

COHU INC  
Form 10-Q  
October 28, 2016

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**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 24, 2016**

**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" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer      Accelerated filer      Non-accelerated filer      Smaller reporting company

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 12, 2016 the Registrant had 26,711,690 shares of its \$1.00 par value common stock outstanding.

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**COHU, INC.**

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**SEPTEMBER 24, 2016**

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**Item 1.****COHU, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

(in thousands, except par value)

	<b>September 24, 2016</b>	<b>December 26, 2015 *</b>
	<b>(Unaudited)</b>	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 109,217	\$ 115,370
Short-term investments	19,451	1,652
Accounts receivable, net	56,826	59,832
Inventories:		
Raw materials and purchased parts	24,906	24,423
Work in process	18,005	20,124
Finished goods	5,256	6,801
	48,167	51,348
Other current assets	7,172	6,261
Total current assets	240,833	234,463
Property, plant and equipment, at cost:		
Land and land improvements	4,316	4,607
Buildings and building improvements	8,016	8,971
Machinery and equipment	34,887	31,888
	47,219	45,466
Less accumulated depreciation and amortization	(28,407 )	(26,466 )
Net property, plant and equipment	18,812	19,000
Goodwill	61,028	60,264
Intangible assets, net	20,338	25,297
Other assets	6,477	6,322
	<b>\$ 347,488</b>	<b>\$ 345,346</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 25,699	\$ 27,290
Accrued compensation and benefits	17,394	15,628
Accrued warranty	3,787	3,785
Deferred profit	5,726	3,730
Income taxes payable	1,787	4,195
Other accrued liabilities	9,137	8,563
Total current liabilities	63,530	63,191
Accrued retirement benefits	16,040	15,397

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Noncurrent deferred gain on sale of facility	12,053	13,142
Deferred income taxes	6,006	6,954
Noncurrent income tax liabilities	6,807	6,761
Other accrued liabilities	2,089	1,764
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$1 par value; 1,000 shares authorized, none issued	-	-
Common stock, \$1 par value; 60,000 shares authorized, 26,712 shares issued and outstanding in 2016 and 26,240 shares in 2015	26,712	26,240
Paid-in capital	108,995	105,516
Retained earnings	124,340	128,153
Accumulated other comprehensive loss	(19,084 )	(21,772 )
Total stockholders' equity	240,963	238,137
	\$ 347,488	\$ 345,346

\* Derived from December 26, 2015 audited financial statements

*The accompanying notes are an integral part of these statements.*

**COHU, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(Unaudited)

(in thousands, except per share amounts)

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 24, 2016</b>	<b>September 26, 2015</b>	<b>September 24, 2016</b>	<b>September 26, 2015</b>
Net sales	\$69,259	\$ 67,512	\$211,390	\$ 206,170
Cost and expenses:				
Cost of sales	46,038	44,718	142,044	137,529
Research and development	8,634	8,605	24,742	24,901
Selling, general and administrative	13,591	11,923	41,976	38,006
	68,263	65,246	208,762	200,436
Income from operations	996	2,266	2,628	5,734
Interest and other, net	71	9	173	19
Income from continuing operations before taxes	1,067	2,275	2,801	5,753
Income tax provision	849	940	1,832	2,251
Income from continuing operations	218	1,335	969	3,502
Income (loss) from discontinued operations	51	(222 )	(4 )	(5,201 )
Net income (loss)	\$269	\$ 1,113	\$965	\$ (1,699 )
Income (loss) per share:				
Basic:				
Income from continuing operations	\$0.01	\$ 0.05	\$0.04	\$ 0.13
Loss from discontinued operations	0.00	(0.01 )	0.00	(0.20 )
Net income (loss)	\$0.01	\$ 0.04	\$0.04	\$ (0.07 )
Diluted:				
Income from continuing operations	\$0.01	\$ 0.05	\$0.04	\$ 0.13
Loss from discontinued operations	0.00	(0.01 )	0.00	(0.19 )
Net income (loss)	\$0.01	\$ 0.04	\$0.04	\$ (0.06 )
Weighted average shares used in computing loss per share:				
Basic	26,761	26,175	26,596	25,995
Diluted	27,367	26,796	27,356	26,679
Cash dividends declared per share	\$0.06	\$ 0.06	\$0.18	\$ 0.18

*The accompanying notes are an integral part of these statements.*



**COHU, INC.****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

(Unaudited)

(in thousands)

	<b>Three Months Ended September</b>		<b>Nine Months Ended September</b>	
	<b>24, 2016</b>	<b>26, 2015</b>	<b>24, 2016</b>	<b>26, 2015</b>
Net income (loss)	\$269	\$ 1,113	\$965	\$ (1,699 )
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	561	(4,221 )	2,724	(9,754 )
Adjustments related to postretirement benefits	(2 )	99	(35 )	(33 )
Change in unrealized gain/loss on investments	(3 )	-	(1 )	-
Other comprehensive income (loss), net of tax	556	(4,122 )	2,688	(9,787 )
Comprehensive income (loss)	\$825	\$ (3,009 )	\$3,653	\$ (11,486 )

*The accompanying notes are an integral part of these statements.*

**COHU, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited)

(in thousands)

	<b>Nine Months Ended</b>	
	<b>September 24,</b>	<b>September 26,</b>
	<b>2016</b>	<b>2015</b>
Cash flows from operating activities:		
Net income (loss)	\$965	\$ (1,699 )
Reconciliation of net income (loss) to net cash provided by operating activities:		
Loss on disposal of assets	37	-
Loss on disposal of microwave communications equipment business	4	3,232
Operating cash flows of discontinued operations	-	(1,039 )
Depreciation and amortization	8,089	8,533
Share-based compensation expense	5,276	5,081
Deferred income taxes	(1,111 )	(1,086 )
Asset impairment charge	-	279
Changes in other accrued liabilities	716	1,624
Changes in other assets	(32 )	(522 )
Changes in current assets and liabilities, excluding effects from divestitures:		
Accounts receivable	3,073	12,860
Inventories	3,551	(5,273 )
Other current assets	(411 )	2,891
Accounts payable	(2,109 )	2,219
Deferred profit	1,970	(1,127 )
Income taxes payable	(2,451 )	1,804
Accrued compensation, warranty and other liabilities	980	(3,217 )
Net cash provided by operating activities	18,547	24,560
Cash flows from investing activities, excluding effects from divestitures:		
Purchases of short-term investments	(31,453 )	(453 )
Sales and maturities of short-term investments	13,654	155
Purchases of property, plant and equipment	(2,797 )	(3,687 )
Cash received from sale of facility and fixed assets	852	-
Cash received from sale of microwave communications equipment business	-	5,339
Investing cash flows of discontinued operations	-	(74 )
Net cash provided by (used in) investing activities	(19,744 )	1,280
Cash flows from financing activities:		
Cash dividends paid	(4,748 )	(4,648 )
Issuance (repurchases) of common stock, net	(1,325 )	201
Net cash used in financing activities	(6,073 )	(4,447 )
Effect of exchange rate changes on cash and cash equivalents	1,117	(3,018 )

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Net increase (decrease) in cash and cash equivalents	(6,153 )	18,375
Cash and cash equivalents at beginning of period	115,370	70,885
Cash and cash equivalents at end of period	\$109,217	\$ 89,260

Supplemental disclosure of cash flow information:

Cash paid (refunded) for income taxes	\$5,977	\$ (414 )
Inventory capitalized as property, plant and equipment	\$201	\$ 220
Dividends declared but not yet paid	\$1,603	\$ 1,567
Capitalized facility under build-to-suit lease	\$-	\$ 682

*The accompanying notes are an integral part of these statements.*

**Cohu, Inc.**

**Notes to Unaudited Condensed Consolidated Financial Statements**

**September 24, 2016**

**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 26, 2015 has been derived from our audited financial statements at that date. The interim condensed consolidated financial statements as of September 24, 2016 (also referred to as “the third quarter of fiscal 2016” and “the first nine months of fiscal 2016”) and September 26, 2015 (also referred to as “the third quarter of fiscal 2015” and “the first nine months of fiscal 2015”) 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 24, 2016 and September 26, 2015 were each 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 26, 2015, which are included in our 2015 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”.

**Discontinued Operations**

In June 2015, we sold our microwave communications equipment segment, Broadcast Microwave Services, Inc. (“BMS”). The operating results of BMS are being presented as discontinued operations and all prior period amounts have been reclassified accordingly. See Note 2, “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 24, 2016 and December 26, 2015. 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 24, 2016, 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.

## **Goodwill, Other Intangible Assets and Long-lived Assets**

We evaluate goodwill for impairment annually on October 1<sup>st</sup> of each year and when an event occurs or circumstances change that indicate that the carrying value may not be recoverable. As a part of our annual assessment process for 2015 we performed a qualitative assessment to determine whether current events or changes in circumstances lead us to a determination that it is more likely than not (defined as a likelihood of more than 50 percent) that the fair value of our reporting unit is less than its carrying amount. Under this approach, absent a qualitative determination that the fair value of our reporting unit is more likely than not to be less than its carrying value, we do not need to proceed to the traditional estimated fair value test for that asset, which would involve comparing the book value of net assets to the fair value of our identified reporting unit.



**Cohu, Inc.**

**Notes to Unaudited Condensed Consolidated Financial Statements**

**September 24, 2016**

As of October 1, 2015, the results of our qualitative assessment indicated there was no impairment.

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 asset's carrying amount and estimated fair value.

**Foreign 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. 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. During the three and nine months ended September 24, 2016, we recognized foreign exchange losses of \$0.3 million and \$1.0 million in our consolidated statements of operations, respectively. During the three and nine months ended September 26, 2015, we recognized approximately \$1.5 million and \$1.1 million of foreign exchange gains in our consolidated statements of operations, respectively. 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), future forfeitures 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.

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

	Three Months Ended September		Nine Months Ended September	
	2016	2015	2016	2015
Cost of sales	\$160	\$ 100	\$264	\$ 413
Research and development	288	256	998	841
Selling, general and administrative	1,220	1,281	4,014	3,827
Total share-based compensation	1,668	1,637	5,276	5,081
Income tax benefit	(76 )	(70 )	(189 )	(181 )
Total share-based compensation, net	\$1,592	\$ 1,567	\$5,087	\$ 4,900



**Cohu, Inc.****Notes to Unaudited Condensed Consolidated Financial Statements****September 24, 2016****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 24, 2016, options to issue approximately 707,000 and 752,000 shares of common stock were excluded from the computation, respectively. For the three and nine months ended September 26, 2015, options to issue approximately 857,000 and 912,000 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 24, 2016	September 26, 2015	September 24, 2016	September 26, 2015
Weighted average common shares	26,761	26,175	26,596	25,995
Effect of dilutive stock options	606	621	760	684
	27,367	26,796	27,356	26,679

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 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 and kit revenue is generally recognized upon shipment.

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.

**Cohu, Inc.****Notes to Unaudited Condensed Consolidated Financial Statements****September 24, 2016**

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 24, 2016, we had deferred revenue totaling approximately \$6.4 million and deferred profit of \$5.7 million. At December 26, 2015, we had deferred revenue totaling approximately \$5.0 million and deferred profit of \$3.7 million. The periodic increase is primarily a result of 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 September		Nine Months Ended September	
	24, 2016	26, 2015	24, 2016	26, 2015
Customers individually accounting for more than 10% of net sales	three	two	two	two
Percentage of net sales	37.4%	28.8	% 30.5%	28.5

**Comprehensive Loss**

Our accumulated other comprehensive loss balance totaled approximately \$19.1 million and \$21.8 million at September 24, 2016 and December 26, 2015, 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 income during the first nine months of fiscal 2016 and 2015 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 2016 and 2015 was not significant.

## Recent Accounting Pronouncements

*Recently Adopted Accounting Pronouncements* – In the first quarter of 2016 we adopted Accounting Standards Update (“ASU”) No. 2015-16 “Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments” (ASU 2015-16). ASU 2015-16 requires an entity to: recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined; record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date; and present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. The adoption of this authoritative guidance did not impact on our condensed consolidated financial statements.

*Recently Issued Accounting Pronouncements* – On March 31, 2016, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2016-09, “Compensation – Stock Compensation” (Topic 718). The FASB issued this update to improve the accounting for employee share-based payments. It affects all organizations that issue share-based payment awards to their employees. Several aspects of the accounting for share-based payment award transactions are simplified, including: (a) income tax consequences; (b) classification of awards as either equity or liabilities; and (c) classification on the statement of cash flows. The updated guidance is effective for annual periods beginning after December 15, 2016, including interim periods within those fiscal years, with early adoption permitted. We are currently evaluating potential early adoption of this standard during fiscal 2016, but do not expect the adoption of this standard to have a material effect on our Consolidated Statements of Operations or Consolidated Balance Sheets.

**Cohu, Inc.**

**Notes to Unaudited Condensed Consolidated Financial Statements**

**September 24, 2016**

In February 2016, the FASB issued ASU No. 2016-02, “Leases (Topic 842)”, which requires lessees to record most leases on their balance sheets. The new standard states that a lessee will recognize a lease liability for the obligation to make lease payments and a right-of-use asset for the right to use the underlying asset for the lease term. Expense related to leases determined to be operating leases will be recognized on a straight-line basis, while those determined to be financing leases will be recognized following a front-loaded expense profile in which interest and amortization are presented separately in the income statement. The standard is effective for interim and annual periods beginning after December 15, 2018. Early adoption is permitted. The new guidance must be adopted using a modified retrospective transition, and provides for certain practical expedients. We are currently evaluating the impact of this new standard on our financial reporting, but recognizing the lease liabilities and related right-of-use assets will impact our balance sheet.

In January 2016, the FASB issued ASU No. 2016-01, “Recognition and Measurement of Financial Assets and Liabilities”, which amends the guidance on the classification and measurement of financial instruments. The changes primarily affect the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. Under the new guidance, equity investments in unconsolidated entities that are not accounted for under the equity method will generally be measured at fair value through earnings. When the fair value option has been elected for financial liabilities, changes in fair value due to instrument-specific credit risk will be recognized separately in other comprehensive income. The guidance is effective for interim and annual periods beginning after December 15, 2017. We are currently evaluating the impact that the new guidance will have on our consolidated financial statements.

In July 2015, the FASB issued ASU 2015-11 “Simplifying the Measurement of Inventory”. ASU 2015-11 simplifies the guidance on the subsequent measurement of inventory, excluding inventory measured using last-in, first out or the retail inventory method. Under the new standard, in scope inventory should be measured at the lower of cost and net realizable value. The standard is effective for interim and annual periods beginning after December 15, 2016, with early adoption permitted. We are evaluating the impact of the new standard on our consolidated financial statements and our timing for adoption.

In August 2014, the FASB issued ASU 2014-15, “Presentation of Financial Statements - Going Concern, Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern”. This standard sets forth management’s responsibility to evaluate, at each reporting period, whether there is substantial doubt about an entity’s ability to continue as a going concern, and if so, to provide related footnote disclosures. The standard is effective for interim and annual periods ending after December 15, 2016. The Company does not believe that the adoption of this guidance will have any material impact on its financial position or results of operations.

In May 2014, the FASB issued new guidance on revenue from contracts with customers. The amended guidance outlines a single comprehensive revenue model for entities to use in accounting for revenue arising from contracts with customers. The guidance supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of the revenue model is that “an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.” Entities have the option of using either a full retrospective or modified approach to adopt the guidance. This guidance is effective for fiscal years, and interim reporting periods within those years, beginning after December 15, 2016. In April 2015, the FASB agreed to propose a one-year deferral of the revenue recognition standard's effective date for all entities, which would change the effectiveness to annual reporting periods beginning after December 15, 2017, with the option to adopt as early as December 15, 2016. We expect to adopt the provisions of this new accounting standard at the beginning of fiscal year 2018 and we are evaluating the impact of the new guidance on our financial statements and have not yet determined which transition method we will utilize upon adoption or the potential impact of this new guidance on our consolidated financial statements.

## **2. 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.

**Cohu, Inc.****Notes to Unaudited Condensed Consolidated Financial Statements****September 24, 2016**

As part of the divestiture of BMS at June 27, 2015, we recorded a long-term contingent consideration receivable that has been classified as Level 3 in the fair value hierarchy. See Note 4, "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 based on BMS achieving 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. We adjusted the value of the contingent consideration receivable to \$0.5 million at September 24, 2016, based on updated revenue forecasts received from BMS. The change in the fair value was recognized in discontinued operations below.

In connection with the disposal of BMS we incurred divestiture-related costs in the first quarter of 2015 that would not have been incurred otherwise. These costs consist of legal and investment banking advisory services, success based compensation arrangements and certain other items that are incremental to normal operating charges and were expensed as incurred. These costs are included in the loss from sale amount presented below.

Operating results of our discontinued segment are summarized as follows (*in thousands*):

	Three Months Ended September 24, 2016		Nine Months Ended September 24, 2015	
	2016	2015	2016	2015
Net sales	\$-	\$ -	\$-	\$ 6,965
Operating loss before income taxes	-	-	-	(1,963 )
Gain (loss) from sale of BMS	51	(222 )	(4)	(3,232 )
Income (loss) before taxes	51	(222 )	(4)	(5,195 )
Income tax provision	-	-	-	6
Income (loss), net of tax	\$51	\$ (222 )	\$(4)	\$ (5,201 )

**3. Goodwill and Other Purchased Intangible Assets**

Changes in the carrying value of goodwill during the year ended December 26, 2015 and the nine-month period ended September 24, 2016 were as follows (*in thousands*):

	Goodwill
Balance, December 27, 2014	\$ 63,132
Impact of currency exchange	(2,868 )
Balance, December 26, 2015	60,264
Impact of currency exchange	764
Balance, September 24, 2016	\$ 61,028

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

	September 24, 2016			December 26, 2015	
	Gross Carrying Amount	Accumulated Amortization	Remaining Useful Life (in years)	Gross Carrying Amount	Accumulated Amortization
Rasco technology	\$27,513	\$ 26,868	0.2	\$26,904	\$ 23,776
Ismeca technology	27,492	13,049	4.3	27,043	10,329
Trade names	5,651	401	14.0	5,547	92
	\$60,656	\$ 40,318		\$59,494	\$ 34,197

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. Amortization expense related to intangible assets was approximately \$1.7 million in the third quarter of fiscal 2015 and \$5.3 million in the first nine months of fiscal 2015. Changes in the carrying values of these intangible assets are a result of the impact of fluctuations in currency exchange rates.



**Cohu, Inc.****Notes to Unaudited Condensed Consolidated Financial Statements****September 24, 2016****4. 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.

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

	September 24, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Corporate debt securities <sup>(1)</sup>	\$11,489	\$ -	\$ 5	\$ 11,484
Foreign government security	639	-	-	639
Government-sponsored enterprise securities	4,012	2	-	4,014
Bank certificates of deposit	3,313	1	-	3,314
	\$19,453	\$ 3	\$ 5	\$ 19,451

	December 26, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Foreign government security	\$650	\$ -	\$ -	\$ 650

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Bank certificates of deposit	1,002	-	-	1,002
	\$ 1,652	\$ -	\$ -	\$ 1,652

(1) As of September 24, 2016 there were \$10.5 million of investments in our portfolio in a loss position. As of December 26, 2015 there were no investments in our portfolio in a loss position

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

	September 24, 2016		December 26, 2015	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	\$19,453	\$ 19,451	\$1,450	\$ 1,450
Due after one year through three years	-	-	202	202
	\$19,453	\$ 19,451	\$1,652	\$ 1,652

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.

**Cohu, Inc.****Notes to Unaudited Condensed Consolidated Financial Statements****September 24, 2016**

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 24, 2016 using:			Total estimated fair value
	Level 1	Level 2	Level 3	
Cash	\$58,299	\$-	\$ -	\$58,299
Corporate debt securities	-	19,952	-	19,952
Government-sponsored enterprise securities	-	4,014	-	4,014
Money market funds	-	42,450	-	42,450
Bank certificates of deposit	-	3,314	-	3,314
Foreign government security	-	639	-	639
	\$58,299	\$70,369	\$ -	\$128,668

	Fair value measurements at December 26, 2015 using:			Total estimated fair value
	Level 1	Level 2	Level 3	
Cash	\$73,746	\$-	\$ -	\$73,746
Foreign government security	-	650	-	650
Money market funds	-	41,624	-	41,624
Bank certificates of deposit	-	1,002	-	1,002
	\$73,746	\$43,276	\$ -	\$117,022

**5. 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 24, 2016, there were 1,815,471 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 2016 we did not grant any stock options and we issued 32,555 shares of our common stock on the exercise of options that were granted previously.

At September 24, 2016, we had 1,730,496 stock options outstanding. These options had a weighted-average exercise price of \$10.71 per share, an aggregate intrinsic value of approximately \$3.1 million and the weighted average remaining contractual term was approximately 4.1 years.

At September 24, 2016, we had 1,617,819 stock options outstanding that were exercisable. These options had a weighted-average exercise price of \$10.78 per share, an aggregate intrinsic value of \$2.9 million and the weighted average remaining contractual term was approximately 3.9 years.

**Cohu, Inc.**

**Notes to Unaudited Condensed Consolidated Financial Statements**

**September 24, 2016**

**Restricted Stock Units**

We grant restricted stock units (“RSUs”) to certain employees, consultants and outside 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 restricted stock units 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 24, 2016.

In the first nine months of fiscal 2016 we awarded 471,225 RSUs and we issued 396,225 shares of our common stock on vesting of previously granted awards. At September 24, 2016, we had 1,115,355 restricted stock units outstanding with an aggregate intrinsic value of approximately \$12.9 million and the weighted average remaining vesting period was approximately 2.3 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 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 the Company’s annualized Total Shareholder Return (“TSR”) for the performance period and the relative performance of the Company’s TSR compared with the annualized TSR of certain peer companies for the performance period. PSUs granted in 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 24, 2016.

In the first nine months of fiscal 2016, we awarded 222,316 PSUs and we issued 172,053 shares of our common stock on vesting of previously granted awards. At September 24, 2016, we had 403,738 PSUs outstanding with an aggregate intrinsic value of approximately \$4.7 million and the weighted average remaining vesting period was approximately 1.5 years.

### **Employee Stock Purchase Plan (ESPP)**

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 2016, 56,288 shares of our common stock were sold to our employees under the Plan leaving 754,775 shares available for future issuance.

### **6. Income Taxes**

Ordinarily, interim tax provisions are calculated using the estimated effective tax rate (“ETR”) expected to be applicable for the full fiscal year. However, when a reliable estimate of the annual ETR cannot be made, the actual ETR for the year-to-date period may be the best estimate of the annual ETR. For the three and nine months ended September 24, 2016 and September 26, 2015, we used the actual year-to-date ETR in computing our tax provision, as a reliable estimate of the annual ETR cannot be made, since relatively small changes in our projected income produce a significant variation in our ETR. The actual year-to-date ETR on income from continuing operations for the three months ended September 24, 2016 and September 26, 2015, was 79.6% and 41.3%, respectively. The actual year-to-date ETR on income from continuing operations for the nine months ended September 24, 2016 and September 26, 2015, was 65.4% and 39.1%, respectively. The tax provision on income from continuing operations in 2016 and 2015 differs from the U.S. federal statutory rate primarily due to the lack of a benefit on our domestic losses as a result of our valuation allowance on deferred tax assets, foreign income taxed at lower rates, changes in our deferred tax asset valuation allowance, state taxes and interest related to unrecognized tax benefits.

**Cohu, Inc.**

**Notes to Unaudited Condensed Consolidated Financial Statements**

**September 24, 2016**

As of September 24, 2016, \$65.9 million of our cash and cash equivalents and short term-investments 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. We repatriated approximately \$17 million from our Singapore subsidiary in 2016 due to the reduction in business activity of that operation. This repatriation did not result in incremental U.S. taxes due to previously taxed income, loss carryforwards and a full valuation allowance against our domestic deferred tax assets. Our intent is to continue to indefinitely reinvest the remaining funds in our foreign operations and we have no current plans that would require us to repatriate these funds to the U.S.

Other than foreign currency exchange rate changes, 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 24, 2016 and September 26, 2015.

**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 the matters described above 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 24, 2016	September 26, 2015	September 24, 2016	September 26, 2015
Balance at beginning of period	\$5,118	\$ 5,212	\$4,886	\$ 5,848
Warranty expense accruals	1,320	1,867	4,586	5,062
Warranty payments	(1,401)	(1,905 )	(4,435)	(5,736 )
Balance at end of period	\$5,037	\$ 5,174	\$5,037	\$ 5,174

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 \$1.3 million at September 24, 2016 and \$1.1 million at December 26, 2015.

### Standby Letters of Credit

During the ordinary course of business, we provide standby letters of credit instruments to certain parties as required. As of September 24, 2016, no amounts were outstanding under standby lines of credit.

### Lines of Credit

One of our wholly owned subsidiaries has two available lines of credit which provide it with borrowings of up to a total of 2.5 million Swiss Francs. At September 24, 2016 and December 26, 2015, no amounts were outstanding under the lines of credit.



**Cohu, Inc.**

**Management's Discussion and Analysis of Financial Condition and Results of Operations**

**September 24, 2016**

**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 2015 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 sub-systems 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 cyclical trends. We expect that the semiconductor equipment industry will continue to be cyclical and volatile in part because consumer electronics, the principal end market for integrated circuits, is a highly dynamic industry and demand has traditionally fluctuated.

Orders for semiconductor test and assembly equipment as reported by Semiconductor Equipment and Materials International (SEMI) increased sequentially each month from October 2015 through January 2016 followed by declining orders in February and March 2016. The downward order momentum within the back-end equipment segment ceased in March 2016 with global orders for equipment increasing during the second quarter reaching a peak in June and then declining throughout the third quarter of 2016. Similar to the broader market our operating results for the third quarter were down sequentially. During the first nine months our net sales in 2016 are up, slightly, from 2015

and have benefitted from demand for equipment for testing devices used in mobile, automotive and computing applications. We monitor our customers' test floors, and equipment utilization was essentially flat throughout the third quarter of 2016. Looking ahead, we see momentum in the automotive and mobile markets and are optimistic about the long-term prospects for the semiconductor equipment industry due to the increasing technological functionality of mobile devices, growing integrated circuit and LED content in automobiles and consumer products, and expanding applications in industrial. We are focused on growing our market share in the mobility, automotive and solid state markets and expanding into the test contacting and wafer level package test markets.

### **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.

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 market concerns equal to the difference between the cost of inventory and the estimated market 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 24, 2016 was approximately \$45.9 million, with a valuation allowance of approximately \$42.9 million. Our deferred tax assets consist primarily of 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.

**Cohu, Inc.**

**Management's Discussion and Analysis of Financial Condition and Results of Operations**

**September 24, 2016**

**Goodwill, Other Intangible Assets and Long-lived Assets:** We evaluate goodwill for impairment annually on October 1<sup>st</sup> of each year and when an event occurs or circumstances change that indicate that the carrying value may not be recoverable. As a part of our annual assessment process for 2015 we performed a qualitative assessment to determine whether current events or changes in circumstances lead us to a determination that it is more likely than not (defined as a likelihood of more than 50 percent) that the fair value of our reporting unit is less than its carrying amount. Under this approach, absent a qualitative determination that the fair value of our reporting unit is more likely than not to be less than its carrying value, we do not need to proceed to the traditional estimated fair value test for that asset, which would involve comparing the book value of net assets to the fair value of our identified reporting unit.

As of October 1, 2015, the results of our qualitative assessment indicated there was no impairment.

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 asset's 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 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. 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.

## 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.

## RESULTS OF OPERATIONS

In June 2015, we sold our mobile microwave communications equipment business. The operating results of this business are being presented as discontinued operations and all prior period amounts have been reclassified. Unless otherwise indicated the discussion below covers the comparative results from continuing operations.

The following table summarizes certain operating data as a percentage of net sales:

	Three Months Ended			Nine Months Ended		
	September 24, 2016	September 26, 2015		September 24, 2016	September 26, 2015	
Net sales	100.0%	100.0	%	100.0%	100.0	%
Cost of sales	(66.5)%	(66.2)	)%	(67.2)%	(66.7)	)%
Gross margin	33.5 %	33.8	%	32.8 %	33.3	%
Research and development	(12.5)%	(12.7)	)%	(11.7)%	(12.1)	)%
Selling, general and administrative	(19.6)%	(17.7)	)%	(19.9)%	(18.4)	)%
Income from operations	1.4 %	3.4	%	1.2 %	2.8	%

**Cohu, Inc.**

**Management's Discussion and Analysis of Financial Condition and Results of Operations**

**September 24, 2016**

**Third Quarter of Fiscal 2016 Compared to Third Quarter of Fiscal 2015**

*Net Sales*

Our consolidated net sales increased 2.6% to \$69.3 million in 2016, compared to \$67.5 million in 2015. Global demand for back-end semiconductor test and assembly equipment is highly cyclical. Our net sales in the third quarter of 2016 are up, slightly, from the corresponding period of 2015 and reflect the slowly improving business conditions in the semiconductor industry and demand for equipment for testing devices used in mobile, automotive and computing applications.

*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 of products sold, product support costs, increase 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 33.5% in 2016 and 33.8% in 2015.

We compute the majority of our excess and obsolete inventory reserve requirements using a one-year inventory usage forecast. In the third quarter of 2016 we recorded charges to cost of sales of \$0.5 million for excess and obsolete inventory. In the third quarter of 2015, we recorded charges of approximately \$0.7 million. While we believe our reserves for excess and obsolete inventory and lower of cost or market concerns are adequate to cover known exposures at September 24, 2016, 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 \$8.6 million in both 2016 and 2015 representing 12.5% and 12.7% of net sales, respectively. New product development programs resulted in increased R&D spending on labor and materials during the third quarter of 2016, however, these additional costs were offset by \$0.6 million of cost reimbursements received under a cost-sharing arrangement that was entered into with a customer during the first quarter of 2016.

***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 \$13.6 million or 19.6% in 2016, compared to \$11.9 million or 17.7% in 2015. SG&A expense in the third quarter of 2016 was negatively impacted by the recognition of \$0.3 million of foreign currency losses whereas the corresponding period of 2015 benefited from \$1.5 million of foreign currency gains.

***Income Taxes***

Ordinarily, interim tax provisions are calculated using the estimated effective tax rate (“ETR”) expected to be applicable for the full fiscal year. However, when a reliable estimate of the annual ETR cannot be made, the actual ETR for the year-to-date period may be the best estimate of the annual ETR. For the three months ended September 24, 2016 and September 26, 2015, we used the actual year-to-date ETR in computing our tax provision, as a reliable estimate of the annual ETR cannot be made, since relatively small changes in our projected income produce a significant variation in our ETR. The actual year-to-date ETR on income from continuing operations for the three months ended September 24, 2016 and September 26, 2015, was 79.6% and 41.3%, respectively. The tax provision on income from continuing operations in 2016 and 2015 differs from the U.S. federal statutory rate primarily due to the lack of a benefit on our domestic losses as a result of our valuation allowance on deferred tax assets, foreign income taxed at lower 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, there was no material change to our unrecognized tax benefits and related accrued interest and penalties during the three-month periods ended September 24, 2016 and September 26, 2015.



**Cohu, Inc.**

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***Income from Continuing Operations and Net Income***

As a result of the factors set forth above, our income from continuing operations was \$0.2 million in 2016, compared to \$1.3 million in 2015. Including the impact of the disposal of our discontinued mobile microwave communication equipment business, which included a gain of \$0.1 million due to a favorable adjustment to the fair value of the contingent consideration, our net income in the third quarter of 2016, was \$0.3 million. In 2015, which includes a \$0.2 million loss resulting from the sale of our microwave communication equipment business, our net income was \$1.1 million.

**First Nine Months of Fiscal 2016 Compared to First Nine Months of Fiscal 2015**

***Net Sales***

Our consolidated net sales increased 2.5% to \$211.4 million in 2016, compared to \$206.2 million in 2015. Global market demand for back-end semiconductor test and assembly equipment is highly cyclical and sales in the first nine months of 2016 are up, slightly, and have benefitted from slowly improving business conditions in the semiconductor industry and demand for equipment for testing devices used in mobile, automotive and computing applications. Our net sales in 2016 also benefitted from the recognition of \$3.0 million for deferred sales credits that expired in the second quarter.

***Gross Margin***

Our gross margin, as a percentage of net sales, decreased to 32.8% in 2016 from 33.3% in 2015. Gross margin in the first nine months of 2016 benefitted from the recognition of deferred sales credits for which there was no associated cost; however, this benefit was more than offset by unfavorable product mix resulting in a year-over-year decrease.

During both the first nine months of fiscal 2016 and 2015 we recorded net charges to cost of sales of approximately \$1.9 million for excess and obsolete inventory.

### ***R&D Expense***

R&D expense was \$24.7 million or 11.7% of net sales in 2016, compared to \$24.9 million or 12.1% in 2015. New product development programs resulted in higher R&D labor and material expense in the first nine months of 2016, however, this increase was more than offset by \$1.6 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 \$42.0 million or 19.9% of net sales in 2016, compared to \$38.0 million or 18.4% in 2015. SG&A expense in the first nine months of 2016 was negatively impacted by the recognition of \$1.0 million of foreign currency losses whereas the corresponding period of 2015 benefited from \$1.1 million of foreign currency gains. Additionally, SG&A expense for the first nine months of 2016 includes approximately \$1.2 million related to consulting, training and preparation for aligning our global Enterprise Resource Planning (ERP) system.

### ***Income Taxes***

For the nine months ended September 24, 2016 and September 26, 2015, we used the actual year-to-date ETR in computing our tax provision, as a reliable estimate of the annual ETR cannot be made, since relatively small changes in our projected income produce a significant variation in our ETR. The actual year-to-date ETR on income from continuing operations for the nine months ended September 24, 2016 and September 26, 2015, was 65.4% and 39.1%, respectively. The tax provision on income from continuing operations in 2016 and 2015 differs from the U.S. federal statutory rate primarily due to the lack of a benefit on our domestic losses as a result of our valuation allowance on deferred tax assets, foreign income taxed at lower 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, there was no material change to our unrecognized tax benefits and related accrued interest and penalties during the nine-month periods ended September 24, 2016 and September 26, 2015.

### ***Income from Continuing Operations and Net Income***

As a result of the factors set forth above, our income from continuing operations was \$1.0 million in 2016 compared to \$3.5 million in 2015. Including the impact of our discontinued mobile microwave communication equipment business, our net income was \$1.0 million in 2016. In 2015, which includes BMS' operating loss of \$2.0 million and a loss of \$3.2 million resulting from the sale of the business, our net loss was \$1.7 million.

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**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 cyclical 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 24, 2016, \$65.9 million of our cash and cash equivalents and short term-investments 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. We repatriated approximately \$17 million from our Singapore subsidiary in 2016 due to the reduction in business activity of that operation. This repatriation did not result in incremental U.S. taxes due to previously taxed income, loss carryforwards and a full valuation allowance against our domestic deferred tax assets. Our intent is to continue to indefinitely reinvest the remaining funds in our foreign operations and we have no current plans that would require us to repatriate these funds to the U.S.

**Liquidity**

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

	September 24, 2016	December 26, 2015	Increase	Percentage Change	
<i>(in thousands)</i>					
Cash, cash equivalents and short-term investments	\$ 128,668	\$ 117,022	\$ 11,646	10.0	%
Working capital	\$ 177,303	\$ 171,272	\$ 6,031	3.5	%

**Cash Flows**

**Operating Activities:** Operating cash flows for the first nine months of fiscal 2016 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 and deferred income taxes. Our net cash provided by operating activities in the first nine months of fiscal 2016 totaled \$18.5 million. Net cash provided by operating activities was impacted by changes in current assets and liabilities and included decreases in accounts receivable of \$3.1 million, inventories of \$3.6 million, accounts payable of \$2.1 million and income taxes payable \$2.5 million. The decrease in accounts receivable resulted from a sequential decrease in product shipments and the timing of the resulting cash conversion cycle. Product shipments and improved inventory and supply chain management led to the reduction in our inventories. Accounts payable decreased as a result of the timing of cash payments made to our suppliers and the decrease in income taxes payable stemmed from payments made. Deferred profit increased \$2.0 million from deferral of certain sales in accordance with our revenue recognition policy.

**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 divestitures and cash used for purchases of investments and business acquisitions. Net cash used in investing activities in the first nine months of fiscal 2016 totaled \$19.7 million and was primarily the result of \$31.5 million in cash used for purchases of short-term investments offset by \$13.7 million in net proceeds from sales and maturities 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 \$2.8 million were made to support the operating and development activities of our business. Proceeds from the sale of assets totaled \$0.9 million and primarily resulted from the sale of a facility located in Chandler, Arizona that we no longer utilized.

**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 2016, we used cash totaling \$1.3 million, net of \$0.8 million of cash generated by stock issuances, to repurchase common stock to settle the minimum statutory tax withholding requirements paid by us on behalf of our employees upon vesting of restricted stock awards. We paid dividends totaling \$4.7 million, or \$0.18 per common share. On October 25, 2016, Cohu's Board of Directors approved a quarterly cash dividend of \$0.06 per share payable on January 2, 2017, to shareholders of record on November 18, 2016. 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.

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**Capital Resources**

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 24, 2016, no amounts were outstanding under standby letters of credit under the Secured Facility. 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 24, 2016, 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 operating leases, unrecognized tax benefits, pensions, post-retirement benefits and warranties. These obligations have not changed materially from those disclosed in our Annual Report on Form 10-K for the year ended December 26, 2015.

**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 24, 2016, 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 24, 2016, our investment portfolio included short-term, fixed-income investment securities with a fair value of approximately \$19.5 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 24, 2016, we had \$10.5 million of investments with loss positions.

**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 and Philippine Peso. 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 income. As a result of fluctuations in certain foreign currency exchange rates in relation to the U.S. Dollar as of September 24, 2016 compared to December 26, 2015, our stockholders' equity increased by \$2.7 million.





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 24, 2016 would result in an approximate \$16.1 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 24, 2016 would result in an approximate \$16.1 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 quarter ended September 24, 2016, we began the process of implementing a new financial consolidation system. This change was not in response to any identified deficiency or weakness in our internal control over financial reporting. There have been no other changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) during the quarter ended September 24, 2016 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 do not currently believe are 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 2015 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 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) probing 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 risks associated with acquisitions, investments and divestitures.***

We have made, and may in the future make, acquisitions of, or significant investments in, businesses with complementary products, services and/or technologies. 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 or customers of Cohu or acquired businesses;  
lack of synergy, or the inability to realize expected synergies, resulting from the acquisition;  
failure to commercialize purchased technology; and  
the impairment of acquired intangible assets and goodwill that could result in significant charges to operating results in future periods.

We may be required 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.

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 24, 2016, we had goodwill and net purchased intangible assets balances of \$61.0 million and \$20.3 million, respectively.

***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 that we do not face domestically. Certain aspects inherent in transacting business internationally could negatively impact our operating results, including:

costs and difficulties in staffing and managing international operations;  
unexpected changes in regulatory requirements;

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 are in the process of transitioning our manufacturing to Asia. Our inability to manage multiple manufacturing sites during this transition 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 the global economic conditions may impact their ability to operate their business. They may also be impacted by the 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 cease manufacturing certain components 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 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 cyclical 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 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 market inventory write-offs and reserve requirements. In fiscal 2015, 2014 and 2013, we recorded pre-tax inventory-related charges of approximately \$2.4 million, \$2.6 million, and \$7.1 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. We believe that competitive conditions in the semiconductor test handler market have intensified over the last several years. This 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 increased exposure resulted in significant charges to operations during each of the years in the three-year period ended December 26, 2015. 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 are capable of achieving 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, which have deteriorated significantly in many countries and regions and may remain depressed for the foreseeable future. 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 the 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. In order 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 cyclical 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 volatile changes in demand for its products. A number of factors including the semiconductor industry's continually changing and unpredictable capacity requirements and changes in integrated circuit design and packaging, result in changes in product demand. Sudden changes in demand for semiconductor equipment have a significant impact on our operations. Typically, we reduce and increase our workforce, particularly in manufacturing, based on customer demand for our products. These changes in workforce levels place enormous demands on our employees, operations and infrastructure since newly hired personnel rarely possess the expertise and level of experience of current employees. Additionally, these transitions divert management time and attention from other activities and adversely impact employee morale. 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 cyclical 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, 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 in order 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.

***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 in the event that 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.

***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 the Philippines, Malaysia and China. 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, and do not presently have redundant, multiple site capacity in the event of a natural disaster. In the event of such disaster, our business would suffer.

***Our financial and operating results may vary and may 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:

- cyclical 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 writedowns;
- inability to deliver solutions as expected by our customers; and
- intangible and deferred tax asset writedowns.

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 last three years the price of our common stock has ranged from \$13.84 to \$8.63. The price of our stock may be more volatile than the stock of other companies due to, among other factors, the unpredictable and cyclical 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.

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

*Recent Sales of Unregistered Securities*

None.

*Issuer Purchases of Equity Securities*

None.

**Item 3. Defaults Upon Senior Securities.**

None.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information.**

None.



**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
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- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
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- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
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**SIGNATURES**

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

COHU, INC.  
(Registrant)

Date: October 28, 2016

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

Date: October 28, 2016

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

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