

THE FOLLOWING FIRST QUARTER REPORT 1996, the sections entitled "To Our Shareholders" and "Market Perspective" may contain forward-looking statements about the prospects for Cypress as well as the semiconductor industry more generally including without limitation statements about, revenue goals, profit goals, growth rate goals, market share goals, market size and growth projections, market product acceptance goals, and the Digital Signal Processing market. 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 following: (i) increased competition which could result in loss sales or price erosion; (ii) changes in product demand or acceptance by the electronics and semiconductor industries in general, which are noted for rapidly changing needs, coupled with the ability of Cypress to generate product enhancements or new product introductions which will keep pace with those rapidly changing needs; (iii) failure by Cypress to develop or introduce successfully new products in areas of expected new or increased demand, or development and introduction of superior new products serving those areas by others; (iv) failure of expected growth in demand for, or areas of expected new demand for semiconductor products to materialize; (v) failure to successfully manufacture and/or bring on line and utilize additional manufacturing capacity; (vi) inability to develop, adopt and utilize more advanced manufacturing technology; (vii) inability of the Cypress's patents or other proprietary rights to ensure adequate protection against encroachment on Cypress's technology by competitors.

FIRST QUARTER 1996

RECORD EPS DESPITE SLOWDOWN

T O OUR SHAREHOLDERS:

Cypress's revenue for the first quarter of 1996 was \$170.2 million, up 38% from the \$123.4 million we reported in the first quarter of 1995, but down 4% from last quarter's revenue of \$177.3 million. Normally, that performance would be disappointing to us: it broke a three-year string of quarterly revenue growth. That lack of growth triggered the shutdown of our profit-sharing program, adding 1.5 cents to our bottom line, but disappointing management and employees.

With some time to reflect upon the quarter, the slowdown in the semiconductor industry, and the performance of our competitors, our results for the first quarter of 1996 seem better. First, we did set a record for earnings per share, 39 cents, up from 38 cents reported last quarter and up 63% from the EPS of 24 cents reported a year ago. In addition, our revenue performance moved us from the No. 13 to the No. 11 slot on the revenue list of America's 200 semiconductor manufacturers. Our Mission Statement calls for us to be in the No. 10 position by 1997.

Our gross margins improved from 54.6% last quarter to 54.8%, despite reduced selling prices for static RAMs. Our margins and earnings improved as a result of: 1) our aggressive manufacturing cost reduction programs, 2) a reduction in overhead costs, 3) the elimination of profit sharing, and 4) the reduction of share count due to our \$70 million buyback program.

In the first quarter we finally shipped most of the huge backlog we carried for all of 1995. We entered the current quarter with a total backlog of \$170 million, and 77% of the quarter booked. Bookings for the industry and for us continued to be slow as of the writing of this report (May 17, 1996). The industry book-to-bill ratio for April was 0.78, about the same as it was in March. We cannot predict whether or not April represents the bottom of the current trough, but there have been signs in the spot marketplace in both Taiwan and the United States that memory supplies are tightening somewhat. Although it may be disconcerting to investors to talk about a tight semiconductor market, we have entered this period with 32% pretax profit margins, an excellent level of profitability that will buffer us against the uncertainties of the next quarter or two—quarters in which we expect to gain some ground on our competitors.

Sincerely,

T. J. Rodgers
President and CEO

MARKET PERSPECTIVE

THE GROWTH OF DIGITAL SIGNAL PROCESSING AND ITS IMPACT ON CYPRESS

The recent availability of low cost Digital Signal Processor (DSP) semiconductors from several manufacturers has caused a significant shift in the design methodology used by engineers developing high speed modems, disk drives, cellular handsets, telecommunication switches, and several other end products. This shift has resulted in new opportunities for Cypress Semiconductor in two major product areas, static memories (SRAMs) and programmable memories (UVEPROMs).

In order to understand the impact of Digital Signal Processors on new designs, we need to first describe the ‘world’ in which the electronic engineering designer works.

The ‘Real World’ is an Analog World

Electronic design engineers spend much of their time building products that create, modify, and interpret electronic signals. In the past several decades, our industry has focused on creating products that work primarily with signals that have only two levels, high and low. These levels become the basic “1” and “0” states associated with semiconductor microprocessors and memories. These signals are special cases of an electronic engineer’s work, and the special case is known as Digital Electronics. With few exceptions, the bulk of the ‘innards’ of any system in the world today is Digital. This includes personal computers, cellular phones, set top boxes, calculators, watches, etc.

With the preoccupation of our industry for ‘Digital’ products, it might surprise the average investor to learn that much of certain design teams’ energies are spent analyzing signals in which the information is not binary (or ‘digital’), but rather an entire spectrum of time and amplitude dependent points. These signals are found everywhere in nature and are essential for information transfer to humans. These signals are lumped into the broad classification named ‘Analog’ signals.

Analog signals appear on sensors that capture sights and sounds of our world and they must be generated in order for humans to understand the information. Analog designs, therefore, must be developed within almost every electronic product manufactured, but especially:

- Audio Systems
- Television
- Modems
- Hard Disk Drives
- Set Top Boxes
- Automobile Electronics
- Telecommunication Systems
- Data Communication Systems
- Printers/Scanners/Plotters

The Problems of Analog Design

Designing for analog signals has always been a study in trade-offs. Analog systems tend to require ‘tuning’ and they are more affected by environmental conditions than digital signals.

In addition, analog signals cannot be manipulated as quickly or as comprehensively as digital signals, and signal manipulation is a key part of a designer's tasks.

The Rise of Digital Signal Processing

An obvious solution would be to convert analog signals to a stream of digital signals, manipulate the digital signals, and then re-convert the digital stream back to an analog output. The system needed for this task is known as Digital Signal Processing. DSP has been used for decades in military applications, but the overall cost was too prohibitive to be used in everyday applications. Beginning in the early 1990's, a new generation of low cost, single chip DSPs came on the market. These products allowed designers to use DSP techniques in high volume applications for the first time.

Cypress's Role in DSP Systems – Very High Speed Memories

DSP chips cannot work alone. As seen from Figure 1, a typical DSP system requires additional components. Three of these components are Cypress components—high-speed SRAM, high-speed PROM, and a multiple clock chip. Cypress product is particularly suited to DSP applications because of the high speed demands on the SRAM, PROM and clock. Remember that a DSP system starts by converting an analog signal to a digital bit stream. This digital bit stream must 'run' at a rate that is up to 1000 times faster than the analog signal. For that reason, only very high speed memories can be used in DSP systems.

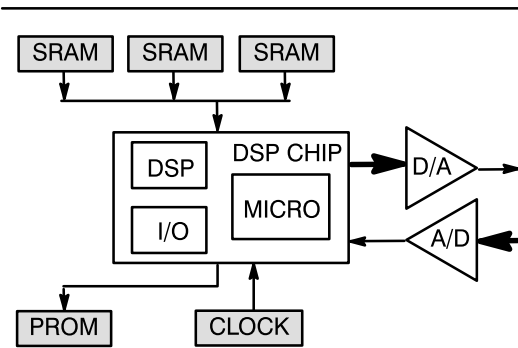


Figure 1. Block Diagram of a DSP Based System

Market Dynamics on DSP Systems

At the present time, DSP based designs have appeared, in volume, in the following applications:

- Hard Disk Drives
- High Speed PC Modems
- Cellular Handsets
- Video Compression/De-Compression
- Audio Entertainment Systems

Cypress is presently engaged with over 20 companies in production of DSP based designs. The market forecast for DSP semiconductors, and for the associated memory components is shown in Figure 2.

Conclusion

DSP-based architecture is now becoming a standard design methodology for many mixed (analog and digital) signal products. DSP semiconductors require additional memory and clock components. Cypress products, because of high speed, high density and low power capability, are well positioned to participate in the growth of this important new market.

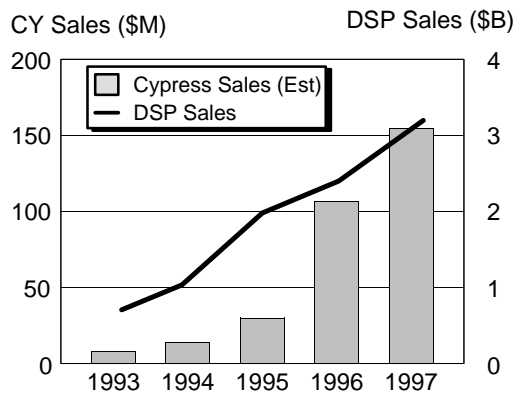


Figure 2. Cypress Memory Sales in Relation to DSP Sales

CONSOLIDATED BALANCE SHEETS

	(Unaudited) Apr 1, 1996	Jan1, 1996
(Dollars in thousands)		
ASSETS		
Current assets:		
Cash and short-term investments	\$ 111,073	\$ 161,618
Accounts receivable	101,536	108,587
Other receivables	11,097	8,335
Inventories	36,858	28,978
Other current assets	47,297	44,119
Total current assets	307,861	351,637
Property and equipment, net	387,456	336,593
Other assets	68,375	62,498
Total assets	\$ 763,692	\$ 750,728
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 86,016	\$ 82,315
Accrued liabilities	40,735	46,800
Deferred income on sales to distributors	14,263	13,190
Income taxes payable	26,828	18,752
Total current liabilities	167,842	161,057
Convertible subordinated note	96,452	95,879
Other long-term debt	5,881	6,040
Deferred income taxes	15,653	15,653
Total liabilities	285,828	278,629
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$.01 par value, 5,000,000 shares authorized; none issued and outstanding	--	--
Common stock, \$.01 par value, 250,000,000 shares authorized; 89,779,000 and 88,924,000 issued; 79,519,000 and 81,501,000 outstanding	181,125	209,637
Retained earnings	296,739	262,462
Total stockholders' equity	477,864	472,099
Total liabilities and stockholders' equity	\$ 763,692	\$ 750,728

CONSOLIDATED STATEMENTS OF OPERATIONS

	<u>THREE MONTHS ENDED</u>		
	(Unaudited)		
(Dollars in thousands, except per share data)	Apr 1, 1996	Apr 3, 1995	Jan 1, 1996
Revenues	\$ 170,171	\$ 123,365	\$ 177,279
Cost and expenses:			
Cost of revenues	76,861	60,834	80,567
Research and development	21,416	15,671	21,300
Selling, general and administrative	18,140	15,291	20,568
Other non-recurring costs	--	17,800	--
Total operating costs and expenses	116,417	109,596	122,435
Operating income	53,754	13,769	54,844
Interest expense	(1,647)	(1,733)	(1,530)
Interest income & other	1,873	2,303	2,677
Income before income taxes	53,980	14,339	55,991
Provision for income taxes	(19,703)	(5,234)	(20,441)
Net income	\$ 34,277	\$ 9,105	\$ 35,550
Net income per share:			
Primary	\$ 0.41	\$ 0.11	\$ 0.40
Fully diluted	0.39	0.11	0.38
Weighted average shares of common stock and common stock equivalents:			
Primary	83,418	87,223	88,926
Fully diluted	91,358	95,607	96,860

Cypress does not disclose its internal casts. To get a forecast from the analyst follow the semiconductor industry, you contact the following:

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