
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2017

OR

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

Commission file number 001-04298

COHU, INC.

(Exact name of registrant as specified in its charter)

Delaware

*(State or other jurisdiction of
incorporation or organization)*

95-1934119

(I.R.S. Employer Identification No.)

12367 Crosthwaite Circle, Poway, California

(Address of principal executive offices)

92064-6817

(Zip Code)

Registrant's telephone number, including area code (858) 848-8100

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 (§232.405 of this chapter) 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 the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer

Smaller reporting company Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of October 19, 2017 the Registrant had 28,288,018 shares of its \$1.00 par value common stock outstanding.

COHU, INC.
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FORM 10-Q
SEPTEMBER 30, 2017

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Item 1.

COHU, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except par value)

	September 30, 2017	December 31, 2016 *
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 121,984	\$ 96,045
Short-term investments	16,340	31,990
Accounts receivable, net	76,548	63,019
Inventories:		
Raw materials and purchased parts	26,470	23,037
Work in process	22,711	17,599
Finished goods	7,230	4,866
	56,411	45,502
Other current assets	8,288	8,593
Total current assets	279,571	245,149
Property, plant and equipment, at cost:		
Land and land improvements	7,917	4,079
Buildings and building improvements	13,612	7,967
Machinery and equipment	45,292	35,157
	66,821	47,203
Less accumulated depreciation and amortization	(32,558)	(28,969)
Net property, plant and equipment	34,263	18,234
Goodwill	65,483	58,849
Intangible assets, net	17,766	17,835
Other assets	7,381	5,445
	<u>\$ 404,464</u>	<u>\$ 345,512</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Short-term borrowings	\$ 3,130	\$ -
Current installments of long-term debt	1,300	-
Accounts payable	29,907	31,444
Accrued compensation and benefits	18,509	14,770
Accrued warranty	4,344	3,737
Deferred profit	6,721	6,886
Income taxes payable	2,725	1,920
Other accrued liabilities	10,526	9,932
Total current liabilities	77,162	68,689
Accrued retirement benefits	17,033	15,673
Noncurrent deferred gain on sale of facility	10,597	11,689
Deferred income taxes	7,132	5,852
Noncurrent income tax liabilities	6,600	6,375
Long-term debt, excluding current installments	4,853	-
Other accrued liabilities	2,290	1,765
Stockholders' equity:		
Preferred stock, \$1 par value; 1,000 shares authorized, none issued	-	-
Common stock, \$1 par value; 60,000 shares authorized, 28,213 shares issued and outstanding in 2017 and 26,842 shares in 2016	28,213	26,842
Paid-in capital	123,064	111,950
Retained earnings	145,536	124,559
Accumulated other comprehensive loss	(18,016)	(27,882)
Total stockholders' equity	<u>278,797</u>	<u>235,469</u>
	<u>\$ 404,464</u>	<u>\$ 345,512</u>

* Derived from December 31, 2016 audited financial statements

The accompanying notes are an integral part of these statements.

COHU, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)
(in thousands, except per share amounts)

	Three Months Ended		Nine Months Ended	
	September 30,	September 24,	September 30,	September 24,
	2017	2016	2017	2016
Net sales	\$ 93,651	\$ 69,259	\$ 268,614	\$ 211,390
Cost and expenses:				
Cost of sales	56,742	45,979	162,319	142,089
Research and development	9,609	8,673	28,851	24,698
Selling, general and administrative	16,882	13,701	47,362	41,990
	<u>83,233</u>	<u>68,353</u>	<u>238,532</u>	<u>208,777</u>
Income from operations	10,418	906	30,082	2,613
Interest and other, net	174	71	417	173
Income from continuing operations before taxes	10,592	977	30,499	2,786
Income tax provision	1,837	849	4,273	1,832
Income from continuing operations	8,755	128	26,226	954
Income (loss) from discontinued operations	-	51	(278)	(4)
Net income	<u>\$ 8,755</u>	<u>\$ 179</u>	<u>\$ 25,948</u>	<u>\$ 950</u>
Income (loss) per share:				
Basic:				
Income from continuing operations	\$ 0.31	\$ 0.01	\$ 0.95	\$ 0.04
Income (loss) from discontinued operations	-	0.00	(0.01)	0.00
Net income	<u>\$ 0.31</u>	<u>\$ 0.01</u>	<u>\$ 0.94</u>	<u>\$ 0.04</u>
Diluted:				
Income from continuing operations	\$ 0.30	\$ 0.01	\$ 0.92	\$ 0.03
Income (loss) from discontinued operations	-	0.00	(0.01)	0.00
Net income	<u>\$ 0.30</u>	<u>\$ 0.01</u>	<u>\$ 0.91</u>	<u>\$ 0.03</u>
Weighted average shares used in computing income (loss) per share:				
Basic	<u>28,155</u>	<u>26,761</u>	<u>27,614</u>	<u>26,596</u>
Diluted	<u>29,105</u>	<u>27,367</u>	<u>28,640</u>	<u>27,382</u>
Cash dividends declared per share	<u>\$ 0.06</u>	<u>\$ 0.06</u>	<u>\$ 0.18</u>	<u>\$ 0.18</u>

The accompanying notes are an integral part of these statements.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)
(in thousands)

	Three Months Ended		Nine Months Ended	
	September 30, 2017	September 24, 2016	September 30, 2017	September 24, 2016
Net income	\$ 8,755	\$ 179	\$ 25,948	\$ 950
Other comprehensive income, net of tax:				
Foreign currency translation adjustments	2,570	561	9,975	2,724
Adjustments related to postretirement benefits	12	(2)	(116)	(35)
Change in unrealized gain/loss on investments	6	(3)	7	(1)
Other comprehensive income, net of tax	2,588	556	9,866	2,688
Comprehensive income	<u>\$ 11,343</u>	<u>\$ 735</u>	<u>\$ 35,814</u>	<u>\$ 3,638</u>

The accompanying notes are an integral part of these statements.

COHU, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(in thousands)

	Nine Months Ended	
	September 30, 2017	September 24, 2016
Cash flows from operating activities:		
Net income	\$ 25,948	\$ 950
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss on disposal of microwave communications equipment business	278	4
Depreciation and amortization	6,731	8,089
Share-based compensation expense	5,336	5,291
Amortization of inventory step-up	1,404	-
Deferred income taxes	(932)	(1,111)
Mark to market adjustment to Kita contingent consideration liability	668	-
Changes in other accrued liabilities	427	716
Changes in other assets	572	(32)
(Gain) loss on disposal of assets	(22)	37
Changes in current assets and liabilities, excluding effects from acquisitions:		
Accounts receivable	(9,013)	3,073
Inventories	(6,701)	3,551
Accounts payable	(3,620)	(2,109)
Other current assets	1,257	(411)
Income taxes payable	1,272	(2,451)
Deferred profit	(299)	1,970
Accrued compensation, warranty and other liabilities	303	980
Net cash provided by operating activities	23,609	18,547
Cash flows from investing activities, excluding effects from acquisitions:		
Sales and maturities of short-term investments	39,315	13,654
Purchases of short-term investments	(23,665)	(31,453)
Cash paid for Kita, net of cash received	(11,716)	-
Purchases of property, plant and equipment	(4,739)	(2,797)
Cash received from sale of fixed assets	109	852
Net cash used in investing activities	(696)	(19,744)
Cash flows from financing activities:		
Issuance (repurchases) of common stock, net	7,149	(1,325)
Cash dividends paid	(4,894)	(4,748)
Repayments of long-term debt	(1,280)	-
Net cash provided by (used in) financing activities	975	(6,073)
Effect of exchange rate changes on cash and cash equivalents	2,051	1,117
Net increase (decrease) in cash and cash equivalents	25,939	(6,153)
Cash and cash equivalents at beginning of period	96,045	115,370
Cash and cash equivalents at end of period	\$ 121,984	\$ 109,217
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	\$ 3,740	\$ 5,977
Inventory capitalized as property, plant and equipment	\$ 113	\$ 201
Dividends declared but not yet paid	\$ 1,683	\$ 1,603
Property, plant and equipment purchases included in accounts payable	\$ 594	\$ 118

The accompanying notes are an integral part of these statements.

Cohu, Inc.
Notes to Unaudited Condensed Consolidated Financial Statements
September 30, 2017

1. Summary of Significant Accounting Policies

Basis of Presentation

Our fiscal years are based on a 52- or 53-week period ending on the last Saturday in December. The condensed consolidated balance sheet at December 31, 2016 has been derived from our audited financial statements at that date. The interim condensed consolidated financial statements as of September 30, 2017 (also referred to as “the third quarter of fiscal 2017” and “the first nine months of fiscal 2017”) and September 24, 2016 (also referred to as “the third quarter of fiscal 2016” and “the first nine months of fiscal 2016”) are unaudited. However, in management’s opinion, these financial statements reflect all adjustments (consisting only of normal, recurring items) necessary to provide a fair presentation of our financial position, results of operations and cash flows for the periods presented. The three- and nine-month periods ended September 30, 2017 were comprised of 14 and 39 weeks, respectively. The three- and nine-month periods ended September 24, 2016 were comprised of 13 and 39 weeks, respectively.

Our interim results are not necessarily indicative of the results that should be expected for the full year. For a better understanding of Cohu, Inc. and our financial statements, we recommend reading these interim condensed consolidated financial statements in conjunction with our audited financial statements for the year ended December 31, 2016, which are included in our 2016 Annual Report on Form 10-K, filed with the U. S. Securities and Exchange Commission (“SEC”). In the following notes to our interim condensed consolidated financial statements, Cohu, Inc. is referred to as “Cohu”, “we”, “our” and “us”.

Certain prior year amounts have been restated as a result of our early adoption of Accounting Standards Update (“ASU”) No. 2016-09, Compensation - Stock Compensation (Topic 718): *Improvements to Employee Share-Based Payment Accounting* (ASU 2016-09). While the effective date of ASU 2016-09 was for fiscal years beginning after December 15, 2016, earlier adoption was permitted and we elected to adopt ASU 2016-09 during the fourth quarter of fiscal 2016.

As part of our adoption of ASU 2016-09 we elected to eliminate the use of an estimated forfeiture rate and recognize actual forfeitures as they occur. This amendment was adopted on a modified retrospective basis and, as a result, our share-based compensation expense for the three- and nine-month periods ended September 24, 2016 were revised and were approximately \$0.1 million and \$15,000 higher in each period, respectively, under the new method, than what was previously reported.

Discontinued Operations

In June 2015, we sold our microwave communications equipment segment, Broadcast Microwave Services, Inc. (“BMS”). See Note 6, “Discontinued Operations” for additional information. Unless otherwise indicated, all amounts herein relate to continuing operations.

Concentration of Credit Risk

Financial instruments that potentially subject us to significant credit risk consist principally of cash equivalents, short-term investments and trade accounts receivable. We invest in a variety of financial instruments and, by policy, limit the amount of credit exposure with any one issuer.

Trade accounts receivable are presented net of allowance for doubtful accounts of \$0.1 million at both September 30, 2017 and December 31, 2016. Our customers include semiconductor manufacturers and semiconductor test subcontractors throughout many areas of the world. While we believe that our allowance for doubtful accounts is adequate and represents our best estimate at September 30, 2017, we will continue to monitor customer liquidity and other economic conditions, which may result in changes to our estimates regarding collectability.

Segment Information

We applied the provisions of ASC Topic 280, *Segment Reporting*, (“ASC 280”), which sets forth a management approach to segment reporting and establishes requirements to report selected segment information quarterly and to report annually entity-wide disclosures about products, major customers and the geographies in which the entity holds material assets and reports revenue. An operating segment is defined as a component that engages in business activities whose operating results are reviewed by the chief operating decision maker and for which discrete financial information is available. Based on the provisions of ASC 280, we have determined that our identified operating segments qualify for aggregation under ASC 280 due to similarities in their customers, their economic characteristics, and the nature of products and services provided. As a result, we report in one segment, semiconductor equipment and the financial information disclosed herein materially represents all of the financial information related to our semiconductor equipment segment.

Cohu, Inc.
Notes to Unaudited Condensed Consolidated Financial Statements
September 30, 2017

Goodwill, Other Intangible Assets and Long-lived Assets

We evaluate goodwill for impairment annually and when an event occurs or circumstances change that indicate that the carrying value may not be recoverable. We test goodwill for impairment by first comparing the book value of net assets to the fair value of the reporting units. If the fair value is determined to be less than the book value, a second step is performed to compute the amount of impairment as the difference between the estimated fair value of goodwill and the carrying value. We estimated the fair values of our reporting units primarily using the income approach valuation methodology that includes the discounted cash flow method, taking into consideration the market approach and certain market multiples as a validation of the values derived using the discounted cash flow methodology. Forecasts of future cash flows are based on our best estimate of future net sales and operating expenses, based primarily on customer forecasts, industry trade organization data and general economic conditions.

We conduct our annual impairment test as of October 1st of each year, and have determined there was no impairment as of October 1, 2016 as we determined that the estimated fair values of our reporting units exceeded their carrying values on that date. Other events and changes in circumstances may also require goodwill to be tested for impairment between annual measurement dates. As of September 30, 2017, we do not believe that circumstances have occurred that indicate impairment of our goodwill is more-likely-than-not. In the event we determine that an interim goodwill impairment review is required in a future period, the review may result in an impairment charge, which would have a negative impact on our results of operations.

Long-lived assets, other than goodwill, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets might not be recoverable. Conditions that would necessitate an impairment assessment include a significant decline in the observable market value of an asset, a significant change in the extent or manner in which an asset is used, or any other significant adverse change that would indicate that the carrying amount of an asset or group of assets may not be recoverable. For long-lived assets, impairment losses are only recorded if the asset's carrying amount is not recoverable through its undiscounted, probability-weighted future cash flows. We measure the impairment loss based on the difference between the carrying amount and estimated fair value.

Foreign Remeasurement and Currency Translation

Assets and liabilities of our wholly owned foreign subsidiaries that use the U.S. Dollar as their functional currency are re-measured using exchange rates in effect at the end of the period, except for nonmonetary assets, such as inventories and property, plant and equipment, which are re-measured using historical exchange rates. Revenues and costs are re-measured using average exchange rates for the period, except for costs related to those balance sheet items that are re-measured using historical exchange rates. Gains and losses on foreign currency transactions are recognized as incurred. During the three and nine months ended September 30, 2017, we recognized foreign exchange losses of \$0.2 million and \$2.7 million, respectively, in our condensed consolidated statements of income. During the three and nine months ended September 24, 2016, we recognized approximately \$0.3 million and \$1.0 million of foreign exchange losses in our condensed consolidated statements of income, respectively. Certain of our foreign subsidiaries have designated the local currency as their functional currency and, as a result, their assets and liabilities are translated at the rate of exchange at the balance sheet date, while revenue and expenses are translated using the average exchange rate for the period. Cumulative translation adjustments resulting from the translation of the financial statements are included as a separate component of stockholders' equity.

Share-Based Compensation

We measure and recognize all share-based compensation under the fair value method. Our estimate of share-based compensation expense requires a number of complex and subjective assumptions including our stock price volatility, employee exercise patterns (expected life of the options) and related tax effects. The assumptions used in calculating the fair value of share-based awards represent our best estimates, but these estimates involve inherent uncertainties and the application of management judgment. Although we believe the assumptions and estimates we have made are reasonable and appropriate, changes in assumptions could materially impact our reported financial results.

Cohu, Inc.
Notes to Unaudited Condensed Consolidated Financial Statements
September 30, 2017

Reported share-based compensation is classified, in the condensed consolidated interim financial statements, as follows (*in thousands*):

	Three Months Ended		Nine Months Ended	
	September 30, 2017	September 24, 2016	September 30, 2017	September 24, 2016
Cost of sales	\$ 123	\$ 101	\$ 327	\$ 309
Research and development	278	327	856	955
Selling, general and administrative	1,459	1,330	4,153	4,027
Total share-based compensation	1,860	1,758	5,336	5,291
Income tax benefit	(107)	(76)	(429)	(189)
Total share-based compensation, net	<u>\$ 1,753</u>	<u>\$ 1,682</u>	<u>\$ 4,907</u>	<u>\$ 5,102</u>

Income (Loss) Per Share

Basic income (loss) per common share is computed by dividing net income (loss) by the weighted-average number of common shares outstanding during the reporting period. Diluted income (loss) per share includes the dilutive effect of common shares potentially issuable upon the exercise of stock options, vesting of outstanding restricted stock and performance stock units and issuance of stock under our employee stock purchase plan using the treasury stock method. In loss periods, potentially dilutive securities are excluded from the per share computations due to their anti-dilutive effect. For purposes of computing diluted income (loss) per share, stock options with exercise prices that exceed the average fair market value of our common stock for the period are excluded. For the three and nine months ended September 30, 2017, options to issue approximately 5,000 and 103,000 shares of common stock were excluded from the computation, respectively. For the three and nine months ended September 24, 2016, options to issue approximately 707,000 and 752,000 shares of common stock were excluded from the computation, respectively.

The following table reconciles the denominators used in computing basic and diluted income (loss) per share (*in thousands*):

	Three Months Ended		Nine Months Ended	
	September 30, 2017	September 24, 2016	September 30, 2017	September 24, 2016
Weighted average common shares	28,155	26,761	27,614	26,596
Effect of dilutive securities	950	606	1,026	786
	<u>29,105</u>	<u>27,367</u>	<u>28,640</u>	<u>27,382</u>

Cohu has utilized the “control number” concept in the computation of diluted earnings per share to determine whether potential common stock instruments are dilutive. The control number used is income from continuing operations. The control number concept requires that the same number of potentially dilutive securities applied in computing diluted earnings per share from continuing operations be applied to all other categories of income or loss, regardless of their anti-dilutive effect on such categories.

Revenue Recognition

Our net sales are derived from the sale of products and services and are adjusted for estimated returns and allowances, which historically have been insignificant. We recognize revenue when there is persuasive evidence of an arrangement, title and risk of loss have passed, delivery has occurred or the services have been rendered, the sales price is fixed or determinable and collection of the related receivable is reasonably assured. Title and risk of loss generally pass to our customers upon shipment. In circumstances where either title or risk of loss pass upon destination or acceptance, we defer revenue recognition until such events occur.

Revenue for established products that have previously satisfied a customer’s acceptance requirements and provide for full payment tied to shipment is generally recognized upon shipment and passage of title. In certain instances, customer payment terms may provide that a minority portion (e.g. up to 20%) of the equipment purchase price be paid only upon customer acceptance. In those situations, the majority portion (e.g. 80%) of revenue where the contingent payment is tied to shipment and the entire product cost of sale are recognized upon shipment and passage of title and the minority portion of the purchase price related to customer acceptance is deferred and recognized upon receipt of customer acceptance. In cases where a prior history of customer acceptance cannot be demonstrated or from sales where customer payment dates are not determinable and in the case of new products, revenue and cost of sales is deferred until customer acceptance has been received. Our post-shipment obligations typically include installation and standard warranties. The estimated fair value of installation related revenue is recognized in the period the installation is performed. Service revenue is recognized ratably over the period of the related contract or upon completion of the services if they are short-term in nature. Spares, contactor and kit revenue is generally recognized upon shipment.

Cohu, Inc.
Notes to Unaudited Condensed Consolidated Financial Statements
September 30, 2017

Certain of our equipment sales are accounted for as multiple-element arrangements. A multiple-element arrangement is a transaction which may involve the delivery or performance of multiple products, services, or rights to use assets, and performance may occur at different points in time or over different periods of time. For arrangements containing multiple elements, the revenue relating to the undelivered elements is deferred using the relative selling price method utilizing estimated sales prices until delivery of the deferred elements. We limit the amount of revenue recognition for delivered elements to the amount that is not contingent on the future delivery of products or services, future performance obligations or subject to customer-specified return or adjustment.

On shipments where sales are not recognized, gross profit is generally recorded as deferred profit in our consolidated balance sheet representing the difference between the receivable recorded and the inventory shipped. At September 30, 2017, we had deferred revenue totaling approximately \$9.9 million and deferred profit of \$6.7 million. At December 31, 2016, we had deferred revenue totaling approximately \$9.3 million and deferred profit of \$6.9 million. The periodic change is primarily a result of increases and decreases in deferrals of revenue associated with product shipments made to our customers in accordance with our revenue recognition policy.

A small number of customers historically have been responsible for a significant portion of our net sales. Significant customer concentration information is as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2017	September 24, 2016	September 30, 2017	September 24, 2016
Customers individually accounting for more than 10% of net sales	two	three	two	two
Percentage of net sales	26.5%	37.4%	28.5%	30.5%

Accumulated Other Comprehensive Loss

Our accumulated other comprehensive loss balance totaled approximately \$18.0 million and \$27.9 million at September 30, 2017 and December 31, 2016, respectively, and was attributed to all non-owner changes in stockholders' equity and consists of, on an after-tax basis where applicable, foreign currency adjustments resulting from the translation of certain of our subsidiary accounts where the functional currency is not the U.S. Dollar and adjustments related to postretirement benefits. Reclassification adjustments from accumulated other comprehensive loss during the three- and nine-month periods ended of fiscal 2017 and 2016 were not significant.

Retiree Medical Benefits

We provide post-retirement health benefits to certain executives and directors under a noncontributory plan. The net periodic benefit cost incurred during the first nine months of fiscal 2017 and 2016 was not significant.

Recent Accounting Pronouncements

Recently Adopted Accounting Pronouncements – In July 2015, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2015-11, *Simplifying the Measurement of Inventory*. Under this guidance, inventory should be measured at the lower of cost and net realizable value. Subsequent measurement is unchanged for inventory measured using LIFO or the retail inventory method. The adoption of this authoritative guidance did not have a material impact on our consolidated financial statements.

Cohu, Inc.
Notes to Unaudited Condensed Consolidated Financial Statements
September 30, 2017

Recently Issued Accounting Pronouncements – In March 2017, the FASB issued ASU No. 2017-07, *Compensation – Retirement Benefits (Topic 715) – Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*, which provides additional guidance on the presentation of net periodic pension and postretirement benefit costs in the income statement and on the components eligible for capitalization. The amendments in this guidance require that an employer report the service cost component of the net periodic benefit costs in the same income statement line item as other compensation costs arising from services rendered by employees during the period. The non-service-cost components of net periodic benefit costs are to be presented in the income statement separately from the service cost components and outside a subtotal of income from operations. The guidance also allows for the capitalization of the service cost components, when applicable (i.e., as a cost of internally manufactured inventory or a self-constructed asset). The guidance is effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods; early adoption is permitted as of the beginning of an annual period for which financial statements (interim or annual) have not been issued or made available for issuance. The amendments in this guidance are to be applied retrospectively. We are currently assessing the impact this guidance will have on our consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-04, *Simplifying the Test for Goodwill Impairment*. It eliminates Step 2 from the goodwill impairment test and requires an entity to recognize an impairment charge for the amount by which the carrying amount of goodwill exceeds the reporting unit's fair value, not to exceed the carrying amount of goodwill. This guidance is effective for annual and any interim impairment tests in fiscal years beginning after December 15, 2019. We do not expect this guidance to have any impact on our consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-01, *Clarifying the Definition of a Business*. It revises the definition of a business and provides a framework to evaluate when an input and a substantive process are present in an acquisition to be considered a business. This guidance is effective for annual periods beginning after December 15, 2017. We do not expect this guidance to have any impact on our consolidated financial statements.

In November 2016, the FASB issued ASU No. 2016-18, *Restricted Cash*. It requires that amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. This guidance is effective for interim and annual reporting periods beginning after December 15, 2017. We do not expect this guidance to have a material impact on our consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, *Classification of Certain Cash Receipts and Cash Payments*. It provides guidance on eight specific cash flow issues with the objective of reducing the existing diversity in practice in how they are classified in the statement of cash flows. This guidance is effective for interim and annual reporting periods beginning after December 15, 2017. Early adoption is permitted, provided that all of the amendments are adopted in the same period. We do not expect this guidance to have a material impact on our consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. Under this guidance, lessees will be required to recognize a right-of-use asset and a lease liability for all operating leases defined under previous GAAP. This guidance is effective for interim and annual reporting periods beginning after December 15, 2018. The new guidance must be adopted using a modified retrospective transition, and provides for certain practical expedients. We are still completing our analysis on the impact this guidance will have on our consolidated financial statements and related disclosures, but recognizing the lease liabilities and related right-of-use assets will impact our balance sheet.

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606) (ASU 2014-09)*, which amends the existing accounting standards for revenue recognition. In August 2015, the FASB issued ASU No. 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*, which delays the effective date of *ASU 2014-09* by one year. The FASB also agreed to allow entities to choose to adopt the standard as of the original effective date. In March 2016, the FASB issued Accounting Standards Update No. 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net) (ASU 2016-08)* which clarifies the implementation guidance on principal versus agent considerations. The guidance includes indicators to assist an entity in determining whether it controls a specified good or service before it is transferred to customers. The new revenue recognition standard will be effective for us in the first quarter of 2018. We will adopt the new standard effective December 31, 2017, which is the first day of our 2018 fiscal year. The new standard also permits two methods of adoption: retrospectively to each prior reporting period presented (the full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (the modified retrospective method)

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We currently anticipate adopting the standard using the modified retrospective method. We are still in the process of completing our analysis on the impact this guidance will have on our consolidated financial statements and related disclosures. Based on our preliminary review of our customer agreements, we currently expect that our revenue will continue to be recognized at a point in time, generally upon shipment of products to customers, consistent with our current revenue recognition model. In certain instances, when customer payment terms provide that a minority portion of the equipment purchase price be paid only upon customer acceptance, recognition of revenue may occur sooner under the new model. When adopting the new standard, on December 31, 2017, revenue that was not recognized in fiscal 2017, because the equipment had not been accepted by the customer, will be recognized as a cumulative catch-up adjustment to the opening balance of retained earnings as opposed to being recognized as future revenue upon acceptance. As the timing of customer acceptances cannot be predicted, we do not know the impact on future revenues and associated operating income at this time. However, revenues, deferred profit, cost of sales, and associated operating income may be materially impacted depending on the timing of customer acceptance.

2. Business Acquisitions, Goodwill and Other Purchased Intangible Assets

Kita

On January 4, 2017, we completed the acquisition of all the outstanding share capital of Kita Manufacturing Co., LTD. and Kita USA, Inc. (together “Kita”) (the “Acquisition”). Kita, headquartered in Osaka, Japan, and with operations in Attleboro, Massachusetts and Kyoto, Japan, designs, manufactures and sells spring probe contacts used in final test contactors, probe cards, PCB test boards and connectors sold to customers worldwide. The acquisition of Kita was a strategic transaction to expand our total available market, extend our market leadership and broaden our product offerings. In connection with the Acquisition we incurred acquisition related costs, which were expensed to selling, general and administrative, that totaled \$1.0 million and \$0.9 million during the first nine months of September 30, 2017 and September 24, 2016, respectively.

The Acquisition has been accounted for in conformity with FASB Accounting Standards Codification 805, *Business Combinations* (“ASC 805”). The purchase price for Kita was funded primarily by cash reserves and consisted of the following (*in thousands*):

Cash paid to Kita shareholders	\$	15,000
Fair value of contingent consideration		823
Total purchase price	\$	15,823

The contingent consideration represents the estimated fair value of future payments totaling up to \$3.0 million we would be required to make as a result of Kita achieving annual revenue and EBITDA targets in 2017 and 2018 as specified in the purchase agreement for the Acquisition. The fair value of the contingent consideration recognized on the acquisition date was estimated by using the Monte Carlo simulation model. The contingent consideration payable has been classified as level 3 in the fair value hierarchy. See Note 3 “Financial Instruments Measured at Fair Value” for additional information on the three-tier fair value hierarchy.

Contingent consideration is recorded in our condensed consolidated balance sheets in other accrued liabilities. Adjustments to the fair value of contingent consideration are reflected in selling, general, and administrative expense in our condensed consolidated statements of income and are included in the acquisition related costs above.

The following table presents the fair value of contingent consideration from the date of acquisition through September 30, 2017 (*in thousands*):

	Fair Value of Consideration Recognized at Acquisition Date	Settlement of Contingent Consideration	Mark to Market Adjustment Charged to Expense	Impact of Currency Exchange	Fair Value of Consideration at September 30, 2017
Kita	\$ 823	\$ -	\$ 668	\$ 9	\$ 1,500

We have not finalized the purchase price allocation. Accordingly, the preliminary purchase price allocation shown below could materially change as the fair values of the tangible and intangible assets acquired and liabilities assumed and the related income tax effects are finalized during the remainder of the measurement period (which will not exceed 12 months from the Acquisition closing date). The Acquisition was nontaxable to Cohu and certain of the assets acquired, including goodwill and intangibles, will not be deductible for tax purposes. The acquired assets and liabilities of Kita were recorded at their respective fair values including an amount for goodwill representing the difference between the Acquisition consideration and the fair value of the identifiable net assets.

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The table below summarizes the assets acquired and liabilities assumed as of January 4, 2017 (*in thousands*):

Current assets, including cash received	\$	10,491
Property, plant and equipment		12,751
Other assets		2,291
Intangible assets subject to amortization		2,100
Goodwill		3,142
Total assets acquired		30,775
Liabilities assumed		(14,952)
Net assets acquired	\$	<u>15,823</u>

The preliminary allocation of the intangible assets subject to amortization is as follows (*in thousands*):

Description	Estimated Fair Value	Average Useful Life (in years)
Developed technology	\$ 700	8
Customer relationships	600	4
Covenant not-to-compete	300	10
Product backlog	100	1
Trade names	400	5
	<u>\$ 2,100</u>	

The preliminary value assigned to the developed technology was determined by using the multi-period excess earnings method under the income approach. Developed technology, which comprises products that have reached technological feasibility, includes the products in Kita's product line. The revenue estimates used to value the developed technology were based on estimates of relevant market sizes and growth factors, expected trends in technology and the nature and expected timing of new product introductions by Kita and its competitors. The estimated cash flows were based on revenues for the developed technology net of operating expenses and net of contributory asset charges. The discount rate utilized to discount the net cash flows of the developed technology to present value was based on the risk associated with the respective cash flows taking into consideration the perceived risk of the technology relative to the other acquired assets, the weighted average cost of capital, the internal rate of return, and the weighted average return on assets.

The value assigned to customer relationships was determined by using the with and without method under the income approach, which analyzes the difference in discounted cash flows generated with the customer relationships in place compared to the discounted cash flows generated without the customer relationships in place.

The value assigned to the covenant not-to-compete was estimated based upon the with and without method of the income approach. Specifically, the present value of the differential of the projected cash flows with and without the covenant in place was measured utilizing the appropriate expected rate of return.

The value assigned to backlog acquired was estimated based upon the contractual nature of the backlog as of the acquisition date, using the income approach to discount back to present value the cash flows attributable to the backlog.

The value assigned to trade names was estimated using the relief-from-royalty method of the income approach. This approach is based on the assumption that in lieu of ownership, a company would be willing to pay a royalty in order to exploit the related benefits of this intangible asset.

Kita's results of operations were included in, but not material to, Cohu's consolidated statements of income and comprehensive income commencing January 4, 2017 and Kita's net sales for the three- and nine-month periods ended September 30, 2017 were \$5.3 million and \$14.4 million, respectively. Prior to the acquisition by Cohu, Kita's net sales for the three- and nine-month periods ended September 24, 2016 were \$4.3 million and \$12.9 million, respectively.

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Goodwill and Intangible Assets

Changes in the carrying value of goodwill during the year ended December 31, 2016 and the nine-month period ended September 30, 2017 were as follows (*in thousands*):

	Goodwill
Balance, December 26, 2015	\$ 60,264
Impact of currency exchange	(1,415)
Balance, December 31, 2016	58,849
Additions, net	3,142
Impact of currency exchange	3,492
Balance, September 30, 2017	<u>\$ 65,483</u>

Purchased intangible assets, subject to amortization are as follows (*in thousands*):

	September 30, 2017			December 31, 2016	
	Gross Carrying Amount	Accum. Amort.	Remaining Weighted Average Amort. Period (in years)	Gross Carrying Amount	Accum. Amort.
Developed technology	\$ 20,785	\$ 11,977	3.6	\$ 19,195	\$ 9,597
Customer relationships	7,935	4,582	3.3	6,996	3,644
Trade names	6,139	849	12.4	5,353	468
Covenant not-to-compete	312	23	9.3	-	-
Backlog	104	78	0.3	-	-
Total intangible assets	<u>\$ 35,275</u>	<u>\$ 17,509</u>		<u>\$ 31,544</u>	<u>\$ 13,709</u>

Amortization expense related to intangible assets was approximately \$1.1 million in the third quarter of fiscal 2017 and \$3.2 million in the first nine months of fiscal 2017. Amortization expense related to intangible assets was approximately \$1.8 million in the third quarter of fiscal 2016 and \$5.4 million in the first nine months of fiscal 2016. The year-over-year decrease in amortization is a result of certain intangible assets that became fully amortized in the prior year. Changes in the carrying values of these intangible assets are a result of the impact of fluctuations in currency exchange rates.

3. Financial Instruments Measured at Fair Value

Our cash, cash equivalents, and short-term investments consisted primarily of cash and other investment grade securities. We do not hold investment securities for trading purposes. All short-term investments are classified as available-for-sale and recorded at fair value. Investment securities are exposed to market risk due to changes in interest rates and credit risk and we monitor credit risk and attempt to mitigate exposure by making high-quality investments and through investment diversification.

Gains and losses on investments are calculated using the specific-identification method and are recognized during the period in which the investment is sold or when an investment experiences an other-than-temporary decline in value. Factors that could indicate an impairment exists include, but are not limited to: earnings performance, changes in credit rating or adverse changes in the regulatory or economic environment of the asset. Gross realized gains and losses on sales of short-term investments are included in interest income. Realized gains and losses for the periods presented were not significant.

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Investments that we have classified as short-term, by security type, are as follows (*in thousands*):

	September 30, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses ⁽¹⁾	Estimated Fair Value
Corporate debt securities ⁽²⁾	\$ 9,843	\$ 1	\$ 2	\$ 9,842
U.S. Treasury securities	4,596	-	-	4,596
Bank certificates of deposit	1,299	-	-	1,299
Foreign government security	603	-	-	603
	<u>\$ 16,341</u>	<u>\$ 1</u>	<u>\$ 2</u>	<u>\$ 16,340</u>

	December 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses ⁽¹⁾	Estimated Fair Value
Corporate debt securities ⁽²⁾	\$ 22,513	\$ 1	\$ 6	\$ 22,508
Government-sponsored enterprise securities	8,109	-	1	8,108
Bank certificates of deposit	750	1	-	751
Foreign government security	623	-	-	623
	<u>\$ 31,995</u>	<u>\$ 2</u>	<u>\$ 7</u>	<u>\$ 31,990</u>

(1) As of September 30, 2017, there were \$7.5 million of investments in our portfolio in a loss position. As of December 31, 2016, the cost and fair value of investments with loss positions were approximately \$26.6 million. We evaluated the nature of these investments, credit worthiness of the issuer and the duration of these impairments to determine if an other-than-temporary decline in fair value had occurred and concluded that these losses were temporary and we have the ability and intent to hold these investments to maturity.

(2) Corporate debt securities include investments in financial and other corporate institutions. No single issuer represents a significant portion of the total corporate debt securities portfolio.

Effective maturities of short-term investments are as follows (*in thousands*):

	September 30, 2017		December 31, 2016	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ 16,341	\$ 16,340	\$ 31,372	\$ 31,367
Due after one year through three years	-	-	623	623
	<u>\$ 16,341</u>	<u>\$ 16,340</u>	<u>\$ 31,995</u>	<u>\$ 31,990</u>

Accounting standards pertaining to fair value measurements establish a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions. When available, we use quoted market prices to determine the fair value of our investments, and they are included in Level 1. When quoted market prices are unobservable, we use quotes from independent pricing vendors based on recent trading activity and other relevant information, and they are included in Level 2.

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The following table summarizes, by major security type, our financial instruments that are measured at fair value on a recurring basis and are categorized using the fair value hierarchy (*in thousands*):

	Fair value measurements at September 30, 2017 using:			Total estimated fair value
	Level 1	Level 2	Level 3	
Cash	\$ 98,678	\$ -	\$ -	\$ 98,678
U.S. Treasury securities	-	4,596	-	4,596
Corporate debt securities	-	19,329	-	19,329
Money market funds	-	13,820	-	13,820
Bank certificates of deposit	-	1,298	-	1,298
Foreign government security	-	603	-	603
	<u>\$ 98,678</u>	<u>\$ 39,646</u>	<u>\$ -</u>	<u>\$ 138,324</u>

	Fair value measurements at December 31, 2016 using:			Total estimated fair value
	Level 1	Level 2	Level 3	
Cash	\$ 70,279	\$ -	\$ -	\$ 70,279
Foreign government security	-	623	-	623
Corporate debt securities	-	24,108	-	24,108
Government-sponsored enterprise securities	-	8,108	-	8,108
Money market funds	-	24,166	-	24,166
Bank certificates of deposit	-	751	-	751
	<u>\$ 70,279</u>	<u>\$ 57,756</u>	<u>\$ -</u>	<u>\$ 128,035</u>

4. Employee Stock Benefit Plans

Our 2005 Equity Incentive Plan (the “2005 Plan”) is a broad-based, long-term retention program intended to attract, motivate, and retain talented employees as well as align stockholder and employee interests. Awards that may be granted under the program include, but are not limited to, non-qualified and incentive stock options, restricted stock units, and performance stock units. We settle employee stock option exercises, employee stock purchase plan purchases, and the vesting of restricted stock units, and performance stock units with newly issued common shares. At September 30, 2017, there were 1,459,354 shares available for future equity grants under the 2005 Equity Incentive Plan.

Stock Options

Stock options may be granted to employees, consultants and directors to purchase a fixed number of shares of our common stock. The exercise prices of options granted are at least equal to the fair market value of our common stock on the dates of grant and options vest and become exercisable in annual increments that range from one to four years from the date of grant. Stock options granted under the 2015 Plan have a maximum contractual term of ten years. In the first nine months of fiscal 2017 we did not grant any stock options and we issued 930,883 shares of our common stock on the exercise of options that were granted previously.

At September 30, 2017, we had 705,284 stock options outstanding. These options had a weighted-average exercise price of \$10.61 per share, an aggregate intrinsic value of approximately \$4.8 million and the weighted average remaining contractual term was approximately 4.2 years.

At September 30, 2017, we had 701,951 stock options outstanding that were exercisable. These options had a weighted-average exercise price of \$10.61 per share, an aggregate intrinsic value of \$4.8 million and the weighted average remaining contractual term was approximately 4.2 years.

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Restricted Stock Units

We grant restricted stock units (“RSUs”) to certain employees, consultants and directors. RSUs vest in annual increments that range from one to four years from the date of grant. Prior to vesting, RSUs do not have dividend equivalent rights, do not have voting rights and the shares underlying the RSUs are not considered issued and outstanding. New shares of our common stock will be issued on the date the RSUs vest net of the minimum statutory tax withholding requirements to be paid by us on behalf of our employees. As a result, the actual number of shares issued will be fewer than the actual number of RSUs outstanding at September 30, 2017.

In the first nine months of fiscal 2017 we awarded 349,956 RSUs and we issued 398,529 shares of our common stock on vesting of previously granted awards. At September 30, 2017, we had 1,014,145 RSUs outstanding with an aggregate intrinsic value of approximately \$17.7 million and the weighted average remaining vesting period was approximately 2.2 years.

Performance Stock Units

We also grant performance stock units (“PSUs”) to senior executives as a part of our long-term equity compensation program. The number of shares of common stock that will ultimately be issued to settle PSUs granted in 2017 and 2016 ranges from 25% to 200% and is determined based on certain performance criteria over a three-year measurement period. For PSUs granted in 2015, the number of shares of common stock issued to settle PSUs granted is determined based on a two-year measurement period. The performance criteria for the PSUs are based on a combination of our annualized Total Shareholder Return (“TSR”) for the performance period and the relative performance of our TSR compared with the annualized TSR of certain peer companies for the performance period. PSUs granted in 2017 and 2016 vest 100% on the third anniversary of their grant and PSUs granted in 2015 vest 50% on the second and third anniversary of their grant, respectively.

We estimated the fair value of the PSUs using a Monte Carlo simulation model on the date of grant. Compensation expense is recognized ratably over the derived service period. New shares of our common stock will be issued on the date the PSUs vest net of the minimum statutory tax withholding requirements to be paid by us on behalf of our employees. As a result, the actual number of shares issued will be fewer than the actual number outstanding at September 30, 2017.

In the first nine months of fiscal 2017, we awarded 185,305 PSUs and we issued 186,146 shares of our common stock on vesting of previously granted awards. At September 30, 2017, we had 357,333 PSUs outstanding with an aggregate intrinsic value of approximately \$6.2 million and the weighted average remaining vesting period was approximately 1.6 years.

Employee Stock Purchase Plan

The Cohu, Inc. 1997 Employee Stock Purchase Plan (the “Plan”) provides for the issuance of shares of our common stock. Under the Plan, eligible employees may purchase shares of Cohu common stock through payroll deductions at a price equal to 85 percent of the lower of the fair market value of Cohu common stock at the beginning or end of each 6-month purchase period, subject to certain limits. During the first nine months of fiscal 2017, 61,313 shares of our common stock were sold to our employees under the Plan leaving 639,171 shares available for future issuance.

5. Income Taxes

For the three and nine months ended September 30, 2017, we used the estimated effective tax rate (“ETR”) expected to be applicable for the full fiscal year in computing our tax provision. The ETR on income from continuing operations for the three months ended September 30, 2017 and September 24, 2016, was 17.3% and 86.9%, respectively, and 14.0% and 65.8% for the nine months ended September 30, 2017 and September 24, 2016, respectively. The tax provision on income from continuing operations in 2017 and 2016 differs from the U.S. federal statutory rate primarily due to the lack of a provision (benefit) on our domestic income (losses) as a result of our valuation allowance on deferred tax assets, foreign income taxed at different rates, changes in our deferred tax asset valuation allowance, state taxes and interest related to unrecognized tax benefits.

Other than for foreign currency exchange rate changes and the Kita acquisition, there was no material change to our unrecognized tax benefits and related accrued interest and penalties during the three- and nine-month periods ended September 30, 2017 and September 24, 2016.

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6. Discontinued Operations

In June 2015, we sold all of the outstanding stock of BMS for \$4.9 million in cash and up to \$2.5 million of contingent cash consideration. Our decision to sell this non-core business resulted from management’s determination that it was no longer a strategic fit within our organization. As part of the divestiture of BMS we recorded a long-term contingent consideration receivable that has been classified as Level 3 in the fair value hierarchy. See Note 3, “Financial Instruments Measured at Fair Value” for additional information on the three-tier fair value hierarchy. The contingent consideration represents the estimated fair value of future payments we are due from the buyer should BMS achieve specified annual revenue targets in certain years as specified in the sale agreement. The periodic fair value of the contingent consideration is determined through the use of the Monte Carlo simulation model. Based on updated information the contingent consideration receivable was adjusted in the second quarter of 2017 and is included in the loss from sale of BMS amount below.

	Three Months Ended		Nine Months Ended	
	September 30, 2017	September 24, 2016	September 30, 2017	September 24, 2016
Net sales	\$ -	\$ -	\$ -	\$ -
Operating loss before income taxes	-	-	-	-
Loss from sale of BMS	-	51	(278)	(4)
Loss before taxes	-	51	(278)	(4)
Income tax provision	-	-	-	-
Loss, net of tax	\$ -	\$ 51	\$ (278)	\$ (4)

7. Contingencies

From time-to-time we are involved in various legal proceedings, examinations by various tax authorities and claims that have arisen in the ordinary course of our business. The outcome of any litigation is inherently uncertain. While there can be no assurance, we do not believe at the present time that the resolution of these matters will have a material adverse effect on our assets, financial position or results of operations.

8. Guarantees and Other Obligations

Product Warranty

Our products are generally sold with warranty periods that range from 12 to 36 months following sale or acceptance. Parts and labor are covered under the terms of the warranty agreement. The warranty provision is based on historical and projected experience by product and configuration.

Changes in accrued warranty were as follows (*in thousands*):

	Three Months Ended		Nine Months Ended	
	September 30, 2017	September 24, 2016	September 30, 2017	September 24, 2016
Balance at beginning of period	\$ 5,070	\$ 5,118	\$ 4,350	\$ 4,886
Warranty expense accruals	1,720	1,320	5,446	4,586
Warranty payments	(1,773)	(1,401)	(4,829)	(4,435)
Warranty liability assumed	-	-	50	-
Balance at end of period	\$ 5,017	\$ 5,037	\$ 5,017	\$ 5,037

Accrued warranty amounts expected to be incurred after one year are included in noncurrent other accrued liabilities in the condensed consolidated balance sheet. These amounts total \$0.7 million at September 30, 2017 and \$0.6 million at December 31, 2016.

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Borrowings

Revolving Lines of Credit

As a result of the Acquisition, we assumed a series of revolving credit facilities with various financial institutions in Japan. The credit facilities renew monthly and provide Kita with access to working capital totaling up to \$6.2 million. At September 30, 2017, total borrowings outstanding under the revolving lines of credit were \$3.1 million. As these credit facility agreements renew monthly, they have been included in short-term borrowings in our condensed consolidated balance sheet. The revolving lines of credit are denominated in Japanese Yen and, as a result, amounts disclosed herein will fluctuate because of changes in currency exchange rates.

Term Loans

As a result of the Acquisition, we assumed certain term loans from a series of Japanese financial institutions that had an aggregate amount outstanding of \$6.2 million as of September 30, 2017 primarily related to the expansion of Kita's facility in Osaka, Japan. The loans are collateralized by the facility and land, carry interest rates ranging from 0.05% to 0.45%, and expire at various dates through 2034. At September 30, 2017, \$1.3 million of the term loans have been included in current installments of long-term debt in our condensed consolidated balance sheet. The fair value of our debt approximates the carrying value at September 30, 2017. The term loans are denominated in Japanese Yen and, as a result, amounts disclosed herein will fluctuate because of changes in currency exchange rates.

Lines of Credit

We have two available lines of credit, which provide one of our wholly owned subsidiaries with borrowings up to 2.5 million Swiss Francs. At September 30, 2017 and December 31, 2016, no amounts were outstanding under the lines of credit.

Standby Letters of Credit

During the ordinary course of business, from time-to-time we provide standby letters of credit instruments to certain parties as required. As of September 30, 2017, no amounts were outstanding under standby lines of credit.

Cohu, Inc.
Management's Discussion and Analysis of Financial Condition and Results of Operations
September 30, 2017

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Form 10-Q contains certain forward-looking statements including expectations of market conditions, challenges and plans, within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and is subject to the Safe Harbor provisions created by that statute. Such forward-looking statements are based on management's current expectations and beliefs, including estimates and projections about our business and include, but are not limited to, statements concerning financial position, business strategy, and plans or objectives for future operations. Forward-looking statements are not guarantees of future performance, and are subject to certain risks, uncertainties, and assumptions that are difficult to predict and may cause actual results to differ materially from management's current expectations. Such risks and uncertainties include those set forth in this Quarterly Report on Form 10-Q and our 2016 Annual Report on Form 10-K under the heading "Item 1A. Risk Factors". The forward-looking statements in this report speak only as of the time they are made, and do not necessarily reflect management's outlook at any other point in time. We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events, or for any other reason, however, readers should carefully review the risk factors set forth in other reports or documents we file from time to time with the SEC after the date of this Quarterly Report.

OVERVIEW

Cohu is a leading supplier of semiconductor test and inspection handlers, micro-electro mechanical system (MEMS) test modules, test contactors and thermal subsystems used by global semiconductor manufacturers and test subcontractors. Our business is significantly dependent on capital expenditures by semiconductor manufacturers and test subcontractors, which in turn is dependent on the current and anticipated market demand for semiconductors that is subject to seasonal trends. We expect that the semiconductor equipment industry will continue to be seasonal in part because consumer electronics, automotive and mobility, the principal end markets for integrated circuits, are highly dynamic industries and demand has traditionally fluctuated with global consumer spending. In light of these conditions, our results can vary significantly year-over-year, as well as quarter-over-quarter.

During the quarter ended September 30, 2017, sales of our products were essentially flat quarter over quarter, however, consolidated net sales increased 35.2% from the quarter ended September 24, 2016, as a result of the improved business conditions within the semiconductor industry and our success in growing share in the test handler and test contactor markets. In 2017, demand was driven primarily by semiconductor equipment for testing devices used in automotive, mobility and IoT (Internet of Things) markets. Customer test cell utilization remains strong and long-term, we continue to see momentum in the consumer electronics, automotive, mobile and industrial markets and are optimistic about the prospects for our business due to increasing ubiquity of semiconductors, the diminishing impact of parallel test, increasing semiconductor complexity and increasing quality demands of semiconductor customers. We are focused on growing our market share in the semiconductor test handling and test contactor markets, and expanding into the semiconductor inspection market.

Application of Critical Accounting Estimates and Policies

Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. We base our estimates on historical experience, forecasts and on various other assumptions that are believed to be reasonable under the circumstances, however actual results may differ from those estimates under different assumptions or conditions. The methods, estimates and judgments we use in applying our accounting policies have a significant impact on the results we report in our financial statements. Some of our accounting policies require us to make difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain.

Our critical accounting estimates that we believe are the most important to an investor's understanding of our financial results and condition and require complex management judgment include:

- revenue recognition, including the deferral of revenue on sales to customers, which impacts our results of operations;
- estimation of valuation allowances and accrued liabilities, specifically product warranty, inventory reserves and allowance for bad debts, which impact gross margin or operating expenses;
- the recognition and measurement of current and deferred income tax assets and liabilities, unrecognized tax benefits and the valuation allowance on deferred tax assets, which impact our tax provision;
- the assessment of recoverability of long-lived assets including goodwill and other intangible assets, which primarily impacts gross margin or operating expenses if we are required to record impairments of assets or accelerate their depreciation or amortization; and
- the valuation and recognition of share-based compensation, which impacts gross margin, research and development expense, and selling, general and administrative expense.

Cohu, Inc.
Management's Discussion and Analysis of Financial Condition and Results of Operations
September 30, 2017

Below, we discuss these policies further, as well as the estimates and judgments involved. We also have other policies that we consider key accounting policies; however, these policies typically do not require us to make estimates or judgments that are difficult or subjective.

Revenue Recognition: We generally recognize revenue upon shipment and title passage for established products (i.e., those that have previously satisfied customer acceptance requirements) that provide for full payment tied to shipment. Revenue for products that have not previously satisfied customer acceptance requirements or from sales where customer payment dates are not determinable is recognized upon customer acceptance. In certain instances, customer payment terms may provide that a minority portion (e.g. up to 20%) of the equipment purchase price be paid only upon customer acceptance. In those situations, the majority portion (e.g. 80%) of revenue where the contingent payment is tied to shipment and the entire product cost of sale are recognized upon shipment and passage of title and the minority portion of the purchase price related to customer acceptance is deferred and recognized upon receipt of customer acceptance. For arrangements containing multiple elements the revenue relating to the undelivered elements is deferred using the relative selling price method utilizing estimated sales prices until delivery of the deferred elements. We limit the amount of revenue recognition for delivered elements to the amount that is not contingent on the future delivery of products or services, future performance obligations or subject to customer-specified return or adjustment. On shipments where sales are not recognized, gross profit is generally recorded as deferred profit in our consolidated balance sheet, representing the difference between the receivable recorded and the inventory shipped.

Accounts Receivable: We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our customers deteriorates, resulting in an impairment of their ability to make payments, additional allowances may be required.

Inventory: The valuation of inventory requires us to estimate obsolete or excess inventory as well as inventory that is not of saleable quality. The determination of obsolete or excess inventory requires us to estimate the future demand for our products. The demand forecast is a direct input in the development of our short-term manufacturing plans. We record valuation reserves on our inventory for estimated excess and obsolete inventory and lower of cost or net realizable value concerns equal to the difference between the cost of inventory and the estimated realizable value based upon assumptions about future product demand, market conditions and product selling prices. If future product demand, market conditions or product selling prices are less than those projected by management or if continued modifications to products are required to meet specifications or other customer requirements, increases to inventory reserves may be required which would have a negative impact on our gross margin.

Income Taxes: We estimate our liability for income taxes based on the various jurisdictions where we conduct business. This requires us to estimate our (i) current taxes; (ii) temporary differences that result from differing treatment of certain items for tax and accounting purposes and (iii) unrecognized tax benefits. Temporary differences result in deferred tax assets and liabilities that are reflected in the consolidated balance sheet. The deferred tax assets are analyzed and reduced by a valuation allowance by jurisdiction, if, based upon all available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. Establishing, reducing or increasing a valuation allowance in an accounting period generally results in an increase or decrease in tax expense in the statement of operations. We must make significant judgments to determine the provision for income taxes, deferred tax assets and liabilities, unrecognized tax benefits and any valuation allowance to be recorded against deferred tax assets. Our gross deferred tax asset balance as of September 30, 2017 was approximately \$50.1 million, with a valuation allowance of approximately \$46.5 million. Our deferred tax assets consist primarily of deferred gains and profits, reserves and accruals that are not yet deductible for tax and tax credit and net operating loss carryforwards.

Segment Information: We applied the provisions of ASC Topic 280, *Segment Reporting*, ("ASC 280"), which sets forth a management approach to segment reporting and establishes requirements to report selected segment information quarterly and to report annually entity-wide disclosures about products, major customers and the geographies in which the entity holds material assets and reports revenue. An operating segment is defined as a component that engages in business activities whose operating results are reviewed by the chief operating decision maker and for which discrete financial information is available. Based on the provisions of ASC 280, we have determined that our identified operating segments qualify for aggregation under ASC 280 due to similarities in their customers, their economic characteristics, and the nature of products and services provided. As a result, we report in one segment, semiconductor equipment.

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Goodwill, Other Intangible Assets and Long-lived Assets:

We evaluate goodwill for impairment annually and when an event occurs or circumstances change that indicate that the carrying value may not be recoverable. We test goodwill for impairment by first comparing the book value of net assets to the fair value of the reporting units. If the fair value is determined to be less than the book value, a second step is performed to compute the amount of impairment as the difference between the estimated fair value of goodwill and the carrying value. We estimated the fair values of our reporting units primarily using the income approach valuation methodology that includes the discounted cash flow method, taking into consideration the market approach and certain market multiples as a validation of the values derived using the discounted cash flow methodology. Forecasts of future cash flows are based on our best estimate of future net sales and operating expenses, based primarily on customer forecasts, industry trade organization data and general economic conditions.

We conduct our annual impairment test as of October 1st of each year, and have determined there was no impairment as of October 1, 2016 as we determined that the estimated fair values of our reporting units exceeded their carrying values on that date. Other events and changes in circumstances may also require goodwill to be tested for impairment between annual measurement dates. As of September 30, 2017, we do not believe that circumstances have occurred that indicate impairment of our goodwill is more-likely-than-not. In the event we determine that an interim goodwill impairment review is required in a future period, the review may result in an impairment charge, which would have a negative impact on our results of operations.

Long-lived assets, other than goodwill, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets might not be recoverable. Conditions that would necessitate an impairment assessment include a significant decline in the observable market value of an asset, a significant change in the extent or manner in which an asset is used, or any other significant adverse change that would indicate that the carrying amount of an asset or group of assets may not be recoverable. For long-lived assets, impairment losses are only recorded if the asset's carrying amount is not recoverable through its undiscounted, probability-weighted future cash flows. We measure the impairment loss based on the difference between the carrying amount and estimated fair value.

Warranty: We provide for the estimated costs of product warranties in the period sales are recognized. Our warranty obligation estimates are affected by historical product shipment levels, product performance and material and labor costs incurred in correcting product performance problems. Should product performance, material usage or labor repair costs differ from our estimates, revisions to the estimated warranty liability would be required.

Contingencies: We are subject to certain contingencies that arise in the ordinary course of our businesses which require us to assess the likelihood that future events will confirm the existence of a loss or an impairment of an asset. If a loss or asset impairment is probable and the amount of the loss or impairment is reasonably estimable, we accrue a charge to operations in the period such conditions become known.

Share-based Compensation: Share-based compensation expense related to restricted stock unit awards is calculated based on the market price of our common stock on the grant date, reduced by the present value of dividends expected to be paid on our common stock prior to vesting of the restricted stock unit. Share-based compensation on performance stock units with market-based goals is calculated using a Monte Carlo simulation model on the date of the grant. Share-based compensation expense related to stock options is recorded based on the fair value of the award on its grant date, which we estimate using the Black-Scholes valuation model.

Recent Accounting Pronouncements

For a description of accounting changes and recent accounting pronouncements, including the expected dates of adoption and estimated effects, if any, on our consolidated financial statements, see Note 1, "Recent Accounting Pronouncements" in Part I, Item 1 of this Form 10-Q.

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RESULTS OF OPERATIONS

On January 4, 2017, we completed the acquisition of Kita and the results of its operations have been included in our consolidated financial statements since that date. The following table summarizes certain operating data as a percentage of net sales:

	Three Months Ended		Nine Months Ended	
	September 30, 2017	September 24, 2016	September 30, 2017	September 24, 2016
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	(60.6)%	(66.4)%	(60.4)%	(67.2)%
Gross margin	39.4%	33.6%	39.6%	32.8%
Research and development	(10.3)%	(12.5)%	(10.7)%	(11.7)%
Selling, general and administrative	(18.0)%	(19.8)%	(17.6)%	(19.9)%
Income from operations	11.1%	1.3%	11.3%	1.2%

Third Quarter of Fiscal 2017 Compared to Third Quarter of Fiscal 2016**Net Sales**

Our consolidated net sales increased 35.2% to \$93.7 million in 2017, compared to \$69.3 million in 2016. Global demand for back-end semiconductor test and assembly equipment is seasonal and volatile in part because consumer electronics, the principle end market for integrated circuits, is a highly dynamic industry and demand has traditionally fluctuated. Consolidated net sales in the third quarter of 2017 were up from 2016 as a result of the improved business conditions within the semiconductor industry and our success in growing share in the test handler and test contactor markets. Our increased sales were driven primarily by demand for equipment testing semiconductor devices used in automotive, mobility and IoT markets. Consolidated net sales in the third quarter of 2017 also include \$5.3 million of net sales for Kita, which was acquired on January 4, 2017.

Gross Margin

Gross margin consists of net sales less cost of sales. Cost of sales consists primarily of the materials, assembly and test labor and overhead from operations. Our gross margin can fluctuate due to a number of factors, including, but not limited to, the mix and volume of products sold, product support costs, increases to inventory reserves or the sale of previously reserved inventory and utilization of manufacturing capacity. Our gross margin, as a percentage of net sales, was 39.4% in 2017 and 33.6% in 2016. As compared to the prior year, gross margin in the third quarter of 2017 benefitted from lower manufacturing costs as a result of our transition of volume handler manufacturing from the U.S. and Europe to Asia, as well as a significant increase in business volume which enabled us to better leverage our fixed costs. The third quarter of 2017 also benefitted from \$0.7 million in lower intangible asset amortization due to certain assets being fully amortized in 2016 offset, in part, by the amortization of \$0.6 million related to the purchase accounting inventory step-up adjustment recorded in connection with our acquisition of Kita.

As highlighted above, our gross margin can be impacted by charges to cost of sales related to excess, obsolete and lower of cost or net realizable value inventory issues. We compute the majority of our excess and obsolete inventory reserve requirements using a one-year inventory usage forecast. In the third quarter of 2017, we recorded charges to cost of sales of \$0.7 million for excess and obsolete inventory. In the third quarter of 2016, we recorded charges of approximately \$0.5 million. While we believe our reserves for excess and obsolete inventory and lower of cost or net realizable value concerns are adequate to cover known exposures at September 30, 2017, reductions in customer forecasts or continued modifications to products, as a result of our failure to meet specifications or other customer requirements, may result in additional charges to operations that could negatively impact our gross margin in future periods.

Research and Development Expense ("R&D Expense")

R&D expense consists primarily of salaries and related costs of employees engaged in ongoing research, product design and development activities, costs of engineering materials and supplies and professional consulting expenses. R&D expense was \$9.6 million in 2017 and \$8.7 million in 2016 representing 10.3% and 12.5% of net sales, respectively. New product development programs resulted in increased R&D spending on labor and materials during the third quarter of 2017, however, these additional costs were partially offset by \$0.7 million of cost reimbursements received under a cost-sharing arrangement that was entered into with a customer during the first quarter of 2016.

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Selling, General and Administrative Expense ("SG&A Expense")

SG&A expense consists primarily of salaries and benefit costs of employees, commission expense for independent sales representatives, product promotion and costs of professional services. SG&A expense was \$16.9 million or 18.0% of net sales in 2017, compared to \$13.7 million or 19.8% in 2016. Our SG&A expense has been negatively affected by the fluctuation of the Swiss Franc and Euro against the U.S. Dollar, which resulted in the recognition of foreign currency transaction losses totaling \$0.2 million and \$0.3 million in the third quarter of 2017 and 2016, respectively. Costs incurred specifically related to the Kita acquisition recorded in SG&A totaled \$0.1 million and \$0.5 million in the third quarter of 2017 and 2016, respectively. SG&A expense in the third quarter of 2017 was also negatively impacted by a \$0.7 million mark-to-market adjustment related to the fair value of the Kita contingent consideration liability and includes \$1.0 million of incremental SG&A costs due to the acquisition of Kita.

Income Taxes

For the three months ended September 30, 2017, we used the estimated effective tax rate ("ETR") in computing our tax provision. The ETR on income from continuing operations for the three months ended September 30, 2017 and September 24, 2016, was 17.3% and 86.9%, respectively. The tax provision on income from continuing operations in 2017 and 2016 differs from the U.S. federal statutory rate primarily due to the lack of a provision (benefit) on our domestic income (losses) as a result of our valuation allowance on deferred tax assets, foreign income taxed at different rates, changes in our deferred tax asset valuation allowance, state taxes and interest related to unrecognized tax benefits.

Other than for foreign currency exchange rate changes and the Kita Acquisition, there was no material change to our unrecognized tax benefits and related accrued interest and penalties during the three-month periods ended September 30, 2017 and September 24, 2016.

Income from Continuing Operations and Net Income

As a result of the factors set forth above, our income from continuing operations was \$8.8 million in 2017, compared to \$0.1 million in 2016. Including the impact of the disposal of our discontinued mobile microwave communication equipment business, our net income was \$8.8 million and \$0.2 million in 2017 and 2016, respectively.

First Nine Months of Fiscal 2017 Compared to First Nine Months of Fiscal 2016

Net Sales

Our consolidated net sales increased 27.1% to \$268.6 million in 2017, compared to \$211.4 million in 2016. Consolidated net sales in the first nine months of 2017 increased from 2016 as a result of the improved business conditions within the semiconductor industry and our success in growing share in the test handler and test contactor markets. Our increased sales were driven primarily by demand for equipment to test semiconductor devices used in automotive, mobility and IoT markets. Consolidated net sales in the first nine months of 2017 also include the net sales of Kita, totaling \$14.4 million, which was acquired on January 4, 2017.

Gross Margin

Our gross margin, as a percentage of net sales, increased to 39.6% in 2017 from 32.8% in 2016. As compared to the prior year, gross margin in the first nine months of 2017 benefitted from lower manufacturing costs as a result of our transition of volume handler manufacturing from the U.S. and Europe to Asia, as well as a significant increase in business volume which enabled us to better leverage our fixed costs, and lower charges for excess and obsolete inventory. The first nine months of 2017 benefitted by \$2.0 million from lower intangible asset amortization due to certain assets being fully amortized in 2016 offset, in part, by the amortization of \$1.4 million related to the purchase accounting inventory step-up adjustment recorded in connection with our acquisition of Kita.

In the first nine months of fiscal 2017 and 2016 we recorded charges to cost of sales of approximately \$0.5 million and \$1.9 million for excess and obsolete inventory, respectively.

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R&D Expense

R&D expense was \$28.9 million or 10.7% of net sales in 2017, compared to \$24.7 million or 11.7% in 2016. New product development programs resulted in higher R&D labor and material expense in the first nine months of 2017, however, this increase was partially offset by \$1.0 million of cost reimbursements received under a cost-sharing arrangement entered into with a customer in the first quarter of 2016.

SG&A Expense

SG&A expense was \$47.4 million or 17.6% of net sales in 2017, compared to \$42.0 million or 19.9% in 2016. Our SG&A expense has been negatively affected by the strengthening of the Swiss Franc and Euro against the U.S. Dollar, which resulted in the recognition of \$2.7 million and \$1.0 million in foreign currency transaction losses in the first nine months of 2017 and 2016, respectively. Costs incurred specifically related to the Kita acquisition recorded in SG&A totaled \$0.3 million and \$0.9 million in the first nine months of 2017 and 2016, respectively. SG&A expense in the first nine months of 2017 was negatively impacted by a \$0.7 million mark-to-market adjustment related to the fair value of the Kita contingent consideration liability and includes \$2.5 million of incremental SG&A costs due to the acquisition of Kita.

Income Taxes

The ETR on income from continuing operations for the nine months ended September 30, 2017 and September 24, 2016, was 14.0% and 65.8%, respectively. The tax provision on income from continuing operations in 2017 and 2016 differs from the U.S. federal statutory rate primarily due to the lack of a provision (benefit) on our domestic income (losses) as a result of our valuation allowance on deferred tax assets, foreign income taxed at different rates, changes in our deferred tax asset valuation allowance, state taxes and interest related to unrecognized tax benefits.

Other than foreign currency exchange rate changes and the Kita Acquisition, there was no material change to our unrecognized tax benefits and related accrued interest and penalties during the nine-month periods ended September 30, 2017 and September 24, 2016.

Income from Continuing Operations and Net Income

As a result of the factors set forth above, our income from continuing operations was \$26.2 million in 2017 compared to \$1.0 million in 2016. Including the impact of the disposal of our discontinued mobile microwave communication equipment business, which included a loss of \$0.3 million due to an adjustment to the fair value of the contingent consideration, our net income in the first nine months of 2017, was \$25.9 million.

LIQUIDITY AND CAPITAL RESOURCES

Our primary business is dependent on capital expenditures by semiconductor manufacturers and test subcontractors that are, in turn, dependent on the current and anticipated market demand for semiconductors. The seasonal and volatile nature of demand for semiconductor equipment, our primary industry, makes estimates of future revenues, results of operations and net cash flows difficult.

Our primary historical source of liquidity and capital resources has been cash flow generated by our operations and we manage our business to maximize operating cash flows as our primary source of liquidity. We use cash to fund growth in our operating assets and to fund new products and product enhancements primarily through research and development. As of September 30, 2017, \$77.6 million of our cash and cash equivalents was held by our foreign subsidiaries. If these funds are needed for our operations in the U.S., we may be required to accrue and pay U.S. taxes if we repatriate these funds. Except for certain geographic locations where we have curtailed operations and from which repatriation would not result in incremental U.S. or foreign withholding tax, our intent is to indefinitely reinvest these funds in our foreign operations and we have no current plans that would require us to repatriate these funds to the U.S.

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Liquidity

Working Capital: The following summarizes our cash, cash equivalents, short-term investments and working capital:

<i>(in thousands)</i>	September 30, 2017	December 31, 2016	Increase	Percentage Change
Cash, cash equivalents and short-term investments	\$ 138,324	\$ 128,035	\$ 10,289	8.0%
Working capital	\$ 202,409	\$ 176,460	\$ 25,949	14.7%

Cash Flows

Operating Activities: Operating cash flows for the first nine months of fiscal 2017 consist of our net income, adjusted for non-cash expenses and changes in operating assets and liabilities. These adjustments include depreciation expense on property, plant and equipment, share-based compensation expense, amortization of intangible assets, deferred income taxes, mark-to-market charge of the Kita on contingent consideration and amortization of inventory step-up. Our net cash provided by operating activities in the first nine months of fiscal 2017 totaled \$23.6 million. Excluding the impact of the acquisition of Kita, net cash provided by operating activities was impacted by changes in current assets and liabilities and included increases in accounts receivable of \$9.0 million and inventories of \$6.7 million, and a decrease in accounts payable of \$3.6 million. The increase in accounts receivable resulted from a sequential increase in product shipments and the timing of the resulting cash conversion cycle. The significant increase in business volume resulted in an increase in our consolidated inventory. The decrease in accounts payable balance is a result of the timing of payments to customers.

Investing Activities: Investing cash flows consist primarily of cash used for capital expenditures in support of our businesses, proceeds from investment maturities, asset disposals and cash used for purchases of investments and business acquisitions. Net cash used in investing activities in the first nine months of fiscal 2017 totaled \$0.7 million and included \$11.7 million used for the acquisition of Kita. The acquisition of Kita was a strategic transaction to expand our total available market, extend our market leadership and broaden our product offerings. Investing activities in the first nine months of fiscal 2017 were also impacted by \$39.3 million in net proceeds from sales and maturities of short-term investments offset by \$23.7 million in cash used for purchases of short-term investments. We invest our excess cash, in an attempt to seek the highest available return while preserving capital, in short-term investments since excess cash is only temporarily available and may be required for a business-related purpose. Additions to property, plant and equipment of \$4.7 million were made to support the operating and development activities of our business.

Financing Activities: Cash flows from financing activities consist primarily of net proceeds from the issuance of common stock under our stock option and employee stock purchase plans and cash used to pay dividends to our stockholders. We issue stock options and maintain an employee stock purchase plan as components of our overall employee compensation. In the first nine months of fiscal 2017, net proceeds from the exercise of employee stock options were \$7.1 million. We paid dividends totaling \$4.9 million, or \$0.18 per common share. On October 31, 2017, Cohu's Board of Directors approved a quarterly cash dividend of \$0.06 per share payable on January 2, 2018 to shareholders of record on November 17, 2017. Future quarterly dividends are subject to our cash liquidity, capital availability and periodic determinations by our Board of Directors that cash dividends are in the best interests of our stockholders. Total repayments of short-term borrowings and long-term debt during the first nine months of fiscal 2017 totaled \$1.3 million.

Capital Resources

In connection with the acquisition of Kita on January 4, 2017, we assumed a series of revolving credit facilities with various financial institutions in Japan. The credit facilities renew monthly and provide Kita with access to working capital totaling up to \$6.2 million. At September 30, 2017 total borrowings outstanding under the revolving lines of credit were \$3.1 million. As these credit facility agreements renew monthly, they have been included in short-term borrowings in our condensed consolidated balance sheet. We also assumed long-term term loans from a series of Japanese financial institutions totaling \$6.2 million primarily related to the expansion of Kita's facility in Osaka, Japan. The loans are collateralized by the facility and land. The loans carry interest rates ranging from 0.05% to 0.45% and expire at various dates through 2034. At September 30, 2017, \$1.3 million of the term loans have been included in current installments of long-term debt in our condensed consolidated balance sheet. The revolving lines of credit and term loans are denominated in Japanese Yen and, as a result, amounts will fluctuate as a result of changes in currency exchange rates.

We have a secured letter of credit facility (the "Secured Facility") under which Bank of America, N.A., has agreed to administer the issuance of letters of credit on our behalf. The Secured Facility requires us to maintain deposits of cash or other approved investments, which serve as collateral, in amounts that approximate our outstanding letters of credit. As of September 30, 2017, no amounts were outstanding under standby letters of credit under the Secured Facility.

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We also have credit agreements with multiple financial institutions under which they administer lines of credit on behalf of our wholly owned Ismeca subsidiary. The agreements provide Ismeca with 2.5 million Swiss Francs of available credit and at September 30, 2017, no amounts were outstanding. We expect that we will continue to make capital expenditures to support our business and we anticipate that present working capital will be sufficient to meet our operating requirements for at least the next twelve months.

Contractual Obligations and Off-Balance Sheet Arrangements

Contractual Obligations: Our significant contractual obligations consist of liabilities for debt, operating leases, unrecognized tax benefits, pensions, post-retirement benefits and warranties. As a result of the acquisition of Kita on January 4, 2017, our contractual obligations for debt increased approximately \$9.2 million, of which approximately \$0.3 million will be due in the remainder of 2017, \$1.3 million will be due in 2018, \$1.1 million will be due in 2019, \$1.0 million will be due in 2020, \$1.1 million will be due in 2021 and \$4.4 million thereafter.

Purchase Commitments: From time to time, we enter into commitments with our vendors and outsourcing partners to purchase inventory at fixed prices or in guaranteed quantities. We are not able to determine the aggregate amount of such purchase orders that represent contractual obligations, as purchase orders may represent authorizations to purchase rather than binding agreements. Our purchase orders are based on our current manufacturing needs and are fulfilled by our vendors within relatively short time horizons. We typically do not have significant agreements for the purchase of raw materials or other goods specifying minimum quantities or set prices that exceed our expected requirements for the next three months.

Off-Balance Sheet Arrangements: During the ordinary course of business, we provide standby letters of credit instruments to certain parties as required. As of September 30, 2017, no amounts were outstanding under standby letters of credit.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Investment and Interest Rate Risk.

At September 30, 2017, our investment portfolio included short-term fixed-income investment securities with a fair value of approximately \$16.3 million. These securities are subject to interest rate risk and will likely decline in value if interest rates increase. Our future investment income may fall short of expectations due to changes in interest rates or we may suffer losses in principal if we are forced to sell securities that decline in market value due to changes in interest rates. As we classify our short-term securities as available-for-sale, no gains or losses are recognized due to changes in interest rates unless such securities are sold prior to maturity or declines in fair value are determined to be other-than-temporary. Due to the relatively short duration of our investment portfolio, an immediate ten percent change in interest rates would have no material impact on our financial condition or results of operations.

We evaluate our investments periodically for possible other-than-temporary impairment by reviewing factors such as the length of time and extent to which fair value has been below cost basis, the financial condition of the issuer and our ability and intent to hold the investment for a period of time sufficient for anticipated recovery of market value. As of September 30, 2017, we had \$7.5 million of investments with loss positions. We evaluated the nature of these investments, credit worthiness of the issuer and the duration of these impairments and concluded that these losses were temporary and we have the ability and intent to hold these investments to maturity.

Foreign Currency Exchange Risk.

We have operations in several foreign countries and conduct business in the local currency in these countries. As a result, we have risk associated with currency fluctuations as the value of foreign currencies fluctuate against the U.S. dollar, in particular the Swiss Franc, Euro, Malaysian Ringgit, Chinese Yuan, Philippine Peso and, with the acquisition of Kita, the Japanese Yen. These fluctuations can impact our reported earnings.

Fluctuations in currency exchange rates also impact the U.S. Dollar amount of our net investment in foreign operations. The assets and liabilities of our foreign subsidiaries are translated into U.S. Dollars at the exchange rates in effect at the fiscal year-end balance sheet date. Income and expense accounts are translated at an average exchange rate during the year which approximates the rates in effect at the transaction dates. The resulting translation adjustments are recorded in stockholders' equity as a component of accumulated other comprehensive loss. As a result of fluctuations in certain foreign currency exchange rates in relation to the U.S. Dollar as of September 30, 2017 compared to December 31, 2016, our stockholders' equity increased by \$10.0 million.

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Based upon the current levels of net foreign assets, a hypothetical 10% devaluation of the U.S. Dollar as compared to these currencies as of September 30, 2017 would result in an approximate \$15.5 million positive translation adjustment recorded in other comprehensive income within stockholders' equity. Conversely, a hypothetical 10% appreciation of the U.S. Dollar as compared to these currencies as of September 30, 2017 would result in an approximate \$15.5 million negative translation adjustment recorded in other comprehensive income within stockholders' equity.

Item 4. Controls and Procedures.

(a) Evaluation of Disclosure Controls and Procedures. Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we evaluated the effectiveness of our disclosure controls and procedures, as such term is defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this quarterly report.

It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events. Because of these and other inherent limitations of control systems, there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote. Our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives and our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

(b) Changes in Internal Control over Financial Reporting. During the third quarter of fiscal 2017, certain of our wholly owned subsidiaries implemented an integrated finance/accounting and manufacturing software system. The implementation involved changes in systems that included internal controls, and accordingly, these changes have required changes to our system of internal controls. We reviewed the system as it was being implemented and the controls affected by the implementation of the new system and made appropriate changes to affected internal controls during the implementation process. We believe that the controls as modified are appropriate and functioning effectively.

Other than the described above, there have been no changes in our internal control over financial reporting during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect our internal control over financial reporting.

Part II OTHER INFORMATION

Item 1. Legal Proceedings.

The information set forth above under Note 7 contained in the "Notes to Unaudited Condensed Consolidated Financial Statements" of this Form 10-Q is incorporated herein by reference.

Item 1A. Risk Factors.

The risks described below may not be the only risks we face. Additional risks that we are unaware of, or that we currently believe are not material, may also impair our business operations. The risk factors set forth below with an asterisk () next to the title contain changes to the description of the risk factors associated with our business as previously disclosed in Item 1A to our 2016 Annual Report on Form 10-K. If any of the events or circumstances described in the following risks occur, our business, financial condition, results of operations or cash flows could suffer, and the trading price of our common stock and our market capitalization could decline.*

* ***We are exposed to risks associated with acquisitions, investments and divestitures.***

As part of our business strategy, we regularly evaluate investments in, or acquisitions of, complementary businesses, joint ventures, services and technologies, and we expect that periodically we will continue to make such investments and acquisitions in the future, such as our acquisition of Kita, which was completed on January 4, 2017. Acquisitions and investments involve numerous risks, including, but not limited to:

- difficulties and increased costs in connection with integration of the personnel, operations, technologies and products of acquired businesses;
- increasing the scope, geographic diversity and complexity of our business;
- diversion of management's attention from other operational matters;
- the potential loss of key employees, customers or suppliers of Cohu or acquired businesses;
- lack of synergy, or the inability to realize expected synergies, resulting from the acquisition;
- potential unknown liabilities associated with the acquired businesses;
- failure to commercialize purchased technology;
- the impairment of acquired intangible assets and goodwill that could result in significant charges to operating results in future periods; and
- challenges caused by distance, language and cultural differences.

We may decide to finance future acquisitions and investments through a combination of borrowings, proceeds from equity or debt offerings and the use of cash, cash equivalents and short-term investments. If we finance acquisitions by issuing convertible debt or equity securities, our existing stockholders may be diluted which could affect the market price of our stock.

Mergers, acquisitions and investments are inherently risky and the inability to effectively manage these risks could materially and adversely affect our business, financial condition and results of operations. At September 30, 2017, we had goodwill and net purchased intangible assets balances of \$65.5 million and \$17.8 million, respectively.

We are making investments in new products to enter new markets, which may adversely affect our operating results; these investments may not be successful.

Given the highly competitive and rapidly evolving technology environment in which we operate, we believe it is important to develop new product offerings to meet strategic opportunities as they evolve. This includes developing products that we believe are necessary to meet the future needs of the marketplace. We are currently investing in new product development programs to enable us to compete in the test contactor and wafer level package (WLP) probe and inspection markets. We expect to continue to make investments and we may at any time, based on product need or marketplace demand, decide to significantly increase our product development expenditures in these or other products. The cost of investments in new product offerings can have a negative impact on our operating results and there can be no assurance that any new products we develop will be accepted in the marketplace or generate material revenues for us.

We are exposed to the risks of operating a global business.

We are a global corporation with offices and subsidiaries in certain foreign locations to manufacture our products, support our sales and services to the global semiconductor industry and, as such, we face risks in doing business abroad. Certain aspects inherent in transacting business internationally could negatively impact our operating results, including:

- costs and difficulties in staffing and managing international operations;
- legislative or regulatory requirements and potential changes in or interpretations of requirements in the United States and in the countries in which we manufacture or sell our products;
- trade restrictions, including treaty changes, sanctions and the suspension of export licenses;
- compliance with and changes in import/export tariffs and regulations;
- difficulties in enforcing contractual and intellectual property rights;
- longer payment cycles;
- local political and economic conditions;
- potentially adverse tax consequences, including restrictions on repatriating earnings and the threat of “double taxation”; and
- fluctuations in foreign currency exchange rates against the U.S. Dollar, which can affect demand for our products and increase our costs.

Additionally, managing geographically dispersed operations presents difficult challenges associated with organizational alignment and infrastructure, communications and information technology, inventory control, customer relationship management, terrorist threats and related security matters and cultural diversities. If we are unsuccessful in managing such operations effectively, our business and results of operations will be adversely affected.

* ***We have manufacturing operations in Asia. Any failure to effectively manage multiple manufacturing sites and to secure raw materials meeting our quality, cost and other requirements, or failures by our suppliers to perform, could harm our sales, service levels and reputation.***

Our reliance on overseas manufacturers exposes us to significant risks including complex management, foreign currency, legal, tax and economic risks, which we may not be able to address quickly and adequately. In addition, it is time consuming and costly to qualify overseas supplier relationships. Therefore, if we should fail to effectively manage overseas manufacturing operations or if one or more of them should experience delays, disruptions or quality control problems, or if we had to change or add additional manufacturing sites, our ability to ship products to our customers could be delayed. Also, the addition of overseas manufacturing locations increases the demands on our administrative and operations infrastructure and the complexity of our supply chain management. If our overseas manufacturing locations are unable to meet our manufacturing requirements in a timely manner, our ability to ship products and to realize the related revenues when anticipated could be materially affected.

Our suppliers are subject to the fluctuations in general economic cycles, and global economic conditions may impact their ability to operate their business. They may also be impacted by increasing costs of raw materials, labor and distribution, resulting in demands for less attractive contract terms or an inability for them to meet our requirements or conduct their own businesses. The performance and financial condition of a supplier may cause us to alter our business terms or to cease doing business with a particular supplier, or change our sourcing practices generally, which could in turn adversely affect our own business and financial condition.

Failure of critical suppliers to deliver sufficient quantities of parts in a timely and cost-effective manner could adversely impact our operations.

We use numerous vendors to supply parts, components and subassemblies for the manufacture of our products. It is not always possible to maintain multiple qualified suppliers for all of our parts, components and subassemblies. As a result, certain key parts may be available only from a single supplier or a limited number of suppliers. In addition, suppliers may significantly raise prices or cease manufacturing certain components (with or without advance notice to us) that are difficult to replace without significant reengineering of our products. On occasion, we have experienced problems in obtaining adequate and reliable quantities of various parts and components from certain key suppliers. Our results of operations may be materially and adversely impacted if we do not receive sufficient parts to meet our requirements in a timely and cost-effective manner.

The semiconductor industry we serve is highly seasonal, volatile and unpredictable.

Visibility into our markets is limited. The semiconductor equipment business is highly dependent on the overall strength of the semiconductor industry. Historically, the semiconductor industry has been highly seasonal, volatile and unpredictable with recurring periods of oversupply and excess capacity, which often have had a significant effect on the semiconductor industry's demand for capital equipment, including equipment of the type we manufacture and market. We anticipate that the markets for newer generations of semiconductors and semiconductor equipment may also be subject to similar cycles and severe downturns. Any significant reductions in capital equipment investment by semiconductor integrated device manufacturers and test subcontractors will materially and adversely affect our business, financial position and results of operations. In addition, the seasonal, volatile and unpredictable nature of semiconductor equipment demand has in the past and may in the future expose us to significant excess and obsolete and lower of cost or net realizable value inventory write-offs and reserve requirements. In 2016, 2015 and 2014, we recorded pre-tax inventory-related charges of approximately \$1.1 million, \$2.4 million, and \$2.6 million, respectively, primarily as a result of changes in customer forecasts.

Due to the nature of our business, we need continued access to capital, which if not available to us or if not available on favorable terms, could harm our ability to operate or expand our business.

Our business requires capital to finance accounts receivable and product inventory that is not financed by trade creditors when our business is expanding. If cash from available sources is insufficient or cash is used for unanticipated needs, we may require additional capital sooner than anticipated.

We believe that our existing sources of liquidity, including cash resources and cash provided by operating activities will provide sufficient resources to meet our working capital and cash requirements for at least the next twelve months. In the event we are required, or elect, to raise additional funds, we may be unable to do so on favorable terms, or at all, and may incur expenses in raising the additional funds and future indebtedness could adversely affect our operating results and severely limit our ability to plan for, or react to, changes in our business or industry. We could also be limited by financial and other restrictive covenants in credit arrangements, including limitations on our borrowing of additional funds and issuing dividends. If we choose to issue new equity securities, existing stockholders may experience dilution, or the new equity securities may have rights, preferences or privileges senior to those of existing holders of common stock. If we cannot raise funds on acceptable terms, we may not be able to take advantage of future opportunities or respond to competitive pressures or unanticipated requirements. Any inability to raise additional capital when required could have an adverse effect on our business and operating results.

The semiconductor equipment industry in general and the test handler market in particular, is highly competitive.

The semiconductor test handler industry is intensely competitive, and we face substantial competition from numerous companies throughout the world. The test handler industry, while relatively small in terms of worldwide market size compared to other segments of the semiconductor equipment industry, has several participants resulting in intense competitive pricing pressures. Future competition may include companies that do not currently supply test handlers. Some of our competitors are part of larger corporations that have substantially greater financial, engineering, manufacturing and customer support capabilities and provide more extensive product offerings. In addition, there are emerging semiconductor equipment companies that provide or may provide innovative technology incorporated in products that may compete successfully against our products. We expect our competitors to continue to improve the design and performance of their current products and introduce new products with improved performance capabilities. Our failure to introduce new products in a timely manner, the introduction by our competitors of products with perceived or actual advantages, or disputes over rights to use certain intellectual property or technology could result in a loss of our competitive position and reduced sales of, or margins on our existing products. Intense competition has adversely impacted our product average selling prices and gross margins on certain products. If we are unable to reduce the cost of our existing products and successfully introduce new lower cost products we expect these competitive conditions to negatively impact our gross margin and operating results in the foreseeable future.

Semiconductor equipment is subject to rapid technological change, product introductions and transitions which may result in inventory write-offs, and our new product development involves numerous risks and uncertainties.

Semiconductor equipment and processes are subject to rapid technological change. We believe that our future success will depend in part on our ability to enhance existing products and develop new products with improved performance capabilities. We expect to continue to invest heavily in research and development and must manage product transitions successfully, as introductions of new products, including the products obtained in our acquisitions, may adversely impact sales and/or margins of existing products. In addition, the introduction of new products by us or by our competitors, the concentration of our revenues in a limited number of large customers, the migration to new semiconductor testing methodologies and the custom nature of our inventory parts increases the risk that our established products and related inventory may become obsolete, resulting in significant excess and obsolete inventory exposure. This exposure resulted in charges to operations during each of the years in the three-year period ended December 31, 2016. Future inventory write-offs and increased inventory reserve requirements could have a material adverse impact on our results of operations and financial condition.

The design, development, commercial introduction and manufacture of new semiconductor equipment is an inherently complex process that involves a number of risks and uncertainties. These risks include potential problems in meeting customer acceptance and performance requirements, integration of the equipment with other suppliers' equipment and the customers' manufacturing processes, transitioning from product development to volume manufacturing and the ability of the equipment to satisfy the semiconductor industry's constantly evolving needs and achieve commercial acceptance at prices that produce satisfactory profit margins. The design and development of new semiconductor equipment is heavily influenced by changes in integrated circuit assembly, test and final manufacturing processes and integrated circuit package design changes. We believe that the rate of change in such processes and integrated circuit packages is accelerating. As a result of these changes and other factors, assessing the market potential and commercial viability of handling, MEMS, system-level and burn-in test equipment is extremely difficult and subject to a great deal of risk. In addition, not all integrated circuit manufacturers employ the same manufacturing processes. Differences in such processes make it difficult to design standard test products that can achieve broad market acceptance. As a result, we might not accurately assess the semiconductor industry's future equipment requirements and fail to design and develop products that meet such requirements and achieve market acceptance. Failure to accurately assess customer requirements and market trends for new semiconductor test products may have a material adverse impact on our operations, financial condition and results of operations.

The transition from product development to the manufacture of new semiconductor equipment is a difficult process and delays in product introductions and problems in manufacturing such equipment are common. We have in the past and may in the future experience difficulties in manufacturing and volume production of our new equipment. In addition, as is common with semiconductor equipment, after sale support and warranty costs have typically been significantly higher with new products than with our established products. Future technologies, processes and product developments may render our current or future product offerings obsolete and we might not be able to develop, introduce and successfully manufacture new products or make enhancements to our existing products in a timely manner to satisfy customer requirements or achieve market acceptance. Furthermore, we might not realize acceptable profit margins on such products.

Global economic conditions may have an impact on our business and financial condition in ways that we currently cannot predict.

Our operations and financial results depend on worldwide economic conditions and their impact on levels of business spending. Continued uncertainties may reduce future sales of our products and services. While we believe we have a strong customer base and have experienced strong collections in the past, if the current market conditions deteriorate, we may experience increased collection times and greater write-offs, either of which could have a material adverse effect on our cash flow.

In addition, the tightening of credit markets and concerns regarding the availability of credit may make it more difficult for our customers to raise capital, whether debt or equity, to finance their purchases of capital equipment, including the products we sell. Delays in our customers' ability to obtain such financing, or the unavailability of such financing would adversely affect our product sales and revenues and therefore harm our business and operating results. We cannot predict the timing, duration of or effect on our business of an economic slowdown or the timing or strength of a subsequent recovery.

A limited number of customers account for a substantial percentage of our net sales.

A small number of customers have been responsible for a significant portion of our net sales. During the past five years, the percentage of our sales derived from these significant customers has varied greatly. Such variations are due to changes in the customers' business, consolidation within the semiconductor industry and their purchase of products from our competitors. It is common in the semiconductor test handler industry for customers to purchase equipment from more than one equipment supplier, increasing the risk that our competitive position with a specific customer may deteriorate. No assurance can be given that we will continue to maintain our competitive position with these or other significant customers. Furthermore, we expect the percentage of our revenues derived from significant customers will vary greatly in future periods. The loss of, or a significant reduction in, orders by these or other significant customers as a result of competitive products, market conditions including end market demand for our customers' products, outsourcing final semiconductor test to test subcontractors that are not our customers or other factors, would have a material adverse impact on our business, financial condition and results of operations. Furthermore, the concentration of our revenues in a limited number of large customers is likely to cause significant fluctuations in our future annual and quarterly operating results.

If we cannot continue to develop, manufacture and market products and services that meet customer requirements for innovation and quality, our revenue and gross margin may suffer.

The process of developing new high technology products and services and enhancing existing products and services is complex, costly and uncertain, and any failure by us to anticipate customers' changing needs and emerging technological trends accurately could significantly harm our market share and results of operations. In addition, in the course of conducting our business, we must adequately address quality issues associated with our products and services, including defects in our engineering, design and manufacturing processes, as well as defects in third-party components included in our products. To address quality issues, we work extensively with our customers and suppliers and engage in product testing to determine the cause of quality problems and appropriate solutions. Finding solutions to quality issues can be expensive and may result in additional warranty, replacement and other costs, adversely affecting our profits. In addition, quality issues can impair our relationships with new or existing customers and adversely affect our reputation, which could lead to a material adverse effect on our operating results.

The seasonal nature of the semiconductor equipment industry places enormous demands on our employees, operations and infrastructure.

The semiconductor equipment industry is characterized by dramatic and sometimes rapid changes in demand for its products. These are generally dictated by introduction of new consumer products, launch of new model vehicles, implementation of new communications infrastructure, or in response to an increase in industrial equipment and machinery that utilizes semiconductors. A number of other factors including changes in integrated circuit design and packaging may affect demand for our products. Sudden changes in demand for semiconductor equipment commonly occur, and have a significant impact on our operations. We have in the past and may in the future experience difficulties, particularly in manufacturing, in training and recruiting the large number of additions to our workforce. The volatility in headcount and business levels, combined with the seasonal nature of the semiconductor industry, may require that we invest substantial amounts in new operational and financial systems, procedures and controls. We may not be able to successfully adjust our systems, facilities and production capacity to meet our customers' changing requirements. The inability to meet such requirements will have an adverse impact on our business, financial position and results of operations.

The loss of key personnel could adversely impact our business.

Certain key personnel are critical to our business. Our future operating results depend substantially upon the continued service of our key personnel, many of whom are not bound by employment or non-competition agreements. Our future operating results also depend in significant part upon our ability to attract and retain qualified management, manufacturing, technical, engineering, marketing, sales and support personnel. Competition for qualified personnel, particularly those with technical skills, is intense, and we cannot ensure success in attracting or retaining qualified personnel. In addition, the cost of living in the San Diego, California, Kolbermoor, Germany and La Chaux-de-Fonds, Switzerland areas, where the majority of our development personnel are located, is high and we have had difficulty in recruiting prospective employees from other locations. There may be only a limited number of persons with the requisite skills and relevant industry experience to serve in these positions and it may become increasingly difficult for us to hire personnel over time. Our business, financial condition and results of operations could be materially adversely affected by the loss of any of our key employees, by the failure of any key employee to perform in his or her current position, or by our inability to attract and retain skilled employees.

Third parties may violate our proprietary rights or accuse us of infringing upon their proprietary rights.

We rely on patent, copyright, trademark and trade secret laws to establish and maintain proprietary rights in our technology and products. Any of our proprietary rights may expire due to patent life, or be challenged, invalidated or circumvented. In addition, from time to time, we receive notices from third parties regarding patent or copyright claims. Any such claims, with or without merit, could be time-consuming to defend, result in costly litigation, divert management's attention and resources and cause us to incur significant expenses. In the event of a successful claim of infringement against us and our failure or inability to license the infringed technology or to substitute similar non-infringing technology, our business, financial condition and results of operations could be adversely affected.

A majority of our revenues are generated from exports to foreign countries, primarily in Asia, that are subject to economic and political instability and we compete against a number of Asian test handling equipment suppliers.

The majority of our export sales are made to destinations in Asia. Political or economic instability, particularly in Asia, may adversely impact the demand for capital equipment, including equipment of the type we manufacture and market. In addition, we face intense competition from a number of Asian suppliers that have certain advantages over United States ("U.S.") suppliers, including us. These advantages include, among other things, proximity to customers, lower cost structures, favorable tariffs and affiliation with significantly larger organizations. In addition, changes in the amount or price of semiconductors produced in Asia could impact the profitability or capital equipment spending programs of our foreign and domestic customers.

*** *Unanticipated changes in our tax provisions or exposure to additional income tax liabilities could affect our profitability.***

We are subject to income and other taxes in the U.S. and numerous foreign jurisdictions. Our tax liabilities are affected by, among other things, the amounts our affiliated entities charge each other for intercompany transactions. We may be subject to ongoing tax examinations in various jurisdictions. Tax authorities may disagree with our intercompany charges or other matters and assess additional taxes. While we regularly assess the likely outcomes of these examinations to determine the appropriateness of our tax provision, tax audits are inherently uncertain and an unfavorable outcome could occur. An unanticipated, unfavorable outcome in any specific period could harm our operating results for that period or future periods. The financial cost and management attention and time devoted to defending income tax positions may divert resources from our business operations, which could harm our business and profitability. Tax examinations may also impact the timing and/or amount of our refund claims. In addition, our effective tax rate in the future could be adversely affected by changes in the mix of earnings in countries with differing statutory tax rates, changes in the valuation of our deferred tax assets and liabilities, changes in tax laws and the discovery of new information in the course of our tax return preparation process. In particular, the carrying value of our deferred tax assets and the utilization of our net operating loss and credit carryforwards are dependent on our ability to generate future taxable income in the U.S. and other countries. Furthermore, these carryforwards may be subject to annual limitations as a result of changes in Cohu's ownership.

In addition, in October 2015, the Organization for Economic Co-operation and Development (OECD) issued its reports on the 15 focus areas identified in its Action Plan on Base Erosion and Profit Shifting ("BEPS"). Some BEPS measures will require treaty based or legislative action by countries. The final impact of BEPS on Cohu's income tax provision and liability is currently not quantifiable and is likely to result in additional recordkeeping and administrative cost to implement certain of its requirements. Furthermore, the U.S. House of Representatives Committee on Ways and Means released draft legislation, referred to as the Tax Cuts and Jobs Act, on November 2, 2017 in an effort to reform the U.S. federal income tax system. Among other changes, the draft legislation has provisions regarding deemed repatriation of currently deferred foreign profits, a minimum tax on foreign profits, limits on the deductibility of net interest expense, and a lower overall corporate tax rate. At this time, it is not possible to ascertain what provisions would be included in a final legislative package or whether the legislation will pass at all and, therefore, we cannot estimate what effect these changes, if enacted, may have on our business results.

Compliance with regulations may impact sales to foreign customers and impose costs.

Certain products and services that we offer require compliance with U.S. and other foreign country export and other regulations. Compliance with complex U.S. and other foreign country laws and regulations that apply to our international sales activities increases our cost of doing business in international jurisdictions and could expose us or our employees to fines and penalties. These laws and regulations include import and export requirements, the U.S. State Department International Traffic in Arms Regulations ("ITAR") and U.S. and other foreign country laws such as the Foreign Corrupt Practices Act ("FCPA"), and local laws prohibiting corrupt payments to governmental officials. Violations of these laws and regulations could result in fines, criminal sanctions against us, our officers or our employees, prohibitions on the conduct of our business and damage to our reputation. Although we have implemented policies and procedures designed to ensure compliance with these laws, there can be no assurance that our employees, contractors or agents will not violate our policies, or that our policies will be effective in preventing all potential violations. Any such violations could include prohibitions on our ability to offer our products and services to one or more countries, and could also materially damage our reputation, our brand, our international expansion efforts, our ability to attract and retain employees, our business and our operating results. Further, defending against claims of violations of these laws and regulations, even if we are successful, could be time-consuming, result in costly litigation, divert management's attention and resources and cause us to incur significant expenses.

In addition to government regulations regarding sale and export, we are subject to other regulations regarding our products. For example, the U.S. Securities and Exchange Commission has adopted disclosure rules for companies that use conflict minerals in their products, with substantial supply chain verification requirements if the materials come from, or could have come from, the Democratic Republic of the Congo or adjoining countries. These new rules and verification requirements will impose additional costs on us and on our suppliers, and may limit the sources or increase the cost of materials used in our products. Further, if we are unable to certify that our products are conflict free, we may face challenges with our customers that could place us at a competitive disadvantage, and our reputation may be harmed.

Our business and operations could suffer in the event of security breaches.

Attempts by others to gain unauthorized access to information technology systems are becoming more sophisticated and are sometimes successful. These attempts, which might be related to industrial or other espionage, include covertly introducing malware to our computers and networks and impersonating authorized users, among others. We seek to detect and investigate all security incidents and to prevent their recurrence, but in some cases, we might be unaware of an incident or its magnitude and effects. The theft, unauthorized use or publication of our intellectual property and/or confidential business information could harm our competitive position, reduce the value of our investment in research and development and other strategic initiatives or otherwise adversely affect our business. To the extent that any security breach results in inappropriate disclosure of our customers' or licensees' confidential information, we may incur liability as a result. In addition, we may be required to devote additional resources to the security of our information technology systems.

* ***Our implementation of enterprise resource planning (“ERP”) systems may adversely affect our business and results of operations or the effectiveness of internal controls over financial reporting.***

We recently completed the implementation of a new ERP system within our Switzerland and Malaysia operations, to conform these operations to the same ERP system used within our other principal business locations. ERP implementations are complex and time-consuming projects that involve substantial expenditures on system software and implementation activities. If we did not effectively implement the ERP system or if the system does not operate as intended, it could adversely affect our financial reporting systems and our ability to produce financial reports and process transactions, the effectiveness of internal controls over financial reporting, and our business, financial condition, results of operations and cash flows.

The occurrence of natural disasters and geopolitical instability caused by terrorist attacks and other threats may adversely impact our operations and sales.

Our Corporate headquarters is located in San Diego, California, our Asian sales and service headquarters is located in Singapore and the majority of our sales are made to destinations in Asia. In addition, we have manufacturing plants in Malaysia, Philippines and Japan. These regions are known for being vulnerable to natural disasters and other risks, such as earthquakes, tsunamis, fires, and floods, which at times have disrupted the local economies. A significant earthquake or tsunami could materially affect operating results. We are not insured for most losses and business interruptions of this kind, or for geopolitical or terrorism impacts, and presently have limited redundant, multiple site capacity in the event of a disaster. In the event of such disaster, our business would materially suffer.

Our financial and operating results may vary and fall below analysts' estimates, which may cause the price of our common stock to decline.

Our operating results may fluctuate from quarter to quarter due to a variety of factors including, but not limited to:

- seasonal, volatile and unpredictable nature of the semiconductor equipment industry;
- timing and amount of orders from customers and shipments to customers;
- inability to recognize revenue due to accounting requirements;
- inventory write-downs;
- inability to deliver solutions as expected by our customers; and
- intangible and deferred tax asset write-downs.

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Due to these factors or other unanticipated events, quarter-to-quarter comparisons of our operating results may not be reliable indicators of our future performance. In addition, from time to time our quarterly financial results may fall below the expectations of the securities and industry analysts who publish reports on our company or of investors in general. This could cause the market price of our stock to decline, perhaps significantly.

* ***We have experienced significant volatility in our stock price.***

A variety of factors may cause the price of our stock to be volatile. In recent years, the stock market in general, and the market for shares of high-technology companies in particular, including ours, have experienced extreme price fluctuations, which have often been unrelated to the operating performance of affected companies. During the three-year period ended September 30, 2017 the price of our common stock has ranged from \$23.88 to \$9.14. The price of our stock may be more volatile than the stock of other companies due to, among other factors, the volatile, unpredictable and seasonal nature of the semiconductor industry, our significant customer concentration, intense competition in the test handler industry, our limited backlog and our relatively low daily stock trading volume. The market price of our common stock is likely to continue to fluctuate significantly in the future, including fluctuations related and unrelated to our performance.

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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information.

None.

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Item 6. Exhibits.

- 3(i).1 [Amended and Restated Certificate of Incorporation of Cohu, Inc. incorporated herein by reference to Exhibit 3.1\(a\) from the Cohu, Inc. Form 10-Q for the quarterly period ended June 30, 1999](#)
- 3(i).2 [Certificate of Amendment of Amended and Restated Certificate of Incorporation of Cohu, Inc. incorporated herein by reference to Exhibit 4.1\(a\) from the Cohu, Inc. Form S-8 filed with the Securities and Exchange Commission on June 30, 2000](#)
- 3(ii) [Amended and Restated Bylaws of Cohu, Inc. incorporated herein by reference to Exhibit 3.2 from the Cohu, Inc. Report on Form 8-K filed with the Securities and Exchange Commission on December 12, 1996](#)
- 31.1 [Certification pursuant to Section 302\(a\) of the Sarbanes-Oxley Act of 2002](#)
- 31.2 [Certification pursuant to Section 302\(a\) of the Sarbanes-Oxley Act of 2002](#)
- 32.1 [Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002](#)
- 32.2 [Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002](#)
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

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.

COHU, INC.
(Registrant)

Date: November 7, 2017

/s/ Luis A. Müller
Luis A. Müller
President & Chief Executive Officer

Date: November 7, 2017

/s/ Jeffrey D. Jones
Jeffrey D. Jones
Vice President, Finance & Chief Financial Officer
(Principal Financial & Accounting Officer)

COHU, INC.
SARBANES-OXLEY ACT SECTION 302(a)
CERTIFICATION

I, Luis A. Müller, certify that:

1. I have reviewed this Form 10-Q of Cohu, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 7, 2017

/s/ Luis A. Müller
Luis A. Müller
President & Chief Executive Officer

COHU, INC.
SARBANES-OXLEY ACT SECTION 302(a)
CERTIFICATION

I, Jeffrey D. Jones, certify that:

1. I have reviewed this Form 10-Q of Cohu, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 7, 2017

/s/ Jeffrey D. Jones

Jeffrey D. Jones
Vice President Finance & Chief Financial Officer

CERTIFICATION PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002
(18 U.S.C. SECTION 1350)

In connection with the accompanying Quarterly Report of Cohu, Inc. (the "Company") on Form 10-Q for the fiscal quarter ended September 30, 2017 (the "Report"), I, Luis A. Müller, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, based on my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 7, 2017

/s/ Luis A. Müller

Luis A. Müller,
President & Chief Executive Officer

CERTIFICATION PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002
(18 U.S.C. SECTION 1350)

In connection with the accompanying Quarterly Report of Cohu, Inc. (the "Company") on Form 10-Q for the fiscal quarter ended September 30, 2017 (the "Report"), I, Jeffrey D. Jones, Vice President Finance & Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, based on my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 7, 2017

/s/ Jeffrey D. Jones

Jeffrey D. Jones,
Vice President Finance & Chief Financial Officer

