

COHU INC  
Form 10-Q  
November 07, 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 September 29, 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)*

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**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 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, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer      Accelerated filer      Non-accelerated filer

Smaller reporting company      Emerging growth company

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

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

As of October 23, 2018 the Registrant had 40,700,448 shares of its \$1.00 par value common stock outstanding.



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COHU, INC.

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**Item 1.**  
**COHU, INC.**  
**CONDENSED**  
**CONSOLIDATED**  
**BALANCE**  
**SHEETS**  
(in thousands,  
except par value)

	<b>September 29, 2018</b>	<b>December 30, 2017 *</b>
	(Unaudited)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 170,695	\$ 134,286
Short-term investments	549	21,329
Accounts receivable, net	78,575	71,125
Inventories	63,824	62,085
Other current assets	8,643	8,613
Total current assets	322,286	297,438
Property, plant and equipment, net	32,922	34,172
Goodwill	64,579	65,613
Intangible assets, net	13,512	16,748
Other assets	9,707	6,486
	\$ 443,006	\$ 420,457
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Short-term borrowings	\$ 3,080	\$ 3,108
Current installments of long-term debt	1,021	1,280
Accounts payable	39,770	37,556
Accrued compensation and benefits	17,746	20,178
Accrued warranty	4,357	4,280
Deferred profit	1,894	6,608
Income taxes payable	6,072	2,159
Other accrued liabilities	15,985	10,098
Total current liabilities	89,925	85,267
Accrued retirement benefits	18,783	18,544
Noncurrent deferred gain on sale of facility	9,140	10,233
Deferred income taxes	3,166	2,921
Noncurrent income tax liabilities	6,293	6,270
Long-term debt	3,840	4,575
Other accrued liabilities	2,852	3,556

Stockholders' equity:		
Preferred stock, \$1 par value; 1,000 shares authorized, none issued	-	-
Common stock, \$1 par value; 60,000 shares authorized, 28,901 shares issued and outstanding in 2018 and 28,489 shares in 2017	28,901	28,489
Paid-in capital	130,194	127,663
Retained earnings	171,110	150,726
Accumulated other comprehensive loss	(21,198 )	(17,787 )
Total stockholders' equity	309,007	289,091
	\$ 443,006	\$ 420,457

\* Derived  
from  
December  
30, 2017  
audited  
financial  
statements

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

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

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 29, 2018</b>	<b>September 30, 2017</b>	<b>September 29, 2018</b>	<b>September 30, 2017</b>
Net sales	\$86,164	\$ 93,651	\$281,131	\$ 268,614
Cost and expenses:				
Cost of sales	51,786	56,742	165,701	162,319
Research and development	11,088	9,609	33,914	28,851
Selling, general and administrative	16,511	16,882	50,926	47,362
	79,385	83,233	250,541	238,532
Income from operations	6,779	10,418	30,590	30,082
Interest income	326	174	880	417
Income from continuing operations before taxes	7,105	10,592	31,470	30,499
Income tax provision	2,302	1,837	6,897	4,273
Income from continuing operations	4,803	8,755	24,573	26,226
Loss from discontinued operations	-	-	-	(278 )
Net income	\$4,803	\$ 8,755	\$24,573	\$ 25,948
Income per share:				
Basic:				
Income from continuing operations	\$0.17	\$ 0.31	\$0.85	\$ 0.95
Loss from discontinued operations	-	-	-	(0.01 )
Net income	\$0.17	\$ 0.31	\$0.85	\$ 0.94
Diluted:				
Income from continuing operations	\$0.16	\$ 0.30	\$0.83	\$ 0.92
Loss from discontinued operations	-	-	-	(0.01 )
Net income	\$0.16	\$ 0.30	\$0.83	\$ 0.91
Weighted average shares used in computing income (loss) per share:				
Basic	28,948	28,155	28,814	27,614
Diluted	29,770	29,105	29,650	28,640
Cash dividends declared per share	\$0.06	\$ 0.06	\$0.18	\$ 0.18



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

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CONSOLIDATED  
STATEMENTS OF  
COMPREHENSIVE  
INCOME**(Unaudited)  
(in thousands)

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 29, 2018</b>	<b>September 30, 2017</b>	<b>September 29, 2018</b>	<b>September 30, 2017</b>
Net income	\$4,803	\$ 8,755	\$24,573	\$ 25,948
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	(475 )	2,570	(3,435 )	9,975
Adjustments related to postretirement benefits	(24 )	12	17	(116 )
Change in unrealized gain/loss on investments	9	6	7	7
Other comprehensive income (loss), net of tax	(490 )	2,588	(3,411 )	9,866
Comprehensive income	\$4,313	\$ 11,343	\$21,162	\$ 35,814

*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>Nine Months Ended</b>	
	<b>September 29,</b>	<b>September 30,</b>
	<b>2018</b>	<b>2017</b>
Cash flows from operating activities:		
Net income	\$24,573	\$ 25,948
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss on disposal of microwave communications equipment business	-	278
Depreciation and amortization	7,276	6,731
Share-based compensation expense	5,497	5,336
Amortization of inventory step-up	-	1,404
Deferred income taxes	(253 )	(932 )
Adjustment to contingent consideration liability	657	668
Changes in other accrued liabilities	(409 )	427
Changes in other assets	(667 )	572
(Gain) loss on disposal of assets	29	(22 )
Changes in current assets and liabilities, excluding effects from acquisitions:		
Accounts receivable	(8,092 )	(9,013 )
Inventories	(2,555 )	(6,701 )
Accounts payable	1,037	(3,620 )
Other current assets	328	1,257
Income taxes payable	3,898	1,272
Deferred profit	(3,463 )	(299 )
Accrued compensation, warranty and other liabilities	1,351	303
Net cash provided by operating activities	29,207	23,609
Cash flows from investing activities, excluding effects from acquisitions:		
Sales and maturities of short-term investments	59,480	39,315
Purchases of short-term investments	(38,700 )	(23,665 )
Cash paid for Kita, net of cash received	-	(11,716 )
Purchases of property, plant and equipment	(2,472 )	(4,739 )
Cash received from sale of fixed assets	25	109
Net cash provided by (used in) investing activities	18,333	(696 )
Cash flows from financing activities:		
Issuance (repurchases) of common stock, net	(2,553 )	7,149
Cash dividends paid	(5,217 )	(4,894 )
Payment of contingent consideration for Kita	(823 )	-
Repayments of long-term debt	(975 )	(1,280 )
Net cash provided by (used in) financing activities	(9,568 )	975

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Effect of exchange rate changes on cash and cash equivalents	(1,563 )	2,051
Net increase in cash and cash equivalents	36,409	25,939
Cash and cash equivalents at beginning of period	134,286	96,045
Cash and cash equivalents at end of period	\$ 170,695	\$ 121,984

Supplemental disclosure of cash flow information:

Capitalized debt issuance costs included in current other accrued liabilities	\$ 1,522	\$ -
Cash paid for income taxes	\$ 3,549	\$ 3,740
Dividends declared but not yet paid	\$ 1,734	\$ 1,683
Capitalized cloud computing service costs included in accounts payable	\$ 1,044	\$ -
Inventory capitalized as property, plant and equipment	\$ 514	\$ 113
Property, plant and equipment purchases included in accounts payable	\$ 311	\$ 594

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

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**Cohu, Inc.**

**Notes to Unaudited Condensed Consolidated Financial Statements**

**September 29, 2018**

**1. Summary of Significant Accounting Policies**

**Basis of Presentation**

Our fiscal years are based on a 52- or 53-week period ending on the last Saturday in December. The condensed consolidated balance sheet at December 30, 2017, has been derived from our audited financial statements at that date. The interim condensed consolidated financial statements as of September 29, 2018, (also referred to as “the third quarter of fiscal 2018” and “the first nine months of fiscal 2018”) and September 30, 2017, (also referred to as “the third quarter of fiscal 2017” and “the first nine 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 three- and nine-month periods ended September 29, 2018, were comprised of 13 and 39 weeks, respectively. The three- and nine-month periods ended September 30, 2017, were comprised of 14 and 39 weeks, respectively.

Our interim results are not necessarily indicative of the results that should be expected for the full year. For a better understanding of Cohu, Inc. and our financial statements, we recommend reading these interim condensed consolidated financial statements in conjunction with our audited financial statements for the year ended December 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”.

Unless otherwise indicated all amounts presented herein pertain only to Cohu, Inc. and exclude the impact of Xcerra Corporation (“Xcerra”) which was acquired on October 1, 2018. See Note 8, “Acquisition of Xcerra”, located in Part I, Item 1 of this Form 10-Q for further information.

**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 September 29, 2018 and December 30, 2017. Our customers include semiconductor manufacturers and semiconductor test subcontractors throughout many areas of the world. While we believe that our allowance for doubtful accounts is adequate and represents our best estimate at September 29, 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 market 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*):

	September 29, 2018	December 30, 2017
Raw materials and purchased parts	\$ 30,770	\$ 27,918
Work in process	24,210	25,130
Finished goods	8,844	9,037
Total inventories	\$ 63,824	\$ 62,085

Table of Contents**Cohu, Inc.****Notes to Unaudited Condensed Consolidated Financial Statements****September 29, 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*):

	September 29, 2018	December 30, 2017
Land and land improvements	\$ 7,855	\$ 8,017
Buildings and building improvements	14,038	13,779
Machinery and equipment	46,894	45,333
	68,787	67,129
Less accumulated depreciation and amortization	(35,865 )	(32,957 )
Property, plant and equipment, net	\$ 32,922	\$ 34,172

**Segment Information**

We applied the provisions of Accounting Standards Codification (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 September 29, 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.



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**Cohu, Inc.**

**Notes to Unaudited Condensed Consolidated Financial Statements**

**September 29, 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. During the three and nine months ended September 29, 2018, we recognized a foreign exchange loss of \$0.2 million and a gain of \$1.2 million, respectively, in our condensed consolidated statements of income. During the three and nine months ended September 30, 2017, we recognized foreign exchange losses of \$0.2 million and \$2.7 million in our condensed consolidated statements of income, respectively. Certain of our foreign subsidiaries have designated the local currency as their functional currency and, as a result, their assets and liabilities are translated at the rate of exchange at the balance sheet date, while revenue and expenses are translated using the average exchange rate for the period. Cumulative translation adjustments resulting from the translation of the financial statements are included as a separate component of stockholders' equity.

**Share-Based Compensation**

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

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

Three Months Ended	Nine Months Ended
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	September 29, 2018	September 30, 2017	September 29, 2018	September 30, 2017
Cost of sales	\$125	\$ 123	\$408	\$ 327
Research and development	354	278	1,098	856
Selling, general and administrative	1,401	1,459	3,991	4,153
Total share-based compensation	1,880	1,860	5,497	5,336
Income tax benefit	(115 )	(107 )	(555 )	(429 )
Total share-based compensation, net	\$1,765	\$ 1,753	\$4,942	\$ 4,907

**Income (Loss) Per Share**

Basic income (loss) per common share is computed by dividing net income (loss) by the weighted-average number of common shares outstanding during the reporting period. Diluted income (loss) per share includes the dilutive effect of common shares potentially issuable upon the exercise of stock options, vesting of outstanding restricted stock and performance stock units and issuance of stock under our employee stock purchase plan using the treasury stock method. In loss periods, potentially dilutive securities are excluded from the per share computations due to their anti-dilutive effect. For purposes of computing diluted income (loss) per share, stock options with exercise prices that exceed the average fair market value of our common stock for the period are excluded. For the three months ended September 29, 2018, no options to issue shares of common stock were excluded from the computation. For the nine months ended September 29, 2018, options to issue approximately 12,000 shares of common stock were excluded from the computation. For the three and nine months ended September 30, 2017, options to issue approximately 5,000 and 103,000 shares of common stock were excluded from the computation, respectively.

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

	Three Months Ended		Nine Months Ended	
	September 29, 2018	September 30, 2017	September 29, 2018	September 30, 2017
Weighted average common shares	28,948	28,155	28,814	27,614
Effect of dilutive securities	822	950	836	1,026
	29,770	29,105	29,650	28,640

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

**Adoption of New Revenue Accounting Standard**

We adopted 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 September 29, 2018 and the nine months ended September 29, 2018, have been accounted for using ASC 606 and the prior year quarter ended September 30, 2017 and none months ended September 30, 2017, have 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*):

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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 and nine months ended September 29, 2018 and our condensed consolidated balance sheet at September 29, 2018 were materially affected due to the adoption of ASC 606 (*in thousands*):

Condensed Consolidated Statements of Income	For the Three Months Ended September 29, 2018		
	As Reported	Balances without adoption of ASC 606	Effect of Change
Net sales	\$86,164	\$86,820	\$(656 )
Income tax provision	\$2,302	\$2,421	\$(119 )
Net income	\$4,803	\$5,340	\$(537 )
Income per share:			
Basic:	\$0.17	\$0.18	\$(0.01 )
Diluted:	\$0.16	\$0.18	\$(0.02 )

Table of Contents**Cohu, Inc.****Notes to Unaudited Condensed Consolidated Financial Statements****September 29, 2018**

	For the Nine Months Ended September 29, 2018		
	As Reported	Balances without adoption of ASC 606	Effect of Change
Condensed Consolidated Statements of Income			
Net sales	\$281,131	\$279,038	\$2,093
Income tax provision	\$6,897	\$6,517	\$380
Net income	\$24,573	\$22,860	\$1,713
Income per share:			
Basic:	\$0.85	\$0.79	\$0.06
Diluted:	\$0.83	\$0.77	\$0.06

	Balances without Effect of Change		
	As Reported	Balances without adoption of ASC 606	Effect of Change
Condensed Consolidated Balance Sheets*			
Deferred profit	\$1,894	\$5,396	\$(3,502)
Retained earnings	\$171,110	\$168,339	\$2,771

\* 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 the performance obligation has been satisfied 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.

**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 we transfer control to our customer 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.

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**Cohu, Inc.**

**Notes to Unaudited Condensed Consolidated Financial Statements**

**September 29, 2018**

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. 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.

On shipments where sales are not recognized, gross profit is generally recorded as deferred profit in our consolidated balance sheet representing the difference between the receivable recorded and the inventory shipped. At September 29, 2018, we had deferred revenue totaling approximately \$3.6 million, current deferred profit of \$1.9 million and deferred profit expected to be recognized after one year included in noncurrent other accrued liabilities of \$1.1 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 September 29, 2018, include a \$1.1 million beginning retained earnings adjustment as a 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 September 29, 2018	Nine Months Ended September 29, 2018
Systems	\$ 42,278	\$ 152,846
Non-systems	43,886	128,285
Net sales	\$ 86,164	\$ 281,131

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

	Three Months Ended September 29, 2018	Nine Months Ended September 29, 2018
China	\$ 23,628	\$ 63,011
United States	11,585	41,725
Malaysia	13,682	38,539
Philippines	11,158	31,620
Rest of the World	26,111	106,236
Net sales	\$ 86,164	\$ 281,131



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

	Three Months Ended September 29, 30, 2018 2017		Nine Months Ended September 29, 30, 2018 2017		
Customers individually accounting for more than 10% of net sales	one	two	one	two	
Percentage of net sales	11.2%	26.5	%	10.8%	28.5 %

**Accumulated Other Comprehensive Loss**

Our accumulated other comprehensive loss balance totaled approximately \$21.2 million and \$17.8 million at September 29, 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 nine months of fiscal 2018 and 2017 were not significant.

**Retiree Medical Benefits**

We provide post-retirement health benefits to certain executives, directors and their eligible dependents under a noncontributory plan. The net periodic benefit cost incurred during the first nine 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 fair 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.

## **Recent Accounting Pronouncements**

### **Recently Adopted Accounting Pronouncements**

In August 2018, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2018-15, *Intangibles – Goodwill and Other – Internal-Use Software* (Subtopic 350-40), which amends ASU No. 2015-05, *Customers Accounting for Fees in a Cloud Computing Agreement*, to help entities evaluate the accounting for fees paid by a customer in a cloud computing arrangement (hosting arrangement) by providing guidance for determining when the arrangement includes a software license. The most significant change will align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software and hosting arrangements that include an internal-use software license. Accordingly, the amendments in ASU 2018-15 require an entity in a hosting arrangement that is a service contract to follow the guidance in Subtopic 350-40 to determine which implementation costs to capitalize as an asset related to the service contract and which costs to expense. The amendments in ASU 2018-15 are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, although early adoption is permitted, including adoption in any interim period and the amendments can be applied either retrospectively or prospectively. Cohu adopted ASU 2018-15 in the third quarter of 2018 prospectively for all implementation costs incurred related to our global cloud computing systems and capitalized \$1.5 million as of September 29, 2018. These amounts are recorded as other current (\$0.3 million) and non-current (\$1.2 million) assets in our condensed consolidated balance sheet.

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**Notes to Unaudited Condensed Consolidated Financial Statements**

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In March 2017, the FASB issued ASU No. 2017-07, *Compensation – Retirement Benefits (Topic 715) – Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*, which provides additional guidance on the presentation of net periodic pension and postretirement benefit costs in the income statement and on the components eligible for capitalization. The amendments in this guidance require that an employer report the service cost component of the net periodic benefit costs in the same income statement line item as other compensation costs arising from services rendered by employees during the period. The non-service-cost components of net periodic benefit costs are to be presented in the income statement separately from the service cost components and outside a subtotal of income from operations. The guidance also allows for the capitalization of the service cost components, when applicable (i.e., as a cost of internally manufactured inventory or a self-constructed asset). The guidance is effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods. 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 combination. 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 August 2018, the FASB issued ASU 2018-14, *Disclosure Framework - Changes to the Disclosure Requirements for Defined Benefit Plans*, which improves defined benefit disclosure requirements by removing disclosures that are not cost beneficial, clarifying disclosures' specific requirements and adding relevant disclosure requirements. This ASU is effective for fiscal years ending after December 15, 2020 and early adoption is permitted. The amendments in this ASU are required to be applied on a retrospective basis to all periods presented. We are currently assessing and have not yet determined the impact that the adoption of ASU 2018-14 will have on the condensed consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, *Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement*, which improves fair value disclosure requirements by removing disclosures that are not cost beneficial, clarifying disclosures' specific requirements and adding relevant disclosure requirements. This ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The amendments on changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements, and the narrative description of measurement uncertainty should be applied prospectively for only the most recent interim or annual period presented in the initial fiscal year of adoption. All other amendments should be applied retrospectively to all periods presented upon their effective date. Early adoption is permitted and an entity can choose to early adopt any removed or modified disclosures upon issuance of this ASU and delay adoption of the additional disclosures until their effective date. We are currently assessing and have not yet determined the impact that the adoption of ASU 2018-13 will have on the condensed consolidated financial statements.

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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 condensed 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 condensed consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. This ASU requires lessees to record a right of use asset and a liability for virtually all leases. This guidance is effective for interim and annual reporting periods beginning after December 15, 2018. We have developed a transition plan and continue to evaluate the impact that the adoption of ASU 2016-02 will have on the consolidated financial statements.

During the second quarter of 2018, we started analyzing the population of leases and have identified that most of our leases fall into one of four categories: real estate, machinery, office equipment, and vehicles. Real estate agreements represent a majority of our rent expense and vary based on various factors negotiated by the landlord; machinery agreements are related to the use of factory machinery; and office equipment and vehicle leases typically utilize standard master leasing contracts that have similar terms. During the first nine months of 2018, we began the process of implementing changes to our systems and discussing changes to future processes and controls to prepare the transition accounting. Total assets and total liabilities will increase significantly in the period the ASU is adopted. In July 2018, the FASB issued ASU 2018-10, *Codification Improvements to Topic 842, Leases*. ASU 2018-10 includes certain clarifications to address potential narrow-scope implementation issues which we are incorporating into our assessment and adoption of ASU 2016-02. Additionally, in July 2018, the FASB issued ASU 2018-11, *Targeted Improvements to Topic 842, Leases*. ASU 2018-11 which provides an additional transition method to adopt ASU 2016-02 identified as comparative reporting at adoption. We expect to use this new transition approach and the comparative periods presented in our financial statements will continue to be reported in accordance with ASC 840, *Leases*. We anticipate that we will elect the package of practical expedients allowed in the standard, which among other things, allows us to carry forward our historical lease classification. We also anticipate that we will make an

accounting policy election to use the practical expedient allowed in the standard to not separate lease and non-lease components when calculating the lease liability under ASU 2016-02.

## **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 pins used in final test contactors, probe cards, PCB test boards and connectors sold to customers worldwide. The acquisition of Kita was a strategic transaction to expand our total available market, extend our market leadership and broaden our product offerings. In connection with the Acquisition we incurred acquisition related costs, which were expensed to selling, general and administrative that totaled \$1.0 million during the nine months ended September 30, 2017. No acquisition related costs were incurred during the nine months ended September 29, 2018.

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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 September 29, 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 changes in fair value of contingent consideration during the year ended December 30, 2017, and the nine-month period ended September 29, 2018 (*in thousands*):

	Fair Value of Contingent Consideration
Balance, December 31, 2016	\$ -
Fair value of consideration at acquisition date	823
Mark-to-market adjustments charged to expense	1,423
Impact of currency exchange	7
Balance, December 30, 2017	2,253
Mark-to-market adjustments charged to expense	657
Settlement of contingent consideration	(1,500 )

Impact of currency exchange	60
Balance, September 29, 2018	\$ 1,470

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.

Goodwill and Intangible Assets

Changes in the carrying value of goodwill during the year ended December 30, 2017, and the nine-month period ended September 29, 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	(1,034 )
Balance, September 29, 2018	\$ 64,579



Table of Contents**Cohu, Inc.****Notes to Unaudited Condensed Consolidated Financial Statements****September 29, 2018**Purchased intangible assets, subject to amortization are as follows (*in thousands*):

	September 29, 2018		Remaining Weighted Average Amort Period (in years)	December 30, 2017	
	Gross Carrying Amount	Accum. Amort.		Gross Carrying Amount	Accum. Amort.
Developed technology	\$20,632	\$14,468	2.7	\$20,780	\$12,623
Customer relationships	7,877	5,572	2.3	7,934	4,838
Trade names	6,088	1,301	11.5	6,185	972
Covenant not-to-compete	310	54	8.3	313	31
Total intangible assets	\$34,907	\$21,395		\$35,212	\$18,464

Amortization expense related to intangible assets was approximately \$1.0 million in the third quarter of fiscal 2018 and \$3.1 million in the first nine months of fiscal 2018. Amortization expense related to intangible assets was approximately \$1.1 million in the third quarter of fiscal 2017 and \$3.2 million in the first nine months of fiscal 2017. 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.

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

	September 29, 2018			
	Amortized Cost	Gross Realized Gains	Gross Unrealized Losses <sup>(1)</sup>	Estimated Fair Value
Foreign government security	\$549	\$ -	\$ -	\$ 549

  

	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 September 29, 2018, there were no 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 evaluated the (1) nature of these investments, credit worthiness of the issuer and the duration of these impairments to determine if an other-than-temporary decline in fair value had occurred and concluded that these losses were temporary and we have the ability and intent to hold these investments to maturity.

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

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

	September 29, 2018		December 30, 2017	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	\$-	\$ -	\$21,338	\$ 21,329
Due after one year through three years	549	549	-	-
	\$549	\$ 549	\$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.

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

	Fair value measurements at September 29, 2018 using:			Total estimated fair value
	Level 1	Level 2	Level 3	
Cash	\$ 141,075	\$-	\$ -	\$ 141,075
Money market funds	-	29,620	-	29,620
Foreign government security	-	549	-	549
	\$ 141,075	\$ 30,169	\$ -	\$ 171,244

Fair value measurements at December 30, 2017 using:

	Level 1	Level 2	Level 3	Total estimated fair value
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 September 29, 2018, there were 1,204,761 shares available for future equity grants under the 2005 Equity Incentive Plan.

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**Cohu, Inc.**

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**Stock Options**

Stock options may be granted to employees, consultants and non-employee directors to purchase a fixed number of shares of our common stock. The exercise prices of options granted are at least equal to the fair market value of our common stock on the dates of grant and options vest and become exercisable in annual increments that range from one to four years from the date of grant. Stock options granted under the 2015 Plan have a maximum contractual term of ten years. In the first nine months of fiscal 2018 we did not grant any stock options and we issued 64,300 shares of our common stock on the exercise of options that were granted previously.

At September 29, 2018, we had 407,926 stock options exercisable and outstanding. These options had a weighted-average exercise price of \$10.24 per share, an aggregate intrinsic value of approximately \$6.1 million and the weighted average remaining contractual term was approximately 3.9 years.

**Restricted Stock Units**

We grant restricted stock units (“RSUs”) to certain employees, consultants and directors. RSUs vest in annual increments that range from one to four years from the date of grant. Prior to vesting, RSUs do not have dividend equivalent rights, do not have voting rights and the shares underlying the RSUs are not considered issued and outstanding. New shares of our common stock will be issued on the date the RSUs vest net of the minimum statutory tax withholding requirements to be paid by us on behalf of our employees. As a result, the actual number of shares issued will be fewer than the actual number of RSUs outstanding at September 29, 2018.

In the first nine months of fiscal 2018 we awarded 286,709 RSUs and we issued 432,031 shares of our common stock on vesting of previously granted awards. At September 29, 2018, we had 800,865 RSUs outstanding with an aggregate intrinsic value of approximately \$20.1 million and the weighted average remaining vesting period was approximately 1.3 years.

**Performance Stock Units**

We also grant performance stock units (“PSUs”) to senior executives as a part of our long-term equity compensation program. The number of shares of common stock that will ultimately be issued to settle PSUs granted in 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 September 29, 2018.

In the first nine months of fiscal 2018, we awarded 88,418 PSUs and we issued 40,640 shares of our common stock on vesting of previously granted awards. At September 29, 2018, we had 339,771 PSUs outstanding with an aggregate intrinsic value of approximately \$8.5 million and the weighted average remaining vesting period was approximately 1.3 years.

### **Employee Stock Purchase Plan**

The Cohu, Inc. 1997 Employee Stock Purchase Plan (“the Plan”) provides for the issuance of shares of our common stock. Under the Plan, eligible employees may purchase shares of Cohu common stock through payroll deductions at a price equal to 85 percent of the lower of the fair market value of Cohu common stock at the beginning or end of each 6-month purchase period, subject to certain limits. During the first nine months of fiscal 2018, 41,694 shares of our common stock were sold to our employees under the Plan leaving 559,646 shares available for future issuance.

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**Cohu, Inc.**

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**5. Income Taxes**

For the three and nine months ended September 29, 2018, we used the estimated effective tax rate (“ETR”) expected to be applicable for the full fiscal year in computing our tax provision. The ETR on income from continuing operations for the three months ended September 29, 2018 and September 30, 2017, was 32.4% and 17.3%, respectively, and 21.9% and 14.0% for the nine months ended September 29, 2018 and September 30, 2017, respectively. Our ETR for the three and nine months ended September 29, 2018 was impacted by approximately \$0.6 million of foreign withholding tax that we accrued in the event we repatriate funds from certain of our foreign subsidiaries. The tax provision on income from continuing operations in 2018 and 2017 differs from the U.S. federal statutory rate primarily due to the lack of a benefit on our domestic losses as a result of our valuation allowance on deferred tax assets, foreign income taxed at 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 September 29, 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 interpretations 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 Topic 740, Income Taxes, (“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 and nine months ended September 29, 2018 did not include any incremental amount of GILTI tax as we expect to utilize existing net operating losses and tax credits, that have a full valuation allowance, to offset the impact of the GILTI inclusion.

Our German subsidiaries income tax returns for 2012 to 2016 are currently under routine examination by tax authorities in Germany. We believe our financial statement accruals for income taxes are appropriate.

Other than for foreign currency exchange rate changes and the Kita acquisition, there was no material change to our unrecognized tax benefits and related accrued interest and penalties during the three- and nine-month periods ended September 29, 2018 and September 30, 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 account 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.



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

	Three Months Ended		Nine Months Ended	
	September 29, 2018	September 30, 2017	September 29, 2018	September 30, 2017
Balance at beginning of period	\$4,948	\$ 5,070	\$4,848	\$ 4,350
Warranty expense accruals	1,600	1,720	4,988	5,446
Warranty payments	(1,946)	(1,773 )	(5,234)	(4,829 )
Warranty liability assumed	-	-	-	50
Balance at end of period	\$4,602	\$ 5,017	\$4,602	\$ 5,017

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 \$0.2 million at September 29, 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 \$6.2 million and at September 29, 2018, total borrowings outstanding under the revolving lines of credit were \$3.1 million. As these credit facility agreements renew monthly, they have been included in short-term borrowings in our condensed consolidated balance sheet. The revolving lines of credit are denominated in Japanese Yen and, as a result, amounts disclosed herein will fluctuate because of changes in currency exchange rates.

Term Loans

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 September 29, 2018 the aggregate amount outstanding was \$4.8 million and \$1.0 million of the term loans have been included in current installments of long-term debt in our condensed consolidated balance sheet. The fair value of our debt approximates the carrying value at September 29, 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 September 29, 2018 and December 30, 2017, no amounts were outstanding under the line of credit.

**8. Acquisition of Xcerra**

Completion of the Acquisition of Xcerra

Pursuant to an Agreement and Plan of Merger (the "Merger Agreement") dated as of May 7, 2018 among Cohu, Inc., a Delaware corporation ("Cohu"), Xcerra Corporation, a Massachusetts corporation ("Xcerra"), and Xavier Acquisition Corporation, a Delaware corporation and a wholly owned subsidiary of Cohu ("Merger Sub"), Merger Sub merged with and into Xcerra (the "Merger"), with Xcerra surviving such merger as a wholly owned subsidiary of Cohu. The Merger was effective on October 1, 2018 (the "Effective Time"). As described above, as a result of the Merger, Xcerra became a wholly owned subsidiary of Cohu. The Merger is a taxable transaction for U.S. federal income tax purposes. Cohu incurred \$5.2 million of acquisition related costs for the Xcerra transaction in the first nine months of 2018.

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**Cohu, Inc.**

**Notes to Unaudited Condensed Consolidated Financial Statements**

**September 29, 2018**

At the Effective Time, each share of Xcerra's common stock, par value \$0.05 per share ("Xcerra Common Stock"), issued and outstanding immediately prior to the Effective Time other than dissenting shares and shares held by Cohu, Merger Sub, Xcerra or any direct or indirect wholly owned subsidiary of Cohu or Xcerra was 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, par value \$1.00 per share ("Cohu Common Stock"), (the "Stock Consideration" and, together with the Cash Consideration, the "Merger Consideration"). No fractional shares of Cohu Common Stock were issued in the Merger, and Xcerra's former stockholders received an amount of cash in lieu of fractional shares, if any, of Cohu Common Stock calculated in accordance with Section 2.11 of the Merger Agreement. The sources of cash funds used in connection with the Merger included cash and cash equivalents on hand with Cohu and Xcerra and the proceeds from the Credit Facility, as defined below.

On October 1, 2018, approximately \$70.5 million of Cohu's cash and short-term investments were used to fund the Merger with Xcerra.

Consideration Transferred

On October 1, 2018, the total consideration transferred to former Xcerra shareholders consisted of 11,776,315 shares of Cohu common stock and \$502.5 million in cash. Additionally, unvested RSUs held by employees of Xcerra were assumed and converted into approximately 530,000 Cohu RSUs that were awarded as replacement awards as a result of the completed Merger. At the Effective Time, Xcerra shares ceased to be traded on the NASDAQ Global Market effective, October 1, 2018.

Secured Term Loan Facility

To provide the majority of the Cash Consideration for the Merger, on October 1, 2018, Cohu entered into a Credit and Guaranty Agreement (the "Credit Agreement") with Cohu, as borrower, certain of its subsidiaries as guarantor subsidiaries, the financial institutions party thereto from time to time as lenders, and Deutsche Bank AG New York Branch, as administrative agent and collateral agent, providing for a \$350.0 million secured term loan facility (the "Credit Facility"). Cohu's obligations under the Credit Facility are (and will be) guaranteed by certain of its existing and subsequently acquired or formed material wholly-owned domestic subsidiaries, (subject to certain exceptions and

exclusions) under the Credit Facility (the “Guarantors”). The Credit Facility is secured by a security interest in substantially all existing and after-acquired assets and property (subject to certain exceptions and exclusions) of Cohu and the Guarantors.

On October 1, 2018, Cohu borrowed the entire amount of the Credit Facility. The proceeds of the Credit Facility were used, along with cash and cash equivalents on hand of Cohu and Xcerra, to pay the Cash Consideration and to pay certain fees and expenses related to the Merger and the Credit Agreement.

Loans under the Credit Facility amortize in equal quarterly installments equal to 0.25% of the original principal amount thereof, with the balance payable at maturity. Subject to certain exceptions and thresholds, the Credit Facility will also require mandatory prepayments in connection with (i) excess cash flow, (ii) non-ordinary course asset sales and other dispositions and (iii) the issuance of certain debt obligations, among other things. Cohu has the right to prepay loans under the Credit Agreement in whole or in part at any time, without premium or penalty other than a 1.00% prepayment fee in connection with certain “repricing” transactions on or before the sixth month anniversary of the closing date of the Credit Agreement. Amounts repaid in respect of loans under the Credit Facility may not be reborrowed. All outstanding principal and interest in respect of the Credit Facility must be repaid on or before October 1, 2025.

Loans under the Credit Facility bear interest at a floating annual rate equal to the LIBOR plus a margin of 3.00%. While a payment or bankruptcy event of default exists, Cohu is obligated to pay a per annum default rate of interest of 2.00% in excess of the interest rate otherwise payable with respect to the overdue principal amount of any loans outstanding and overdue interest payments and other overdue fees and amounts.

The Credit Agreement has incremental facility capacity in an aggregate amount of the greater of \$145 million and 100% of consolidated EBITDA, with an additional \$35 million available for revolving facilities, subject to certain conditions. Once Cohu’s first lien net leverage ratio is below a certain threshold, incremental facilities may be utilized in an unlimited amount.

The Credit Agreement contains certain customary affirmative and negative covenants, including covenants that limit the ability of Cohu and its subsidiaries to, among other things, grant liens, incur debt, dispose of assets, make loans and investments, make acquisitions, make certain restricted payments, merge or consolidate or change their business, in each case subject to customary exceptions for a credit facility of this size and type.

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The Credit Agreement includes customary events of default that include, among other things, non-payment of principal, interest or fees, inaccuracy of representations and warranties, breach of covenants, cross-default to certain material indebtedness, bankruptcy and insolvency and change of control. Upon the occurrence and during the continuance of an event of default, the lenders may declare all outstanding principal and accrued but unpaid interest under the Credit Agreement immediately due and payable and may exercise the other rights and remedies provided under the Credit Agreement and related loan documents.

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**Cohu, Inc.**

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

**September 29, 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 nine months of 2018, our net sales increased 4.7% from the corresponding period of 2017. This increase has been driven by improved conditions in automotive, industrial and IoT (Internet of Things) semiconductor markets and capturing new customers for semiconductor test handlers and test contactors, along with growth in sales of semiconductor inspection equipment. Cohu's sales in the third quarter of 2018 decreased 13.6% from the second quarter of 2018 as a result of softening in the broader market for semiconductors primarily those used in mobility applications. We continue to see momentum in the automotive and industrial semiconductor 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 sales in our semiconductor test handling and test contactor businesses and expanding into the semiconductor inspection market.

### **Xcerra Acquisition**

On October 1, 2018, Cohu completed the acquisition of Xcerra Corporation, and Xcerra became a wholly owned subsidiary of Cohu (the "Merger"). In connection with the Merger, Cohu and certain of its subsidiaries entered into a Credit and Guaranty Agreement with Deutsche Bank AG New York Branch, and other lenders that may from time to time be a party to the Credit and Guaranty Agreement. Pursuant to the Credit and Guaranty Agreement, the lenders have provided Cohu with a senior secured term loan facility of \$350 million to finance a portion of the cash used to complete the acquisition and to pay related costs and expenses. See Note 8, "Acquisition of Xcerra", located in Part I, Item 1 of this Form 10-Q for further information.

Unless otherwise indicated all amounts presented herein pertain only to Cohu, Inc. and exclude the impact of Xcerra.

### **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.

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**Cohu, Inc.**

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

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

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

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

**Revenue Recognition:** 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.

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**Cohu, Inc.**

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**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 and nine months ended September 29, 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 September 29, 2018, was approximately \$31.6 million, with a valuation allowance of approximately \$25.1 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.

**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 September 29, 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.

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

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

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

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

**Recent Accounting Pronouncements**

For a description of accounting changes and recent accounting pronouncements, including the expected dates of adoption and estimated effects, if any, on our consolidated financial statements, see "Recent Accounting

Pronouncements”, in Note 1 located in Part I, Item 1 of this Form 10-Q.

## RESULTS OF OPERATIONS

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

	Three Months		Nine Months			
	Ended		Ended			
	September	September	September	September		
	29,	30,	29,	30,		
	2018	2017	2018	2017		
Net sales	100.0%	100.0	%	100.0%	100.0	%
Cost of sales	(60.1 )	(60.6 )	)	(58.9 )	(60.4 )	)
Gross margin	39.9	39.4		41.1	39.6	
Research and development	(12.9 )	(10.3 )	)	(12.1 )	(10.7 )	)
Selling, general and administrative	(19.2 )	(18.0 )	)	(18.1 )	(17.6 )	)
Income from operations	7.8 %	11.1 %	%	10.9 %	11.3 %	%

### Third Quarter of Fiscal 2018 Compared to Third Quarter of Fiscal 2017

#### *Net Sales*

Our consolidated net sales decreased 8.0% to \$86.2 million in 2018, compared to \$93.7 million in 2017. The decrease in sales in the third quarter of 2018 was primarily a result of a softening in the broader market for semiconductors primarily those used in mobility and IoT (Internet of Things) applications.

#### *Gross Margin*

Gross margin consists of net sales less cost of sales. Cost of sales consists primarily of the materials, assembly and test labor and overhead from operations. Our gross margin can fluctuate due to a number of factors, including, but not limited to, the mix and volume of products sold, product support costs, increases to inventory reserves or the sale of previously reserved inventory and utilization of manufacturing capacity. Our gross margin, as a percentage of net sales, was 39.9% in 2018 and 39.4% in 2017. Gross margin in the third quarter of 2017 included a \$0.6 million charge related to the amortization of purchase accounting inventory step-up adjustment recorded in connection with our acquisition of Kita. No amounts were expensed in 2018 as all inventory step-up amounts were amortized in 2017.



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Our gross margin can be impacted by charges to cost of sales related to excess, obsolete and lower of cost or net realizable value inventory issues. We compute the majority of our excess and obsolete inventory reserve requirements using a one-year inventory usage forecast. In both the third quarter of 2018 and 2017, we recorded charges to cost of sales of \$0.7 million for excess and obsolete inventory. While we believe our reserves for excess and obsolete inventory and lower of cost or net realizable value concerns are adequate to cover known exposures at September 29, 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 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 \$11.1 million in 2018 and \$9.6 million in 2017 representing 12.9% and 10.3% of net sales, respectively. During the third quarter of 2018 new product development programs resulted in increased R&D spending on labor and materials. In the third quarter of 2017, we received \$0.7 million of cost reimbursements under a cost-sharing arrangement that reduced R&D expense. No cost reimbursements were received in 2018.

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

SG&A expense consists primarily of salaries and benefit costs of employees, commission expense for independent sales representatives, product promotion and costs of professional services. SG&A expense was \$16.5 million or 19.2% of net sales in 2018, compared to \$16.9 million or 18.0% in 2017. Our SG&A expense continues to be impacted by fluctuations in the Swiss Franc and Euro against the U.S. Dollar. During both the third quarter of 2018 and 2017 the U.S. Dollar slightly weakened which resulted in the recognition of foreign currency transaction loss of \$0.2 million. Our SG&A expense has fluctuated due to costs incurred related to acquisitions. In the third quarter of 2018 we incurred \$1.0 million of costs related to our pending acquisition of Xcerra. Costs incurred in the third quarter of 2017 associated with the acquisition of Kita totaled \$0.1 million. We recorded a mark-to-market adjustment charge, related to the change in the fair value of the Kita contingent consideration liability, totaling \$0.2 million and \$0.7 million in the third quarter of 2018 and 2017 respectively.

### *Income Taxes*

For the three months ended September 29, 2018, we used the estimated effective tax rate (“ETR”) expected to be applicable for the full fiscal year in computing our tax provision. The ETR on income from continuing operations for the three months ended September 29, 2018 and September 30, 2017, was 32.4% and 17.3%, respectively. Our ETR for the three months ended September 29, 2018 was impacted by approximately \$0.6 million of foreign withholding tax that we accrued in the event we repatriate funds from certain of our foreign subsidiaries. The tax provision on income from continuing operations in 2018 and 2017 differs from the U.S. federal statutory rate primarily due to the lack of a benefit on our domestic losses as a result of our valuation allowance on deferred tax assets, foreign income taxed at different rates, changes in our deferred tax asset valuation allowance, state taxes and interest related to unrecognized tax benefits.

Other than for foreign currency exchange rate changes and the Kita Acquisition, there was no material change to our unrecognized tax benefits and related accrued interest and penalties during the three-month periods ended September 29, 2018 and September 30, 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 \$4.8 million in 2018, compared to \$8.8 million in 2017.

### **First Nine Months of Fiscal 2018 Compared to First Nine Months of Fiscal 2017**

#### *Net Sales*

Our consolidated net sales increased 4.7% to \$281.1 million in 2018, compared to \$268.6 million in 2017. Increased sales in the first nine months of 2018 resulted from improved conditions in automotive, industrial and IoT(Internet of Things) semiconductor markets as compared to conditions in the first nine months of 2017, and from capturing new customers for semiconductor test handlers and test contactors, along with growth in sales of semiconductor inspection equipment.



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***Gross Margin***

Our gross margin, as a percentage of net sales, increased to 41.1% in 2018 from 39.6% in 2017. As compared to the prior year, gross margin in the first nine months of 2018 benefitted from the increase in business volume which enabled us to better leverage our fixed costs as well as favorable product mix. Gross margin in the first nine months of 2018 benefitted from the acceptance of our new Eclipse XTA as certain costs had been previously expensed to R&D during product development. During 2017, gross margin was negatively impacted by a purchase accounting inventory step-up adjustment as our cost of sales included \$1.4 million of amortization recorded in connection with our acquisition of Kita. No amounts were expensed in 2018 as all inventory step-up amounts were amortized in 2017.

In the first nine months of fiscal 2018 and 2017 we recorded charges to cost of sales of approximately \$1.3 million and \$0.5 million for excess and obsolete inventory, respectively.

***R&D Expense***

R&D expense was \$33.9 million or 12.1% of net sales in 2018, compared to \$28.9 million or 10.7% in 2017. New product development programs resulted in higher R&D labor and material expense in the first nine months of 2018. Additionally, during 2017 R&D expense benefitted from \$1.0 million of cost reimbursements received under a cost-sharing arrangement that we entered with a customer in the first quarter of 2016.

***SG&A Expense***

SG&A expense was \$50.9 million or 18.1% of net sales in 2018, compared to \$47.4 million or 17.6% in 2017. Increased business volume in the first nine months of 2018 drove higher costs. Our SG&A expense also continues to be impacted by fluctuations in the Swiss Franc and Euro against the U.S. Dollar. During the first nine months of 2018 the U.S. Dollar strengthened which resulted in the recognition of foreign currency transaction gains of \$1.2 million. Conversely, in 2017 the U.S. Dollar weakened and, as a result, we recognized a loss of \$2.7 million. Our SG&A expense has fluctuated due to costs incurred related to acquisitions. Costs incurred specifically related to our pending

Xcerra acquisition in the first nine months of 2018 totaled \$5.2 million and during 2017 we recorded \$0.3 million of costs related to the acquisition of Kita. During the first nine months of 2018 and 2017 mark-to-market adjustments related to the fair value of the Kita contingent consideration liability resulted in the expense of \$0.7 million.

### ***Income Taxes***

The ETR on income from continuing operations for the nine months ended September 29, 2018 and September 30, 2017, was 21.9% and 14.0%, respectively. Our ETR for the nine months ended September 29, 2018 was impacted by approximately \$0.6 million of foreign withholding tax that we accrued in the event we repatriate funds from certain of our foreign subsidiaries. The tax provision on income from continuing operations in 2018 and 2017 differs from the U.S. federal statutory rate primarily due to the lack of a benefit on our domestic losses as a result of our valuation allowance on deferred tax assets, foreign income taxed at different rates, changes in our deferred tax asset valuation allowance, state taxes and interest related to unrecognized tax benefits.

Other than foreign currency exchange rate changes and the Kita Acquisition, there was no material change to our unrecognized tax benefits and related accrued interest and penalties during the nine-month periods ended September 29, 2018 and September 30, 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 \$24.6 million in 2018 as compared to income from continuing operations of \$26.2 million in 2017. Including the impact of the disposal of our discontinued mobile microwave communication equipment business, which included a loss of \$0.3 million due to the write-off of the contingent consideration, our net income in the first nine months of 2017 was \$25.9 million.

## **LIQUIDITY AND CAPITAL RESOURCES**

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

Table of Contents**Cohu, Inc.****Management's Discussion and Analysis of Financial Condition and Results of Operations****September 29, 2018**

Our primary historical source of liquidity and capital resources has been cash flow generated by our operations and we manage our business to maximize operating cash flows as our primary source of liquidity. We use cash to fund growth in our operating assets and to fund new products and product enhancements primarily through research and development. As of September 29, 2018, \$40.0 million of our cash and cash equivalents was held by our foreign subsidiaries. If these funds are needed for our operations in the U.S., we may be required to make additional accruals and pay foreign or U.S. taxes if we repatriate these funds.

**Liquidity**

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

	September 29, 2018	December 30, 2017	Increase	Percentage Change	
<i>(in thousands)</i>					
Cash, cash equivalents and short-term investments	\$ 171,244	\$ 155,615	\$ 15,629	10.0	%
Working capital	\$ 232,361	\$ 212,171	\$ 20,190	9.5	%

On October 1, 2018, approximately \$70.5 million of Cohu's cash and short term investments were used to fund the Merger with Xcerra.

**Cash Flows**

**Operating Activities:** Operating cash flows for the first nine 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 a mark-to-market adjustment on the Kita contingent consideration. Our net cash provided by operating activities in the first nine months of fiscal 2018 totaled \$29.2 million. Net cash provided by operating activities was impacted by changes in current assets and liabilities and included increases in accounts receivable of \$8.1 million, inventories of \$2.6 million, accrued compensation, warranty and other liabilities of \$1.4 million and

income tax payable of \$3.9 million and a decrease in deferred profit of \$3.5 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 inventory is a result of purchases made in anticipation of shipments scheduled to occur in the fourth quarter of 2018. The increase in accrued compensation, warranty and other liabilities was driven by increased legal and other professional services accruals related to the acquisition of Xcerra. The increase in income taxes payable is a result of income generated in the current year. Deferred profit decreased due to the recognition of sales that had been previously deferred in accordance with our revenue recognition policy.

**Investing Activities:** Investing cash flows consist primarily of cash used for capital expenditures in support of our businesses, proceeds from investment maturities, asset disposals and cash used for purchases of investments and business acquisitions. Net cash provided by investing activities in the first nine months of fiscal 2018 totaled \$18.3 million. Investing activities in the first nine months of fiscal 2018 were impacted by \$59.5 million in net proceeds from sales and maturities of short-term investments offset, in part, by \$38.7 million in cash used for purchases of short-term investments. We invest our excess cash, in an attempt to seek the highest available return while preserving capital, in short-term investments since excess cash is only temporarily available and may be required for a business related purpose. Additions to property, plant and equipment of \$2.5 million were made to support the operating and development activities of our business.

**Financing Activities:** Cash flows from financing activities consist primarily of net proceeds from the issuance of common stock under our stock option and employee stock purchase plans and cash used to pay dividends to our stockholders. We issue restricted stock units and stock options and maintain an employee stock purchase plan as components of our overall employee compensation. In the first nine 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 \$2.6 million. We paid dividends totaling \$5.2 million, or \$0.18 per common share and on October 30, 2018, Cohu's Board of Directors approved a quarterly cash dividend of \$0.06 per share payable on January 2, 2019, to shareholders of record on November 16, 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. Furthermore, future quarterly dividends may be reduced from historical levels, or suspended, as a result of the Merger. Total repayments of short-term borrowings and long-term debt during the first nine months of fiscal 2018 totaled \$1.0 million, additionally we made payments of \$0.8 million to settle contingent consideration liabilities related to the acquisition of Kita in 2017.

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**Cohu, Inc.**

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

**September 29, 2018**

**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 \$6.2 million. At September 29, 2018 total borrowings outstanding under the revolving lines of credit were \$3.1 million. As these credit facility agreements renew monthly, they have been included in short-term borrowings in our condensed consolidated balance sheet. We also have long-term term loans from a series of Japanese financial institutions totaling \$4.8 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 September 29, 2018, \$1.0 million of the term loans have been included in current installments of long-term debt in our condensed consolidated balance sheet. The revolving lines of credit and term loans are denominated in Japanese Yen and, as a result, amounts will fluctuate as a result of changes in currency exchange rates.

We 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 September 29, 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 September 29, 2018, no amounts were outstanding under standby letters of credit under the Secured Facility.

Xcerra Acquisition

On October 1, 2018 Cohu completed its acquisition of Xcerra Corporation and entered into a Credit Agreement with Cohu, as borrower, certain of its subsidiaries as guarantor subsidiaries, the financial institutions party thereto from

time to time as lenders, and Deutsche Bank AG New York Branch, as administrative agent and collateral agent, providing for a \$350.0 million Credit Facility.

On October 1, 2018, Cohu borrowed the entire amount of the Credit Facility. The proceeds of the Credit Facility were used, along with cash and cash equivalents on hand of Cohu and Xcerra, to pay the Cash Consideration (as defined below) and to pay certain fees and expenses related to the Merger and the Credit Agreement.

See “Acquisition of Xcerra”, in Note 8 located in Part I, Item 1 of this Form 10-Q for further information.

### **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 as of September 29, 2018 have not changed materially from those disclosed in our Annual Report on Form 10-K for the year ended December 30, 2017.

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**Cohu, Inc.**

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

**September 29, 2018**

Secured Term Loan Facility- Xcerra Acquisition

To provide the majority of the Cash Consideration as part of the Merger, on October 1, 2018, Cohu entered into a Credit and Guaranty Agreement (the "Credit Agreement") with Cohu, as borrower, certain of its subsidiaries as guarantor subsidiaries, the financial institutions party thereto from time to time as lenders, and Deutsche Bank AG New York Branch, as administrative agent and collateral agent, providing for a \$350.0 million secured term loan facility (the "Credit Facility"). Cohu's obligations under the Credit Facility are (and will be) guaranteed by certain of its existing and subsequently acquired or formed material wholly-owned domestic subsidiaries, (subject to certain exceptions and exclusions) under the Credit Facility (the "Guarantors"). The Credit Facility is secured by a security interest in substantially all existing and after-acquired assets and property (subject to certain exceptions and exclusions) of Cohu and the Guarantors.

On October 1, 2018, Cohu borrowed the entire amount of the Credit Facility. The proceeds of the Credit Facility were used, along with cash and cash equivalents on hand of Cohu and Xcerra, to pay the Cash Consideration and to pay certain fees and expenses related to the Merger and the Credit Agreement.

Loans under the Credit Facility amortize in equal quarterly installments equal to 0.25% of the original principal amount thereof, with the balance payable at maturity. Subject to certain exceptions and thresholds, the Credit Facility will also require mandatory prepayments in connection with (i) excess cash flow, (ii) non-ordinary course asset sales and other dispositions and (iii) the issuance of certain debt obligations, among other things. Cohu has the right to prepay loans under the Credit Agreement in whole or in part at any time, without premium or penalty other than a 1.00% prepayment fee in connection with certain "repricing" transactions on or before the sixth month anniversary of the closing date of the Credit Agreement. Amounts repaid in respect of loans under the Credit Facility may not be reborrowed. All outstanding principal and interest in respect of the Credit Facility must be repaid on or before October 1, 2025.

Loans under the Credit Facility bear interest at a floating annual rate equal to the LIBOR plus a margin of 3.00%. While a payment or bankruptcy event of default exists, Cohu is obligated to pay a per annum default rate of interest of 2.00% in excess of the interest rate otherwise payable with respect to the overdue principal amount of any loans outstanding and overdue interest payments and other overdue fees and amounts.

The Credit Agreement has incremental facility capacity in an aggregate amount of the greater of \$145 million and 100% of consolidated EBITDA, with an additional \$35 million available for revolving facilities, subject to certain conditions. Once Cohu's first lien net leverage ratio is below a certain threshold, incremental facilities may be utilized in an unlimited amount.

The Credit Agreement contains certain customary affirmative and negative covenants, including covenants that limit the ability of Cohu and its subsidiaries to, among other things, grant liens, incur debt, dispose of assets, make loans and investments, make acquisitions, make certain restricted payments, pay dividends, merge or consolidate or change their business, in each case subject to customary exceptions for a credit facility of this size and type.

The Credit Agreement includes customary events of default that include, among other things, non-payment of principal, interest or fees, inaccuracy of representations and warranties, breach of covenants, cross-default to certain material indebtedness, bankruptcy and insolvency and change of control. Upon the occurrence and during the continuance of an event of default, the lenders may declare all outstanding principal and accrued but unpaid interest under the Credit Agreement immediately due and payable and may exercise the other rights and remedies provided under the Credit Agreement and related loan documents.

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

***Off-Balance Sheet Arrangements:*** During the ordinary course of business, we provide standby letters of credit instruments to certain parties as required. As of September 29, 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 September 29, 2018, our investment portfolio included short-term fixed-income investment securities with a fair value of approximately \$0.5 million. These securities are subject to interest rate risk and will likely decline in value if interest rates increase. Our future investment income may fall short of expectations due to changes in interest rates or we may suffer losses in principal if we are forced to sell securities that decline in market value due to changes in



interest rates. As we classify our short-term securities as available-for-sale, no gains or losses are recognized due to changes in interest rates unless such securities are sold prior to maturity or declines in fair value are determined to be other-than-temporary. Due to the relatively short duration of our investment portfolio, an immediate ten percent change in interest rates would have no material impact on our financial condition or results of operations.

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We evaluate our investments periodically for possible other-than-temporary impairment by reviewing factors such as the length of time and extent to which fair value has been below cost basis, the financial condition of the issuer and our ability and intent to hold the investment for a period of time sufficient for anticipated recovery of market value. As of September 29, 2018, we held no investments with loss positions.

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

We have operations in several foreign countries and conduct business in the local currency in these countries. As a result, we have risk associated with currency fluctuations as the value of foreign currencies fluctuate against the U.S. dollar, in particular the Swiss Franc, Euro, Malaysian Ringgit, Chinese Yuan, 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 September 29, 2018, compared to December 30, 2017, our stockholders' equity decreased by \$3.4 million.

Based upon the current levels of net foreign assets, a hypothetical 10% devaluation of the U.S. Dollar as compared to these currencies as of September 29, 2018 would result in an approximate \$12.3 million positive translation adjustment recorded in other comprehensive income within stockholders' equity. Conversely, a hypothetical 10% appreciation of the U.S. Dollar as compared to these currencies as of September 29, 2018 would result in an approximate \$12.3 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 period covered by this quarterly report 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.*

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

Pursuant to an Agreement and Plan of Merger (the "Merger Agreement") dated as of May 7, 2018 among Cohu, Inc., a Delaware corporation ("Cohu"), Xcerra Corporation, a Massachusetts corporation ("Xcerra"), and Xavier Acquisition Corporation, a Delaware corporation and a wholly owned subsidiary of Cohu ("Merger Sub"), Merger Sub merged with and into Xcerra (the "Merger"), with Xcerra surviving such merger as a wholly owned subsidiary of Cohu. The Merger was effective on October 1, 2018.

Our ability to realize the anticipated benefits of the Merger will depend, to a large extent, on our ability to integrate Xcerra, which is expected to be 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.

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:

difficulties entering new markets or manufacturing in new geographies where Cohu has no or limited direct prior experience;

such a new market for Cohu, the automated test equipment market, is intensely competitive with entrenched large competitors who are much larger than Cohu

successfully managing relationships with Cohu and Xcerra's combined supplier and customer base;

coordinating and integrating independent research and development and engineering teams across technologies and product platforms to enhance product development while reducing costs;

coordinating sales and marketing efforts to effectively position the combined company's capabilities and the direction of product development;

difficulties and significant costs in integrating the systems and processes of two companies with complex operations including multiple manufacturing sites;

the increased scale and complexity of Cohu's operations resulting from the Merger;

Cohu's ability to achieve the cost synergies contemplated by the proposed transaction within the expected time frame, and significant costs of integration and restructuring;

retaining key employees of Cohu and Xcerra;

obligations that Cohu will have to counterparties of Xcerra that arise as a result of the change in control of Xcerra;

the impact of litigation and potential liabilities we may be inheriting from Xcerra; and

diversion of management's attention to integration matters.

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.

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

Although we have completed the Merger, we have incurred, and will continue to incur, significant transaction costs in connection with the Merger, including restructuring expenses and the 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 expect to incur material restructuring and integration charges in connection with the Merger, which may adversely affect our operating results in the period in which such expenses are recorded or our cash flow in the period in which any related costs are actually paid. Cohu incurred \$5.2 million of acquisition related costs for the Xcerra transaction in the first nine months of 2018.

***\* Xcerra may underperform relative to our expectations.***

The business and financial performance of Xcerra are subject to certain risks and uncertainties. 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. Any underperformance could have a material adverse effect on our financial condition and results of operations.

***\* Cohu's ability to utilize Xcerra's net operating loss and credit carryforwards may be severely limited.***

As a result of the Merger an ownership change has occurred at Xcerra and as a consequence Cohu's ability to utilize Xcerra's net operating loss and credit carryforwards, that were already limited due to a prior acquisition, will be subject to annual limitations as provided for in Internal Revenue Code Sections 382 and 383. These annual limitations, which are currently unknown and subject to further analysis, may result in the inability of Cohu to utilize a substantial portion of these carryforwards. In addition, Cohu must assess whether its operating loss and credit carryforwards are similarly limited as a result of the Merger.

***\* Uncertainties underlie Cohu's expectation that, relative to Cohu on a stand-alone basis, the Merger will be accretive to Cohu's earnings per share.***

Cohu believes that, relative to Cohu on a stand-alone basis, the Merger will actually be accretive to Cohu's earnings per share. However, Cohu cannot give any assurance that the Merger will be accretive to Cohu's earnings per share. In addition to the uncertainties that underlie any financial forecast, Cohu will account for the Merger as an acquisition under Accounting Standards Codification Topic 805, "Business Combinations," or "ASC 805". The total cost of the Merger will be allocated to the underlying identifiable net tangible and intangible assets and liabilities based on their respective estimated fair values. Until these allocations are completed, Cohu can only estimate the allocation of the acquisition price to the net assets acquired and the effect of the allocation on future results. That estimate could materially change.

***\* The use of cash and incurrence of substantial indebtedness in connection with the financing of the Merger may have an adverse impact on Cohu's liquidity, limit Cohu's flexibility in responding to other business opportunities and increase Cohu's vulnerability to adverse economic and industry conditions.***

The Merger was financed in part by using Cohu's and Xcerra's cash on hand and the incurrence of indebtedness. In connection with the Merger, Cohu entered into a term loan facility, with an aggregate principal amount of \$350.0 million (the "Debt Financing"). Cohu used approximately \$178 million of Cohu's and Xcerra's cash on hand to complete the Merger. After completing the Merger and paying acquisition related costs, Cohu's (including Xcerra's) estimated cash, cash equivalents and short-term investments as of October 1, 2018 were approximately \$147.5 million. The use of cash on hand and indebtedness to finance the acquisition has reduced Cohu's liquidity and could cause Cohu to place more reliance on cash generated from operations to pay principal and interest on Cohu's debt, thereby reducing the availability of Cohu's cash flow for working capital, dividend and capital expenditure needs or to pursue other potential strategic plans. The Debt Financing agreements contain certain negative covenants, including limitations on Cohu's ability to incur additional liens and indebtedness or to pay dividends and make certain investments. Cohu's ability to comply with these negative covenants may be affected by events beyond its control. The indebtedness and these negative covenants also has the effect, among other things, of limiting Cohu's ability to obtain additional financing, if needed, limiting its flexibility in the conduct of its business and making Cohu more vulnerable to economic downturns and adverse competitive and industry conditions. In addition, a breach of the negative covenants could result in an event of default with respect to the indebtedness, which, if not cured or waived, could result in the indebtedness becoming immediately due and payable and could have a material adverse effect on Cohu's business, financial condition or operating results.

***\* Because of high debt levels, Cohu may not be able to service its debt obligations in accordance with their terms; the Tax Cuts and Jobs Act severely limits the deductibility of interest expense.***

Cohu's ability to meet its expense and debt service obligations contained in the Debt Financing agreements will depend on Cohu's future performance, which will be affected by financial, business, economic and other factors, including potential changes in industry conditions, industry supply and demand balance, customer preferences, the success of Cohu's products and pressure from competitors. In addition, Cohu is subject to interest rate risks, and continuing increases in interest rates will increase Cohu's debt service obligations. Should Cohu's revenues decline after the Merger, Cohu may not be able to generate sufficient cash flow to pay its debt service obligations when due. If Cohu is unable to meet its debt service obligations after the Merger or should Cohu fail to comply with the covenants contained in the agreements governing its indebtedness, Cohu may be required to refinance all or part of its debt, sell important strategic assets at unfavorable prices, incur additional indebtedness or issue Cohu Common Stock or other equity securities. Cohu may not be able to, at any given time, refinance its debt, sell assets, incur additional indebtedness or issue equity securities on terms acceptable to Cohu, in amounts sufficient to meet Cohu's needs or at all. If Cohu is able to raise additional funds through the issuance of equity securities, such issuance would also result in dilution to Cohu's stockholders. Cohu's inability to service its debt obligations or refinance its debt could have a material adverse effect on its business, financial conditions or operating results after the Merger. In addition, Cohu's debt obligations may limit its ability to make required investments in capacity, technology or other areas of its business, which could have a material adverse effect on its business, financial conditions or operating results. Furthermore, the Tax Cuts and Jobs Act limits the deductibility of interest expense in a given year to 30% of adjusted taxable income, as defined. This may result in the inability of Cohu to utilize a substantial portion of its interest expense deductions. However, the Act permits indefinite carryforward of any disallowed business interest, subject to Internal Revenue Code section 382 limitations on utilization.





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***\* 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 was financed in part by the issuance of additional shares of our common stock to shareholders of Xcerra, comprised approximately 11.8 million shares of common stock, or approximately 29% of our issued and outstanding shares of common stock immediately after completing the Merger. These issuances of additional shares of our common stock have diluted shareholders' ownership interest in our company, and shareholders now have a proportionately reduced ownership and voting interest in our company as a result of completion of the Merger.

***\* Cohu cannot provide assurance that it will be able to continue paying dividends at the current rate.***

Cohu stockholders may not receive the same dividends in the future for various reasons, including the following:

as a result of the Merger and the issuance of shares of Cohu Common Stock in connection with the Merger, the total amount of cash required for Cohu to pay dividends at its current rate will increase;  
Cohu's credit agreement restricts payments of dividends under certain circumstances;  
Cohu may not have enough cash to pay such dividends due to Cohu's cash requirements, capital spending plans, cash flow or financial position;  
decisions on whether, when and in which amounts to make any future distributions will remain at all times entirely at the discretion of the Cohu Board, which reserves the right to change Cohu's dividend practices at any time;  
rising interest rates, which increase Cohu's debt service obligations;  
Cohu may desire to retain cash to maintain or improve its credit ratings; and  
the amount of dividends that Cohu's subsidiaries may distribute to Cohu may be subject to restrictions imposed by state or foreign law, restrictions that may be imposed by state or foreign regulators, and restrictions imposed by the terms of any current or future indebtedness that these subsidiaries may incur.

***\* The Merger has resulted in changes to the Cohu Board that may affect the strategy and operations of the combined company as compared to that of Cohu and Xcerra as they existed prior to the Merger.***

Upon completion of the Merger, the Cohu Board added two new members selected from members of the Xcerra Board. There can be no assurance that the newly constituted Cohu Board will function effectively as a team and that there will not be any adverse effect on the combined company's business as a result.

***\* We have elected to terminate Xcerra's agreement with Spirox Corporation as a distributor in China and Taiwan. If we are unable to adequately replace Spirox, or if its performance deteriorates during the transition period, it may adversely impact our business.***

The Xcerra division has relied on Spirox Corporation ("Spirox") as its primary distribution channel for sales and service in China and Taiwan for its Semiconductor Test Solutions products, a region that represents a material portion of Xcerra's revenues. Spirox has direct contact with Xcerra's customers, and Spirox is obligated to satisfy all installation and service obligations for the Semiconductor Test Solutions products. After a thorough review of this arrangement,

on October 12, 2018, we notified Spirox of our intention to terminate the Spirox distribution agreement, effective October 12, 2019. Our business and financial performance within the China and Taiwan region can be negatively impacted by many factors relating to Spirox, including if Spirox, for any reason, does not satisfy its obligations to customers in China and Taiwan or to us during the transition, Spirox is ineffective in its sales or service efforts or incurs difficulties in staffing and or training, if the distributor relationship between Xterra and Spirox deteriorates during the transition, or if Cohu is delayed and otherwise fails to timely and adequately staff and fund sales and service resources in the region to replace those resources being provided by Spirox.

***We are exposed to other risks associated with other 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.

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

Mergers, acquisitions and investments are inherently risky and the inability to effectively manage these risks could materially and adversely affect our business, financial condition and results of operations. At September 29, 2018, we had goodwill and net purchased intangible assets balances of \$64.6 million and \$13.5 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 an ongoing investment in our PANTHER platform, while also investing in next generation test handlers and automated test equipment. 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.

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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 possible import, export, tariff and other trade barriers, 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.

***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 because of changes in customer forecasts. More recently, in third quarter 2018, we saw slowness in the mobility market segment, which adversely impacted our third quarter 2018 sales, and fourth quarter 2018 sales guidance.

***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.

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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 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.

***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.



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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. Possible import, export, tariff and other trade barriers, which could be imposed by Asia, the United States, other countries or the European Union might also have a material adverse effect on our operating results. We cannot predict the timing, duration of or effect on our business of an economic slowdown or the timing or strength of a subsequent recovery.

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

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

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

The process of developing new high technology products and services and enhancing existing products and services is complex, costly and uncertain, and any failure by us to anticipate customers' changing needs and emerging technological trends accurately could significantly harm our sales 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 and Bay Area, California, Boston, Massachusetts, Rosenheim and 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. Our German subsidiaries income tax returns for 2012 to 2016 are currently under routine examination by tax authorities in Germany. 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 to our consolidated financial statements.

***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.

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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; increased duties, tariffs or other restrictions; public company reporting requirements; environmental regulation and antitrust enforcement.

***\* Global economic and political conditions, including trade tariffs and restrictions, may have an impact on our business and financial condition in ways that we currently cannot predict.***

Recent public policy changes and new trade tariffs and restrictions between the United States and China may, in our view, create an uncertain business environment. In particular, if tariffs or restrictions are imposed on our products or the products of our customers, there could be a negative impact on our operations and financial performance. For example, in June, August and September, 2018, the Office of the United States Trade Representative (the “USTR”) published a list of products covering more than 6,000 separate U.S. tariff lines valued at approximately \$250 billion in 2018 trade values, imposing an additional duty of 10% or 25% on the listed product lines. The list generally focuses on products from industrial sectors that contribute to or benefit from the “Made in China 2025” industrial policy, which include industries such as aerospace, information and communications technology, robotics, industrial machinery, new materials, and automobiles. We are continuing to evaluate the impact of the announced and other proposed tariffs on products that we import from China, and we may experience a material increase in the cost of our products, which may result in our products becoming less attractive relative to products offered by our competitors. In addition, future actions, retaliation or escalations by either the United States or China that affect trade relations may also impact our business, or that of our suppliers or customers, and we cannot provide any assurances as to whether such actions will occur or the form that they may take. To the extent that our sales or profitability are negatively affected by any such tariffs or other trade actions, our business and results of operations may be materially adversely affected.

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

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***\* Our global Enterprise Resource Management (“ERP”) upgrade may adversely affect our business and results of operations or the effectiveness of internal controls over financial reporting.***

We are in development stage for the global replacement of our existing ERP solution. The new solution is being developed as an enterprise solution in partnership with a leading provider of ERP tools. Additional investments in enterprise tools that focus on product life-cycle management, our customer experience, and supply chain management are in process to support our growing business. These implementations are extremely complex and time-consuming projects that involve substantial expenditures on software and implementation activities. If we do not effectively implement the system or if the system does not operate as intended, it could result in the loss or corruption of data, delayed order processing and shipments and increased costs. It could also adversely affect our financial reporting systems and our ability to produce financial reports and process transactions, the effectiveness of internal controls over financial reporting, and our business, financial condition, results of operations and cash flows.

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

Our corporate headquarters is located in San Diego, California, our Asian sales and service headquarters is located in Singapore and the majority of our sales are made to destinations in Asia. In addition, we have manufacturing plants in Malaysia, Philippines and Japan. These regions are known for being vulnerable to natural disasters and other risks, such as earthquakes, tsunamis, fires and floods, 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 September 29, 2018 the price of our common stock has ranged from \$27.83 to \$9.38. 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.**

- 2.1 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
- 3.1 Amended and Restated Certificate of Incorporation of Cohu, Inc. incorporated herein by reference to Exhibit 3.1 from the Cohu, Inc. Form 8-K filed with the Securities and Exchange Commission on May 17, 2018
- 3.2 Amended and Restated Bylaws of Cohu, Inc. incorporated herein by reference to Exhibit 3.2 from the Cohu, Inc. Form 8-K filed with the Securities and Exchange Commission on May 17, 2018
- 10.1 Credit and Guaranty Agreement dated as of October 1, 2018, by and among Cohu, Inc., Certain Subsidiaries of Cohu, Inc. and Deutsche Bank AG New York Branch
- 10.2 Pledge and Security Agreement dated as of October 1, 2018, by and among Cohu, Inc., Certain Subsidiaries of Cohu, Inc. and Deutsche Bank AG New York Branch
- 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: November 7, 2018 /s/ Luis A. Müller  
Luis A. Müller  
President & Chief Executive Officer

Date: November 7, 2018 /s/ Jeffrey D. Jones  
Jeffrey D. Jones  
Vice President, Finance & Chief Financial Officer  
  
(Principal Financial & Accounting Officer)