

COHU INC  
Form 10-Q  
May 10, 2018

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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 March 31, 2018**

**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 92064-6817**

*(Address of principal executive offices) (Zip Code)*

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer

Smaller reporting company Emerging growth company

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

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



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

	<b>March 31,</b>	<b>December</b>
	<b>2018</b>	<b>30,</b>
	(Unaudited)	<b>2017 *</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 115,136	\$ 134,286
Short-term investments	24,594	21,329
Accounts receivable, net	85,176	71,125
Inventories	62,676	62,085
Other current assets	9,924	8,613
Total current assets	297,506	297,438
Property, plant and equipment, net	35,122	34,172
Goodwill	66,784	65,613
Intangible assets, net	16,131	16,748
Other assets	7,175	6,486
	\$ 422,718	\$ 420,457
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Short-term borrowings	\$ 3,293	\$ 3,108
Current installments of long-term debt	1,291	1,280
Accounts payable	40,970	37,556
Accrued compensation and benefits	13,608	20,178
Accrued warranty	4,570	4,280
Deferred profit	2,914	6,608
Income taxes payable	1,546	2,159
Other accrued liabilities	9,959	10,098
Total current liabilities	78,151	85,267
Accrued retirement benefits	18,990	18,544
Noncurrent deferred gain on sale of facility	9,868	10,233
Deferred income taxes	3,812	2,921
Noncurrent income tax liabilities	6,435	6,270
Long-term debt	4,547	4,575
Other accrued liabilities	2,563	3,556

Stockholders' equity:		
Preferred stock, \$1 par value; 1,000 shares authorized, none issued	-	-
Common stock, \$1 par value; 60,000 shares authorized, 28,796 shares issued and outstanding in 2018 and 28,489 shares in 2017	28,796	28,489
Paid-in capital	125,448	127,663
Retained earnings	158,124	150,726
Accumulated other comprehensive loss	(14,016 )	(17,787 )
Total stockholders' equity	298,352	289,091
	\$ 422,718	\$ 420,457

\* Derived  
from  
December  
30, 2017  
audited  
financial  
statements

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

Table of Contents**COHU, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

(Unaudited)

(in thousands, except per share amounts)

	<b>Three Months Ended</b>	
	<b>March 31, 2018</b>	<b>March 25, 2017</b>
Net sales	\$95,150	\$81,097
Cost and expenses:		
Cost of sales	55,599	48,841
Research and development	11,775	9,776
Selling, general and administrative	17,763	14,460
	85,137	73,077
Income from operations	10,013	8,020
Interest income	236	101
Income from continuing operations before taxes	10,249	8,121
Income tax provision	2,127	1,358
Income from continuing operations	8,122	6,763
Income from discontinued operations	-	-
Net income	\$8,122	\$6,763
Income per share:		
Basic:		
Income from continuing operations	\$0.28	\$0.25
Income from discontinued operations	-	-
Net income	\$0.28	\$0.25
Diluted:		
Income from continuing operations	\$0.28	\$0.24
Income from discontinued operations	-	-
Net income	\$0.28	\$0.24
Weighted average shares used in computing income per share:		
Basic	28,602	26,978
Diluted	29,531	28,252
Cash dividends declared per share	\$0.06	\$0.06

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





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**COHU, INC.**  
**CONDENSED**  
**CONSOLIDATED**  
**STATEMENTS OF**  
**COMPREHENSIVE**  
**INCOME**

(Unaudited)  
(in thousands)

	<b>Three Months</b>	
	<b>Ended</b>	
	<b>March</b>	<b>March</b>
	<b>31,</b>	<b>25,</b>
	<b>2018</b>	<b>2017</b>
Net income	\$8,122	\$6,763
Other comprehensive income, net of tax:		
Foreign currency translation adjustments	3,854	4,046
Adjustments related to postretirement benefits	(73 )	(69 )
Change in unrealized gain/loss on investments	(10 )	1
Other comprehensive income, net of tax	3,771	3,978
Comprehensive income	\$11,893	\$10,741

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

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

	<b>Three Months</b>	
	<b>Ended</b>	
	<b>March</b>	<b>March</b>
	<b>31,</b>	<b>25,</b>
	<b>2018</b>	<b>2017</b>
Cash flows from operating activities:		
Net income	\$8,122	\$6,763
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	2,457	2,202
Share-based compensation expense	1,669	1,717
Deferred income taxes	506	(711 )
Adjustment to contingent consideration liability	(147 )	-
Changes in other accrued liabilities	(762 )	135
Changes in other assets	265	(433 )
Changes in current assets and liabilities, excluding effects from acquisitions:		
Accounts receivable	(13,152 )	(15,780)
Inventories	(338 )	(4,730 )
Accounts payable	2,920	5,445
Other current assets	(1,242 )	(1,422 )
Income taxes payable	(861 )	690
Deferred profit	(2,465 )	(2,121 )
Accrued compensation, warranty and other liabilities	(6,249 )	1,043
Net cash used in operating activities	(9,277 )	(7,202 )
Cash flows from investing activities, excluding effects from acquisitions:		
Purchases of short-term investments	(18,801 )	(8,080 )
Sales and maturities of short-term investments	15,536	17,701
Cash paid for Kita, net of cash received	-	(11,716)
Purchases of property, plant and equipment	(1,074 )	(1,430 )
Cash received from sale of fixed assets	20	-
Net cash used in investing activities	(4,319 )	(3,525 )
Cash flows from financing activities:		
Repurchases of common stock, net	(3,577 )	(957 )
Cash dividends paid	(1,772 )	(1,606 )
Payment of contingent consideration for Kita	(823 )	-
Repayments of long-term debt	(355 )	(470 )
Net cash used in financing activities	(6,527 )	(3,033 )
Effect of exchange rate changes on cash and cash equivalents	973	1,551
Net decrease in cash and cash equivalents	(19,150 )	(12,209)

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Cash and cash equivalents at beginning of period	134,286	96,045
Cash and cash equivalents at end of period	\$115,136	\$83,836
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	\$2,498	\$2,312
Inventory capitalized as property, plant and equipment	\$84	\$42
Dividends declared but not yet paid	\$1,713	\$1,614
Property, plant and equipment purchases included in accounts payable	\$247	\$56

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

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**Cohu, Inc.**

**Notes to Unaudited Condensed Consolidated Financial Statements**

**March 31, 2018**

**I. 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 30, 2017*, has been derived from our audited financial statements at that date. The interim condensed consolidated financial statements as of *March 31, 2018*, (also referred to as “the *first* quarter of fiscal 2018” and “the *first three* months of fiscal 2018”) and *March 25, 2017*, (also referred to as “the *first* quarter of fiscal 2017” and “the *first three* months of fiscal 2017”) 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 *first* quarter of fiscal 2018 was comprised of 13 weeks and 2017 was comprised of 12 weeks.

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 30, 2017*, which are included in our 2017 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”.

**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 \$0.2 million at both *March 31, 2018* and *December 30, 2017*. Our customers include semiconductor manufacturers and semiconductor test subcontractors

and other customers located throughout many areas of the world. While we believe that our allowance for doubtful accounts is adequate and represents our best estimate at *March 31, 2018*, we will continue to monitor customer liquidity and other economic conditions, which *may* result in changes to our estimates regarding collectability.

## Inventories

Inventories are stated at the lower of cost, determined on a *first-in, first-out* basis, or net realizable value. Cost includes labor, material and overhead costs. Determining net realizable value of inventories involves numerous estimates and judgments including projecting average selling prices and sales volumes for future periods and costs to complete and dispose of inventory. As a result of these analyses, we record a charge to cost of sales in advance of the period when the inventory is sold when estimated net realizable values are below our costs.

Inventories by category were as follows (*in thousands*):

	March 31, 2018	December 30, 2017
Raw materials and purchased parts	\$27,277	\$ 27,918
Work in process	25,267	25,130
Finished goods	10,132	9,037
Total inventories	\$62,676	\$ 62,085

Table of Contents**Cohu, Inc.****Notes to Unaudited Condensed Consolidated Financial Statements***March 31, 2018***Property, Plant and Equipment**

Depreciation and amortization of property, plant and equipment is calculated principally on the straight-line method based on estimated useful lives of *thirty to forty* years for buildings, *five to fifteen* years for building improvements and *three to ten* years for machinery, equipment and software. Land is *not* depreciated.

Property, plant and equipment, at cost, consisted of the following (*in thousands*):

	March 31, 2018	December 30, 2017
Land and land improvements	\$8,331	\$ 8,017
Buildings and building improvements	14,265	13,779
Machinery and equipment	46,018	45,333
	68,614	67,129
Less accumulated depreciation and amortization	(33,492)	(32,957 )
Property, plant and equipment, net	\$35,122	\$ 34,172

**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, which are Digital Test Handlers (DTH), Analog Test Handlers (ATH) and Integrated Test Solutions (ITS), 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.

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

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

We conduct our annual impairment test as of *October 1st* of each year, and have determined there was *no* impairment as of *October 1, 2017*, as we determined that the estimated fair values of our reporting units exceeded their carrying values on that date. Other events and changes in circumstances *may* also require goodwill to be tested for impairment between annual measurement dates. As of *March 31, 2018*, we do *not* believe there have been any events or circumstances that would require us to perform an interim goodwill impairment review. In the event we determine that an interim goodwill impairment review is required, in a future period, the review *may* result in an impairment charge, which would have a negative impact on our results of operations.

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



Table of Contents**Cohu, Inc.****Notes to Unaudited Condensed Consolidated Financial Statements***March 31, 2018***Foreign Remeasurement and Currency Translation**

Assets and liabilities of our wholly owned foreign subsidiaries that use the U.S. Dollar as their functional currency are re-measured using exchange rates in effect at the end of the period, except for nonmonetary assets, such as inventories and property, plant and equipment, which are re-measured using historical exchange rates. Revenues and costs are re-measured using average exchange rates for the period, except for costs related to those balance sheet items that are re-measured using historical exchange rates. Gains and losses on foreign currency transactions are recognized as incurred. 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* months ended *March 31, 2018*, and *March 25, 2017*, we recognized foreign exchange losses of *\$1.6* million and *\$1.3* million, respectively, in our consolidated income statements. Cumulative translation adjustments resulting from the translation of the financial statements are included as a separate component of stockholders' equity.

**Share-Based Compensation**

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

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

	Three Months
	Ended
	March    March
	31,      25,

	2018	2017
Cost of sales	\$121	\$83
Research and development	349	316
Selling, general and administrative	1,199	1,318
Total share-based compensation	1,669	1,717
Income tax benefit	(314 )	(75 )
Total share-based compensation, net	\$1,355	\$1,642

### Income Per Share

Basic income per common share is computed by dividing net income by the weighted-average number of common shares outstanding during the reporting period. Diluted income 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 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* months ended *March 31, 2018*, approximately *34,000* shares of common stock were excluded from the computation. For the *three* months ended *March 25, 2017*, approximately *258,000* shares of common stock were excluded from the computation.

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

	Three Months Ended	
	March 31, 2018	March 25, 2017
Weighted average common shares	28,602	26,978
Effect of dilutive securities	929	1,274
	29,531	28,252

Table of Contents**Cohu, Inc.****Notes to Unaudited Condensed Consolidated Financial Statements***March 31, 2018***Adoption of New Revenue Accounting Standard**

We adopted Accounting Standards Codification (ASC) Topic 606, *Revenue from Contracts with Customers* (“ASC 606”), on December 31, 2017, the first day of our 2018 fiscal year. We elected to implement the new standard using the modified retrospective method of adoption which only applies to those contracts which were not completed as of December 31, 2017. Revenues for the quarter ended March 31, 2018, have been accounted for using ASC 606 and the prior year period ended March 25, 2017, has not been adjusted. Upon adoption of ASC 606, we recorded a cumulative-effect adjustment to retained earnings of \$1.1 million on December 31, 2017, which represents the impact of ASC 606 on our deferred revenue.

Material changes recorded in connection with the cumulative-effect adjustment were as follows (*in thousands*):

Financial Statement Line Item	Balance at December 30, 2017	Adjustments due to adoption of ASC 606	Balance at December 31, 2017
Deferred profit	\$6,608	\$ (1,258 )	\$5,350
Income taxes payable	\$2,159	\$ 201	\$2,360
Retained earnings	\$150,726	\$ 1,057	\$151,783

The adoption of ASC 606 had no impact to cash used in net operating, investing or financing activities in our condensed consolidated statements of cash flows. The following table presents the amounts by which financial statement line items included in our condensed consolidated statements of income for the three months ended March 31, 2018 and our condensed consolidated balance sheet at March 31, 2018 were materially affected due to the adoption of ASC 606 (*in thousands*):

For the Period Ended March  
31, 2018  
Balances

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Condensed Consolidated Statements of Income	As Reported	without adoption of ASC 606	Effect of Change
Net sales	\$95,150	\$92,662	\$2,488
Income tax provision	\$2,127	\$1,883	\$244
Net income	\$8,122	\$5,878	\$2,244
Income per share:			
Basic:	\$0.28	\$0.21	\$0.07
Diluted:	\$0.28	\$0.20	\$0.08

Condensed Consolidated Balance Sheets*	As of March 31, 2018		
	As Reported	Balances without adoption of ASC 606	Effect of Change
Deferred profit	\$2,914	\$6,664	\$(3,750)
Income taxes payable	\$1,546	\$984	\$562
Deferred income taxes	\$3,812	\$3,929	\$(117 )
Retained earnings	\$158,124	\$154,819	\$3,305

\* Balance sheet line items include the cumulative-effect adjustment recorded on December 31, 2017.

Under ASC 606 our revenue will continue to be recognized at a point in time when all revenue criteria have been met and transfer of control has occurred, typically, this occurs upon shipment of products to our customers. In certain instances, when customer payment terms provide that a minority portion of the equipment purchase price be paid only upon customer acceptance, recognition of revenue may occur sooner under ASC 606.

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**Cohu, Inc.**

**Notes to Unaudited Condensed Consolidated Financial Statements**

***March 31, 2018***

**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 the obligations under the terms of a contract with our customers are satisfied; generally, this occurs with the transfer of control of our systems, non-system products or services. In circumstances where control is not transferred until destination or acceptance, we defer revenue recognition until such events occur.

Revenue for established products that have previously satisfied a customer's acceptance requirements is generally recognized upon shipment. In cases where a prior history of customer acceptance cannot be demonstrated or from sales where customer payment dates are not determinable and in the case of new products, revenue and cost of sales are 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 over time as the transfer of control is completed for the related contract or upon completion of the services if they are short-term in nature. Spares, contactor and kit revenue is generally recognized upon shipment.

Certain of our equipment sales have multiple performance obligations. These arrangements involve the delivery or performance of multiple performance obligations, and transfer of control of performance obligations may occur at different points in time or over different periods of time. For arrangements containing multiple performance obligations, the revenue relating to the undelivered performance obligation is deferred using the relative standalone selling price method utilizing estimated sales prices until satisfaction of the deferred performance obligation.

Unsatisfied performance obligations primarily represent contracts for products with future delivery dates and with an original expected duration of one year or less. As allowed under ASC 606, we have opted to not disclose unsatisfied performance obligations as these contracts have original expected durations of less than one year.

We generally sell our equipment with a product warranty. The product warranty provides assurance to customers that delivered products are as specified in the contract (an "assurance-type warranty"). Therefore, we account for such product warranties under ASC 460, *Guarantees* (ASC 460), and not as a separate performance obligation.

The transaction price reflects our expectations about the consideration we will be entitled to receive from the customer and may include fixed or variable amounts. Fixed consideration primarily includes sales to customers that are known as of the end of the reporting period. Variable consideration includes sales in which the amount of consideration that we will receive is unknown as of the end of a reporting period. Such consideration primarily includes sales made to certain customers with cumulative tier volume discounts offered. Variable consideration arrangements are rare; however, when they occur, we estimate variable consideration as the expected value to which we expect to be entitled. Included in the transaction price estimate are amounts in which it is probable that a significant reversal of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved. The estimate is based on information available for projected future sales. Variable consideration that does not meet revenue recognition criteria is deferred.

Our contracts are typically less than one year in duration and we have elected to use the practical expedient available in ASC 606 to expense cost to obtain contracts as they are incurred because they would be amortized over less than one year.

Accounts receivable represents our unconditional right to receive consideration from our customer. Payments terms do not exceed one year from the invoice date and therefore do not include a significant financing component. To date, there have been no material impairment losses on accounts receivable. There were no material contract assets or contract liabilities recorded on the condensed consolidated balance sheet in any of the periods presented.

Table of Contents**Cohu, Inc.****Notes to Unaudited Condensed Consolidated Financial Statements*****March 31, 2018***

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 March 31, 2018, we had deferred revenue totaling approximately \$5.9 million, current deferred profit of \$2.9 million and deferred profit expected to be recognized after one year included in noncurrent other accrued liabilities of \$0.8 million. At December 30, 2017, we had deferred revenue totaling approximately \$10.4 million, current deferred profit of \$6.6 million and deferred profit expected to be recognized after one year included in noncurrent other accrued liabilities of \$0.8 million. Our balances at March 31, 2018, include a \$1.1 million beginning retained earnings adjustment as result of our adoption of ASC 606 on the first day of fiscal 2018. The periodic change is primarily a result of increases and decreases in deferrals of revenue associated with product shipments made to our customers in accordance with our revenue recognition policy.

Net sales by type are as follows (*in thousands*):

	Three Months Ended March 31, 2018
Systems	\$54,905
Non-systems	40,245
Net sales	\$95,150

Revenue by geographic area based upon product shipment destination (*in thousands*):

	Three Months Ended March 31, 2018
China	\$20,243
United States	14,478

Malaysia	11,809
Philippines	10,546
Rest of the World	38,074
Net sales	\$95,150

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 March	
	31, 2018	25, 2017
Customers individually accounting for more than 10% of net sales	one	one
Percentage of net sales	12%	20%

### Accumulated Other Comprehensive Loss

Our accumulated other comprehensive loss balance totaled approximately \$14.0 million and \$17.8 million at *March 31, 2018* and *December 30, 2017*, respectively, and was attributed to all non-owner changes in stockholders' equity and consists of, on an after-tax basis where applicable, foreign currency adjustments resulting from the translation of certain of our subsidiary accounts where the functional currency is *not* the U.S. Dollar and adjustments related to postretirement benefits. Reclassification adjustments from accumulated other comprehensive loss during the *first three* months of fiscal *2018* and *2017* 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 three* months of fiscal *2018* and *2017* was *not* significant.

### Discontinued Operations

In *2015*, we sold all of the outstanding stock of our mobile microwave communication equipment segment, Broadcast Microwave Services (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 they were *no* longer a strategic fit within our organization.



As part of the divestiture of BMS we recorded a contingent consideration receivable that was classified as Level 3 in the fair value hierarchy. See Note 3, “Financial Instruments Measured at Fair Value” for additional information on the *three*-tier fair value hierarchy. The contingent consideration represented the estimated fair value of future payments we are due based on BMS achieving annual revenue targets in *2016* and *2017* as specified in the sale agreement. We determined the value of the contingent consideration using a Monte Carlo simulation model with changes to the fair value of the contingent consideration being recognized in discontinued operations. During *2017*, BMS failed to meet the necessary revenue targets and the contingent consideration receivable was written-off. Unless otherwise indicated, all amounts herein relate to continuing operations.

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**Cohu, Inc.**

**Notes to Unaudited Condensed Consolidated Financial Statements**

**March 31, 2018**

**Recent Accounting Pronouncements**

**Recently Adopted Accounting Pronouncements**

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

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

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

In *October 2016*, the FASB issued ASU 2016-16, *Accounting for Income Taxes: Intra-Entity Asset Transfers of Assets Other than Inventory*. ASU 2016-16 changes the timing of income tax recognition for an intercompany sale of assets excluding inventory. ASU 2016-16 requires the seller's tax effects and the buyer's deferred taxes to be recognized immediately upon the sale instead of deferring accounting for the income tax implications until the assets are sold to a *third party* or recovered through use. ASU 2016-16 is effective for fiscal years beginning after *December 15, 2017* including interim periods within the year of adoption. The adoption of ASU 2016-16 did *not* have a material impact on our condensed consolidated financial statements.

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

### **Recently Issued Accounting Pronouncements**

In *February 2018*, the FASB issued ASU 2018-02, *Income Statement-Reporting Comprehensive Income* to give companies the option to reclassify the income tax effects on items within accumulated other comprehensive income resulting from U.S. tax reform to retained earnings. ASU 2018-02 is effective for fiscal years beginning after *December 15, 2018*, including interim periods within those years. Early adoption is permitted. We are currently assessing and have *not* yet determined the impact ASU 2018-02 *may* have on our consolidated financial statements.

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

Table of Contents**Cohu, Inc.****Notes to Unaudited Condensed Consolidated Financial Statements***March 31, 2018*

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

**2. Business Acquisitions, Goodwill and Purchased Intangible Assets***Kita*

On *January 4, 2017*, we completed the acquisition of all the outstanding share capital of Kita Manufacturing Co., LTD. and Kita USA, Inc. (together “Kita”) (the “Acquisition”). Kita, headquartered in Osaka, Japan, and with operations in Attleboro, Massachusetts and Kyoto, Japan, designs, manufactures and sells spring probe contacts used in final test contactors, probe cards, PCB test boards and connectors sold to customers worldwide. The acquisition of Kita was a strategic transaction to expand our total available market, extend our market leadership and broaden our product offerings. In connection with the Acquisition we incurred acquisition related costs, which were expensed to selling, general and administrative that totaled \$0.2 million during the *three* months ended *March 25, 2017*. No acquisition related costs were incurred during the *three* months ended *March 31, 2018*.

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

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

The contingent consideration represents the estimated fair value of future payments totaling up to \$3.0 million we would be required to make as a result of Kita achieving annual revenue and EBITDA targets in 2017 and 2018 as specified in the purchase agreement for the Acquisition. The fair value of the contingent consideration recognized on the acquisition date and at *March 31, 2018* was estimated by using the Monte Carlo simulation model. Adjustments to the fair value of contingent consideration are reflected in selling, general, and administrative expense in our condensed consolidated statements of income. The contingent consideration payable has been classified as level 3 in the fair value hierarchy. See Note 3 “Financial Instruments Measured at Fair Value” for additional information on the *three-tier* fair value hierarchy. The fair value of the contingent consideration is recorded in our condensed consolidated balance sheets in current other accrued liabilities.

The following table presents the fair value of contingent consideration from the date of acquisition through *March 31, 2018 (in thousands)*:

Fair Value of Consideration Recognized at Acquisition Date	Settlement of Contingent Consideration	Mark-to-Market Adjustment Charged to Expense	Impact of Currency Exchange	Fair Value of Consideration at March 31, 2018
\$ 823	\$ (1,500 )	\$ 1,276	\$ 141	\$ 740

The Acquisition was nontaxable to Cohu and certain of the assets acquired, including goodwill and intangibles, will *not* be deductible for tax purposes. The acquired assets and liabilities of Kita were recorded at their respective fair values including an amount for goodwill which represented the difference between the Acquisition consideration and the fair value of the identifiable net assets and was allocated to our ITS operating segment.

Table of Contents**Cohu, Inc.****Notes to Unaudited Condensed Consolidated Financial Statements****March 31, 2018**Goodwill and Intangible Assets

Changes in the carrying value of goodwill during the year ended *December 30, 2017*, and the *three-month*, period ended *March 31, 2018* were as follows (*in thousands*):

	Goodwill
Balance, December 31, 2016	\$ 58,849
Additions, net	2,654
Impact of currency exchange	4,110
Balance, December 30, 2017	65,613
Impact of currency exchange	1,171
Balance, March 31, 2018	\$ 66,784

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

	March 31, 2018		Remaining Weighted Average Amort. Period (in years)	December 30, 2017	
	Gross Carrying Amount	Accum. Amort.		Gross Carrying Amount	Accum. Amort.
Developed technology	\$21,263	\$13,567	3.1	\$20,780	\$12,623
Customer relationships	8,131	5,215	2.8	7,934	4,838
Trade names	6,347	1,118	11.9	6,185	972
Covenant not-to-compete	331	41	8.8	313	31
Total intangible assets	\$36,072	\$19,941		\$35,212	\$18,464

Amortization expense related to intangible assets in the *first* quarter of fiscal *2018* and *2017* was *\$1.1* million in both periods. Changes in the carrying values of these intangible assets are a result of the impact of fluctuations in currency exchange rates.

### 3. Financial Instruments Measured at Fair Value

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

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

Table of Contents**Cohu, Inc.****Notes to Unaudited Condensed Consolidated Financial Statements****March 31, 2018**

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

	March 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses <sup>(1)</sup>	Estimated Fair Value
Corporate debt securities <sup>(2)</sup>	\$11,313	\$ -	\$ 9	\$ 11,304
U.S. Treasury securities	8,913	-	8	8,905
Bank certificates of deposit	2,800	-	1	2,799
Government-sponsored enterprise securities	992	-	-	992
Foreign government security	594	-	-	594
	\$24,612	\$ -	\$ 18	\$ 24,594

	December 30, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses <sup>(1)</sup>	Estimated Fair Value
Corporate debt securities <sup>(2)</sup>	\$12,784	\$ 1	\$ 6	\$ 12,779
U.S. treasury securities	7,935	-	4	7,931
Foreign government security	619	-	-	619
	\$21,338	\$ 1	\$ 10	\$ 21,329

As of *March 31, 2018*, there were \$23.5 million of investments in our portfolio in a loss position. As of *December 30, 2017*, the cost and fair value of investments with loss positions were approximately \$13.2 million. We <sup>(1)</sup> evaluated the nature of these investments, credit worthiness of the issuer and the duration of these impairments to determine if an other-than-temporary decline in fair value had occurred and concluded that these losses were temporary and we have the ability and intent to hold these investments to maturity.

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

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



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	March 31, 2018		December 30, 2017	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	\$24,612	\$24,594	\$21,338	\$21,329

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*.

Table of Contents**Cohu, Inc.****Notes to Unaudited Condensed Consolidated Financial Statements***March 31, 2018*

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 March 31, 2018 using:			Total estimated fair value
	Level 1	Level 2	Level 3	
Cash	\$84,773	\$-	\$ -	\$84,773
U.S. Treasury securities	-	9,904	-	9,904
Corporate debt securities	-	25,330	-	25,330
Government-sponsored enterprise securities	-	992	-	992
Money market funds	-	15,338	-	15,338
Bank certificates of deposit	-	2,798	-	2,798
Foreign government security	-	595	-	595
	\$84,773	\$54,957	\$ -	\$139,730

	Fair value measurements at December 30, 2017 using:			Total estimated fair value
	Level 1	Level 2	Level 3	
Cash	\$100,850	\$-	\$ -	\$100,850
Corporate debt securities	-	22,014	-	22,014
U.S. treasury securities	-	8,431	-	8,431
Government-sponsored enterprise securities	-	1,496	-	1,496
Money market funds	-	22,205	-	22,205
Foreign government security	-	619	-	619
	\$100,850	\$54,765	\$ -	\$155,615

**4. Employee Stock Benefit Plans**

Our 2005 Equity Incentive Plan (the “2005 Plan”) is a broad-based, long-term retention program intended to attract, motivate, and retain talented employees as well as align stockholder and employee interests. Awards that *may* be granted under the program include, but are *not* limited to, non-qualified and incentive stock options, restricted stock units, and performance stock units. We settle employee stock option exercises, employee stock purchase plan purchases, and the vesting of restricted stock units, and performance stock units with newly issued common shares. At *March 31, 2018*, there were *1,215,372* 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 three* months of fiscal 2018 we did *not* grant any stock options and we issued *19,000* shares of our common stock on the exercise of options that were granted previously.

At *March 31, 2018*, we had *453,226* stock options exercisable and outstanding. These options had a weighted-average exercise price of *\$10.18* per share, an aggregate intrinsic value of approximately *\$5.7* million and the weighted average remaining contractual term was approximately *4.2* years.

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**Cohu, Inc.**

**Notes to Unaudited Condensed Consolidated Financial Statements**

***March 31, 2018***

**Restricted Stock Units**

We grant restricted stock units (“RSUs”) to certain employees, consultants and directors. RSUs vest in annual increments that range from *one* to *four* years from the date of grant. Prior to vesting, RSUs do *not* have dividend equivalent rights, do *not* have voting rights and the shares underlying the RSUs are *not* considered issued and outstanding. New shares of our common stock will be issued on the date the RSUs vest net of the minimum statutory tax withholding requirements to be paid by us on behalf of our employees. As a result, the actual number of shares issued will be fewer than the actual number of RSUs outstanding at *March 31, 2018*.

In the *first three* months of fiscal *2018* we awarded *250,342* RSUs and we issued *409,215* shares of our common stock on vesting of previously granted awards. At *March 31, 2018*, we had *812,639* RSUs outstanding with an aggregate intrinsic value of approximately *\$18.5* million and the weighted average remaining vesting period was approximately *1.7* 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 *2018, 2017 and 2016* ranges from *25%* to *200%* of the number granted and is determined based on certain performance criteria over a *three-year* measurement period. For PSUs granted in *2015*, the number of shares of common stock issued to settle PSUs granted is determined based on a *two-year* measurement period. The performance criteria for the PSUs are based on a combination of our annualized Total Shareholder Return (“TSR”) for the performance period and the relative performance of our TSR compared with the annualized TSR of certain peer companies for the performance period. PSUs granted in *2018, 2017 and 2016* vest *100%* on the *third* anniversary of their grant and PSUs granted in *2015* vest *50%* on the *second* and *third* anniversary of their grant, respectively.

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

31, 2018.

In the *three* months of fiscal 2018, we awarded 88,418 PSUs and we issued 39,174 shares of our common stock on vesting of previously granted awards. At *March 31, 2018*, we had 343,771 PSUs outstanding with an aggregate intrinsic value of approximately \$7.8 million and the weighted average remaining vesting period was approximately 1.8 years.

### **Employee Stock Purchase Plan**

The Cohu, Inc. 1997 Employee Stock Purchase Plan (“the Plan”) provides for the issuance of shares of our common stock. Under the Plan, eligible employees *may* purchase shares of Cohu common stock through payroll deductions at a price equal to 85 percent of the lower of the fair market value of Cohu common stock at the beginning or end of each 6-month purchase period, subject to certain limits. During the *first three* months of fiscal 2018, *no* shares of our common stock were sold to our employees under the Plan leaving 601,340 shares available for future issuance.

### **5. Income Taxes**

We used the estimated effective tax rate (“ETR”) expected to be applicable for the full fiscal year in computing our interim tax provisions. The ETR on income from continuing operations for the *three* months ended *March 31, 2018* and *March 25, 2017* was 20.8% and 16.7%, respectively. The tax provision in 2018 and 2017 differs from the U.S. federal statutory rate primarily due to the lack of a provision (benefit) on our domestic income (losses) as a result of our valuation allowance on deferred tax assets, foreign income taxed at different rates, changes in our deferred tax asset valuation allowance, state taxes and interest related to unrecognized tax benefits.

We have *not* adjusted our provisional tax estimates related to the U.S. Tax Cuts and Jobs Act (“Tax Act”) that we recorded in the *fourth* quarter of 2017. Our accounting remains incomplete as of *March 31, 2018* and will be refined and, if necessary, adjusted throughout 2018 as required by SEC Staff Accounting Bulletin No. 118 (“SAB 118”) based on our ongoing analysis of data and tax positions along with new guidance from regulators and interpretation of the law.

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**Cohu, Inc.**

**Notes to Unaudited Condensed Consolidated Financial Statements**

***March 31, 2018***

Due to the complexity of the Tax Act's global intangible low-taxed income ("GILTI") tax rules, we are continuing to evaluate this provision and the application of ASC 740. Under GAAP, we are allowed to make an accounting policy election to either (i) treat taxes due on future U.S. inclusions in taxable income related to GILTI as a current-period expense when incurred or (ii) factor such amounts into a company's measurement of its deferred taxes. We have *not* yet decided on an accounting policy with respect to the new GILTI tax rules. Our net tax provision for the quarter ended *March 31, 2018* did *not* include any incremental amount of GILTI tax as we expect to utilize existing net operating losses, that have a full valuation allowance, to offset the impact of the GILTI inclusion.

Other than for foreign currency exchange rate changes and the Kita acquisition, there was *no* material change to our unrecognized tax benefits and related accrued interest and penalties during the *three-month* periods ended *March 31, 2018* and *March 25, 2017*.

**6. Contingencies**

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

**7. 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. The product warranty promises customers that delivered products are as specified in the contract (an "assurance-type warranty"). Therefore, we accounts for such product warranties under ASC 460, and *not* as a separate performance obligation. 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	
	March	March
	31,	25,
	2018	2017
Balance at beginning of period	\$4,849	\$4,350
Warranty expense accruals	1,582	1,736
Warranty payments	(1,515)	(1,191)
Warranty liability assumed	-	50
Balance at end of period	\$4,916	\$4,945

Accrued warranty amounts expected to be incurred after *one* year are included in noncurrent other accrued liabilities in the condensed consolidated balance sheet. These amounts total \$0.3 million at *March 31, 2018*, and \$0.6 million at *December 30, 2017*.

## **Borrowings**

### *Revolving Lines of Credit*

We have credit agreements with multiple financial institutions in Japan under which they administer lines of credit on behalf of our wholly owned Kita subsidiary. The credit facilities renew monthly and provide Kita with access to working capital totaling up to \$6.6 million and at *March 31, 2018*, total borrowings outstanding under the revolving lines of credit were \$3.3 million. As these credit facility agreements renew monthly, they have been included in short-term borrowings in our condensed consolidated balance sheet. The revolving lines of credit are denominated in Japanese Yen and, as a result, amounts disclosed herein will fluctuate because of changes in currency exchange rates.

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**Cohu, Inc.**

**Notes to Unaudited Condensed Consolidated Financial Statements**

***March 31, 2018***

Term Loans

We have long-term term loans from a series of Japanese financial institutions related to the expansion of Kita's facility in Osaka, Japan. The loans are collateralized by the facility and land, carry interest rates ranging from 0.05% to 0.45%, and expire at various dates through 2034. At *March 31, 2018* the aggregate amount outstanding was \$5.8 million and \$1.3 million of the term loans have been included in current installments of long-term debt in our condensed consolidated balance sheet. The fair value of our debt approximates the carrying value at *March 31, 2018*. The term loans are denominated in Japanese Yen and, as a result, amounts disclosed herein will fluctuate because of changes in currency exchange rates.

Lines of Credit

We have *one* available line of credit, which provides *one* of our wholly owned subsidiaries with borrowings up to 2.0 million Swiss Francs. At *March 31, 2018* and *December 30, 2017*, *no* amounts were outstanding under the line of credit.

**8. Subsequent Event**

On May 8, 2018, we announced that we entered into an Agreement and Plan of Merger (the "Merger Agreement"), dated as of May 7, 2018, by and among Cohu, Inc., a Delaware corporation ("Cohu"), Xavier Acquisition Corporation, a Delaware corporation and a wholly-owned subsidiary of Cohu (the "Merger Sub") and Xcerra Corporation, a Massachusetts corporation ("Xcerra"). Under the terms of the Merger Agreement, the acquisition of Xcerra will be accomplished through a merger of Merger Sub with and into Xcerra (the "Merger"), with Xcerra surviving the Merger as a wholly-owned subsidiary of Cohu.

At the effective time of the Merger, each share of Xcerra's common stock ("Xcerra Common Stock") issued and outstanding immediately prior to the Merger (other than dissenting shares and shares held by Cohu, Merger Sub,



Xcerra or any of their respective subsidiaries) will be converted into the right to receive (i) \$9.00 in cash, without interest, (the “Cash Consideration”) and (ii) 0.2109 of a validly issued, fully paid and nonassessable share of common stock of Cohu (“Cohu Common Stock”) (the “Stock Consideration” and, together with the Cash Consideration, the “Merger Consideration”).

Pursuant to the Merger Agreement, each outstanding Xcerra restricted stock unit (a “Xcerra Restricted Stock Unit”) that will either (i) vest automatically according to its terms at the effective time of the Merger, or (ii) is held by members of Xcerra’s board of directors, will be cancelled and converted into the right to receive the Merger Consideration. All Xcerra Restricted Stock Units not described in the preceding sentence that are outstanding and unvested at the effective time of the Merger will be converted into equivalent restricted stock unit awards in respect of Cohu Common Stock using a customary exchange ratio equivalent to the Merger Consideration.

Our Board of Directors has unanimously approved the Merger Agreement. Our stockholders will be asked to vote on the issuance of Cohu Common Stock in the Merger at a special stockholders meeting that will be held on a date to be announced. The closing of the Merger is subject to the adoption of the Merger Agreement by the affirmative vote of two-thirds of the outstanding shares of common stock of Xcerra entitled to vote at the special stockholders meeting. We currently expect the Merger, which is subject to stockholder and regulatory approvals, and other customary closing conditions, to close by the end of 2018.

The Merger Agreement contains certain customary termination rights, including, among others, (i) the right of either Cohu or Xcerra to terminate the Merger Agreement if Xcerra’s stockholders fail to adopt the Merger Agreement, or if Cohu’s shareholders fail to approve the issuance of Cohu Common Stock, (ii) the right of either party to terminate the Merger Agreement if the board of directors of the other party changes its recommendation, (iii) the right of Xcerra to terminate the Merger Agreement to accept a superior proposal (subject to the payment of a termination fee as described further below) (iv) the right of either Cohu or Xcerra to terminate the Merger Agreement if the Merger has not occurred by November 7, 2018 (the “Termination Date”, which date the Merger Agreement provides to be extended by either party to May 7, 2019 under certain circumstances) and (v) the right of either party to terminate the Merger Agreement due to a material breach by the other party of any of its representations, warranties or covenants, subject to certain conditions.

The Merger Agreement provides for Xcerra to pay to Cohu a termination fee of \$22.8 million if the Merger Agreement is terminated (i) by Cohu as a result of the Xcerra board of directors changing its recommendation that Xcerra stockholders adopt the Merger Agreement or if the Merger Agreement is terminated by Xcerra to accept a superior proposal; (ii) as a result of Xcerra stockholder approval not being obtained or the Merger not being consummated by the Termination Date, where a competing proposal was publicly disclosed and not publicly, irrevocably withdrawn prior to Xcerra stockholder meeting or the termination of the Merger Agreement as a result of the Merger not being consummated by the Termination Date, as applicable, and Xcerra subsequently consummates a competing proposal within twelve months of such termination or Xcerra enters into a definitive agreement for a competing proposal within such twelve month period and such competing proposal is subsequently consummated; or (iii) by Cohu if Xcerra is in breach of a representation, warranty or covenant that would cause the closing conditions to fail, and the breach cannot be cured within 20 calendar days, so long as Cohu has not materially breached the Merger Agreement.

The Merger Agreement provides for Cohu to pay to Xcerra a termination fee of \$22.8 million if the Merger Agreement is terminated by Xcerra (i) if Cohu is in breach of a representation, warranty or covenant that would cause the closing conditions to fail, and the breach cannot be cured within 20 calendar days, so long as Xcerra has not materially breached the Merger Agreement or (ii) if the Cohu board of directors changes its recommendation that the Cohu shareholders approve the issuance of Cohu Common Stock. The Merger Agreement further provides for Cohu to pay to Xcerra a termination fee of \$45 million if the Merger Agreement is terminated by Xcerra if, upon the satisfaction of closing conditions and the expiration of a marketing period in connection with Cohu's debt financing, Cohu fails to consummate the Merger within five business days following written notice from Xcerra to Cohu in the form described in the Merger Agreement.

Cohu has obtained debt financing commitments for the transactions contemplated by the Merger Agreement. Deutsche Bank Securities Inc., a subsidiary of Deutsche Bank AG, has committed to capitalize Cohu to fund the transaction.

The foregoing description of the Merger and the Merger Agreement does not purport to be complete and is qualified in its entirety by reference to the Merger Agreement, which is filed as Exhibit 2.1 to Cohu's Current Report on Form 8 K filed with the SEC on May 8, 2018.

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**Cohu, Inc.**

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

**March 31, 2018**

**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 2017 Annual Report on Form 10-K under the heading "Item 1A. Risk Factors". The forward-looking statements in this report speak only as of the time they are made, and do not necessarily reflect management's outlook at any other point in time. We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events, or for any other reason, however, readers should carefully review the risk factors set forth in other reports or documents we file from time to time with the SEC after the date of this Quarterly Report.*

**OVERVIEW**

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

During the first three months of 2018, our net sales increased 11% from the fourth quarter of 2017 and 17% from the first quarter of 2017. The increase in sales was driven by market share gains for semiconductor test handlers used for testing devices used in mobility and IoT (Internet of Things) and automotive markets. Customer test cell utilization and business conditions remain strong. We continue to see momentum in the automotive, mobility and industrial

markets and are optimistic about the prospects for our business due to the increasing ubiquity of semiconductors, the diminishing impact of parallel test, increasing semiconductor complexity and increasing quality demands from semiconductor customers. We are continuing our investment in new products and are focused on growing our market share in the semiconductor test handling and test contactor markets, and expanding into the semiconductor inspection market.

### **Subsequent Event**

On May 8, 2018, we announced that we entered into the Merger Agreement, dated as of May 7, 2018, by and between Cohu and Xcerra. At the effective time of the Merger, each share of Xcerra Common Stock issued and outstanding immediately prior to the Merger will be converted into the right to receive \$9.00 in cash, without interest, and 0.2109 of a validly issued, fully paid and nonassessable share of Cohu Common Stock. We currently expect the Merger, which is subject to stockholder and regulatory approvals, and other customary closing conditions, to close in the second half of 2018.

### **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;



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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:** 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 the obligations under the terms of a contract with our customers are satisfied; generally, this occurs with the transfer of control of our systems, non-system products or services. In circumstances where control is not transferred until destination or acceptance, we defer revenue recognition until such events occur. Revenue for established products that have previously satisfied a customer's acceptance requirements is generally recognized upon shipment. In cases where a prior history of customer acceptance cannot be demonstrated or from sales where customer payment dates are not determinable and in the case of new products, revenue and cost of sales are 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 over time as the transfer of control is completed for the related contract or upon completion of the services if they are short-term in nature. Spares, contactor and kit revenue is generally recognized upon shipment. Certain of our equipment sales have multiple performance obligations. These arrangements involve the delivery or performance of multiple performance obligations, and transfer of control of performance obligations may occur at different points in time or over different periods of time. For arrangements containing multiple performance obligations, the revenue relating to the undelivered performance obligation is deferred using the relative standalone selling price method utilizing estimated sales prices until satisfaction of the deferred performance obligation. Unsatisfied performance obligations primarily represent contracts for products with future delivery dates and with an original expected duration of one year or less. As allowed under ASC 606, we have opted to not disclose unsatisfied performance obligations as these contracts have original expected durations of less than one year. We generally sell our equipment with a product warranty. The product warranty provides assurance to customers that delivered products are as specified in the contract (an "assurance-type warranty"). Therefore, we account for such product warranties under ASC 460, Guarantees (ASC 460), and not as a separate performance obligation. The transaction price reflects our expectations about the consideration we will be entitled to receive from the customer and may include fixed or variable amounts. Fixed consideration primarily includes sales to customers that are known as of the end of the reporting period. Variable consideration includes sales in which the amount of consideration that we will receive is unknown as of the end of a reporting period. Such consideration primarily includes sales made to certain customers with cumulative tier volume

discounts offered. Variable consideration arrangements are rare; however, when they occur, we estimate variable consideration as the expected value to which we expect to be entitled. Included in the transaction price estimate are amounts in which it is probable that a significant reversal of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved. The estimate is based on information available for projected future sales. Variable consideration that does not meet revenue recognition criteria is deferred. Accounts receivable represents our unconditional right to receive consideration from our customer. Payments terms do not exceed one year from the invoice date and therefore do not include a significant financing component. To date, there have been no material impairment losses on accounts receivable. There were no material contract assets or contract liabilities recorded on the condensed consolidated balance sheet in any of the periods presented. On shipments where sales are not recognized, gross profit is generally recorded as deferred profit in our consolidated balance sheet representing the difference between the receivable recorded and the inventory shipped.

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

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

**Income Taxes:** The Tax Cuts and Jobs Act (“Tax Act”) was enacted on December 22, 2017. Due to the timing of the enactment and the complexity involved in applying the provisions of the Tax Act, we have made reasonable estimates of the effects and recorded provisional amounts in our financial statements for the year ended December 30, 2017 and the three months ended March 31, 2018, as provided for in SAB 118. As we collect and prepare necessary data, and interpret any additional guidance issued by the U.S. Treasury Department, the IRS or other standard-setting bodies, we may make adjustments to the provisional amounts. Those adjustments may materially impact the provision for income taxes and the effective tax rate in the period in which the adjustments are made. The accounting for the tax effects of the enactment of the Tax Act will be completed in 2018.

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 reduced by a valuation allowance 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 December 30, 2017, was approximately \$37.7 million, with a valuation allowance of approximately \$31.5 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 carry-forwards.



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**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.

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

We conduct our annual impairment test as of October 1st of each year, and have determined there was no impairment as of October 1, 2017, as we determined that the estimated fair values of our reporting units exceeded their carrying values on that date. Other events and changes in circumstances may also require goodwill to be tested for impairment between annual measurement dates. As of March 31, 2018, we do not believe that circumstances have occurred that indicate impairment of our goodwill is more-likely-than-not. In the event we determine that an interim goodwill impairment review is required, in a future period, the review may result in an impairment charge, which would have a negative impact on our results of operations.

Long-lived assets, other than goodwill, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets might not be recoverable. Conditions that would necessitate an impairment assessment include a significant decline in the observable market value of an asset, a significant change in the extent or manner in which an asset is used, or any other significant adverse change that would indicate that the carrying amount of an asset or group of assets may not be recoverable. For long-lived assets, impairment losses are

only recorded if the asset's carrying amount is not recoverable through its undiscounted, probability-weighted future cash flows. We measure the impairment loss based on the difference between the carrying amount and estimated fair value.

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

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

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

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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**

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

	Three Months Ended	
	March 31, 2018	March 25, 2017
Net sales	100.0%	100.0%
Cost of sales	(58.4 )	(60.2 )
Gross margin	41.6	39.8
Research and development	(12.4 )	(12.1 )
Selling, general and administrative	(18.7 )	(17.8 )
Income from operations	10.5 %	9.9 %

**First Quarter of Fiscal 2018 Compared to First Quarter of Fiscal 2017***Net Sales*

Our consolidated net sales increased 17.3% to \$95.2 million in 2018, compared to net sales of \$81.1 million in 2017. Consolidated net sales in 2018 continued to benefit from favorable business conditions within the semiconductor industry and our success in growing share in the test handler and test contactor markets. Increased sales in 2018, as compared to 2017, were driven primarily by demand for thermal subsystems for mobile processor test

### ***Gross Margin***

Gross margin consists of net sales less cost of sales. Cost of sales consists primarily of the cost of 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, inventory reserve adjustments, and utilization of manufacturing capacity. Our gross margin, as a percentage of net sales, was 41.6% in 2018 and 39.8% in 2017. As compared to the prior year, gross margin in the first quarter of 2018 benefitted from favorable product mix and increased business volume which enabled us to better leverage our fixed costs. Additionally, in the first quarter of 2018 our gross margin benefited from the acceptance of our new Eclipse XTA as certain costs had been previously expensed to R&D during product development. In 2017, gross margin was negatively impacted by the amortization of \$0.3 million of purchase accounting inventory step-up adjustment recorded in cost of sales as a result of our acquisition of Kita. No amounts were expensed in 2018 as all inventory step-up amounts were amortized in 2017.

Our gross margin can be impacted by charges to cost of sales related to excess, obsolete and lower of cost or net realizable value inventory issues. We compute the majority of our excess and obsolete inventory reserve requirements using a one-year inventory usage forecast. During the first quarter of fiscal 2018 and 2017, we recorded charges to cost of sales of approximately \$0.4 million and \$0.1 million for excess and obsolete inventory, respectively. While we believe our reserves for excess and obsolete inventory and lower of cost or market concerns are adequate to cover known exposures at March 31, 2018, 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 results of operations and 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 \$11.8 million or 12.4% of net sales in 2018, compared to \$9.8 million or 12.1% in 2017. New product development programs resulted in higher R&D labor and material expense in 2018.

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***Selling, General and Administrative Expense (“SG&A Expense”)***

SG&A expense consists primarily of salaries and benefit costs of employees, commission expense for independent sales representatives, product promotion and costs of professional services. SG&A expense was \$17.8 million or 18.7% of net sales in 2018, compared to \$14.5 million or 17.8% in 2017. SG&A expense in 2018 was higher as a result of increased business volume. Our SG&A expense has also been negatively affected by the weakening of the U.S. Dollar, which resulted in the recognition of \$1.6 million and \$1.3 million in foreign currency transaction losses in the first quarter of 2018 and 2017, respectively.

***Income Taxes***

We used the estimated effective tax rate (“ETR”) expected to be applicable for the full fiscal year in computing our interim tax provisions. The ETR on income from continuing operations for the three months ended March 31, 2018 and March 25, 2017 was 20.8% and 16.7%, respectively. The tax provision in 2018 and 2017 differs from the U.S. federal statutory rate primarily due to the lack of a provision (benefit) on our domestic income (losses) as a result of our valuation allowance on deferred tax assets, foreign income taxed at different rates, changes in our deferred tax asset valuation allowance, state taxes and interest related to unrecognized tax benefits.

We have not adjusted our provisional tax estimates related to the U.S. Tax Cuts and Jobs Act (“Tax Act”) that we recorded in the fourth quarter of 2017. Our accounting remains incomplete as of the first three months of 2018 and will be refined and, if necessary, adjusted throughout 2018 as required by SEC SAB No. 118 based on our ongoing analysis of data and tax positions along with new guidance from regulators and interpretation of the law.

Due to the complexity of the Tax Act’s global intangible low-taxed income (“GILTI”) tax rules, we are continuing to evaluate this provision and the application of ASC 740. Under GAAP, we are allowed to make an accounting policy election to either (i) treat taxes due on future U.S. inclusions in taxable income related to GILTI as a current-period expense when incurred or (ii) factor such amounts into a company’s measurement of its deferred taxes. We have not yet decided on an accounting policy with respect to the new GILTI tax rules. Our net tax provision for the quarter ended March 31, 2018 did not include any incremental amount of GILTI tax as we expect to utilize existing net operating losses, that have a full valuation allowance, to offset the impact of the GILTI inclusion.

Other than for foreign currency exchange rate changes and the Kita Acquisition, there was no material change to our unrecognized tax benefits and related accrued interest and penalties during the three-month periods ended March 31, 2018 and March 25, 2017.

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

As a result of the factors set forth above, our income from continuing operations and net income was \$8.1 million during the three months ended March 31, 2018. In 2017, income from continuing operations and net income was \$6.8 million during the three months ended March 25, 2017.

**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 businesses 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 March 31, 2018, \$79.9 million or 57% of our cash and cash equivalents was held by our foreign subsidiaries. If these funds are needed for our operations in the U.S., we may be required to accrue and pay foreign withholding taxes if we repatriate these funds. At March 31, 2018 we accrued \$2.4 million of foreign withholding tax that would be payable in the event we repatriate funds from certain of our foreign subsidiaries.

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

	March 31, 2018	December 30, 2017	Increase (Decrease)	Percentage Change
<i>(in thousands)</i>				
Cash, cash equivalents and short-term investments	\$ 139,730	\$ 155,615	\$ (15,885 )	(10.2 )%
Working capital	\$ 219,355	\$ 212,171	\$ 7,184	3.4 %

**Cash Flows**

**Operating Activities:** Operating cash flows for the first three months of fiscal 2018 consisted of our net income, adjusted for non-cash expenses and changes in operating assets and liabilities. These adjustments include depreciation expense on property, plant and equipment, share-based compensation expense, amortization of intangible assets deferred income taxes and mark-to-market adjustment on the Kita contingent consideration. Our net cash used in operating activities in the first three months of fiscal 2018 totaled \$9.3 million. Net cash used in operating activities was impacted by changes in current assets and liabilities and included increases in accounts receivable of \$13.2 million, accounts payable of \$2.9 million and decreases in deferred profit of \$2.5 million and accrued compensation, warranty and other liabilities of \$6.2 million. The increase in accounts receivable resulted from a sequential increase in product shipments and the timing of the resulting cash conversion cycle. The increase in accounts payable was driven by increased product shipments in the first quarter of 2018 and the timing of cash payments to our vendors and suppliers. Deferred profit decreased due to the recognition of sales that had been previously deferred in accordance with our revenue recognition policy. Accrued compensation, warranty and other liabilities decreased as a result of incentive compensation and profit sharing earned during 2017 that was paid during the first quarter of 2018.

**Investing Activities:** Investing cash flows consist primarily of cash used for capital expenditures in support of our businesses, proceeds from investment maturities, asset disposals and cash used for purchases of investments and business acquisitions. Net cash used in investing activities in the first three months of fiscal 2018 totaled \$4.3 million. The acquisition of Kita was a strategic transaction to expand our total available market, extend our market leadership

and broaden our product offerings. Investing activities in the first three months of fiscal 2018 were impacted by \$18.8 million in cash used for purchases of short-term investments offset, in part, by \$15.5 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 \$1.1 million were made to support the operating and development activities of our business.

**Financing Activities:** Cash flows from financing activities consist primarily of net proceeds from the issuance of common stock under our stock option and employee stock purchase plans, cash used to pay dividends to our stockholders. We issue restricted stock units, stock options and maintain an employee stock purchase plan as components of our overall employee compensation. In the first three months of fiscal 2018, cash used to settle the minimum statutory tax withholding requirements on behalf of our employees upon vesting of restricted and performance stock awards, net of proceeds from the exercise of employee stock options was \$3.6 million. We paid dividends totaling \$1.8 million, or \$0.06 per common share and on May 3, 2018, Cohu's Board of Directors approved a quarterly cash dividend of \$0.06 per share payable on July 27, 2018 to shareholders of record on June 15, 2018. Future quarterly dividends are subject to our cash liquidity, capital availability and periodic determinations by our Board of Directors that cash dividends are in the best interests of our stockholders. Total repayments of short-term borrowings and long-term debt during the first three months of fiscal 2018 totaled \$0.4 million, additionally we made payments of \$0.8 million to settle contingent consideration liabilities related to the acquisition of Kita in 2017.

## Capital Resources

We have credit agreements with multiple financial institutions in Japan under which they administer lines of credit on behalf of our wholly owned Kita subsidiary. The credit facilities renew monthly and provide Kita with access to working capital totaling up to \$6.6 million. At March 31, 2018 total borrowings outstanding under the revolving lines of credit were \$3.3 million. As these credit facility agreements renew monthly, they have been included in short-term borrowings in our condensed consolidated balance sheet. We also have long-term term loans from a series of Japanese financial institutions totaling \$5.8 million primarily related to the expansion of Kita's facility in Osaka, Japan. The loans are collateralized by the facility and land. The loans carry interest rates ranging from 0.05% to 0.45% and expire at various dates through 2034. At March 31, 2018, \$1.3 million of the term loans have been included in current installments of long-term debt in our condensed consolidated balance sheet. The revolving lines of credit and term loans are denominated in Japanese Yen and, as a result, amounts will fluctuate as a result of changes in currency exchange rates.



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We also have a credit agreement with a financial institution under which it administers a line of credit on behalf of our wholly owned Ismeca subsidiary. The agreement provides Ismeca with 2.0 million Swiss Francs of available credit and at March 31, 2018, 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.

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 and contains customary restrictive covenants. As of March 31, 2018, no amounts were outstanding under standby letters of credit under the Secured Facility.

Xcerra Acquisition

On May 7, 2018, Cohu entered to a Merger Agreement with Xcerra and Xavier Acquisition Corporation, a wholly owned subsidiary of Cohu. Refer to Note 8, "Subsequent Event," herein for further information. Deutsche Bank Securities Inc., a subsidiary of Deutsche Bank AG, has committed to capitalize Cohu to fund the transaction.

**Contractual Obligations and Off-Balance Sheet Arrangements**

**Contractual Obligations:** Our significant contractual obligations consist of liabilities for debt, operating leases, unrecognized tax benefits, pensions, post-retirement benefits and warranties. These obligations have not changed materially from those disclosed in our Annual Report on Form 10-K for the year ended December 30, 2017.

**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 March 31, 2018, no amounts were outstanding under standby letters of credit.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

#### **Investment and Interest Rate Risk.**

At March 31, 2018, our investment portfolio included short-term, fixed-income investment securities with a fair value of approximately \$24.6 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 March 31, 2018, we had \$23.5 million of investments with loss positions. We evaluated the nature of these investments, credit worthiness of the issuer and the duration of these impairments and concluded that these losses were temporary and we have the ability and intent to hold these investments to maturity.

#### **Foreign Currency Exchange Risk.**

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

Fluctuations in currency exchange rates also impact the U.S. Dollar amount of our net investment in foreign operations. The assets and liabilities of our foreign subsidiaries are translated into U.S. Dollars at the exchange rates in effect at the fiscal year-end balance sheet date. Income and expense accounts are translated at an average exchange rate during the year which approximates the rates in effect at the transaction dates. The resulting translation adjustments are recorded in stockholders' equity as a component of accumulated other comprehensive loss. As a result of fluctuations in certain foreign currency exchange rates in relation to the U.S. Dollar as of March 31, 2018 compared to December 30, 2017, our stockholders' equity increased by \$3.9 million.

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Based upon the current levels of net foreign assets, a hypothetical 10% devaluation of the U.S. Dollar as compared to these currencies as of March 31, 2018 would result in an approximate \$20.0 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 March 31, 2018 would result in an approximate \$20.0 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.** There have been no changes in our internal control over financial reporting that occurred during the first quarter of 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**Part II OTHER INFORMATION**

**Item 1. Legal Proceedings.**

The information set forth above under Note 6 contained in the "Notes to Unaudited Condensed Consolidated Financial Statements" of this Form 10-Q is incorporated herein by reference.

**Item 1A. Risk Factors.**

*The risks described below may not be the only risks we face. Additional risks that we are unaware of, or that we currently believe are not material, may also impair our business operations. The risk factors set forth below with an asterisk (\*) next to the title contain changes to the description of the risk factors associated with our business as previously disclosed in Item 1A to our 2017 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.*

***\* There can be no assurance that we will successfully complete our acquisition of Xcerra Corporation on the terms or timetable currently proposed or at all.***

On May 8, 2018, we announced that we entered into an Agreement and Plan of Merger (the "Merger Agreement"), dated as of May 7, 2018, by and among Cohu, Xavier Acquisition Corporation, a Delaware corporation and a wholly-owned subsidiary of Cohu ("Merger Sub") and Xcerra Corporation, a Massachusetts corporation ("Xcerra"). Under the terms of the Merger Agreement, the acquisition of Xcerra will be accomplished through a merger of Merger Sub with and into Xcerra (the "Merger"), with Xcerra surviving the Merger as a wholly-owned subsidiary of Cohu.

We currently anticipate that we will close the Merger by the end of 2018, but we cannot be certain when or if the conditions for the Merger will be satisfied or waived. The Merger cannot be completed until the conditions are satisfied or waived, including receipt of our stockholders' approval of the issuance of additional shares of Cohu common stock as consideration in the Merger, receipt of Xcerra's stockholders' approval of the Merger, receipt of required antitrust and other regulatory approvals, and other customary closing conditions. Satisfying the conditions to the closing of the Merger may take longer than we expect.

***\* We have incurred and will continue to incur significant transaction costs in connection with the Merger that could adversely affect our results of operations.***

Whether or not we complete the Merger, we have incurred, and will continue to incur, significant transaction costs in connection with the Merger, including payment of certain fees and expenses incurred in connection with the Merger and related financing transactions. Additional unanticipated costs may be incurred in the integration process. These could adversely affect our results of operations in the period in which such expenses are recorded or our cash flow in the period in which any related costs are actually paid. Furthermore, we may incur material restructuring charges in connection with the Merger, which may adversely affect our operating results following the closing of the Merger in which such expenses are recorded or our cash flow in the period in which any related costs are actually paid. A delay in closing or a failure to complete the Merger could have a negative impact on our business.

***\* We may fail to realize all of the anticipated benefits of the Merger or those benefits may take longer to realize than expected.***

Our ability to realize the anticipated benefits of the Merger will depend, to a large extent, on our ability to integrate Xcerra, which is a complex, costly and time-consuming process. The integration process may disrupt our business and, if implemented ineffectively, could restrict the realization of the full expected benefits. The failure to meet the challenges involved in the integration process and to realize the anticipated benefits of the Merger could cause an interruption of, or a loss of momentum in, our operations and could adversely affect our business, financial condition and results of operations.

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In addition, the integration of Xcerra may result in material unanticipated problems, expenses, liabilities, competitive responses, and loss of customers, suppliers and other business relationships. Additional integration challenges include:

- diversion of management's attention to integration matters;
- difficulties in achieving anticipated cost savings, synergies, business opportunities and growth prospects from the Merger;
- difficulties in the integration of operations and systems;
- difficulties in conforming standards, controls, procedures and accounting and other policies, business cultures and compensation structures;
- difficulties in the assimilation of employees;
- challenges in keeping existing customers and obtaining new customers, including customers that may not consent to the assignment of their contracts or agree to enter into a new contract with us;
- challenges in attracting and retaining key personnel;
- the impact of potential liabilities we may be inheriting from Xcerra; and
- coordinating a geographically dispersed organization.

Many of these factors will be outside of our control and any one of them could result in increased costs, decreases in the amount of expected revenues, and diversion of management's time and energy, which could adversely affect our business, financial condition, and results of operations and result in us becoming subject to litigation. In addition, even if Xcerra is integrated successfully, the full anticipated benefits of the Merger may not be realized, including the synergies, cost savings or sales or growth opportunities that are anticipated. These benefits may not be achieved within the anticipated time frame, or at all. Further, additional unanticipated costs may be incurred in the integration process. All of these factors could cause reductions in our earnings per share and decrease or delay the expected accretive effect of the Merger. As a result, it cannot be assured that the Merger will result in the realization of the full or any anticipated benefits.

***\* The pendency of the Merger could adversely affect our business, financial results and operations.***

The announcement and pendency of the Merger could cause disruptions and create uncertainty surrounding our business and affect our relationships with our customers and employees. In addition, we have diverted, and will continue to divert, significant management resources to complete the Merger, which could have a negative impact on our ability to manage existing operations or pursue alternative strategic transactions, which could adversely affect our business, financial condition and results of operations.

***\* The regulatory approvals required in connection with the Merger may not be obtained or may contain materially burdensome conditions.***

Completion of the Merger is conditioned upon the receipt of certain regulatory approvals, and we cannot provide assurance that these approvals will be obtained. If any conditions or changes to the proposed structure of the Merger are required to obtain these regulatory approvals, they may have the effect of jeopardizing or delaying completion of the Merger or reducing the anticipated benefits of the Merger. If we agree to any material conditions in order to obtain

any approvals required to complete the Merger, the business and results of operations of the combined company may be adversely affected.

***\* The issuance of shares of our common stock in connection with the Merger, and any future offerings of securities by us, will dilute our shareholders' ownership interest in the company.***

The Merger will be financed in part by the issuance of additional shares of our common stock to shareholders of Xcerra, comprising approximately 30% of our issued and outstanding shares of common stock, based on the number of issued and outstanding shares of our common stock on May 7, 2018 and Xcerra's estimated fully diluted shares of common stock outstanding on May 7, 2018. These issuances of additional shares of our common stock will dilute your ownership interest in our company, and you will have a reduced ownership and voting interest in our company following the completion of the Merger.

***\* We expect to incur additional indebtedness to finance the Merger and may not be able to meet our debt service requirements.***

If the Merger is consummated, we will incur significant additional indebtedness of \$350 million or more. This increased level of indebtedness could have important consequences to our business, including, but not limited to:

- reducing the benefits we expect to receive from the Merger;
- increasing our debt service obligations, making it more difficult for us to satisfy our obligations;
- limiting our ability to borrow additional funds and increasing the cost of any such borrowing;
- increasing our vulnerability to, and reducing our flexibility to respond to, general adverse economic and industry conditions;
- limiting our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;
- significantly increasing our risk and exposure should interest rates continue to rise;
- placing us at a competitive disadvantage as compared to our competitors, to the extent that they are not as highly leveraged; and
- restricting us from pursuing certain business opportunities, including other acquisitions.

The definitive documents governing the additional indebtedness will contain covenants that limit our ability to take certain actions. These restrictions may limit our ability to operate our businesses and may prohibit or limit our activity to enhance our operations or take advantage of potential business opportunities as they arise. All of these limitations are subject to significant exceptions and qualifications. These covenants could limit our ability to finance our future operations and capital needs and our ability to pursue business opportunities and activities that may be in our interest.



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***\* If the Merger is completed, Xcerra may underperform relative to our expectations.***

Following completion of the Merger, we may not be able to maintain the growth rate, levels of revenue, earnings, or operating efficiency that we and Xcerra have achieved or might achieve separately. The business and financial performance of Xcerra are subject to certain risks and uncertainties. Our failure to do so could have a material adverse effect on our financial condition and results of operations.

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

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

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

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

Mergers, acquisitions and investments are inherently risky and the inability to effectively manage these risks could materially and adversely affect our business, financial condition and results of operations. At March 31, 2018, we had goodwill and net purchased intangible assets balances of \$66.8 million and \$16.1 million, respectively.

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

Given the highly competitive and rapidly evolving technology environment in which we operate, we believe it is important to develop new product offerings to meet strategic opportunities as they evolve. This includes developing products that we believe are necessary to meet the future needs of the marketplace. We are currently investing in new product development programs to enable us to compete in the test contactor and wafer level package (WLP) probe and inspection markets, which includes a significant ongoing investment in our PANTHER platform. 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 PANTHER, for example, has not generated any material revenues for us. There can be no assurance that any new products we develop will be accepted in the marketplace or generate material revenues for us.

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

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

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

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

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

Our reliance on overseas manufacturers exposes us to significant risks including complex management, foreign currency, legal, tax and economic risks, which we may not be able to address quickly and adequately. In addition, it is time consuming and costly to qualify overseas supplier relationships. If we should fail to effectively manage overseas manufacturing operations, or if one or more of them should experience delays, disruptions or quality control problems,

or if we had to change or add additional manufacturing sites, our ability to ship products to our customers could be delayed. Also, the addition of overseas manufacturing locations increases the demands on our administrative and operations infrastructure and the complexity of our supply chain management. If our overseas manufacturing locations are unable to meet our manufacturing requirements in a timely manner, our ability to ship products and to realize the related revenues when anticipated could be materially affected.

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

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

We use numerous vendors to supply parts, components and subassemblies for the manufacture of our products. It is not always possible to maintain multiple qualified suppliers for all of our parts, components and subassemblies. As a result, certain key parts may be available only from a single supplier (“sole source”) or a limited number of suppliers. In addition, suppliers may significantly raise prices or cease manufacturing certain components (with or without advance notice to us) that are difficult to replace without significant reengineering of our products. On occasion, we have experienced problems in obtaining adequate and reliable quantities of various parts and components from certain key or sole source 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.

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

Visibility into our markets is limited. The semiconductor equipment business is highly dependent on the overall strength of the semiconductor industry. Historically, the semiconductor industry has been seasonal 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 will also be subject to similar cycles and severe downturns. Any significant reductions in capital equipment investment by semiconductor integrated device manufacturers and test subcontractors will materially and adversely affect our business, financial position and results of operations. In addition, the seasonal, volatile and unpredictable nature of semiconductor equipment demand has in the past and may in the future expose us to significant excess and obsolete and lower of cost or net realizable value inventory write-offs and reserve requirements. In 2017, 2016 and 2015, we recorded pre-tax inventory-related charges of approximately \$1.1 million, \$1.1 million, and \$2.4 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 increase our interest rate exposure, and any 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 is intensely competitive.***

The semiconductor test handler industry is intensely competitive and we face substantial competition from numerous companies throughout the world. The test handler industry, while relatively small in terms of worldwide market size compared to other segments of the semiconductor equipment industry, has several participants resulting in intense competitive pricing pressures. Future competition may include companies that do not currently supply test handlers. Some of our competitors are part of larger corporations that have substantially greater financial, engineering,

manufacturing and customer support capabilities and provide more extensive product offerings. In addition, there are emerging semiconductor equipment companies that provide or may provide innovative technology incorporated in products that may compete successfully against our products. We expect our competitors to continue to improve the design and performance of their current products and introduce new products with improved performance capabilities. Our failure to introduce new products in a timely manner, the introduction by our competitors of products with perceived or actual advantages, or disputes over rights to use certain intellectual property or technology could result in a loss of our competitive position and reduced sales of, or margins on our existing products. Intense competition has adversely impacted our product average selling prices and gross margins on certain products. If we are unable to reduce the cost of our existing products and successfully introduce new lower cost products, then we expect that these competitive conditions would negatively impact our gross margin and operating results in the foreseeable future.

In addition, with the acquisition of Kita in 2017, we increased our investments in our test contactor business, and announced significant growth targets for the business over the next several years. The test contactor market is fragmented, with many entrenched regional players, and subject to intense price competition and also high customer support requirements. We believe that customer support and responsiveness and an ability to consistently meet tight deadlines is critical to our success. If we are unable to reduce the cost of our test contactor products, while also meeting customer support requirements and deadlines, then we expect that these competitive conditions would negatively impact our gross margin and operating results in the foreseeable future.

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

Semiconductor equipment and processes are subject to rapid technological change. We believe that our future success will depend in part on our ability to enhance existing products and develop new products with improved performance capabilities. We expect to continue to invest heavily in research and development and must manage product transitions successfully, as introductions of new products, including the products obtained in our acquisitions, may adversely impact sales and/or margins of existing products. In addition, the introduction of new products by us or by our competitors, the concentration of our revenues in a limited number of large customers, the migration to new semiconductor testing methodologies and the custom nature of our inventory parts increases the risk that our established products and related inventory may become obsolete, resulting in significant excess and obsolete inventory exposure. This exposure resulted in charges to operations during each of the years in the three-year period ended December 30, 2017. 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 and test contactors is extremely difficult and subject to a great deal of risk. In addition, not all integrated circuit manufacturers employ the same manufacturing processes. Differences in such processes make it difficult to design standard test products that can achieve broad market acceptance. As a result, we might not accurately assess the semiconductor industry's future equipment requirements and fail to design and develop products that meet such requirements and achieve market acceptance. Failure to accurately assess customer requirements and market trends for new semiconductor test products may have a material adverse impact on our operations, financial condition and results of operations.

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

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

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

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

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

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

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

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

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

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



and results of operations.

***The loss of key personnel could adversely impact our business.***

Certain key personnel are critical to our business. Our future operating results depend substantially upon the continued service of our key personnel, many of whom are not bound by employment or non-competition agreements. Our future operating results also depend in significant part upon our ability to attract and retain qualified management, manufacturing, technical, engineering, marketing, sales and support personnel. Competition for qualified personnel, particularly those with technical skills, is intense, and we cannot ensure success in attracting or retaining qualified personnel. In addition, the cost of living in the San Diego, California, Kolbermoor, Germany, La Chaux-de-Fonds, Switzerland and Osaka, Japan areas, where the majority of our engineering 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.

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

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

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

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

***\* Unanticipated changes in our tax provisions, enactment of new tax laws, or exposure to additional income tax liabilities could affect our profitability.***

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

On December 22, 2017, the Tax Cuts and Jobs Act ("Tax Act") was signed into law in the United States. The changes in the Tax Act are broad and complex and we continue to examine the impact the Tax Act may have on our business and

financial results. Among its many provisions, the Tax Act imposed a mandatory one-time transition tax on undistributed foreign earnings regardless of whether they are repatriated, reduced the U.S. corporate income tax rate from 35% to 21%, imposed limitations on the deductibility of interest and certain other corporate deductions, moved from a “worldwide” system of taxation that generally allows deferral of U.S. tax on foreign earnings until repatriated to a “territorial”/dividend exemption system with a minimum tax that will subject foreign earnings to U.S. Tax when earned and created new taxes on certain foreign-sourced earnings and related-party payments, which are referred to as the global intangible low-taxed income tax and the base erosion and anti-abuse tax, respectively. In accordance with applicable SEC guidance (SAB 118), we recorded a provisional net tax benefit in the fourth quarter of 2017 however, this provisional tax benefit is subject to change in 2018, possibly materially, due to, among other things, changes in estimates, interpretations and assumptions we have made, changes in Internal Revenue Service (IRS) interpretations, the issuance of new guidance, legislative actions, changes in accounting standards or related interpretations in response to the Tax Act and future actions by states within the United States that have not currently adopted the Tax Act. For further information regarding the potential impact of the Tax Act see Note 5, "Income Taxes", to our consolidated financial statements.

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

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

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

***There may be changes in, and uncertainty with respect to, legislation, regulation and governmental policy in the United States.***

The change in administration in the United States has resulted and may continue to result in significant changes in, and uncertainty with respect to, legislation, regulation and government policy. While it is not possible to predict whether and when any such additional changes will occur, changes at the local, state or federal level could impact fuel cell market adoption in the U.S. and the alternative energy technologies sector in the U.S., generally. Specific legislative and regulatory proposals that could have a material impact on us include, but are not limited to, infrastructure renewal programs; and modifications to international trade policy, such as approvals by the Committee on Foreign Investment in the United States; public company reporting requirements; environmental regulation and antitrust enforcement.

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

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

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

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

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

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

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

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

- seasonal, volatile and unpredictable nature of the semiconductor equipment industry;
- timing and amount of orders from customers and shipments to customers;
- customer decisions to cancel orders or push out deliveries;
- inability to recognize revenue due to accounting requirements;
- inventory writedowns;
- unexpected expenses or cost overruns in the introduction and support of products;
- 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. The stock market in general, and the market for shares of high-technology companies in particular, including ours, have experienced extreme price fluctuations, which have often been unrelated to the operating performance of affected companies. During the three-year period ended March 31, 2018 the price of our common stock has ranged from \$26.17 to \$9.14. The price of our stock may be more volatile than the stock of other companies due to, among other factors, the unpredictable, volatile and seasonal nature of the semiconductor industry, our significant customer concentration, intense competition in the test handler industry, our limited backlog and our relatively low daily stock trading volume. The market price of our common stock is likely to continue to fluctuate significantly in the future, including fluctuations related and unrelated to our performance.



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

None.

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

None.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information.**

None.

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**Item 6. Exhibits.**

- 3(i).1 Agreement and Plan of Merger by and among Cohu, Inc., Xavier Acquisition Corporation, and Xcerra Corporation, dated as of May 7, 2018, incorporated herein by reference to Exhibit 2.1 from the Cohu, Inc. Form 8-K filed with the Securities and Exchange Commission on May 8, 2018
- 3(i).2 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 (file no. 001-04298) filed with the Securities and Exchange Commission on July 19, 1999
- 3(i).3 Certificate of Amendment of Amended and Restated Certificate of Incorporation of Cohu, Inc. incorporated herein by reference from the Cohu, Inc. Form S-8 (file no. 333-40610) filed June 30, 2000, Exhibit 4.1(a)
- 3(ii) Amended and Restated Bylaws of Cohu, Inc. incorporated herein by reference to Exhibit 3.2 from the Cohu, Inc. Current Report on Form 8-K (file no. 000-21875) filed with the Securities and Exchange Commission on December 12, 1996
- 31.1 Certification pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002
- 31.2 Certification pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

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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: May 10, 2018 /s/ Luis A. Müller  
Luis A. Müller  
President & Chief Executive Officer

Date: May 10, 2018 /s/ Jeffrey D. Jones  
Jeffrey D. Jones  
Vice President, Finance & Chief Financial Officer  
(Principal Financial & Accounting Officer)