

CYPRESS SEMICONDUCTOR CORP /DE/

Form 10-Q

May 13, 2010

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended April 4, 2010

OR

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 1-10079

**CYPRESS SEMICONDUCTOR CORPORATION**

(Exact name of registrant as specified in its charter)

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|                                                                                      |                                                              |
|--------------------------------------------------------------------------------------|--------------------------------------------------------------|
| <b>Delaware</b><br>(State or other jurisdiction of<br>incorporation or organization) | <b>94-2885898</b><br>(I.R.S. Employer<br>Identification No.) |
| <b>198 Champion Court, San Jose, California 95134</b>                                |                                                              |
| (Address of principal executive offices and zip code)                                |                                                              |
| <b>(408) 943-2600</b>                                                                |                                                              |
| (Registrant's telephone number, including area code)                                 |                                                              |

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

|                         |                                                                        |                           |                          |
|-------------------------|------------------------------------------------------------------------|---------------------------|--------------------------|
| Large accelerated filer | <input checked="" type="checkbox"/>                                    | Accelerated filer         | <input type="checkbox"/> |
| Non-accelerated filer   | <input type="checkbox"/> (Do not check if a smaller reporting company) | Smaller reporting company | <input type="checkbox"/> |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

The total number of outstanding shares of the registrant's common stock as of April 30, 2010 was 163,946,282.

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**PART I FINANCIAL INFORMATION**

**Forward-Looking Statements**

The discussion in this Quarterly Report on Form 10-Q contains statements that are not historical in nature, but are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, that involve risks and uncertainties, including, but not limited to, statements related to our programmability strategy; the markets we intend to pursue; our increased reliance on third party manufacturing; the number and impact of future personnel terminations and the expenses related thereto; our expectations, including the timing, related to our restructuring activities which includes the closure of our Texas manufacturing facility; our expectations regarding our active litigation matters and our intent to defend ourselves in those matters; our foreign currency exposure, the assumptions and calculations of our unrecognized tax benefits, including events that could occur that could cause a material change to such tax benefits, our expected tax rate on foreign earnings, our expectations regarding our pending tax audits, the adequacy of our cash and working capital positions; our expected return on our yield-enhancement program and the risks related to such an investment, our intended use of our line of credit; the value and liquidity of our investments, including auction rate securities and our other debt investments, our expectations regarding our outstanding warranty liability, our plans to repurchase stock under our existing program, our plans to propose a new stock repurchase program in the future, the volatility of our stock price, the impact of the credit crisis on consumers and the likelihood that we will need to settle the outstanding Grace lease payments. We use words such as plan, anticipate, believe, expect, future, intend and similar expressions to identify forward-looking statements. Such forward-looking statements are made as of the date hereof and are based on our current expectations, beliefs and intentions regarding future events or our financial performance and the information available to management as of the date hereof. Except as required by law, we assume no responsibility to update any such forward-looking statements. Our actual results could differ materially from those expected, discussed or projected in the forward-looking statements contained in this Quarterly Report on Form 10-Q for any number of reasons, including, but not limited to, the state and future of the general economy and its impact on the markets we serve and our investments; the current credit conditions; our ability to expand our customer base, our ability to transform our business with a leading portfolio of programmable products; the number and nature of our competitors; the changing environment and/or cycles of the semiconductor industry; our ability to efficiently manage our manufacturing facilities and achieve our cost goals emanating from our flexible manufacturing strategy; our ability to achieve our goals related to our restructuring activities; our ability to maintain the tax-free nature of the SunPower spin-off; our success in our pending litigation matters, our ability to manage our investments and interest rate and exchange rate exposure; our ability to achieve liquidity in our investments and/or the materialization of one or more of the risks set forth above or in Item 1A (*Risk Factors*) in this Quarterly Report on Form 10-Q.

**Table of Contents****ITEM 1. FINANCIAL STATEMENTS****CYPRESS SEMICONDUCTOR CORPORATION****CONDENSED CONSOLIDATED BALANCE SHEETS****(Unaudited)**

|                                                                                                                                                                                                    | April 4,<br>2010<br>(In thousands, except | January 3,<br>2010<br>(In thousands, except |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------|---------------------------------------------|
|                                                                                                                                                                                                    | per-share amounts)                        |                                             |
| ASSETS                                                                                                                                                                                             |                                           |                                             |
| Current assets:                                                                                                                                                                                    |                                           |                                             |
| Cash and cash equivalents                                                                                                                                                                          | \$ 217,041                                | \$ 243,558                                  |
| Short-term investments                                                                                                                                                                             | 79,786                                    | 56,084                                      |
| Accounts receivable, net                                                                                                                                                                           | 109,614                                   | 86,959                                      |
| Inventories, net                                                                                                                                                                                   | 84,342                                    | 91,198                                      |
| Other current assets                                                                                                                                                                               | 40,216                                    | 40,906                                      |
| Total current assets                                                                                                                                                                               | 530,999                                   | 518,705                                     |
| Property, plant and equipment, net                                                                                                                                                                 | 273,691                                   | 272,620                                     |
| Goodwill                                                                                                                                                                                           | 31,836                                    | 31,836                                      |
| Intangible assets, net                                                                                                                                                                             | 15,606                                    | 15,132                                      |
| Other long-term assets                                                                                                                                                                             | 76,907                                    | 74,215                                      |
| Total assets                                                                                                                                                                                       | \$ 929,039                                | \$ 912,508                                  |
| LIABILITIES AND EQUITY                                                                                                                                                                             |                                           |                                             |
| Current liabilities:                                                                                                                                                                               |                                           |                                             |
| Accounts payable                                                                                                                                                                                   | \$ 54,128                                 | \$ 61,712                                   |
| Accrued compensation and employee benefits                                                                                                                                                         | 40,221                                    | 37,756                                      |
| Deferred revenues less cost of revenues                                                                                                                                                            | 86,053                                    | 75,881                                      |
| Income taxes payable                                                                                                                                                                               | 7,637                                     | 7,090                                       |
| Other current liabilities                                                                                                                                                                          | 54,114                                    | 56,623                                      |
| Total current liabilities                                                                                                                                                                          | 242,153                                   | 239,062                                     |
| Deferred income taxes and other tax liabilities                                                                                                                                                    | 40,340                                    | 39,272                                      |
| Other long-term liabilities                                                                                                                                                                        | 3,782                                     | 3,790                                       |
| Total liabilities                                                                                                                                                                                  | 286,275                                   | 282,124                                     |
| Commitments and contingencies (Note 10)                                                                                                                                                            |                                           |                                             |
| Equity:                                                                                                                                                                                            |                                           |                                             |
| Preferred stock, \$.01 par value, 5,000 shares authorized; none issued and outstanding                                                                                                             |                                           |                                             |
| Common stock, \$.01 par value, 650,000 and 650,000 shares authorized; 241,520 and 235,409 shares issued; 161,764 and 159,382 shares outstanding at April 4, 2010 and January 3, 2010, respectively | 2,415                                     | 2,354                                       |
| Additional paid-in-capital                                                                                                                                                                         | 2,290,833                                 | 2,247,716                                   |
| Accumulated other comprehensive loss                                                                                                                                                               | (1,155)                                   | (723)                                       |
| Accumulated deficit                                                                                                                                                                                | (557,070)                                 | (569,744)                                   |
|                                                                                                                                                                                                    | 1,735,023                                 | 1,679,603                                   |
| Less: shares of common stock held in treasury, at cost; 79,755 and 76,027 shares at April 4, 2010 and January 3, 2010, respectively                                                                | (1,090,893)                               | (1,048,016)                                 |

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|                                    |            |            |
|------------------------------------|------------|------------|
| Total Cypress stockholders' equity | 644,130    | 631,587    |
| Noncontrolling interest            | (1,366)    | (1,203)    |
| Total equity                       | 642,764    | 630,384    |
| Total liabilities and equity       | \$ 929,039 | \$ 912,508 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

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**CYPRESS SEMICONDUCTOR CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(Unaudited)**

|                                                         | <b>Three Months Ended</b>                       |                  |
|---------------------------------------------------------|-------------------------------------------------|------------------|
|                                                         | <b>April 4,</b>                                 | <b>March 29,</b> |
|                                                         | <b>2010</b>                                     | <b>2009</b>      |
|                                                         | <b>(In thousands, except per-share amounts)</b> |                  |
| Revenues                                                | \$ 202,271                                      | \$ 139,309       |
| Costs and expenses:                                     |                                                 |                  |
| Cost of revenues                                        | 95,784                                          | 105,294          |
| Research and development                                | 40,049                                          | 50,146           |
| Selling, general and administrative                     | 51,281                                          | 60,715           |
| Amortization of acquisition-related intangibles         | 776                                             | 1,319            |
| Restructuring costs                                     | 327                                             | 6,046            |
| Total costs and expenses, net                           | 188,217                                         | 223,520          |
| Operating income (loss)                                 | 14,054                                          | (84,211)         |
| Interest and other income (expense), net                | 730                                             | (1,499)          |
| Income (loss) before income taxes                       | 14,784                                          | (85,710)         |
| Income tax provision                                    | (2,110)                                         | (2,625)          |
| Income (loss), net of taxes                             | 12,674                                          | (88,335)         |
| Noncontrolling interest, net of taxes                   | (163)                                           | (207)            |
| Net income (loss)                                       | 12,511                                          | (88,542)         |
| Less: net loss attributable to noncontrolling interest  | 163                                             | 207              |
| Net income (loss) attributable to Cypress               | \$ 12,674                                       | \$ (88,335)      |
| Net income (loss) per share attributable to Cypress:    |                                                 |                  |
| Basic                                                   | \$ 0.08                                         | \$ (0.66)        |
| Diluted                                                 | \$ 0.07                                         | \$ (0.66)        |
| Shares used in net income (loss) per share calculation: |                                                 |                  |
| Basic                                                   | 158,931                                         | 134,757          |
| Diluted                                                 | 190,892                                         | 134,757          |

The accompanying notes are an integral part of these condensed consolidated financial statements.

**Table of Contents****CYPRESS SEMICONDUCTOR CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

|                                                                                                    | <b>Three Months Ended</b> |                  |
|----------------------------------------------------------------------------------------------------|---------------------------|------------------|
|                                                                                                    | <b>April 4,</b>           | <b>March 29,</b> |
|                                                                                                    | <b>2010</b>               | <b>2009</b>      |
|                                                                                                    | <b>(In thousands)</b>     |                  |
| Cash flows from operating activities:                                                              |                           |                  |
| Net income (loss)                                                                                  | \$ 12,511                 | \$ (88,542)      |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: |                           |                  |
| Depreciation and amortization                                                                      | 12,673                    | 15,151           |
| Stock-based compensation expense                                                                   | 21,574                    | 48,244           |
| Interest and other non-cash expense related to convertible debt                                    |                           | 398              |
| Impairment of investments                                                                          |                           | 1,730            |
| Restructuring charges                                                                              | 327                       | 6,046            |
| Loss on sale or retirement of property and equipment, net                                          | 4                         | 329              |
| Deferred income taxes                                                                              | 1,070                     | 2,174            |
| Changes in operating assets and liabilities, net of effects of acquisitions and divestitures:      |                           |                  |
| Accounts receivable                                                                                | (22,655)                  | 19,840           |
| Inventories                                                                                        | 6,264                     | 18,957           |
| Other assets                                                                                       | (31)                      | 3,739            |
| Accounts payable and other accrued liabilities                                                     | (3,786)                   | (25,530)         |
| Deferred revenues less cost of revenues                                                            | 10,172                    | (18,340)         |
| Net cash provided by (used in) operating activities                                                | 38,123                    | (15,804)         |
| Cash flows from investing activities:                                                              |                           |                  |
| Purchases of available-for-sale investments                                                        | (25,910)                  | (84)             |
| Proceeds from sales or maturities of available-for-sale investments                                | 2,411                     | 17,770           |
| Net contributions (distributions) of deferred compensation plan                                    | (386)                     | 573              |
| Acquisition of property and equipment                                                              | (17,872)                  | (6,548)          |
| Proceeds from sales of property and equipment                                                      |                           | 3,510            |
| Cash paid for other investments                                                                    | (2,000)                   |                  |
| Net cash provided by (used in) investing activities                                                | (43,757)                  | 15,221           |
| Cash flows from financing activities:                                                              |                           |                  |
| Repurchase of common shares                                                                        |                           | (6,506)          |
| Withholding of common shares for tax obligations on vested restricted shares                       | (8,713)                   | (5,232)          |
| Proceeds from issuance of common shares under employee stock plans                                 | 19,786                    | 17,963           |
| Yield enhancement structured agreements settled in cash, net                                       | 2,208                     |                  |
| Yield enhancement structured agreements settled in stock                                           | (34,164)                  |                  |
| Net cash provided by (used in) financing activities                                                | (20,883)                  | 6,225            |
| Net increase (decrease) in cash and cash equivalents                                               | (26,517)                  | 5,642            |
| Cash and cash equivalents, beginning of period                                                     | 243,558                   | 204,749          |
| Cash and cash equivalents, end of period                                                           | \$ 217,041                | \$ 210,391       |

The accompanying notes are an integral part of these condensed consolidated financial statements.



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**CYPRESS SEMICONDUCTOR CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Fiscal Years**

Cypress Semiconductor Corporation (Cypress or the Company) reports on a fiscal-year basis and we end our quarters on the Sunday closest to the end of the applicable calendar quarter, except in a 53-week fiscal year, in which case the additional week falls into the fourth quarter of that fiscal year. Fiscal 2010 has 52 weeks and fiscal 2009 had 53 weeks. The first quarter of fiscal 2010 ended on April 4, 2010 and the first quarter of fiscal 2009 ended on March 29, 2009.

**Basis of Presentation**

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments necessary to state fairly the financial information included therein. The financial data should be read in conjunction with the audited consolidated financial statements and related notes thereto included in our Annual Report on Form 10-K for the fiscal year ended January 3, 2010.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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.

The condensed consolidated results of operations for the three months ended April 4, 2010 are not necessarily indicative of the results to be expected for the full fiscal year.

**Recently Adopted and Recently Issued Accounting Standards**

In January 2010, the FASB issued updated guidance related to fair value measurements and disclosures, which requires a reporting entity to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and to describe the reasons for the transfers. In addition, in the reconciliation for fair value measurements using significant unobservable inputs, or Level 3, a reporting entity should disclose separately information about purchases, sales, issuances and settlements (that is, on a gross basis rather than one net number). The updated guidance also requires that an entity should provide fair value measurement disclosures for each class of assets and liabilities and disclosures about the valuation techniques and inputs used to measure fair value for both recurring and non-recurring fair value measurements for Level 2 and Level 3 fair value measurements. The updated guidance is effective for interim or annual financial reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances and settlements in the roll forward activity in Level 3 fair value measurements, which are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. Except for the presentation and disclosure requirements required by this guidance, there was no impact on our condensed consolidated financial statements.

**NOTE 2. IMPACT OF ADOPTION OF ACCOUNTING GUIDANCE ON CONVERTIBLE DEBT**

Effective January 1, 2009, we adopted new accounting guidance, which applies to certain convertible debt instruments that have a net settlement feature, which means instruments that by their terms may be settled either wholly or partially in cash upon conversion. Under the guidance, the liability and equity components of convertible debt instruments that may be settled wholly or partially in cash upon conversion must be accounted for separately in a manner reflective of our nonconvertible debt borrowing rate. Since our 1.00% Notes and our 1.25% convertible subordinated notes (1.25% Notes were issued in 2003 which we redeemed in February 2007), had an equity component that could be settled in cash or equity, both debt instruments qualified for this treatment.

Our effective borrowing rate for nonconvertible debt at the time of issuance of the 1.00% Notes was estimated to be 6.15% and for our 1.25% Notes it was estimated to be 6.20%. For the 1.00% Notes, this resulted in \$70.6 million of the \$600 million aggregate principal amount of debentures issued being attributable to equity. For the 1.25% Notes this resulted in \$126.0 million of the \$600 million aggregate principal amount of debentures issued being attributable to equity.



**Table of Contents****CYPRESS SEMICONDUCTOR CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

The cumulative effect as of December 29, 2008 (the first day of fiscal 2009) of the change in accounting principle was a decrease to convertible debt of approximately \$1.0 million for the discount on the 1.00% Notes, a decrease to additional paid-in capital of approximately \$43.4 million, a decrease to accumulated deficit of approximately \$44.5 million and an increase to debt issuance cost of approximately \$0.1 million. As a result of the change in the accounting principle, the cumulative effect of the higher interest cost from both our 1.00% and 1.25% Notes is being offset by the losses on our extinguishment of debt which are now being recorded to equity. Our adoption resulted in higher interest and other expense of \$0.4 million for the first quarter of fiscal 2009. As of September 27, 2009, all of the debt had matured or been redeemed and the debt discount was fully amortized. The tax effect of our adoption was immaterial to our condensed consolidated financial statements.

**NOTE 3. SUNPOWER****Spin-Off of SunPower**

We received a favorable ruling from the Internal Revenue Service ( IRS ) in April 2008 with respect to certain tax issues arising under Section 355 of the Internal Revenue Code in connection with the Spin-Off. The distribution was structured to be tax-free to Cypress and our stockholders for U.S. federal income tax purposes, except in respect to cash received in lieu of fractional shares.

In the third quarter of 2008, a committee of our Board of Directors (the Board ) approved the distribution of the SunPower Class B common stock held by us to our stockholders. On September 29, 2008 we completed the distribution of 42.0 million shares of SunPower Class B common stock to our stockholders (the Spin-Off ).

See Note 9 for a discussion of the adjustments approved by our Board to our stock plans as a result of the Spin-Off and Note 14 for a discussion of the amended tax sharing agreement between SunPower and us as a result of the Spin-Off.

**NOTE 4. GOODWILL AND INTANGIBLE ASSETS****Goodwill**

The carrying amount of goodwill at April 4, 2010 was \$31.8 million in the Consumer and Computation Division ( CCD ) and was unchanged from the balance at January 3, 2010. CCD is the only reportable business segment with goodwill.

**Intangible Assets**

The following tables present details of our intangible assets:

| <b>As of April 4, 2010</b>                               | <b>Gross</b> | <b>Accumulated<br/>Amortization<br/>(In thousands)</b> | <b>Net</b> |
|----------------------------------------------------------|--------------|--------------------------------------------------------|------------|
| Purchased technology                                     | \$ 100,134   | \$ (89,446)                                            | \$ 10,688  |
| Patents, trade names, customer relationships and backlog | 22,009       | (21,995)                                               | 14         |
| Other                                                    | 4,297        | (4,228)                                                | 69         |
| Total acquisition-related intangible assets              | 126,440      | (115,669)                                              | 10,771     |
| Non-acquisition related intangible assets                | 10,398       | (5,563)                                                | 4,835      |

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|                         |            |              |           |
|-------------------------|------------|--------------|-----------|
| Total intangible assets | \$ 136,838 | \$ (121,232) | \$ 15,606 |
|-------------------------|------------|--------------|-----------|

| <b>As of January 3, 2010</b>                            | <b>Gross</b> | <b>Accumulated<br/>Amortization<br/>(In thousands)</b> | <b>Net</b> |
|---------------------------------------------------------|--------------|--------------------------------------------------------|------------|
| Purchased technology                                    | \$ 100,134   | \$ (88,766)                                            | \$ 11,368  |
| Patents, trade name, customer relationships and backlog | 22,009       | (21,937)                                               | 72         |
| Other                                                   | 4,297        | (4,190)                                                | 107        |
| Total acquisition-related intangible assets             | 126,440      | (114,893)                                              | 11,547     |
| Non-acquisition related intangible assets               | 8,713        | (5,128)                                                | 3,585      |
| Total intangible assets                                 | \$ 135,153   | \$ (120,021)                                           | \$ 15,132  |

**Table of Contents****CYPRESS SEMICONDUCTOR CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

As of April 4, 2010, the estimated future amortization expense of intangible assets was as follows:

|                                   |           |
|-----------------------------------|-----------|
| <b>(In thousands)</b>             |           |
| 2010 (remaining nine months)      | \$ 3,510  |
| 2011                              | 4,386     |
| 2012                              | 4,005     |
| 2013                              | 3,233     |
| 2014 and thereafter               | 472       |
| Total future amortization expense | \$ 15,606 |

**NOTE 5. RESTRUCTURING**

We recorded restructuring charges of \$0.3 million and \$6.0 million during the three months ended April 4, 2010 and March 29, 2009, respectively.

**Fiscal 2008/9 Restructuring Plan**

During the third quarter of fiscal 2008, we initiated a restructuring plan, as part of a company-wide cost saving initiative aimed to reduce operating costs in response to the economic downturn, which continued into 2009 ( Fiscal 2008/9 Restructuring Plan ). The determination of when we accrue for severance and benefits costs, and which standard applies, depends on whether the termination benefits are provided under a one-time benefit arrangement or under an on-going benefit arrangement.

Restructuring activities related to personnel costs are summarized as follows:

|                               |          |
|-------------------------------|----------|
| <b>(In thousands)</b>         |          |
| Balance as of January 3, 2010 | \$ 3,267 |
| Provision                     | 191      |
| Non-cash                      | (239)    |
| Cash payments                 | (754)    |
| Balance as of April 4, 2010   | \$ 2,465 |

For the Fiscal 2008/9 Restructuring Plan, we expect to eliminate approximately 835 positions and have recorded a total provision of \$23.3 million related to severance and benefits. As of April 4, 2010, approximately 76 of these employees remained with us and the majority of these remaining employee terminations are to be completed by the end of fiscal 2010.

**Fiscal 2007 Restructuring Plan**

During fiscal 2007, we implemented a restructuring plan to exit our manufacturing facility located in Round Rock, Texas ( Fiscal 2007 Restructuring Plan ). The Fiscal 2007 Restructuring Plan included the termination of employees and the disposal of assets, primarily consisting of land, building and manufacturing equipment, located in the Texas facility.

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Through April 4, 2010, we recorded total restructuring charges of \$10.8 million related to the Fiscal 2007 Restructuring Plan. Of the total restructuring charges, \$8.0 million was related primarily to personnel costs and \$2.8 million was related to property, plant and equipment and other exit costs.

We completed the termination of the remaining employees in the first quarter of fiscal 2009. All balances related to benefits were paid by the third quarter of fiscal 2009.

### Assets Held For Sale:

The Texas facility ceased operations in the fourth quarter of fiscal 2008. As our management has committed to a plan to sell the assets associated with the facility, we have classified the assets as held for sale and recorded the assets at the lower of their carrying amount or estimated fair value less cost to sell. Fair value was determined by an analysis of market prices for similar assets.

**Table of Contents****CYPRESS SEMICONDUCTOR CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

The net book value of the remaining restructured assets that were classified as held for sale and included in Other current assets in the Condensed Consolidated Balance Sheets was \$7.7 million as of April 4, 2010 and January 3, 2010. We had expected to complete the disposal of the restructured assets by the fourth quarter of fiscal 2009; however, due to the downturn and uncertainty in the commercial real estate market we were unable to secure a buyer for the Texas facility. In response, we have revised the asking price for the property and expect to sell the facility in fiscal 2010.

**NOTE 6. BALANCE SHEET COMPONENTS****Accounts Receivable, Net**

|                                                              | As of<br>April 4,<br>2010 | January 3,<br>2010 |
|--------------------------------------------------------------|---------------------------|--------------------|
|                                                              | (In thousands)            |                    |
| Accounts receivable, gross                                   | \$ 115,116                | \$ 91,468          |
| Allowance for doubtful accounts receivable and sales returns | (5,502)                   | (4,509)            |
| Total accounts receivable, net                               | \$ 109,614                | \$ 86,959          |

**Inventories, Net**

|                        | As of<br>April 4,<br>2010 | January 3,<br>2010 |
|------------------------|---------------------------|--------------------|
|                        | (In thousands)            |                    |
| Raw materials          | \$ 10,344                 | \$ 11,551          |
| Work-in-process        | 52,387                    | 56,947             |
| Finished goods         | 21,611                    | 22,700             |
| Total inventories, net | \$ 84,342                 | \$ 91,198          |

**Other Current Assets**

|                                        | As of<br>April 4,<br>2010 | January 3,<br>2010 |
|----------------------------------------|---------------------------|--------------------|
|                                        | (In thousands)            |                    |
| Prepaid expenses                       | \$ 21,609                 | \$ 22,753          |
| Receivable from SunPower (see Note 14) | 1,088                     | 2,255              |
| Assets held for sale (see Note 5)      | 7,690                     | 7,690              |
| Other current assets                   | 9,829                     | 8,208              |

|                            |           |           |
|----------------------------|-----------|-----------|
| Total other current assets | \$ 40,216 | \$ 40,906 |
|----------------------------|-----------|-----------|

**Other Long-Term Assets**

|                                     | As of<br>April 4,<br>2010 | January 3,<br>2010 |
|-------------------------------------|---------------------------|--------------------|
|                                     | (In thousands)            |                    |
| Employee deferred compensation plan | \$ 26,113                 | \$ 25,664          |
| Investments:                        |                           |                    |
| Debt securities                     | 32,689                    | 33,356             |
| Equity securities                   | 3,436                     | 1,425              |
| Other assets                        | 14,669                    | 13,770             |
| Total other long-term assets        | \$ 76,907                 | \$ 74,215          |

**Table of Contents****CYPRESS SEMICONDUCTOR CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Other Current Liabilities**

|                                          | As of<br>April 4,<br>2010 | As of<br>January 3,<br>2010 |
|------------------------------------------|---------------------------|-----------------------------|
|                                          | (In thousands)            |                             |
| Employee deferred compensation plan      | \$ 25,430                 | \$ 25,071                   |
| Accrued sales representative commissions | 1,411                     | 1,134                       |
| Restructuring accrual                    | 2,822                     | 3,740                       |
| Other current liabilities                | 24,451                    | 26,678                      |
| <b>Total other current liabilities</b>   | <b>\$ 54,114</b>          | <b>\$ 56,623</b>            |

**Deferred Income Taxes and Other Tax Liabilities**

|                                                              | As of<br>April 4,<br>2010 | As of<br>January 3,<br>2010 |
|--------------------------------------------------------------|---------------------------|-----------------------------|
|                                                              | (In thousands)            |                             |
| Deferred income taxes                                        | \$ 28                     | \$ (42)                     |
| Non-current tax liabilities                                  | 40,312                    | 39,314                      |
| <b>Total deferred income taxes and other tax liabilities</b> | <b>\$ 40,340</b>          | <b>\$ 39,272</b>            |

**NOTE 7. FAIR VALUE MEASUREMENTS****Assets/Liabilities Measured at Fair Value on a Recurring Basis**

The following table presents the fair value hierarchy for our financial assets and liabilities measured at fair value on a recurring basis as of April 4, 2010:

|                                | Level 1        | Level 2 | Level 3 | Total  |
|--------------------------------|----------------|---------|---------|--------|
|                                | (In thousands) |         |         |        |
| <b><u>Financial Assets</u></b> |                |         |         |        |
| Investments:                   |                |         |         |        |
| Commercial paper               | \$             | \$      | \$ 615  | \$ 615 |
| Money market funds             | 46,599         |         |         | 46,599 |
| U.S. treasuries                | 6,073          |         |         | 6,073  |
| Corporate notes/bonds          |                | 26,848  |         | 26,848 |
| Federal agency                 |                | 3,015   |         | 3,015  |
| Auction rate securities        |                |         | 32,074  | 32,074 |

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|                                      |        |        |
|--------------------------------------|--------|--------|
| Marketable equity securities         | 4,886  | 4,886  |
| Employee deferred compensation plan: |        |        |
| Cash and cash equivalents            | 2,525  | 2,525  |
| Money market                         | 790    | 790    |
| Mutual funds                         | 17,159 | 17,159 |
| Fixed income                         | 1,843  | 1,843  |
| Equity securities                    | 3,796  | 3,796  |

|                        |           |           |           |            |
|------------------------|-----------|-----------|-----------|------------|
| Total financial assets | \$ 83,671 | \$ 29,863 | \$ 32,689 | \$ 146,223 |
|------------------------|-----------|-----------|-----------|------------|

**Financial Liabilities**

|                                     |           |    |    |           |
|-------------------------------------|-----------|----|----|-----------|
| Employee deferred compensation plan | \$ 25,430 | \$ | \$ | \$ 25,430 |
|-------------------------------------|-----------|----|----|-----------|

|                             |           |    |    |           |
|-----------------------------|-----------|----|----|-----------|
| Total financial liabilities | \$ 25,430 | \$ | \$ | \$ 25,430 |
|-----------------------------|-----------|----|----|-----------|

**Table of Contents****CYPRESS SEMICONDUCTOR CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

The following table presents the fair value hierarchy for our financial assets and liabilities measured at fair value on a recurring basis as of January 3, 2010:

|                                      | Level 1        | Level 2   | Level 3   | Total      |
|--------------------------------------|----------------|-----------|-----------|------------|
|                                      | (In thousands) |           |           |            |
| <b><u>Financial Assets</u></b>       |                |           |           |            |
| Investments:                         |                |           |           |            |
| Commercial paper                     | \$             | \$        | \$ 615    | \$ 615     |
| Money market funds                   | 122,111        |           |           | 122,111    |
| U.S. treasuries                      | 6,070          |           |           | 6,070      |
| Corporate notes/bonds                |                | 20,896    |           | 20,896     |
| Federal agency                       |                | 5,012     |           | 5,012      |
| Auction rate securities              |                |           | 32,740    | 32,740     |
| Marketable equity securities         | 5,053          |           |           | 5,053      |
| Employee deferred compensation plan: |                |           |           |            |
| Cash and cash equivalents            | 1,960          |           |           | 1,960      |
| Money market                         | 2,227          |           |           | 2,227      |
| Mutual funds                         | 15,416         |           |           | 15,416     |
| Fixed income                         | 1,941          |           |           | 1,941      |
| Equity securities                    | 4,120          |           |           | 4,120      |
| Derivative instruments:              |                |           |           |            |
| Foreign currency forward contracts   |                | 8         |           | 8          |
| Total financial assets               | \$ 158,898     | \$ 25,916 | \$ 33,355 | \$ 218,169 |
| <b><u>Financial Liabilities</u></b>  |                |           |           |            |
| Employee deferred compensation plan  | \$ 25,071      | \$        | \$        | \$ 25,071  |
| Total financial liabilities          | \$ 25,071      | \$        | \$        | \$ 25,071  |

**Valuation Techniques:**

We use quoted prices for identical instruments in active markets to determine the fair value for our Level 1 financial instruments, which include U.S. treasuries, money market funds and marketable equity securities. Our employee deferred compensation plan is classified as Level 1 as the plan invests in mutual funds, marketable equity securities and our common stock.

If quoted prices in active markets for identical assets or liabilities are not available to determine the fair value of our financial instruments, then we use observable inputs including benchmark yields, reported trades, broker/dealer quotes or alternative pricing sources with reasonable levels of price transparency. These investments are classified as Level 2 and primarily consist of federal agency and corporate notes/bonds. In addition, we have derivative instruments that are classified as Level 2 financial assets. We determine the fair value of these instruments based on modeling techniques that include inputs such as market volatilities, spot rates and interest differentials from published sources.

Our Level 3 financial assets primarily include investments in auction rate securities and a commercial paper investment. The valuation techniques are described as follows:

*Auction Rate Securities:*

As of April 4, 2010, we have classified all of our auction rate securities as Level 3 financial instruments. Auction rate securities are investments with contractual maturities generally between 20 and 30 years. They are usually found in the form of municipal bonds, preferred stock, a pool of student loans or collateralized debt obligations with interest rates resetting every seven to 49 days through an auction process. At the end of each reset period, investors can sell or continue to hold the securities at par. The auction rate securities held by us are primarily backed by student loans and are over-collateralized, insured and guaranteed by the U.S. Federal Department of Education.

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As of April 4, 2010, 95% of our auction rate securities held by us were rated as either AAA or Aaa by the major independent rating agencies and approximately 5% of the student loan auction rate securities held by us have been downgraded from AAA or Aaa to Baa3. The downgrade event was due to the higher rates the issuer is paying out versus the lending rates, which is preventing the issuer from building excess spread as required under the prospectus.

We performed analyses to assess the fair value of our auction rate securities. In the absence of a liquid market to value these securities, we prepared a valuation model based on discounted cash flows. The assumptions used at April 4, 2010 were as follows:

7 years to liquidity;

continued receipt of contractual interest which provides a premium spread for failed auctions; and

discount rates of 2.18% - 5.94%, which incorporates a spread for both credit and liquidity risk.

Based on these assumptions, we estimated that the auction rate securities would be valued at approximately 89% of their stated par value as of April 4, 2010, representing a decline in value of approximately \$4.0 million.

*Commercial Paper:*

As of April 4, 2010, we have classified one commercial paper investment totaling \$0.6 million as a Level 3 financial asset. The investment was issued through a structured investment vehicle that was partially impaired as the issuer was unable to raise sufficient funding to cover maturing obligations. Accordingly, we have determined that the security had suffered other-than-temporary impairment and recorded a \$0.2 million charge. The amount of the write-down was determined by comparing the carrying value of the investment to the valuation of the underlying assets of the fund.

The following table presents a summary of changes in our Level 3 investments measured at fair value on a recurring basis as of April 4, 2010:

|                                                               | <b>Auction Rate<br/>Securities</b> | <b>Commercial<br/>Paper<br/>(In thousands)</b> | <b>Total</b> |
|---------------------------------------------------------------|------------------------------------|------------------------------------------------|--------------|
| Balance as of January 3, 2010                                 | \$ 32,740                          | \$ 615                                         | \$ 33,355    |
| Unrealized loss recorded in Other comprehensive income (loss) | (266)                              |                                                | (266)        |
| Amount settled at par                                         | (400)                              |                                                | (400)        |
| Balance as of April 4, 2010                                   | \$ 32,074                          | \$ 615                                         | \$ 32,689    |

**Available-For-Sale Securities**

The following table presents our fair value hierarchy for our investments measured at fair value on a non-recurring basis and the impairment loss related to these investments:

|                                  |         |         |          |                | Impairment Loss Recorded in |              |
|----------------------------------|---------|---------|----------|----------------|-----------------------------|--------------|
|                                  |         |         |          |                | Interest and Other          |              |
|                                  |         |         |          |                | Income (Expense), Net       |              |
|                                  |         |         |          |                | Three Months                | Three Months |
|                                  |         |         |          | Total as of    | Ended                       | Ended        |
|                                  | Level 1 | Level 2 | Level 3  | April 4,       | April 4,                    | March 29,    |
|                                  |         |         |          | 2010           | 2010                        | 2009         |
|                                  |         |         |          | (In thousands) |                             |              |
| Non-marketable equity securities | \$      | \$      | \$ 2,400 | \$ 2,400       | \$                          | \$           |

We measure our equity investments in privately held companies at fair value on a non-recurring basis. The balance of the investments was \$2.4 million as of April 4, 2010. These investments are measured at fair value when they are deemed to be other-than-temporarily impaired. We measured the fair value of such investments using a combination of the income approach and the market approach. The income approach included a discounted cash flow analysis, which required the use of unobservable inputs, including assumptions of projected revenues, expenses, capital spending and other costs, as well as a discount rate calculated based on the risk profile of the investees. The market approach included using financial metrics and ratios of comparable public companies. All of our impaired non-marketable equity investments were classified as Level 3 instruments, as we use unobservable inputs to value these investments and the valuation requires significant management judgment. The valuation of our non-marketable equity investments also takes into account the movements of the equity and venture capital markets, recent financing activities by the investees, changes in the interest rate environment, the investees' capital structure, liquidation preferences for the investees' capital, and other economic variables.

**Table of Contents****CYPRESS SEMICONDUCTOR CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****NOTE 8. INVESTMENTS****Available-For-Sale Securities**

The following tables summarize our available-for-sale investments:

|                                                           | Cost       | Gross<br>Unrealized<br>Gains<br>(In thousands) | Gross<br>Unrealized<br>Losses<br>(In thousands) | Fair<br>Value |
|-----------------------------------------------------------|------------|------------------------------------------------|-------------------------------------------------|---------------|
| <b>As of April 4, 2010</b>                                |            |                                                |                                                 |               |
| Cash equivalents:                                         |            |                                                |                                                 |               |
| Money market funds                                        | \$ 46,599  | \$                                             | \$                                              | \$ 46,599     |
| Total cash equivalents                                    | 46,599     |                                                |                                                 | 46,599        |
| Short-term investments:                                   |            |                                                |                                                 |               |
| Certificate of deposit                                    | 40,000     |                                                |                                                 | 40,000        |
| U.S. treasuries                                           | 6,053      | 20                                             |                                                 | 6,073         |
| Corporate notes/bonds                                     | 26,737     | 118                                            | (7)                                             | 26,848        |
| Marketable equity securities                              | 1,053      | 2,797                                          |                                                 | 3,850         |
| Federal agency                                            | 2,996      | 19                                             |                                                 | 3,015         |
| Total short-term investments                              | 76,839     | 2,954                                          | (7)                                             | 79,786        |
| Long-term investments:                                    |            |                                                |                                                 |               |
| Auction rate securities                                   | 36,050     |                                                | (3,976)                                         | 32,074        |
| Commercial paper                                          | 615        |                                                |                                                 | 615           |
| Marketable equity securities                              | 1,187      |                                                | (151)                                           | 1,036         |
| Total long-term investments                               | 37,852     |                                                | (4,127)                                         | 33,725        |
| Total available-for-sale securities and other investments | \$ 161,290 | \$ 2,954                                       | \$ (4,134)                                      | \$ 160,110    |

|                              | Cost       | Gross<br>Unrealized<br>Gains<br>(In thousands) | Gross<br>Unrealized<br>Losses<br>(In thousands) | Fair<br>Value |
|------------------------------|------------|------------------------------------------------|-------------------------------------------------|---------------|
| <b>As of January 3, 2010</b> |            |                                                |                                                 |               |
| Cash equivalents:            |            |                                                |                                                 |               |
| Money market funds           | \$ 122,111 | \$                                             | \$                                              | \$ 122,111    |
| Total cash equivalents       | 122,111    |                                                |                                                 | 122,111       |

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|                                                           |            |          |            |            |
|-----------------------------------------------------------|------------|----------|------------|------------|
| Short-term investments:                                   |            |          |            |            |
| Certificate of deposit                                    | 20,069     |          |            | 20,069     |
| U.S. treasuries                                           | 6,013      | 57       |            | 6,070      |
| Corporate notes/bonds                                     | 20,813     | 83       |            | 20,896     |
| Marketable equity securities                              | 1,053      | 2,983    |            | 4,036      |
| Federal agency                                            | 4,988      | 26       | (2)        | 5,012      |
| Total short-term investments                              | 52,936     | 3,149    | (2)        | 56,083     |
| Long-term investments:                                    |            |          |            |            |
| Auction rate securities                                   | 36,450     |          | (3,710)    | 32,740     |
| Commercial paper                                          | 615        |          |            | 615        |
| Marketable equity securities                              | 1,187      |          | (170)      | 1,017      |
| Total long-term investments                               | 38,252     |          | (3,880)    | 34,372     |
| Total available-for-sale securities and other investments | \$ 213,299 | \$ 3,149 | \$ (3,882) | \$ 212,566 |

**Table of Contents****CYPRESS SEMICONDUCTOR CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

The available-for-sale debt investments that we hold are all high investment grade. The unrealized losses on our investments were due primarily to changes in interest rates and market conditions of the underlying securities. Because we do not intend to sell and it is likely we will not be required to sell before recovering our cost, which may be at maturity, except for the impairment recorded in the respective periods, we did not consider these investments to be other-than-temporarily impaired as of April 4, 2010 and January 3, 2010.

For individual marketable equity securities with unrealized losses, we evaluated the near-term prospects in relation to the severity and duration of the impairment. Based on that evaluation and our ability and intent to hold these investments for a reasonable period of time, we did not consider these investments to be other-than-temporarily impaired as of April 4, 2010 and January 3, 2010.

As of April 4, 2010, contractual maturities of our available-for-sale, non-equity investments were as follows:

|                                   | <b>Cost</b>           | <b>Fair Value</b> |
|-----------------------------------|-----------------------|-------------------|
|                                   | <b>(In thousands)</b> |                   |
| Maturing within one year          | \$ 105,815            | \$ 105,914        |
| Maturing in one to three years    | 16,570                | 16,621            |
| Maturing in more than three years | 36,665                | 32,689            |
| Total                             | \$ 159,050            | \$ 155,224        |

Realized gains and losses from sales of available-for-sale and non-equity investments were immaterial for all periods presented. Proceeds from sales or maturities of available-for-sale investments were \$2.4 million and \$17.8 million for the three months ended April 4, 2010 and March 29, 2009, respectively.

**Investments in Equity Securities**

The following table summarizes our equity investments:

|                                  | <b>As of</b>          |                   |
|----------------------------------|-----------------------|-------------------|
|                                  | <b>April 4,</b>       | <b>January 3,</b> |
|                                  | <b>2010</b>           | <b>2010</b>       |
|                                  | <b>(In thousands)</b> |                   |
| Short-term investments:          |                       |                   |
| Marketable equity securities     | \$ 3,850              | \$ 4,036          |
| Long-term investments:           |                       |                   |
| Marketable equity securities     | 1,036                 | 1,017             |
| Non-marketable equity securities | 2,400                 | 408               |
| Total long-term investments      | 3,436                 | 1,425             |
| Total equity investments         | \$ 7,286              | \$ 5,461          |

We did not sell any equity investments during the first quarter of fiscal 2010 and 2009.

## Impairment of Investments

The following table summarizes the impairment loss recorded in the Condensed Consolidated Statements of Operations:

|                         | Three Months Ended |                   |
|-------------------------|--------------------|-------------------|
|                         | April 4,<br>2010   | March 29,<br>2009 |
|                         | (In thousands)     |                   |
| Debt Securities:        |                    |                   |
| Commercial paper        | \$                 | \$ 196            |
| Auction rate securities |                    | 1,393             |
| Corporate notes/bonds   |                    | 141               |
| Total impairment loss   | \$                 | \$ 1,730          |

**Table of Contents****CYPRESS SEMICONDUCTOR CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Employee Deferred Compensation Plan**

We have a deferred compensation plan, which provides certain key employees, including our executive management, with the ability to defer the receipt of compensation in order to accumulate funds for retirement on a tax-deferred basis. We do not make contributions to the deferred compensation plan or guarantee returns on the investments. Participant deferrals and investment gains and losses remain with us and the assets are subject to claims of general creditors.

Under the deferred compensation plan, the assets are recorded at fair value in each reporting period with the offset being recorded in Interest and other income (expense), net. The liabilities are recorded at fair value in each reporting period with the offset being recorded as an operating expense or income. As of April 4, 2010 and January 3, 2010, the fair value of the assets was \$26.1 million and \$25.7 million, respectively, and the fair value of the liabilities was \$25.4 million and \$25.1 million, respectively.

All non-cash expense and income recorded under the deferred compensation plan were included in the following line items in the Condensed Consolidated Statements of Operations:

|                                                   | <b>Three Months Ended</b> |                           |
|---------------------------------------------------|---------------------------|---------------------------|
|                                                   | <b>April 4,<br/>2010</b>  | <b>March 29,<br/>2009</b> |
|                                                   | <b>(In thousands)</b>     |                           |
| Changes in fair value of assets recorded in:      |                           |                           |
| Interest and other income (expense), net          | \$ 835                    | \$ (674)                  |
| Changes in fair value of liabilities recorded in: |                           |                           |
| Cost of revenues                                  | (141)                     | 62                        |
| Research and development expenses                 | (290)                     | 95                        |
| Selling, general and administrative expenses      | (596)                     | 492                       |
| <b>Total income (expense)</b>                     | <b>\$ (192)</b>           | <b>\$ (25)</b>            |

**NOTE 9. STOCK-BASED COMPENSATION****Outstanding Employee Equity Awards**

In conjunction with the Spin-Off (see Note 3), the Board approved certain adjustments to our 1994 and 1999 Stock Plans (together, the Plans). Specifically, the Board approved amendments to make proportionate adjustments to, among other things, outstanding employee equity awards, including stock options, restricted stock units and restricted stock awards, under the Plans to preserve the intrinsic value of the awards before and after the Spin-Off. These changes included a proportionate adjustment in the number of shares issuable pursuant to the outstanding awards and the per-share exercise price of the options.

The Board also approved certain adjustments with respect to our Employee Stock Purchase Plan (the ESPP) to offset the decrease in our common stock price resulting from the Spin-Off. These changes included a proportionate adjustment in the offering date price per share of our common stock and the maximum number of shares participants may purchase under the ESPP.

The modification of the outstanding employee equity awards and the ESPP related to the Spin-Off resulted in additional non-cash stock-based compensation. The amount was measured based upon the difference between the fair value of the awards immediately before and after the modification. Of the total additional non-cash stock-based compensation, \$6.2 million and \$13.4 million, net of forfeitures was recognized in the

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first quarter of fiscal 2010 and 2009, respectively. The remaining \$19.9 million will be recognized over the remaining vesting periods on an accelerated basis less forfeitures.

The following tables summarize the stock-based compensation expense, including the expense related to the modification discussed above, by line item recorded in the Condensed Consolidated Statements of Operations:

|                                            | <b>Three Months Ended</b> |                           |
|--------------------------------------------|---------------------------|---------------------------|
|                                            | <b>April 4,<br/>2010</b>  | <b>March 29,<br/>2009</b> |
|                                            | <b>(In thousands)</b>     |                           |
| Cost of revenues                           | \$ 5,970                  | \$ 14,277                 |
| Research and development                   | 4,357                     | 12,612                    |
| Selling, general and administrative        | 11,247                    | 21,355                    |
| <br>Total stock-based compensation expense | <br>\$ 21,574             | <br>\$ 48,244             |

**Table of Contents****CYPRESS SEMICONDUCTOR CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

As stock-based compensation expense recognized in the Condensed Consolidated Statements of Operations is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. The accounting guidance requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

Consolidated cash proceeds from the issuance of shares under the employee stock plans were approximately \$19.8 million for the three months ended April 4, 2010 and \$18.0 million for the three months ended March 29, 2009. We did not recognize a benefit from stock option exercises in the three months ended April 4, 2010 or March 29, 2009.

As of April 4, 2010 and January 3, 2010, stock-based compensation capitalized in inventories totaled \$5.1 million and \$5.7 million, respectively.

The following table summarizes the stock-based compensation expense by type of award:

|                                                    | <b>Three Months Ended</b> |                           |
|----------------------------------------------------|---------------------------|---------------------------|
|                                                    | <b>April 4,<br/>2010</b>  | <b>March 29,<br/>2009</b> |
|                                                    | <b>(In thousands)</b>     |                           |
| Stock options                                      | \$ 5,263                  | \$ 18,160                 |
| Restricted stock units and restricted stock awards | 15,080                    | 25,191                    |
| ESPP                                               | 1,231                     | 4,893                     |
| Total stock-based compensation expense             | \$ 21,574                 | \$ 48,244                 |

The following table summarizes the unrecognized stock-based compensation balance by type of award as of April 4, 2010:

|                                                     | <b>(In thousands)</b> | <b>Weighted-Average<br/>Amortization<br/>Period<br/>(In years)</b> |
|-----------------------------------------------------|-----------------------|--------------------------------------------------------------------|
| Stock options                                       | \$ 37,521             | 2.04                                                               |
| Restricted stock units and restricted stock awards  | 126,442               | 2.58                                                               |
| ESPP                                                | 1,166                 | 0.39                                                               |
| Total unrecognized stock-based compensation balance | \$ 165,129            | 2.44                                                               |

**Valuation Assumptions**

We estimated the fair value of the stock options and ESPP using the Black-Scholes valuation model with the following assumptions:

**Three Months Ended**

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|                         | <b>April 4,<br/>2010</b> | <b>March 29,<br/>2009</b> |
|-------------------------|--------------------------|---------------------------|
| Expected life           | 0.5 - 7.0 years          | 0.5 - 9.9 years           |
| Volatility              | 42.2% - 54.2%            | 43.5% - 50.5%             |
| Risk-free interest rate | 0.1% - 3.1%              | 2.0% - 3.9%               |
| Dividend yield          | 0.0%                     | 0.0%                      |

The fair value of the restricted stock units and the restricted stock awards was based on our stock price on the date of grant.

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As of April 4, 2010, approximately 15.3 million stock options or 8.1 million restricted stock units and restricted stock awards were available for grant under the Amended 1994 Stock Plan.

***Stock Options:***

The following table summarizes our stock option activities:

|                                           | Shares                | Weighted-Average<br>Exercise Price<br>Per Share |
|-------------------------------------------|-----------------------|-------------------------------------------------|
|                                           | (In thousands, except | per- share amount)                              |
| Options outstanding as of January 3, 2010 | 52,411                | \$ 4.70                                         |
| Granted                                   | 375                   | \$ 11.38                                        |
| Exercised                                 | (4,627)               | \$ 4.28                                         |
| Forfeited or expired                      | (467)                 | \$ 5.98                                         |
| Options outstanding as of April 4, 2010   | 47,692                | \$ 4.78                                         |
| Options exercisable as of April 4, 2010   | 31,616                | \$ 4.21                                         |

**Restricted Stock Units and Restricted Stock Awards:**

The following table summarizes our restricted stock unit and restricted stock award activities:

|                               | Shares                | Weighted-Average<br>Fair Value<br>per Share |
|-------------------------------|-----------------------|---------------------------------------------|
|                               | (In thousands, except | per- share amounts)                         |
| Balance as of January 3, 2010 | 17,733                | \$ 5.51                                     |
| Granted                       | 377                   | \$ 11.93                                    |
| Vested                        | (1,947)               | \$ 11.95                                    |
| Forfeited                     | (783)                 | \$ 7.95                                     |
| Balance as of April 4, 2010   | 15,380                | \$ 4.73                                     |

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The balance as of April 4, 2010 included approximately 8.4 million performance-based restricted stock units and restricted stock awards granted under the 1994 Amended Plan. These performance-based awards ( PARS ) were issued to certain senior-level employees of Cypress in fiscal 2007 and 2008 and can be earned ratably over a remaining period of one to two years, subject to the achievement of certain performance milestones set by the Compensation Committee of the Board ( the Committee ). These performance milestones can include:

stock appreciation target against the Philadelphia Semiconductor Sector Index ( SOXX );

certain levels of non-GAAP free cash flows, non-GAAP operating income, non-GAAP operating expense, non-GAAP gross margin percentage, non-GAAP profit-before-taxes percentage; and

annual revenue growth.

If the milestones are not achieved, the shares are forfeited and cannot be earned in future periods.

**Table of Contents****CYPRESS SEMICONDUCTOR CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

We estimated the fair value of the shares with the market-condition milestone using a Monte Carlo valuation model with the following weighted-average assumptions:

|                                | <b>Three Months Ended</b> |                           |
|--------------------------------|---------------------------|---------------------------|
|                                | <b>April 4,<br/>2010</b>  | <b>March 29,<br/>2009</b> |
| Volatility of our common stock | 39.8%                     | 69.6%                     |
| Volatility of the SOXX         | 30.3%                     | 57.4%                     |
| Correlation coefficient        | 0.77                      | 0.69                      |
| Risk-free interest rate        | 0.3%                      | 0.3%                      |

The fair value of the shares with the performance-related milestones was equivalent to the grant-date fair value of our common stock.

**NOTE 10. COMMITMENTS AND CONTINGENCIES****Lease Guarantees**

During fiscal 2005, we entered into a strategic foundry partnership with Grace Semiconductor Manufacturing Corporation ( Grace ), pursuant to which we have transferred certain of our proprietary process technologies to Grace's Shanghai, China facility. In accordance with a foundry agreement executed in fiscal 2006, we purchase wafers from Grace that are produced using these process technologies.

Pursuant to a master lease agreement, Grace has leased certain semiconductor manufacturing equipment from a financing company. In conjunction with the master lease agreement, we have entered into a series of guarantees with the financing company for the benefit of Grace. As of April 4, 2010, we updated our assessment of the likelihood that we would have to settle the outstanding lease payments under the guarantees and we determined that was not probable. As a result, we have not recorded any liability relating to outstanding lease payments under the guarantees.

Pursuant to the guarantees, we issued irrevocable letters of credit to secure the rental payments under the guarantees in the event a demand is made by the financing company on us. The amount available under the letters of credit will decline according to schedules mutually agreed upon by us and the financing company. If we default, the financing company will be entitled to draw on the letters of credit. In connection with the guarantees, we were granted options to purchase 40.3 million ordinary shares of Grace. As of April 4, 2010, we determined that the fair value of the guarantees and the options was not material to our condensed consolidated financial statements.

As of April 4, 2010, under the guarantees, the outstanding rental payments totaled \$5.6 million and the outstanding irrevocable letters of credit totaled \$9.6 million. By the end of fiscal 2010, no outstanding rental payments will be due under the master lease agreements and the outstanding letters of credit will be reduced to zero.

**Product Warranties**

We generally warrant our products against defects in materials and workmanship for a period of one year and that product warranty is generally limited to a refund of the original purchase price of the product or a replacement part. We estimate our warranty costs based on historical warranty claim experience. Warranty returns are included in the allowance for sales returns. The allowance for sales returns is reviewed quarterly to verify that it properly reflects the remaining obligations based on the anticipated returns over the balance of the obligation period.

The following table presents our warranty activities, including amounts recorded in the allowance for sales returns:

|                   | <b>Three Months Ended</b> |                           |
|-------------------|---------------------------|---------------------------|
|                   | <b>April 4,<br/>2010</b>  | <b>March 29,<br/>2009</b> |
|                   | <b>(In thousands)</b>     |                           |
| Beginning balance | \$ 3,151                  | \$ 3,341                  |
| Settlements made  | (995)                     | (1,879)                   |
| Provisions        | 2,545                     | 2,796                     |
| Ending balance    | \$ 4,701                  | \$ 4,258                  |

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**CYPRESS SEMICONDUCTOR CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

**Litigation and Asserted Claims**

In October 2006, we received a subpoena related to the Antitrust Division of the Department of Justice ( DOJ )'s investigation into the SRAM market. In December 2008, the DOJ closed its two year investigation without any charge or allegation brought against us. As a result of the DOJ's investigation, in October 2006, we, along with a majority of the other SRAM manufacturers, were named in numerous consumer class action suits that are now consolidated in the U.S. District Court for the Northern District of California. Despite the fact that the DOJ's investigation was closed without any allegation or charge brought against us, the civil cases remain active. The cases variously allege claims under the Sherman Antitrust Act and various state antitrust laws. The lawsuits seek restitution, injunction and damages in an unspecified amount. Direct and indirect purchaser classes have been certified. Trial is tentatively scheduled for January 2011. We are also named in purported consumer antitrust class action suits in three provinces of Canada; however, those cases have not been materially active over the last two years. We believe we have meritorious defenses to these allegations asserted in these various cases and we intend to vigorously defend ourselves in each of these matters.

In May 2004, we were among four parties to be named in a trade secret misappropriation litigation filed by Silvaco Data Systems in Santa Clara, California Superior Court. On February 10, 2009, the trial court granted a motion for summary judgment in our favor in this case. Silvaco appealed our victory along with the three other co-defendants in this matter. The appellate court has heard oral arguments in all cases but ours. On April 29, 2010, the court of appeal affirmed the trial court's grant of summary judgment to the three other co-defendants. While our appellate case has not yet been heard, given the shared circumstances with our three co-defendants, we have requested that the appellate court dismiss our case without oral argument based on the court's ruling on April 29, 2010.

On August 21, 2009, X-Point Technologies filed a single patent infringement case against us and 29 other defendants in the U.S. District Court in Delaware. The patent at issue covers X-Point's technology for data transfer between storage devices and network devices without the use of a CPU or memory. The parties are currently engaged in the initial round of discovery. X-Point has made no specific demand for relief in this matter. We believe we have meritorious defenses to the allegations set forth in the complaint and will vigorously defend ourselves in this matter.

We are currently a party to various other legal proceedings, claims, disputes and litigation arising in the ordinary course of business. Based on our own investigations, we believe the ultimate outcome of our current legal proceedings, individually and in the aggregate, will not have a material adverse effect on our financial position, results of operation or cash flows. However, because of the nature and inherent uncertainties of the litigation, should the outcome of these actions be unfavorable, our business, financial condition, results of operations or cash flows could be materially and adversely affected.

**Contractual Obligations**

As of April 4, 2010, our unrecognized tax benefits were \$40.3 million, which were classified as long-term liabilities. At this time, we are unable to make a reasonably reliable estimate of the timing of payments, if any, in individual years due to uncertainties in the timing or outcomes of either actual or anticipated tax audits.

**NOTE 11. DEBT AND EQUITY TRANSACTIONS**

**1.00% Convertible Senior Notes ( 1.00% Notes ) and Convertible Note Hedge and Warrants**

On September 15, 2009, our entire remaining and outstanding 1.00% Notes of approximately \$28.0 million in principal matured and were settled. Holders received cash for the principal amount of the 1.00% Notes and the entire premium. We paid approximately \$51.6 million for the principal amount of 1.00% Notes, premium and accrued and unpaid interest. Also on September 15, 2009, the convertible note hedge matured and as a result we received \$23.6 million from the counterparties. In addition, we repurchased and settled the outstanding warrants, issued in March 2007, through a cash payment of approximately \$20.3 million to the counterparties holding the warrants.



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**CYPRESS SEMICONDUCTOR CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

**Line of Credit**

In March 2010, we extended our line of credit with Silicon Valley Bank to March 2011 with a total available amount of \$25.0 million. Loans made under the line of credit bear interest based upon the Wall Street Journal Prime Rate (3.25% as of April 4, 2010) or LIBOR plus 2.0% (2.29% as of April 4, 2010). The line of credit agreement includes a variety of covenants including restrictions on the incurrence of indebtedness, incurrence of loans, the payment of dividends or distribution on our capital stock, and transfers of assets and financial covenants with respect to an adjusted quick ratio and tangible net worth. As of April 4, 2010, we were in compliance with all of the financial covenants. Our obligations under the line of credit are guaranteed and collateralized by the common stock of certain of our business entities. We intend to use the line of credit on an as-needed basis to fund working capital and capital expenditures. To date, there have been no borrowings under the line of credit.

As of April 4, 2010, in conjunction with certain guarantees, we issued irrevocable standby letters of credit in the aggregate amount of \$9.6 million to secure payments under an equipment lease. See **Lease Guarantees** under Note 10 for further discussion.

**Stock Repurchase Program**

In fiscal 2008, our Board approved up to a total of \$600 million that may be used for stock purchases under the stock repurchase program. During the first quarter of fiscal 2009, we used \$6.5 million to repurchase approximately 1.4 million shares at an average share price of \$4.59. During the second quarter of fiscal 2009, we used \$4.7 million to repurchase approximately 0.7 million shares at an average share price of \$6.82. During the fourth quarter of fiscal 2009, we used \$35.1 million to repurchase approximately 3.7 million shares at an average share price of \$9.52. In light of certain tax constraints placed on us in connection with the Spin-Off, we had no current intentions of repurchasing additional stock under the existing program. Accordingly, on October 28, 2009, the Audit Committee of the Board voted to rescind the remaining \$178.1 million under the program for additional repurchases. Management expects to propose a new stock repurchase program to our Board during the fourth quarter of 2010.

**Yield Enhancement Program**

On October 28, 2009 the Audit Committee approved a yield enhancement strategy intended to improve the yield on our available cash. As part of this program, the Audit Committee authorized us to enter into short-term yield enhanced structured agreements correlated to our stock price. In one such structure, we pay a fixed sum of cash upon execution of an agreement in exchange for the financial institution's obligations to pay either a pre-determined amount of cash or shares of our common stock depending on the closing market price of our common stock on the expiration date of the agreement. Upon expiration of each agreement, if the closing market price of our common stock is above the pre-determined price, we will have our cash investment returned plus a yield substantially above the yield currently available for short-term cash investments. If the closing market price is at or below the pre-determined price, we will receive the number of shares specified at the agreement's inception. As the outcome of these arrangements is based entirely on our stock price and does not require us to deliver either shares or cash, other than the original investment, the entire transaction is recorded in equity.

We entered into a yield enhanced structured agreement based upon a comparison of the yields available in the financial markets for similar maturities against the expected yield to be realized per the structured agreement and the related risks associated with this type of arrangement. We believe the risk associated with these types of agreements is no different than alternative investments available to us with equivalent counterparty credit ratings. All counterparties to a yield enhancement program have a credit rating of at least Aa2 or A as rated by major independent rating agencies. For all such agreements that matured to date, the yields of the structured agreements were far superior to the yields available in the financial markets primarily due to the volatility of our stock price and the pre-payment aspect of the agreements. The counterparty is willing to pay a premium over the yields available in the financial markets due to the structure of the agreement.

In the fourth quarter of fiscal 2009, we entered into short-term yield enhanced structured agreements totaling \$68.0 million with maturities of 30 days or less. We settled these agreements in the fourth quarter of fiscal 2009 and received \$69.1 million in cash. In the first quarter of fiscal 2010, we entered into short-term yield enhanced structured agreements totaling \$98.0 million with maturities of 30 days or less. We settled these

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agreements and received approximately \$66.0 million in cash and 3.0 million shares of our common stock at a cost of \$11.39 per share. In April 2010, we entered into a short-term yield enhanced structured agreement totaling \$50.3 million with maturities of 30 days or less. Upon settlement of this agreement, we may receive \$51.4 million in cash or 4.0 million shares of our common stock.

[Table of Contents](#)**CYPRESS SEMICONDUCTOR CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****NOTE 12. ACCUMULATED OTHER COMPREHENSIVE INCOME AND COMPREHENSIVE LOSS**

The components of accumulated other comprehensive loss were as follows:

|                                                                     | <b>April 4,<br/>2010</b> | <b>As of<br/>January 3,<br/>2010</b> |
|---------------------------------------------------------------------|--------------------------|--------------------------------------|
|                                                                     | <b>(In thousands)</b>    |                                      |
| Accumulated net unrealized losses on available-for-sale investments | \$ (1,155)               | \$ (838)                             |
| Accumulated net unrealized gains on derivatives                     |                          | 115                                  |
| <b>Total accumulated other comprehensive loss</b>                   | <b>\$ (1,155)</b>        | <b>\$ (723)</b>                      |

The components of comprehensive income (loss), net of tax, were as follows:

|                                                                 | <b>Three Months Ended<br/>April 4,<br/>2010</b> | <b>March 29,<br/>2009</b> |
|-----------------------------------------------------------------|-------------------------------------------------|---------------------------|
|                                                                 | <b>(In thousands)</b>                           |                           |
| Net income (loss) attributable to Cypress                       | \$ 12,674                                       | \$ (88,335)               |
| Net unrealized gains (losses) on available-for-sale investments | (432)                                           | 2,436                     |
| Net unrealized gains on derivatives                             |                                                 | 54                        |
| <b>Total comprehensive income (loss)</b>                        | <b>\$ 12,242</b>                                | <b>\$ (85,845)</b>        |

**NOTE 13. FOREIGN CURRENCY DERIVATIVES**

We operate and sell products in various global markets and purchase capital equipment using foreign currencies. As a result, we are exposed to risks associated with changes in foreign currency exchange rates. We may use various hedge instruments from time to time to manage the exposures associated with purchases of foreign sourced equipment, net asset or liability positions of its subsidiaries and forecasted revenues and expenses. We do not enter into foreign currency derivative financial instruments for speculative or trading purposes. The counterparties to these hedging transactions are creditworthy multinational banks and the risk of counterparty nonperformance associated with these contracts is not considered to be material as of April 4, 2010.

As of April 4, 2010 and January 3, 2010, our hedge instruments consisted primarily of foreign currency forward contracts. We estimate the fair value of our forward contracts based on spot and forward rates from published sources.

We record hedges of certain foreign currency denominated monetary assets and liabilities at fair value at the end of each reporting period with the related gains or losses recorded in Interest and other income (expense), net in the Condensed Consolidated Statements of Operations. The gains or losses on these contracts are substantially offset by transaction gains or losses on the underlying balances being hedged. As of April 4, 2010 and January 3, 2010, we had outstanding forward contracts with an aggregate notional value of \$1.3 million and \$1.0 million, respectively, to hedge the risks associated with foreign currency denominated assets and liabilities.

**NOTE 14. INCOME TAXES**

Our income tax expense was \$2.1 million for the three months ended April 4, 2010 and \$2.6 million for the three months ended March 29, 2009. The tax provision for the first quarter of fiscal 2010 and fiscal 2009 was primarily attributable to non-U.S. taxes on income earned in foreign jurisdictions.

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**CYPRESS SEMICONDUCTOR CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

**Unrecognized Tax Benefits**

As of April 4, 2010 and January 3, 2010, the amount of unrecognized tax benefits that, if recognized, would affect our effective tax rate totaled \$38.1 million and \$37.2 million, respectively.

We believe events that could occur in the next 12 months and cause a material change in our unrecognized tax benefits include, but are not limited to, the following:

completion of examinations by the U.S. or foreign taxing authorities; and

expiration of statutes of limitations on our tax returns.

The calculation of unrecognized tax benefits involves dealing with uncertainties in the application of complex global tax regulations. We regularly assess our tax positions in light of legislative, bilateral tax treaty, regulatory and judicial developments in the countries in which we do business. We believe it is possible that we may recognize approximately \$4.0 million of our existing unrecognized tax benefits within the next twelve months as a result of the lapse of statutes of limitations, and the resolution of agreements with various foreign tax authorities.

**Classification of Interest and Penalties**

Our policy is to classify interest and penalties, if any, as components of the income tax provision in the Condensed Consolidated Statements of Operations. As of April 4, 2010 and January 3, 2010, accrued interest and penalties totaled \$7.3 million and \$6.4 million, respectively.

**Tax Years and Examination**

The IRS is currently conducting audits of our federal income tax returns for fiscal 2008, 2007 and 2006. As of April 4, 2010, no adjustments to the tax liabilities have been proposed by the IRS. However, the IRS has not completed their examination and there can be no assurance that there will be no material adjustments upon completion of their review. In addition, non-U.S. tax authorities have completed their examination of our subsidiary in India for fiscal years 2006 and 2005. As of April 4, 2010, the proposed adjustments have been appealed. We believe the ultimate outcome of this appeal will not result in a material adjustment to the tax liability.

While years prior to 2006 for the U.S. corporate tax return are not open for assessment, the IRS can adjust net operating loss and research and development carryovers that were generated in prior years and carried forward to 2006 and subsequent years.

**Spin-Off of SunPower**

We have a tax sharing agreement with SunPower providing for each of the parties' obligations concerning various tax liabilities. The tax sharing agreement is structured such that we will pay all federal, state, local and foreign taxes that are calculated on a consolidated or combined basis (as defined under applicable federal, state or foreign law) reduced by SunPower's portion of such tax liability or benefit determined based upon its separate return tax liability as defined under the tax sharing agreement. Such liability or benefit will be based on a pro forma calculation as if SunPower were filing a separate income tax return in each jurisdiction, rather than on a combined or consolidated basis with us subject to adjustments as set forth in the tax sharing agreement.

In connection with the Spin-Off (see Note 3), Cypress and SunPower entered into an amendment to the existing tax sharing agreement between the parties to address certain transactions that may affect the tax treatment of the Spin-Off and certain other matters. Under the amended tax

sharing agreement, SunPower agreed that, for a period of 25 months following the Spin-Off, it will not: (a) effect a transaction that would result in a recapitalization as defined by the parties ( "Recapitalization" ) or (b) enter into or facilitate any other transaction resulting in an acquisition (within the meaning of Section 355(e) of the Internal Revenue Code) of SunPower's stock without first obtaining our written consent. SunPower further agreed that it will not: (a) effect a Recapitalization during the 36 month period following the Spin-Off without first obtaining a tax opinion to the effect that such Recapitalization (either alone or when taken together with any other transaction or transactions) will not cause the Spin-Off to become taxable under Section 355(e), or (b) seek any private ruling, including any supplemental private ruling, from the IRS with regard to the Spin-Off, or any transaction having any bearing on the tax treatment of the Spin-Off, without our prior written consent.

**Table of Contents****CYPRESS SEMICONDUCTOR CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****NOTE 15. NET INCOME (LOSS) PER SHARE**

The following table sets forth the computation of basic and diluted net income (loss) per share:

|                                           | <b>Three Months Ended</b>                           |                           |
|-------------------------------------------|-----------------------------------------------------|---------------------------|
|                                           | <b>April 4,<br/>2010</b>                            | <b>March 29,<br/>2009</b> |
|                                           | <b>(In thousands, except<br/>per-share amounts)</b> |                           |
| <b>Basic and diluted:</b>                 |                                                     |                           |
| Net income (loss) attributable to Cypress | \$ 12,674                                           | \$ (88,335)               |
| Weighted-average common shares            | 158,931                                             | 134,757                   |
| Weighted-average diluted shares           | 190,892                                             | 134,757                   |
| Net income (loss) per share basic         | \$ 0.08                                             | \$ (0.66)                 |
| Net income (loss) per share diluted       | \$ 0.07                                             | \$ (0.66)                 |

Anti-dilutive securities excluded from the diluted computation were approximately 1.1 million and 95.9 million for the three months ended April 4, 2010 and March 29, 2009, respectively, from stock options, restricted stock units and restricted stock awards.

**NOTE 16. SEGMENT, GEOGRAPHICAL AND CUSTOMER INFORMATION****Segment Information**

The following tables set forth certain information relating to our reportable business segments:

***Revenues:***

|                                   | <b>Three Months Ended</b> |                           |
|-----------------------------------|---------------------------|---------------------------|
|                                   | <b>April 4,<br/>2010</b>  | <b>March 29,<br/>2009</b> |
|                                   | <b>(In thousands)</b>     |                           |
| Consumer and Computation Division | \$ 74,163                 | \$ 52,023                 |
| Data Communications Division      | 26,959                    | 20,400                    |
| Memory and Imaging Division       | 98,556                    | 66,032                    |
| Emerging Technologies and Other   | 2,593                     | 854                       |
| <b>Total revenues</b>             | <b>\$ 202,271</b>         | <b>\$ 139,309</b>         |

***Income (Loss) before Income Taxes:*****Three Months Ended**

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|                                                   | April 4,<br>2010 | March 29,<br>2009 |
|---------------------------------------------------|------------------|-------------------|
|                                                   | (In thousands)   |                   |
| Consumer and Computation Division                 | \$ 4,181         | \$ (14,230)       |
| Data Communications Division                      | 8,654            | (1,589)           |
| Memory and Imaging Division                       | 30,879           | (7,012)           |
| Emerging Technologies and Other                   | (6,031)          | (5,957)           |
| Unallocated items:                                |                  |                   |
| Amortization of acquisition-related intangibles   | (776)            | (1,319)           |
| Restructuring charges                             | (327)            | (6,046)           |
| Stock-based compensation                          | (21,574)         | (48,244)          |
| Interest and non-cash expense on convertible debt |                  | (398)             |
| Impairment of investments                         |                  | (1,730)           |
| Other                                             | (222)            | 815               |
| Income (loss) before income taxes                 | \$ 14,784        | \$ (85,710)       |

**Table of Contents****CYPRESS SEMICONDUCTOR CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)*****Geographical Information***

The following table presents our revenues by geographical locations:

|                | <b>Three Months Ended</b> |                           |
|----------------|---------------------------|---------------------------|
|                | <b>April 4,<br/>2010</b>  | <b>March 29,<br/>2009</b> |
|                | <b>(In thousands)</b>     |                           |
| United States  | \$ 33,404                 | \$ 28,826                 |
| Europe         | 29,225                    | 19,105                    |
| Asia:          |                           |                           |
| China          | 42,610                    | 26,720                    |
| Hong Kong      | 16,724                    | 17,508                    |
| Rest of World  | 80,308                    | 47,150                    |
| Total revenues | \$ 202,271                | \$ 139,309                |

**Customer Information**

For the three months ended April 4, 2010, one global distributor accounted for 15% of our total revenues and no end customer accounted for 10% of our total revenues. For the three months ended March 29, 2009, no single global distributor or end customer accounted for more than 10% of total revenues.

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### **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The Management's Discussion and Analysis of Financial Condition and Results of Operations in this Quarterly Report of Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, that involve risks and uncertainties, which are discussed in the Forward-Looking Statements section under Part I of this Quarterly Report on Form 10-Q.

## **EXECUTIVE SUMMARY**

### **General**

Our mission is to continue the transformation of Cypress Semiconductor Corporation (Cypress) into a leading supplier of proprietary and programmable solutions in systems everywhere. We deliver high-performance, mixed-signal, programmable solutions that provide customers with integration, rapid time-to-market and system value. Our offerings include Programmable System-on-Chip (PSoC) products, capacitive sensing and touchscreen solutions, universal serial bus (USB) controllers, and general-purpose programmable clocks and memories. We also provide wired and wireless connectivity solutions, including, respectively, West Bridge® controllers, which enhance performance in multimedia handsets, and the CyFi low-power RF solution, offering unmatched reliability, simplicity and power-efficiency. We also offer a wide portfolio of static random access memories, nonvolatile memories and image sensor products. We serve numerous markets including consumer, computation, data communications, automotive, medical, industrial and white goods.

As of the end of the first quarter of fiscal 2010, our organization included the following business segments:

#### **Business Segments**

Consumer and Computation Division

Data Communications Division

Memory and Imaging Division

Emerging Technologies and Other

#### **Description**

A product division focusing on PSoC, USB and timing solutions.

A product division focusing on data communication devices for wireless handset and professional/personal video systems.

A product division focusing on static random access memories, nonvolatile memories and image sensor products.

Includes Cypress EnviroSystems and AgiA Tech, Inc., both majority-owned subsidiaries of Cypress, the Optical Navigation Systems (ONS) business unit, China business unit, foundry-related services and certain corporate expenses.

### **Spin-Off of SunPower Corporation (SunPower)**

We received a favorable ruling from the Internal Revenue Service (IRS) in April 2008 with respect to certain tax issues arising under Section 355 of the Internal Revenue Code in connection with the Spin-Off. The distribution was structured to be tax-free to Cypress and our stockholders for U.S. federal income tax purposes, except in respect to cash received in lieu of fractional shares.

In the third quarter of 2008, a committee of our Board of Directors (the Board) approved the distribution of the SunPower Class B common stock held by us to our stockholders. On September 29, 2008 we completed the distribution of 42.0 million shares of SunPower Class B common stock to our stockholders (the Spin-Off).

See Note 9 for a discussion of the adjustments approved by our Board to our stock plans as a result of the Spin-Off and Note 14 for a discussion of the amended tax sharing agreement between SunPower and us as a result of the Spin-Off.

### **Manufacturing Strategy**

Our core manufacturing strategy flexible manufacturing combines capacity from leading foundries with output from our internal manufacturing facilities. This initiative should allow us to meet rapid swings in customer demand while lessening the burden of high fixed costs, a capability that is particularly important in high-volume consumer markets that we serve with our leading programmable product portfolio.

Consistent with this strategy, our Board approved a plan in December 2007 to exit our manufacturing facility in Texas and transfer production to our more cost-competitive facility in Minnesota and outside foundries. We substantially completed our exit plan by the end of fiscal 2008. We

continued to hold the property for sale as of April 4, 2010.

**Table of Contents****Results of Operations****Revenues**

The following table summarizes our consolidated revenues by segments:

|                                   | <b>Three Months Ended</b> |                           |
|-----------------------------------|---------------------------|---------------------------|
|                                   | <b>April 4,<br/>2010</b>  | <b>March 29,<br/>2009</b> |
|                                   | <b>(In thousands)</b>     |                           |
| Consumer and Computation Division | \$ 74,163                 | \$ 52,023                 |
| Data Communications Division      | 26,959                    | 20,400                    |
| Memory and Imaging Division       | 98,556                    | 66,032                    |
| Emerging Technologies and Other   | 2,593                     | 854                       |
| <b>Total revenues</b>             | <b>\$ 202,271</b>         | <b>\$ 139,309</b>         |

**Consumer and Computation Division:**

Revenues from the Consumer and Computation Division increased by \$22.1 million in the first quarter of fiscal 2010, or approximately 42.6%, compared to the same prior-year period. The increase was primarily attributable to an increase of approximately \$14.6 million in sales of our PSOC family of products mainly due to the increase in demand in our capacitive and touchscreen applications in consumer devices. Despite the current challenging economic environment, our PSOC product families, including our touchscreen family, continued to gain new design wins, expand our customer base and increase market penetration in a variety of end-market applications.

**Data Communications Division:**

Revenues from the Data Communications Division increased by \$6.6 million in the first quarter of fiscal 2010, or approximately 32.2%, compared to the same prior-year period. The increase was primarily attributable to a \$6.5 million increase due to an overall increase in market demand and an increase in military shipments.

**Memory and Imaging Division:**

Revenues from the Memory and Imaging Division increased by \$32.5 million in the first quarter of fiscal 2010, or approximately 49.3%, compared to the same prior-year period. The increase was primarily attributable to a \$28.1 million increase in sales of our SRAM products in networking, communications applications and consumer.

**Emerging Technologies and Other:**

Revenues from Emerging Technologies and Other increased by \$1.7 million in the first quarter of fiscal 2010, or approximately 203.6%, compared to the same prior-year period. The increase in revenues was primarily attributable to an increase in demand as our emerging products begin to ramp.

**Cost of Revenues/Gross Margins**

|                                           | <b>Three Months Ended</b> |                           |
|-------------------------------------------|---------------------------|---------------------------|
|                                           | <b>April 4,<br/>2010</b>  | <b>March 29,<br/>2009</b> |
| <b>(In thousands, except percentages)</b> |                           |                           |
| Cost of revenues                          | \$ 95,784                 | \$ 105,294                |
| Gross margin                              | 52.6%                     | 24.4%                     |

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Gross margin percentage increased to 52.6% in the first quarter of fiscal 2010 from 24.4% in the first quarter of fiscal 2009. The gross margin increase is primarily due to increased factory utilization resulting from increased demand when compared to the same prior year period. In addition, there was lower stock-based compensation of \$8.3 million in the first quarter of fiscal 2010 compared to the first quarter of 2009. This decrease in stock-based compensation expense was mainly due to the modification of the outstanding employee equity awards in connection with the Spin-Off.

**Table of Contents****Research and Development ( R&D ) Expenses**

| (In thousands, except percentages) | Three Months Ended |                   |
|------------------------------------|--------------------|-------------------|
|                                    | April 4,<br>2010   | March 29,<br>2009 |
| R&D expenses                       | \$ 40,049          | \$ 50,146         |
| As a percentage of revenues        | 19.8%              | 36.0%             |

R&D expenditures decreased by \$10.1 million in the first quarter of fiscal 2010 compared to same prior-year period. The decrease was primarily attributable to a decrease of \$8.3 million in stock-based compensation expense mainly due to the modification of the outstanding employee equity awards in connection with the Spin-Off in addition to decreased spending in outside services, masks and certain projects.

**Selling, General and Administrative ( SG&A ) Expenses**

| (In thousands, except percentages) | Three Months Ended |                   |
|------------------------------------|--------------------|-------------------|
|                                    | April 4,<br>2010   | March 29,<br>2009 |
| SG&A expenses                      | \$ 51,281          | \$ 60,715         |
| As a percentage of revenues        | 25.4%              | 43.6%             |

SG&A expenses decreased by \$9.4 million in the first quarter of fiscal 2010 compared to the same prior-year period. The decrease was primarily attributable to a reduction of \$10.1 million in stock-based compensation expense mainly due to the modification of the outstanding employee equity awards in connection with the Spin-Off, offset by the increase in SG&A expenditures related to our emerging technologies and certain bonus programs which did not pay out in the prior period.

**Amortization of Acquisition-Related Intangible Assets**

For the three months ended April 4, 2010, amortization decreased by approximately \$0.5 million as compared to the same prior year period. The decrease in amortization was primarily due to certain intangible assets that had been fully amortized during fiscal 2009.

**Restructuring**

We recorded restructuring charges of \$0.3 million and \$6.0 million during the three months ended April 4, 2010 and March 29, 2009, respectively. Upon completion of all of our actions, we anticipate our annual savings in fiscal year 2010 to be approximately \$67.8 million. We estimate the savings will proportionately impact sales, general and administrative expense by 24%, cost of goods sold by 49% and research and development expense by 27% although there can be no assurance of this.

**Fiscal 2008/9 Restructuring Plan**

During the third quarter of fiscal 2008, we initiated a restructuring plan, as part of a company-wide cost saving initiative aimed to reduce operating costs in response to the economic downturn, which continued into 2009 ( Fiscal 2008/9 Restructuring Plan ). The determination of when we accrue for severance and benefits costs, and which standard applies, depends on whether the termination benefits are provided under a one-time benefit arrangement or under an on-going benefit arrangement.

Restructuring activities related to personnel costs are summarized as follows:

|                               |          |
|-------------------------------|----------|
| (In thousands)                |          |
| Balance as of January 3, 2010 | \$ 3,267 |
| Provision                     | 191      |
| Non-cash                      | (239)    |
| Cash payments                 | (754)    |

|                             |          |
|-----------------------------|----------|
| Balance as of April 4, 2010 | \$ 2,465 |
|-----------------------------|----------|

For the Fiscal 2008/9 Restructuring Plan, we expect to eliminate approximately 835 positions and have recorded a total provision of \$23.3 million related to severance and benefits. As of April 4, 2010, approximately 76 of these employees remained with us and the majority of these remaining employee terminations are to be completed by the end of fiscal 2010.

**Table of Contents*****Fiscal 2007 Restructuring Plan***

During fiscal 2007, we implemented a restructuring plan to exit our manufacturing facility located in Round Rock, Texas ( Fiscal 2007 Restructuring Plan ). The Fiscal 2007 Restructuring Plan included the termination of employees and the disposal of assets, primarily consisting of land, building and manufacturing equipment, located in the Texas facility.

Through April 4, 2010, we recorded total restructuring charges of \$10.8 million related to the Fiscal 2007 Restructuring Plan. Of the total restructuring charges, \$8.0 million was related primarily to personnel costs and \$2.8 million was related to property, plant and equipment and other exit costs.

We completed the termination of the remaining employees in the first quarter of fiscal 2009. All balances related to benefits were paid by the third quarter of fiscal 2009.

***Assets Held For Sale:***

The Texas facility ceased operations in the fourth quarter of fiscal 2008. As our management has committed to a plan to sell the assets associated with the facility, we have classified the assets as held for sale and recorded the assets at the lower of their carrying amount or estimated fair value less cost to sell. Fair value was determined by an analysis of market prices for similar assets.

The net book value of the remaining restructured assets that were classified as held for sale and included in Other current assets in the Condensed Consolidated Balance Sheets was \$7.7 million as of April 4, 2010 and January 3, 2010. We had expected to complete the disposal of the restructured assets by the fourth quarter of fiscal 2009; however, due to the downturn and uncertainty in the commercial real estate market we were unable to secure a buyer for the Texas facility. In response, we have revised the asking price for the property and expect to sell the facility in fiscal 2010; however, there can be no assurance of this and our ability to complete the sale of any restructured assets may be impacted by the current economic and credit conditions.

**Interest and Other Income (Expense), Net**

The following table summarizes the components of other expense, net:

| (In thousands)                                                                    | Three Months Ended |                   |
|-----------------------------------------------------------------------------------|--------------------|-------------------|
|                                                                                   | April 4,<br>2010   | March 29,<br>2009 |
| Interest income                                                                   | \$ 589             | \$ 611            |
| Interest expense                                                                  | (5)                | (416)             |
| Impairment of investments                                                         |                    | (1,730)           |
| Foreign currency exchange loss, net                                               | (471)              | (110)             |
| Changes in fair value of investment under the employee deferred compensation plan | 835                | (674)             |
| Other                                                                             | (218)              | 820               |
| Total interest and other income (expense), net                                    | \$ 730             | \$ (1,499)        |

***Interest Expense***

Interest expense decreased by \$0.4 million in the first quarter of fiscal 2010 compared to the first quarter of fiscal 2009. The decrease was primarily attributable to the fact that the 1.00% Notes were no longer outstanding during the first quarter of fiscal 2010.

**Income Taxes**

Our income tax expense was \$2.1 million for the three months ended April 4, 2010 and income tax expense was \$2.6 million for the three months ended March 29, 2009. The tax provision for the first quarter of fiscal 2010 and fiscal 2009 was primarily attributable to non-U.S. taxes on income earned in foreign jurisdictions.



**Table of Contents****LIQUIDITY AND CAPITAL RESOURCES**

The following table summarizes information regarding our cash and investments and working capital:

| (In thousands)                                    | As of            |                    |
|---------------------------------------------------|------------------|--------------------|
|                                                   | April 4,<br>2010 | January 3,<br>2010 |
| Cash, cash equivalents and short-term investments | \$ 296,827       | \$ 299,642         |
| Working capital                                   | \$ 288,846       | \$ 279,643         |

**Key Components of Cash Flows**

| (In thousands)                                      | Three Months Ended |                   |
|-----------------------------------------------------|--------------------|-------------------|
|                                                     | April 4,<br>2010   | March 29,<br>2009 |
| Net cash provided by (used in) operating activities | \$ 38,123          | \$ (15,804)       |
| Net cash provided by (used in) investing activities | \$ (43,757)        | \$ 15,221         |
| Net cash provided by (used in) financing activities | \$ (20,883)        | \$ 6,225          |

During the three months ended April 4, 2010, net cash provided by operating activities was \$38.1 million compared to net cash used in operating activities of \$15.8 million for the three months ended March 29, 2009. Operating cash flows for the three months ended April 4, 2010 were primarily driven by net income adjusted for certain non-cash items including depreciation and amortization, stock-based compensation and partially offset by changes in our working capital. The changes in our working capital as of April 4, 2010 compared to January 3, 2010 were as follows:

Accounts receivable increased by \$22.7 million due to higher distributor shipments.

Inventories decreased by \$6.9 million due to increased shipments to our direct customers and distributors.

Accounts payable decreased by \$7.6 million due to timing of purchases.

Deferred revenues less cost of revenues increased by \$10.2 million due to higher distributor shipments.

During the three months ended April 4, 2010, net cash used in investing activities was \$43.8 million compared to net cash provided by investing activities of \$15.2 million for the three months ended March 29, 2009. For the three months ended April 4, 2010, our investing activities primarily included \$17.9 million of property and equipment expenditures and \$23.5 million from purchases of our investments, net of proceeds from sales and maturities.

During the three months ended April 4, 2010, net cash used in financing activities was \$20.9 million compared to net cash provided by financing activities of \$6.2 million for the three months ended March 29, 2009. For the three months ended April 4, 2010, we used a net of \$32.0 million on the yield structured agreements, offset by net proceeds of \$11.1 million from the issuance of common shares under our employee stock plans.

**Liquidity and Contractual Obligations*****Auction Rate Securities:***

As of April 4, 2010, all of our auction rate securities have experienced failed auctions due to sell orders exceeding buy orders. Currently, these failures are not believed to be a credit issue with the underlying investments, but rather caused by a lack of liquidity. We have classified our auction rate securities totaling \$32.1 million as long-term investments as of April 4, 2010.

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During the first quarter of fiscal 2010, we performed analyses to assess the fair value of the auction rate securities. In the absence of a liquid market to value these securities, we prepared a valuation model based on discounted cash flows. Based on the discounted cash flows, we estimated that the auction rate securities would be valued at approximately 89% of their stated par value as of April 4, 2010.

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### ***Yield Enhancement Program***

On October 28, 2009 the Audit Committee approved a yield enhancement strategy intended to improve the yield on our available cash. As part of this program, the Audit Committee authorized us to enter into short-term yield enhanced structured agreements correlated to our stock price. In one such structure, we pay a fixed sum of cash upon execution of an agreement in exchange for the financial institution's obligations to pay either a pre-determined amount of cash or shares of our common stock depending on the closing market price of our common stock on the expiration date of the agreement. Upon expiration of each agreement, if the closing market price of our common stock is above the pre-determined price, we will have our cash investment returned plus a yield substantially above the yield currently available for short-term cash investments. If the closing market price is at or below the pre-determined price, we will receive the number of shares specified at the agreement's inception. As the outcome of these arrangements is based entirely on our stock price and does not require us to deliver either shares or cash, other than the original investment, the entire transaction is recorded in equity.

We entered into a yield enhanced structured agreement based upon a comparison of the yields available in the financial markets for similar maturities against the expected yield to be realized per the structured agreement and the related risks associated with this type of arrangement. We believe the risk associated with these types of agreements is no different than alternative investments available to us with equivalent counterparty credit ratings. All counterparties to a yield enhancement program have a credit rating of at least Aa2 or A as rated by major independent rating agencies. For all such agreements that matured to date, the yields of the structured agreements were far superior to the yields available in the financial markets primarily due to the volatility of our stock price and the pre-payment aspect of the agreements. The counterparty is willing to pay a premium over the yields available in the financial markets due to the structure of the agreement.

In the fourth quarter of fiscal 2009, we entered into short-term yield enhanced structured agreements totaling \$68.0 million with maturities of 30 days or less. We settled these agreements in the fourth quarter of fiscal 2009 and received \$69.1 million in cash. In the first quarter of fiscal 2010, we entered into short-term yield enhanced structured agreements totaling \$98.0 million with maturities of 30 days or less. We settled these agreements and received approximately \$66.0 million in cash and 3.0 million shares of our common stock at a cost of \$11.39 per share. In April 2010, we entered into a short-term yield enhanced structured agreement totaling \$50.3 million with maturities of 30 days or less. Upon settlement of this agreement, we may receive \$51.4 million in cash or 4.0 million shares of our common stock.

### ***Purchase Obligations:***

We have outstanding purchase obligations, which primarily include non-cancelable purchase orders for materials, services, manufacturing equipment, building improvements and supplies in the ordinary course of business. Purchase obligations are defined as enforceable agreements that are legally binding on us and that specify all significant terms, including quantity, price and timing. As of April 4, 2010, non-cancelable purchase obligations totaled approximately \$82.2 million.

### **Capital Resources and Financial Condition**

Our long-term strategy is to maintain a minimum amount of cash and cash equivalents for operational purposes and to invest the remaining amount of our cash in interest-bearing and highly liquid cash equivalents and debt securities. As of April 4, 2010, in addition to \$217.0 million in cash and cash equivalents, we had \$79.8 million invested in short-term investments for a total cash and short-term investment position of \$296.8 million that is available for use in current operations. In addition, we had \$32.7 million of long-term investments primarily consisting of illiquid auction rate securities.

We believe that liquidity provided by existing cash, cash equivalents and investments and our borrowing arrangements will provide sufficient capital to meet our requirements for at least the next twelve months. However, should prevailing economic conditions and/or financial, business and other factors beyond our control adversely affect our estimates of our future cash requirements, we could be required to fund our cash requirements by alternative financing. There can be no assurance that additional financing, if needed, would be available on terms acceptable to us or at all. We may choose at any time to raise additional capital or debt to strengthen our financial position, facilitate growth, enter into strategic initiatives and provide us with additional flexibility to take advantage of other business opportunities that arise.

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### **Off-Balance Sheet Arrangement**

During fiscal 2005, we entered into a strategic foundry partnership with Grace Semiconductor Manufacturing Corporation ( Grace ), pursuant to which we have transferred certain of our proprietary process technologies to Grace's Shanghai, China facility. In accordance with a foundry agreement, we purchase wafers from Grace that are produced using these process technologies.

Pursuant to a master lease agreement, Grace has leased certain semiconductor manufacturing equipment from a financing company. In conjunction with the master lease agreement, we have entered into a series of guarantees with the financing company for the benefit of Grace. As of April 4, 2010, we updated our assessment of the likelihood that we would have to settle the outstanding lease payments under the guarantees and we determined that was not probable. As a result, we have not recorded any liability relating to outstanding lease payments under the guarantees.

Pursuant to the guarantees, we issued irrevocable letters of credit to secure the rental payments under the guarantees in the event a demand is made by the financing company on us. The amount available under the letters of credit will decline according to schedules mutually agreed upon by us and the financing company. If we default, the financing company will be entitled to draw on the letters of credit. In connection with the guarantees, we were granted options to purchase 40.3 million ordinary shares of Grace. As of April 4, 2010, we determined that the fair value of the guarantees and the options was not material to our condensed consolidated financial statements.

As of April 4, 2010, under the guarantees, the outstanding rental payments totaled \$5.6 million and the outstanding irrevocable letters of credit totaled \$9.6 million. By the end of fiscal 2010, no outstanding rental payments will be due under the master lease agreements and the outstanding letters of credit will be reduced to zero.

### **Non-GAAP Financial Measures**

Regulation G, conditions for use of Non-Generally Accepted Accounting Principles ( Non-GAAP ) financial measures, and other SEC regulations define and prescribe the conditions for use of certain Non-GAAP financial information. To supplement our condensed consolidated financial results presented in accordance with GAAP, we use Non-GAAP financial measures which are adjusted from the most directly comparable GAAP financial measures to exclude certain items, as described below. Management believes that these Non-GAAP financial measures reflect an additional and useful way of viewing aspects of our operations that, when viewed in conjunction with our GAAP results, provide a more comprehensive understanding of the various factors and trends affecting our business and operations. Non-GAAP financial measures used by us include gross margin, research and development expenses, selling, general and administrative expenses, operating income or loss, net income or loss and basic and diluted net income or loss per share.

Our Non-GAAP measures primarily exclude stock-based compensation, acquisition-related charges, impairments to goodwill, gain or losses on divestiture, investment-related gains and losses, discontinued operations, restructuring costs and other special charges and credits. Management believes these Non-GAAP financial measures provide meaningful supplemental information regarding our strategic and business decision making, internal budgeting, forecasting and resource allocation processes. In addition, these Non-GAAP financial measures facilitate management's internal comparisons to our historical operating results and comparisons to competitors' operating results.

We use each of these Non-GAAP financial measures for internal managerial purposes, when providing our financial results and business outlook to the public, to facilitate period-to-period comparisons and are used to formulate our formula driven cash bonus plan and any milestone based stock awards. Management believes that these Non-GAAP measures provide meaningful supplemental information regarding our operational and financial performance of current and historical results. Management uses these Non-GAAP measures for strategic and business decision making, internal budgeting, forecasting and resource allocation processes. In addition, these Non-GAAP financial measures facilitate management's internal comparisons to our historical operating results and comparisons to competitors' operating results.

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The following table shows our Non-GAAP financial measures:

|                                                                        | <b>Three Months Ended</b>                           |                           |
|------------------------------------------------------------------------|-----------------------------------------------------|---------------------------|
|                                                                        | <b>April 4,<br/>2010</b>                            | <b>March 29,<br/>2009</b> |
|                                                                        | <b>(In thousands, except per<br/>share amounts)</b> |                           |
| Non-GAAP gross margin                                                  | \$ 112,457                                          | \$ 48,297                 |
| Non-GAAP research and development expenses                             | 35,654                                              | 37,500                    |
| Non-GAAP selling, general and administrative expenses                  | 40,021                                              | 39,290                    |
| Non-GAAP operating income (loss)                                       | 36,782                                              | (28,494)                  |
| Non-GAAP net income (loss) attributable to Cypress                     | 34,107                                              | (29,471)                  |
| Non-GAAP net income (loss) per share attributable to Cypress - basic   | 0.21                                                | (0.22)                    |
| Non-GAAP net income (loss) per share attributable to Cypress - diluted | 0.17                                                | (0.22)                    |

We believe that providing these Non-GAAP financial measures, in addition to the GAAP financial results, are useful to investors because they allow investors to see our results through the eyes of management as these Non-GAAP financial measures reflect our internal measurement processes. Management believes that these Non-GAAP financial measures enable investors to better assess changes in each key element of our operating results across different reporting periods on a consistent basis and provides investors with another method for assessing our operating results in a manner that is focused on the performance of our ongoing operations.

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The following is a reconciliation of Non-GAAP measures to GAAP measures:

**CYPRESS SEMICONDUCTOR CORPORATION****RECONCILIATION OF GAAP FINANCIAL MEASURES TO NON-GAAP FINANCIAL MEASURES**

(In thousands, except per-share data)

(Unaudited)

|                                                              | <b>Three Months Ended</b> |                           |
|--------------------------------------------------------------|---------------------------|---------------------------|
|                                                              | <b>April 4,<br/>2010</b>  | <b>March 29,<br/>2009</b> |
| <b>GAAP gross margin</b>                                     | \$ 106,487                | \$ 34,015                 |
| Stock-based compensation expense                             | 5,970                     | 14,277                    |
| Changes in value of deferred compensation plan               |                           | 5                         |
| <b>Non-GAAP gross margin</b>                                 | \$ 112,457                | \$ 48,297                 |
| <b>GAAP research and development expenses</b>                | \$ 40,049                 | \$ 50,146                 |
| Stock-based compensation expense                             | (4,357)                   | (12,612)                  |
| Other acquisition-related expense                            | (2)                       | (27)                      |
| Changes in value of deferred compensation plan               | (36)                      | (7)                       |
| <b>Non-GAAP research and development expenses</b>            | \$ 35,654                 | \$ 37,500                 |
| <b>GAAP selling, general and administrative expenses</b>     | \$ 51,281                 | \$ 60,715                 |
| Stock-based compensation expense                             | (11,247)                  | (21,355)                  |
| Other acquisition-related expense                            | (6)                       | (33)                      |
| Changes in value of deferred compensation plan               | (7)                       | (37)                      |
| <b>Non-GAAP selling, general and administrative expenses</b> | \$ 40,021                 | \$ 39,290                 |
| <b>GAAP operating income (loss)</b>                          | \$ 14,054                 | \$ (84,211)               |
| Stock-based compensation expense                             | 21,574                    | 48,244                    |
| Other acquisition-related expense                            | 784                       | 1,379                     |
| Changes in value of deferred compensation plan               | 43                        | 48                        |
| Restructuring charges                                        | 327                       | 6,046                     |
| <b>Non-GAAP operating income (loss)</b>                      | \$ 36,782                 | \$ (28,494)               |
| <b>GAAP net income (loss) attributable to Cypress</b>        | \$ 12,674                 | \$ (88,335)               |
| Stock-based compensation expense                             | 21,574                    | 48,244                    |
| Other acquisition-related expense                            | 784                       | 1,379                     |
| Changes in value of deferred compensation plan               | 43                        | 48                        |
| Restructuring charges                                        | 327                       | 6,046                     |
| Investment-related gains/losses                              | 336                       | 1,014                     |
| Adjustment for convertible debt                              |                           | 398                       |
| Tax effects                                                  | (1,631)                   | 1,735                     |
| <b>Non-GAAP net income (loss) attributable to Cypress</b>    | \$ 34,107                 | \$ (29,471)               |

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|                                                                               |                |                  |
|-------------------------------------------------------------------------------|----------------|------------------|
| <b>GAAP net income (loss) per share attributable to Cypress - basic</b>       | <b>\$ 0.08</b> | <b>\$ (0.66)</b> |
| Stock-based compensation expense                                              | 0.14           | 0.36             |
| Amortization of acquisition-related intangibles                               |                | 0.01             |
| Restructuring charges                                                         |                | 0.04             |
| Investment-related gains/losses                                               |                | 0.01             |
| Tax effects                                                                   | (0.01)         | 0.01             |
| Non-GAAP share count adjustment                                               |                | 0.01             |
| <b>Non-GAAP net income (loss) per share attributable to Cypress - basic</b>   | <b>\$ 0.21</b> | <b>\$ (0.22)</b> |
| <b>GAAP net income (loss) per share attributable to Cypress - diluted</b>     | <b>\$ 0.07</b> | <b>\$ (0.66)</b> |
| Stock-based compensation expense                                              | 0.11           | 0.36             |
| Amortization of acquisition-related intangibles                               |                | 0.01             |
| Restructuring charges                                                         |                | 0.04             |
| Investment-related gains/losses                                               |                | 0.01             |
| Tax effects                                                                   | (0.01)         | 0.01             |
| Non-GAAP share count adjustment                                               |                | 0.01             |
| <b>Non-GAAP net income (loss) per share attributable to Cypress - diluted</b> | <b>\$ 0.17</b> | <b>\$ (0.22)</b> |

**Table of Contents****ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK****Interest Rate Risks**

Excluding auction rate securities, our investment portfolio consists of a variety of financial instruments that exposes us to interest rate risk, including, but not limited to, money market funds, commercial paper, certificates of deposit and corporate securities. These investments are generally classified as available-for-sale and, consequently, are recorded on our balance sheets at fair market value with their related unrealized gain or loss reflected as a component of accumulated other comprehensive income in stockholders' equity. Due to the relatively short-term nature of our investment portfolio, we do not believe that an immediate 10% increase in interest rates would have a material effect on the fair market value of our portfolio. Since we believe we have the ability to liquidate this portfolio, we do not expect our operating results or cash flows to be materially affected to any significant degree by a sudden change in market interest rates on our investment portfolio.

**Auction Rate Securities**

As of April 4, 2010, we have classified all of our auction rate securities as Level 3 financial instruments and as long-term investments. Auction rate securities are investments with contractual maturities generally between 20 and 30 years. The auction rate securities held by us are primarily backed by student loans and are over-collateralized, insured and guaranteed by the U.S. Federal Department of Education.

As of April 4, 2010, 95% of our auction rate securities held by us were rated as either AAA or Aaa by the major independent rating agencies and approximately 5% of the student loan auction rate securities held by us have been downgraded from AAA or Aaa to Baa3.

As of April 4, 2010, all of our auction rate securities have experienced failed auctions due to sell orders exceeding buy orders. Currently, these failures are not believed to be a credit issue with the underlying investments, but rather caused by a lack of liquidity.

We performed analyses to assess the fair value of our auction rate securities. In the absence of a liquid market to value these securities, we prepared a valuation model based on discounted cash flows.

Based on our assumptions, we estimated that the auction rate securities would be valued at approximately 89% of their stated par value as of April 4, 2010, representing a decline in value of approximately \$4.0 million.

The following table summarizes certain information related to our auction rate securities as of April 4, 2010:

|                         | Fair Value | Fair Value Given a 100<br>Basis Point<br>Increase in Interest Rates<br>(In thousands) | Fair Value Given a 100<br>Basis Point<br>Decrease in Interest Rates |
|-------------------------|------------|---------------------------------------------------------------------------------------|---------------------------------------------------------------------|
| Auction rate securities | \$ 32,074  | \$ 35,281                                                                             | \$ 28,867                                                           |

**Investments in Publicly Traded and Privately Held Companies**

We have equity investments in certain publicly traded companies. The marketable equity securities are classified as available-for-sale investments and are recorded at fair value with unrealized gain or loss reported as a component in Accumulated other comprehensive income in the Condensed Consolidated Balance Sheets. The fair value of the common stock is subject to market price volatility. The following table summarizes certain information related to these investments as of April 4, 2010:

| Investments                  | Fair Value | Fair Value Given a 10%<br>Increase in Stock Prices<br>(In thousands) | Fair Value Given a 10%<br>Decrease in Stock<br>Prices |
|------------------------------|------------|----------------------------------------------------------------------|-------------------------------------------------------|
| Marketable equity securities | \$ 4,886   | \$ 5,375                                                             | \$ 4,397                                              |

We also have equity investments in several privately held companies, many of which are start-ups or in development stages. These investments are inherently risky as the market for the technologies or products they have under development are typically in the early stages and may never materialize. As our equity investments generally do not permit us to exert significant influence or control, these amounts generally represent our cost of the investments, less any adjustments we make when we determine that an investment's net realizable value is less than its carrying cost.

As of April 4, 2010, the carrying value of our investments in privately held companies was \$2.4 million.

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### **Foreign Currency Exchange Risk**

We operate and sell products in various global markets and purchase capital equipment using foreign currencies but predominantly the U.S. dollar. As a result, we are exposed to risks associated with changes in foreign currency exchange rates. Changes in exchange rates between foreign currencies and the U.S. dollar may adversely affect our operating margins. For example, when foreign currencies appreciate against the U.S. dollar, inventory and expenses denominated in foreign currencies become more expensive. An increase in the value of the U.S. dollar relative to foreign currencies could make our products more expensive for international customers, thus potentially leading to a reduction in demand, our sales and profitability. Furthermore, many of our competitors are foreign companies that could benefit from such a currency fluctuation, making it more difficult for us to compete with those companies. We cannot predict the impact of future exchange rate fluctuations on our business and results of operations.

We analyzed our foreign currency exposure, including our hedging strategies, to identify assets and liabilities denominated in other currencies. For those assets and liabilities, we evaluated the effects of a 10% shift in exchange rates between those currencies and the U.S. dollar. We have determined that there would be an immaterial effect on our results of operations.

### **ITEM 4. CONTROLS AND PROCEDURES**

#### **Evaluation of Disclosure Controls and Procedures**

We maintain disclosure controls and procedures, as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act), that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q and after considering the foregoing, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

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

There were no material changes in our internal control over financial reporting that occurred during the three month period ended April 4, 2010 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents****PART II OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

The information required by this item is included in Note 10 of Notes to Condensed Consolidated Financial Statements under Item 1, Part 1 of this Quarterly Report on Form 10-Q and is incorporated herein by reference.

**ITEM 1A. RISK FACTORS**

There have been no material changes to the risk factors set forth in our Annual Report on Form 10-K for the year ended January 3, 2010.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. [RESERVED]****ITEM 5. OTHER INFORMATION****Quarterly Executive Incentive Payments**

On May 12, 2010, Cypress's Compensation Committee of the Board of Directors (the "Compensation Committee") approved the incentive payments to our executive officers for the first quarter of fiscal 2010. These payments were earned in accordance with the terms of our Key Employee Bonus Plan (the "KEBP") and the Performance Bonus Plan (the "PBP").

The payments were determined based upon the financial performance of Cypress and each executive's performance. The performance measures under the KEBP include our non-GAAP profit-before-taxes percentage as well as individual strategic, operational and financial goals established for each executive. The following table sets forth the cash payments to our Named Executive Officers (as determined in our Proxy Statement filed with the Securities and Exchange Commission on March 31, 2010) under the KEBP and the PBP in the first quarter of fiscal 2010:

| Named Executive Officers                                                                     | KEBP      | PBP        |
|----------------------------------------------------------------------------------------------|-----------|------------|
| T.J. Rodgers, President and Chief Executive Officer                                          | \$        | \$ 177,433 |
| Christopher Seams, Executive Vice President, Sales and Marketing                             | \$ 48,845 | \$         |
| Brad W. Buss, Executive Vice President, Finance & Administration and Chief Financial Officer | \$ 47,354 | \$         |
| Paul Keswick, Executive Vice President, New Product Development                              | \$ 42,869 | \$         |
| Norman Taffe, Executive Vice President, Consumer and Computation Division                    | \$ 39,271 | \$         |

Additionally, the Compensation Committee authorized quarterly incentive payments under the KEBP totaling \$214,600 to six other senior executive officers who are not Named Executive Officers.

**ITEM 6. EXHIBITS**

**Exhibit**

| <b>Number</b> | <b>Description</b>                                                                                                                                 |
|---------------|----------------------------------------------------------------------------------------------------------------------------------------------------|
| 31.1          | Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                                |
| 31.2          | Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                                |
| 32.1          | Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2          | Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**CYPRESS SEMICONDUCTOR CORPORATION**

Date: May 13, 2010

By: */s/ BRAD W. BUSS*  
**Brad W. Buss**  
*Executive Vice President, Finance and Administration*  
*and Chief Financial Officer*

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**EXHIBIT INDEX**

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