

Cypress Semiconductor Corporation and SunPower Corporation

I published this business school case to provide a means to illustrate enterprise valuation analysis questions such as: 1) Given a stock price, what is the implied value attributable to the operating business? 2) Given a valuation multiple for an operating business, what is the implied target stock price? In addition, the case 1) illustrates how arbitrage acts to enforce the law of one price and keep markets efficient 2) provides a model case to understand why stocks can become mispriced 3) shows application of a "stub" valuation analysis 4) provides an illustration of a common hedge fund strategy (long/short equity) 5) show how to calculate margin requirements for a portfolio containing both long and short positions 6) illustrates the effects of leverage and capital requirements on investment returns 7) provides an example framework to calculate risk in a complex investment position.

Learning Objective

This case study illustrates several important concepts: How arbitrage acts to enforce the law of one price and keep markets efficient - and areas in which the law falls short and provides opportunities for arbitrageurs; Provides a model case to understand why stocks can become mispriced; Use of, and illustrating the importance of, an Enterprise Value approach for business valuation; Application of a "stub" valuation analysis for Cypress; Provides an excellent illustration of a common hedge fund strategy (long/short equity); Analysis of a long/short Cypress/SunPower arbitrage position; Calculating return on investment for a portfolio containing both long and short positions; Calculating margin requirements for a portfolio containing both long and short positions; Illustrates the effects of leverage and capital requirements on investment returns; Balance sheet analysis involving consolidated financial statements; Illustrates the dynamic challenge of calculating the implied value of an asset or business as the value of other assets owned changes with market fluctuations; Provides an example framework to calculate risk in a complex investment position; Short positions require the ability to borrow stock; Short positions have buy-in risk; Shows the economic impact of tax policy.

This case is available from Harvard Business Publishing, a subsidiary of Harvard University reporting into Harvard Business School. You may purchase a copy of the case here:

<https://www.hbsp.harvard.edu/product/909N16-PDF-ENG>

The first page of the case is shown on the following page.

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CYPRESS SEMICONDUCTOR CORPORATION AND SUNPOWER CORPORATION¹

Martin Dirks wrote this case solely to provide material for class discussion. The author does not intend to illustrate either effective or ineffective handling of a managerial situation. The author may have disguised certain names and other identifying information to protect confidentiality.

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Version: (A) 2009-09-15

“Give someone a fish and you feed them for a day. Teach them to arbitrage and they can eat for life.”

-Warren Buffet

On April 17, 2008, Marty Dirks contemplated the financial statements of Cypress Semiconductor Corporation (Cypress) and SunPower Corporation (SunPower) (see Exhibit 1). Based on the expected long-term increases in energy prices and concerns about U.S. dependence on politically unstable or unfriendly countries for the import of oil, solar energy firms, such as SunPower, seemed to have a bright business outlook.

That day, Cypress announced it received a favorable ruling from the IRS with respect to a potential tax-free distribution of its SunPower common shares. This could mean that Cypress would distribute its SunPower shares to its shareholders in a tax-free transaction. This should eliminate any tax-related discount that investors might attribute to Cypress' ownership of SunPower. Dirks wondered if that might create some mispricing opportunity.

Dirks had been a long/short equity analyst or portfolio manager for many years and was now investing his own capital. He liked to maintain his net long exposure at 20 to 30 per cent of equity, although at this time his portfolio was 60 per cent long and 20 per cent short, with a net long exposure of 40 per cent.

CYPRESS SEMICONDUCTOR AND SUNPOWER

Cypress Semiconductor designs and manufactures programmable system-on-chip (PSoC) products, capacitive sensing and touchscreen solutions, universal serial bus (USB) controllers, wireless USB, CyFi low-power radio frequency, programmable clocks, buffers and other semiconductor devices.

¹ This case has been written on the basis of published sources only. Consequently, the interpretation and perspectives presented in this case are not necessarily those of Cypress Semiconductor Corporation or SunPower Corporation or any of their employees.