equity, and of cash flows present fairly, in all material respects, the financial position of Cypress Semiconductor Corporation and its subsidiaries at January 3, 1999 and December 29, 1997 and the results of its operations and its cash flows for each of the three years in the period ended January 3, 1999, 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.

PricewaterhouseCoopers LLP
San Jose, California
January 25, 1999

About Your Investment

Cypress's common stock is listed on the New York Stock Exchange under the trading symbol "CY". The following table sets forth, for the periods indicated, the low, high and closing price for the common stock. Cypress has not paid cash dividends and has no present plans to do so. At January 3, 1999 there were approximately 2,617 holders of record of Cypress's common stock

	Price Range of Common Stock (\$.)		
	Low	High	Close
Fiscal Year ended January 3, 1999:			
First Quarter	8.06	11.00	10.00
Second Quarter	7.38	10.69	8.25
Third Quarter	5.50	9.31	9.06
Fourth Quarter	8.00	12.00	8.31
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



Summary Annual and Quarterly Financial Data

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

(Unaudited)

Year Ended

	Jan 3 1999	Dec 29 1997	Dec 30 1996	Jan 1 1996	Jan 2 1995	Jan 3 1994	Dec 28 1992	Dec 30 1991
Revenues	\$ 486,841	\$ 544,356	\$ 528,385	\$ 596,071	\$ 406,359	\$ 304,512	\$ 272,242	\$ 286,829
Costs and expenses:								
Cost of revenues	367,352	356,919	305,174	276,160	222,620	179,821	158,159	128,149
Research and development	104,887	93,842	84,334	71,667	53,188	49,798	64,951	71,750
Selling, general and administrative	82,970	75,282	64,301	71,273	52,759	46,344	45,068	42,171
Acquisition-related non-recurring costs	—	—	—	—	—	18,271	—	—
Restructuring and other nonrecurring costs (benefits)	58,940	—	(7,018)	17,800	—	(408)	39,700	—
Total costs and expenses	614,149	526,043	446,791	436,900	328,567	293,826	307,878	242,070
Operating income (loss)	(127,308)	18,313	81,594	159,171	77,792	10,686	(35,636)	44,759
Interest expense	(10,853)	(7,197)	(6,895)	(6,239)	(4,041)	(289)	(440)	(1,000)
Interest income and other	13,305	12,916	8,806	8,452	6,364	2,170	3,148	8,012
Income (loss) before income taxes	(124,856)	24,032	83,505	161,384	80,115	12,567	(32,928)	51,771
(Provision) benefit for income taxes	14,006	(5,613)	(30,476)	(58,907)	(29,643)	(4,524)	11,918	(17,600)
Net income (loss)	\$(110,850)	\$ 18,419	\$ 53,029	\$ 102,477	\$ 50,472	\$ 8,043	\$ (21,010)	\$ 34,171
Net income (loss) per share:								
Basic	\$ (1.24)	\$ 0.21	\$ 0.66	\$ 1.25	\$ 0.67	\$ 0.11	\$ (0.28)	\$ 0.46
Diluted	\$ (1.24)	\$ 0.21	\$ 0.62	\$ 1.09	\$ 0.60	\$ 0.11	\$ (0.28)	\$ 0.42
Weighted average common and common equivalent shares outstanding:								
Basic	89,338	87,888	80,241	81,748	75,618	71,785	74,481	74,428
Diluted	89,338	94,648	91,604	97,309	88,311	76,241	74,481	80,838
Depreciation/amortization expense	112,702	111,361	97,606	64,733	45,039	41,245	47,634	41,538
Cash, cash equivalents and short-term investments	152,231	201,561	93,786	161,618	193,275	80,590	82,046	103,703
Stockholders' equity	489,101	643,476	510,746	472,099	352,999	271,685	262,061	298,612
Number of employees	2,901	2,770	2,171	1,859	1,423	1,262	1,529	1,945
Percent of revenue								
Cost of revenue	75%	66%	58%	46%	55%	59%	58%	44%
Research & development	22%	17%	16%	12%	13%	16%	24%	25%
Selling, general & administrative	17%	14%	12%	12%	13%	15%	17%	15%
Total costs and expenses	126%	97%	85%	73%	81%	96%	113%	84%
Operating income (loss)	(26%)	3%	15%	27%	19%	4%	(13%)	16%

Three Months Ended

	Jan 3 1999	Sept 28 1998	June 29 1998	March 30 1998	Dec 29 1997	Sep 29 1997	June 30 1997	Mar 31 1997
	\$ 124,165	\$ 126,048	\$ 119,675	\$ 116,953	\$ 134,134	\$ 146,081	\$ 138,142	\$ 125,999
	83,172	86,406	83,393	114,382	94,538	93,345	86,687	82,349
	28,168	25,968	26,263	24,488	23,833	24,560	24,426	21,023
	20,742	20,152	19,880	22,196	19,606	18,977	19,135	17,564
	—	—	—	—	—	—	—	—
	—	(59)	1,900	57,099	—	—	—	—
	132,082	132,467	131,436	218,165	137,977	136,882	130,248	120,936
	(7,917)	(6,419)	(11,761)	(101,212)	(3,843)	9,199	7,894	5,063
	(2,646)	(2,688)	(2,677)	(2,842)	(3,154)	(948)	(779)	(2,316)
	5,005	4,924	3,275	102	3,095	2,756	2,238	4,826
	(5,558)	(4,183)	(11,163)	(103,952)	(3,902)	11,007	9,353	7,573
	—	2,955	1,072	9,979	4,010	(3,797)	(3,213)	(2,613)
	\$ (5,558)	\$ (1,228)	\$ (10,091)	\$ (93,973)	\$ 108	\$ 7,210	\$ 6,140	\$ 4,960
	\$ (0.07)	\$ (0.01)	\$ (0.11)	\$ (1.03)	\$ 0.00	\$ 0.08	\$ 0.07	\$ 0.06
	\$ (0.07)	\$ (0.01)	\$ (0.11)	\$ (1.03)	\$ 0.00	\$ 0.08	\$ 0.07	\$ 0.06
	85,089	90,161	91,036	91,068	90,890	90,054	88,768	81,838
	85,089	90,161	91,036	91,068	93,923	96,084	94,096	94,489
	28,032	26,365	29,125	29,180	28,804	28,056	26,862	27,639
	152,231	186,583	185,664	198,141	201,561	302,397	123,133	131,225
	489,101	503,485	543,489	555,031	643,476	637,245	615,443	602,866
	2,901	2,650	2,707	2,797	2,770	2,672	2,537	2,299
	67%	69%	70%	98%	70%	64%	63%	65%
	23%	21%	22%	21%	18%	17%	18%	17%
	17%	16%	17%	19%	15%	13%	14%	14%
	106%	105%	110%	187%	103%	94%	94%	96%
	(6%)	(5%)	(10%)	(87%)	(3%)	6%	6%	4%

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 GSM (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**.

RAM5™

An advanced, Cypress-proprietary fabrication technology with 0.25-micron feature geometry and a six- or 8-transistor memory cell having very low power demand, very high data integrity, and a reduced die size.

Root hub (USB root hub)

See **hub (USB)**.

Routers

Equipment in a packet-switching network that determines 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)

USB was conceived by the PC industry as the new standard 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,” instead permitting 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 now finding new applications outside the PC industry in many market sectors, such as industrial control. Cypress’s CY7C63000/64000/65000/66000 families of low- and high-speed USB microcontrollers are an excellent fit for all these market areas.

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

Eric Benhamou^(1,2) Chairman of the Board of Directors, Chairman and CEO, 3Com Corporation
 T. J. Rodgers⁽⁴⁾ President and Chief Executive Officer
 Fred B. Bialek Consultant
 John C. Lewis^(1,2,3) Chairman of the Board, Amdahl Corporation
 Alan F. Shugart⁽³⁾ Chairman, President and CEO, Al Shugart International

EXECUTIVE OFFICERS

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 Antonio Alvarez, Vice President, Memory Products Division
 Emmanuel Hernandez, Vice President, Finance and Administration and Chief Financial Officer
 J. Daniel McCranie, Vice President, Marketing and Sales

VICE PRESIDENTS AND SUBSIDIARY PRESIDENTS

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 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

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REGISTRAR AND TRANSFER AGENT

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

ANNUAL MEETING

The annual meeting of stockholders for Cypress Semiconductor Corporation will be held on Thursday, May 6, 1999 10:00 a.m., local time, at Cypress's offices at 3939 North First Street, San Jose, California 95134-1599.

COMMON STOCK

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

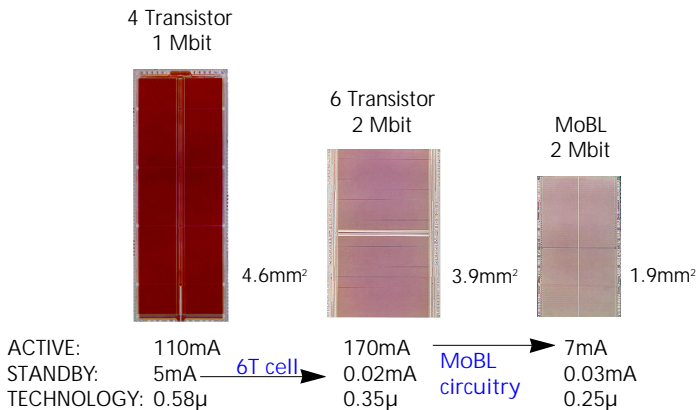
FORM 10K

A copy of Cypress'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 Cypress. Direct requests to the Attention of the Chief Financial Officer at the corporate office listed above.

(1) Member of the Audit Committee
 (2) Member of the Compensation Committee
 (3) Member of the Nominating Committee
 (4) Founder

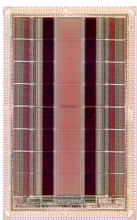
New Products, New Markets

MoBL™ SRAM = MORE BATTERY LIFE™:



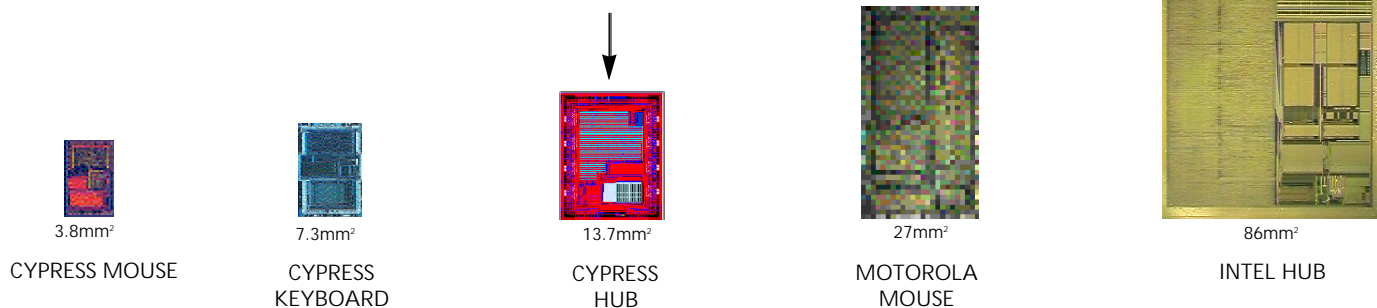
Relative to industry-standard SRAMs made with 4T cells, Cypress has taken two steps forward. In 1996, we introduced a novel 6T cell, which cut down standby current by a factor of 100. In 1998, we added special MoBL™ circuitry to cut down active current by a factor of 20, dramatically increasing mobile phone talk time.

Ultra37000™ CPLDs:



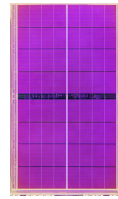
Cypress's Ultra37000™ CPLDs offer unparalleled speed, simplicity, and ease-of-use at densities up to 512 macrocells – four times larger than the biggest of our previous CPLDs. They also offer the unique Cypress advantage of maintaining pin assignments and propagation delays, even through major design changes, so engineers don't have to change their board layouts.

UNIVERSAL SERIAL BUS



Cypress's 1998 addition to its USB family is its hub chip, which allows four peripherals to be plugged into one USB port. Because of our proprietary RISC microcontroller, we have the smallest USB chips in the industry.

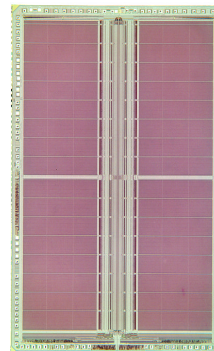
NoBL™ DATA COMMUNICATION SRAM:



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.

1-MEGABIT DUAL-PORT RAM:

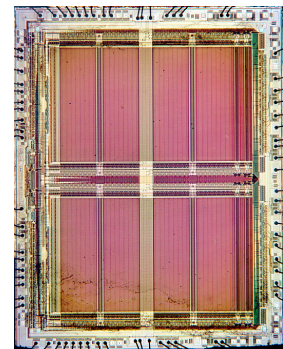
CYPRESS
1 Mbit



PARITY

5.7mm²

LEADING COMPETITOR
1/2 Mbit



NO PARITY

7.1mm²

Cypress's patented dual-port RAM cell is smaller than that of our competitors, allowing us to pack a larger dual-port RAM on a smaller chip. In addition, we provide at no premium a parity bit, a ninth bit for every eight bits of data, to provide more-error-free data storage by detecting data-transmission errors.

Warp2® SOFTWARE, RELEASE 5.0:



Cypress is a pioneer in the programmable logic software field, having offered the first VHDL software and the first low-cost, high-quality tools. In 1998, we added Verilog synthesis to our Warp software. Now users can choose to describe their designs with either of the two leading Hardware Description Languages (HDLs).

The STUFF Inside the Good STUFF™

Cypress components are included in many of the world's leading electronic systems, including communications equipment, personal computers, consumer electronics, and game machines. Our broad product offering includes a wide range of static and specialty memories, timing and clock chips, programmable logic, high-speed data communications devices, and USB microcontrollers. By providing a diversified product portfolio, Cypress has engaged the top manufacturers in all of our target markets. This opens the doors to increased acceptance of our many new product introductions.



The revolutionary RCA DCM105 Digital Cable Modem provides personal computers with two-way, high-speed Internet access. It includes Cypress USB microcontrollers and SRAMs.

Motorola's iDEN® (Integrated Digital Enhanced Network) digital handsets offer an expanded feature set with customizable options in the smallest, lightest, integrated digital handset available. They use Cypress MoBL™ SRAMs.



Cypress USB microcontrollers are part of Altec Lansing's ADA104 TV set-top home theatre speaker system, which features Dolby® Pro-Logic surround sound.

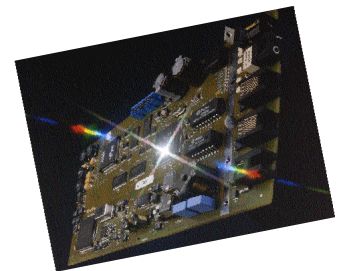
Sony's Playstation® is enjoyed by millions of game enthusiasts around the world. It incorporates Cypress programmable clock chips.



Lucent Technologies' PacketStar™ 6404 IP Switch is designed for network service providers and Internet Service Providers, offering a four million packet-per-second forwarding rate. It uses Cypress FIFOs, clock chips, and RoboClock® products.



Alcatel produces one of the world's leading lines of ADSL modems. It includes Cypress clock chips, RoboClock® devices, FIFOs, and SRAMs.



Nokia's Professional Mobile Radio (PMR), which features high-speed, low-power Cypress SRAMs, offers speech and data links for professional users.



Cypress clock chips are employed in Compaq's high-performance Presario™ 5630 desktop personal computer.

