

COHU INC
Form 10-K
March 02, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2016

OR

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

Commission file number 1-4298

COHU, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of Incorporation or Organization)

95-1934119

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

12367 Crosthwaite Circle, Poway, California

(Address of principal executive offices)

92064-6817

(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:

| | |
|---------------------------------------|--|
| <u>Title of Each Class</u> | <u>Name of Exchange on Which Registered</u> |
| Common Stock, \$1.00 par value | The NASDAQ Stock Market LLC |

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

(Do not check if a smaller reporting company)

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

The aggregate market value of voting stock held by nonaffiliates of the registrant was approximately \$165,000,000 based on the closing stock price as reported by the NASDAQ Stock Market LLC as of June 24, 2016. Shares of common stock held by each officer and director and by each person or group who owns 5% or more of the outstanding common stock have been excluded in that such persons or groups may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of February 16, 2017 the Registrant had 26,847,773 shares of its \$1.00 par value common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for Cohu, Inc.'s 2017 Annual Meeting of Stockholders to be held on May 10, 2017, and to be filed pursuant to Regulation 14A within 120 days after registrant's fiscal year ended December 31, 2016, are incorporated by reference into Part III of this Report.

COHU, INC.

FORM 10-K FOR THE FISCAL YEAR ENDED DECEMBER 31, 2016

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The following discussion should be read in conjunction with the Consolidated Financial Statements and notes thereto included elsewhere in this Annual Report on Form 10-K. This Annual Report on Form 10-K 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 (the “Exchange Act”), and is subject to the Safe Harbor provisions created by that statute. These forward-looking statements are based on management’s current expectations and beliefs, including estimates and projections about our business. Statements concerning financial position, business strategy, and plans or objectives for future operations are forward-looking statements. These 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 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 update publicly 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 Securities and Exchange Commission (“SEC”) after the date of this Annual Report.

PART I

Item 1. Business.

Cohu, Inc. (“Cohu”, “we”, “our” and “us”) was incorporated under the laws of California in 1947, as Kalbfell Lab, Inc. and commenced active operations in the same year. Our name was changed to Kay Lab in 1954. In 1957, Cohu was reincorporated under the laws of the State of Delaware as Cohu Electronics, Inc. and in 1972 our name was changed to Cohu, Inc.

Kita Manufacturing Co. LTD. (“Kita”), acquired by Cohu on January 4, 2017, is a Japan-based manufacturer of spring probe contacts used in final test contactors, probe cards, Printed Circuit Board (PCB) test and connectors sold to customers worldwide. The acquisition of Kita was completed subsequent to Cohu’s fiscal year ended December 31, 2016 and certain disclosures include Kita to enable investors to evaluate the operating and financial effects to our business recognized in the subsequent accounting period. However, unless otherwise indicated, disclosures made throughout this Form 10-K exclude the effect of the acquisition of Kita.

In 2015 we sold our mobile microwave communications equipment business, Broadcast Microwave Services, Inc. (“BMS”) and in 2014 we sold our video camera business, Cohu Electronics. Our decision to sell BMS and Cohu Electronics resulted from the determination that these businesses were no longer a strategic fit within our organization. The operating results of BMS and Cohu Electronics are being presented as discontinued operations and all prior period amounts have been reclassified accordingly. Unless otherwise noted all amounts presented are from continuing operations.

Subsequent to the sale of BMS and Cohu Electronics, we have one reportable segment, semiconductor equipment. Financial information on our reportable segment for each of the last three years is included in Note 8, "Segment and Geographic Information" in Part IV, Item 15(a) of this Form 10-K.

Cohu is a leading supplier of semiconductor test and inspection handlers, micro-electro mechanical system (MEMS) test modules, test contactors and thermal sub-systems used by global semiconductor manufacturers and test subcontractors. We develop, manufacture, sell and service a broad line of equipment capable of handling a wide range of integrated circuits and light-emitting diodes (LEDs). Test handlers are electromechanical systems used to automate testing of integrated circuits and LEDs in the back-end of the semiconductor manufacturing process. Testing determines the quality and performance of the semiconductor device prior to shipment to customers. Testers are designed to verify the performance of semiconductor devices, such as microprocessors, logic, analog, memory or mixed signal devices. Handlers are automated systems engineered to thermally condition and present for testing the packaged semiconductor devices. The majority of test handlers use either pick-and-place, gravity-feed, turret or test-in-strip technologies. The type of device, test parallelism, thermal requirements and signal interface requirements normally determines the appropriate handling approach.

Pick-and-place handling is the predominant solution for devices with leads on all four sides, such as the quad flat pack, or with balls or pads on the bottom or top of the package, such as ball grid array packages, and quad flat no-lead packages as well as certain low profile devices with leads on two sides, such as the thin small outline package, and wafer-level packages. Pick-and-place handlers use robotic mechanisms to move devices from JEDEC (Joint Electron Device Engineering Council) standard trays and place them in precision transport boats or carriers for processing through the system. After testing, devices are sorted and reloaded into designated trays, based on test results.

Gravity-feed handling is the predominant solution for temperature testing of high performance small outline leaded and non-leaded packages, as well as for large packages with leads on only one or two sides as is common in high power devices. In gravity-feed handlers, devices are unloaded from plastic tubes, metal magazines or a bowl at the top of the machine and flow through the system, from top to bottom, propelled by the force of gravity. After testing, devices are sorted and reloaded into tubes, magazines, bulk or tape for additional process steps or final shipment.

Turret handlers are ideally suited for high-volume and low-mix testing of smaller integrated circuit and LED devices. In turret handlers, devices are unloaded from tubes, a bowl, trays or film frame. Turret-based handlers use a rotating turret mechanism that provides very high device throughput and efficient integration of multiple back-end finishing operations.

Test-in-strip handlers accommodate devices in strips or panels prior to the final singulation step in the semiconductor manufacturing process flow and are typically used for high-parallel testing applications.

MEMS test modules are independent physical stimuli units for testing sensor integrated circuits typically used in the automotive and consumer electronics industries. These MEMS test modules can be integrated to our gravity-feed, pick-and-place, turret or test-in-strip handlers for testing a variety of sensors, including pressure, acoustic, magnetic field hall effect, optical and others.

To ensure quality, semiconductors are typically tested at hot and/or cold temperatures, which can simulate the final operating environment. Our test handler products are designed to provide a precisely controlled test environment, often over the range of -60 degrees Celsius to +175 degrees Celsius. As the speed and power of certain integrated circuits, such as microprocessors and mobile processors, have increased so has the need to actively manage the self-generated heat during the test process to maximize yield. This heat is capable of damaging or destroying the integrated circuit and can result in speed downgrading, when devices self-heat and fail to successfully test at their maximum possible speed. Device yields are extremely important and speed grading directly affects the selling price of the integrated circuit and the profitability of the semiconductor manufacturer. In addition to temperature capability, other key factors in the design of test handlers are handling speed, flexibility, parallel test capability, alignment to the test contactors, system size, reliability and cost.

Thermal sub-systems are used in advanced burn-in and system-level test applications to maintain and control the temperature of integrated circuits during the testing process. Burn-in stresses devices for detection of early failures (infant mortality) prior to distribution. The burn-in process is also used by semiconductor manufacturers to develop reliability models of newly introduced devices. The objective of reliability testing is to determine a device's fault-free operation and estimated useful life by exposing the device to various electrical and thermal conditions that impact its performance. System-level testing is required for functional testing of high-end microprocessors as well as mobile processors combined with memory. This is typically the last test operation of complex, expensive integrated circuits prior to the final electronic integration process.

Our products are complex electromechanical systems that are used in high-volume production environments and many are in service twenty-four hours per day, seven days a week. Customers continuously strive to increase the utilization of their production test equipment and expect high reliability from test handlers, MEMS test modules and thermal subsystems used in burn-in and system-level test. The availability of trained technical support personnel is an important competitive factor in the marketplace. We deploy service engineers worldwide, often within customers' production facilities, who work with customer personnel to maintain, repair and continuously improve the performance of our equipment.

Our Products

We offer products for the pick-and-place, gravity-feed, test-in-strip and turret handling, MEMS, burn-in and system-level test markets. We currently sell the following products:

Pick-and-place

The **Delta MATRiX** is a high-performance pick-and-place handler capable of thermally conditioning devices from -60 degrees Celsius to +175 degrees Celsius. It provides increased productivity in several dimensions of performance: high throughput and test parallelism, scalability and active thermal control per test site. With an adjustable test site configuration, customers can reuse existing load-boards, including those made for competitor equipment and gravity handlers. The system also provides flexibility with field upgradeable options including a chamberless tri-temperature test site and auto contactor cleaning.

The **Delta Pyramid** is a high performance thermal handler for microprocessors, graphics processors and other high power integrated circuits. The Pyramid incorporates our proprietary **T-Core** thermal control technology that optimizes test yield of power dissipative integrated circuits.

Delta Eclipse is our next generation pick-and-place platform tailored for Fabless and Outsourced Semiconductor Assembly and Test (OSAT) customers, as well as integrated device manufacturers (IDMs). This is a highly configurable platform capable of handling general purpose integrated circuits to advanced computing and mobile processors that require Cohu's **T-Core** active thermal control during test.

Delta LinX is our platform serving assembly automation. Back-end semiconductor assembly is the major process step prior to device testing and validation. The LinX product line offers advanced JEDEC handling automation that efficiently links various assembly test processes.

Gravity-Feed

The **Rasco SO1000** is a high throughput gravity-feed platform that provides an economical solution for testing up to 4 devices in parallel. This handler can be configured for tube-to-tube or metal magazine input and output, ambient-hot or tri-temperature testing and is easily kit-able for a wide range of integrated circuit packages.

The **Rasco SO2000** is a modular platform that offers a reliable solution for testing small integrated circuit packages up to 4 devices in parallel. The base platform can be configured with various input and output modules: tube, metal magazine, bowl, bulk, tape and reel, and an optional laser marking unit. This handler can be configured for ambient-hot or tri-temperature testing.

Rasco Saturn and **Jupiter** are our next generation gravity handlers delivering a fast index time capability with up to 8 devices tested in parallel at cold and/or hot temperature. Saturn has a configuration that covers testing of very small to medium size packaged integrated circuits, and Jupiter is a version that enables testing of medium to very large

packaged integrated circuits typically serving the power management device market.

Test-in-strip

The **Rasco Jaguar** test-in-strip handler can process an entire strip at once or index the strip for single/multiple device testing. The system has tri-temperature capability, accommodates either stacked or slotted input/output media and is configured with automated vision alignment. The Jaguar is also a solution for in-process testing of next generation multi-stacked packages.

Turret

Ismeca NY32 is a scalable, 32-position turret handler used for testing and inspection of integrated circuits, LEDs, and discrete devices. There are many configurations of the NY32 turret handler: handling wafers in film-frame for input and/or output that is common for LEDs and wafer level package (WLP) devices; tray and tube input and/or output used for integrated circuits and discrete devices; and bowl feeding, tape and de-taping, alignment, laser marking, inspection and test modules. The NY32 is capable of testing devices at ambient and hot temperature.

Ismeca NY20 is a turret handler platform that delivers high throughput combined with fast device change-over time for both high-volume and high-mix testing and inspection of integrated circuits, LEDs and discrete devices. The 20-position turret offers many of the functional modules and capabilities available on the NY32 platform in a smaller footprint, higher throughput handler.

Micro-Electro-Mechanical Systems (“MEMS”)

MEMS test modules generate physical stimuli for testing of sensor integrated circuits. These are typically used in the automotive (e.g. tire pressure, airbag sensors) and consumer electronics (e.g. tilt, motion, microphone and light sensors) industries. The MEMS modules are stand-alone units that can be integrated into our pick-and-place, turret, test-in-strip, or gravity-feed handlers.

Thermal Sub-Systems

We have adapted our proprietary thermal control technology for use by integrated circuit manufacturers in high performance burn-in and system level test. The **Delta T-Core** thermal sub-systems provide fast and accurate temperature control of the integrated circuit during the testing process using the same technology available in the Pyramid handler. T-Core is also used in engineering device characterization applications.

Delta Fusion HD is a tri-temperature thermal sub-system that utilizes T-Core technology for testing mobile processors. The Fusion HD thermal sub-system can test greater than 450 devices in parallel while thermally conditioning and accurately controlling each device temperature through stringent, power dissipative test scripts.

Contactors

We design, manufacture, sell and support various lines of test contactor solutions. These are consumable, electro-mechanical assemblies that connect the device under test, inside our test handlers, and the automated test equipment. Cohu contactors are used in testing digital semiconductor devices utilizing spring probe technology, such as the ones produced by Kita, and also power management and LED semiconductor devices utilizing cantilever technology, and RF semiconductor devices based on high performance contacts designed to operate at frequencies up to 34 GHz.

Spares

We provide consumable and non-consumable items that are used to maintain, sustain or otherwise enable customer's equipment to meet its performance, availability and production requirements.

Tooling (kits)

We design and manufacture a wide range of device dedication kits that enable handlers to process different semiconductor packages. Our Philippines operation designs and manufactures the majority of our handler kits and provides applications support to customers in the southeast Asia region.

Sales by Product Line

During the last three years, our consolidated sales were distributed as follows:

2016 2015 2014

| | | | |
|--|-----|-----|-----|
| Semiconductor test handler systems | 54% | 47% | 47% |
| Thermal sub-systems | 3% | 7% | 9% |
| Spares, contactors, tooling (kits) and service | 43% | 46% | 44% |

Customers

Our customers include semiconductor integrated device manufacturers and test subcontractors. Repeat sales to existing customers represent a significant portion of our sales. During the last three years, the following customers comprised 10% or greater of our consolidated net sales:

| | 2016 | 2015 | 2014 |
|--|-------|-------|-------|
| Intel | 17.2% | 18.0% | 15.7% |
| NXP Semiconductors N.V. ⁽¹⁾ | 13.7% | 11.4% | 11.4% |

(1) *The merger of NXP Semiconductors N.V. and Freescale Semiconductor, Ltd. was completed on December 7, 2015. Sales to these customers have been combined for all periods presented.*

The loss of, or a significant reduction in, orders by these or other significant customers, including reductions due to market, economic or competitive conditions or the outsourcing of final integrated circuit test to subcontractors that are not our customers would adversely affect our financial condition and results of operations and as a result, we believe that our customer concentration is a significant business risk.

Additional financial information on revenues from external customers by geographic area for each of the last three years is included in Note 8, "Segment and Geographic Information" in Part IV, Item 15(a) of this Form 10-K.

Sales and Marketing

We market our products worldwide through a combination of a direct sales force and independent sales representatives. In geographic areas where we believe there is sufficient sales potential, we generally employ our own personnel. Our U.S. sales office is located in Poway, California. The Europe sales offices are located in Kolbermoor, Germany and La Chaux-de-Fonds, Switzerland. We operate in Asia with offices in Singapore, Malaysia, Thailand, Philippines, Taiwan, China, Korea, and subsequent to the acquisition of Kita on January 4, 2017, Japan.

Competition

The semiconductor equipment industry is intensely competitive and is characterized by rapid technological change and demanding worldwide service requirements. Significant competitive factors include product performance, price, reliability, customer support and installed base of products. While we are a leading worldwide supplier of semiconductor test handling equipment, we face substantial competition. The Japanese and Korean markets for test handling equipment are large and represent a significant percentage of the worldwide market. During each of the last three years our sales to Japanese and Korean customers, who have historically purchased test handling equipment from Asian suppliers, have represented less than 10% of our total sales. Some of our current and potential competitors are part of larger corporations that have substantially greater financial, engineering, manufacturing and customer support capabilities and offer more extensive product offerings than Cohu. To remain competitive we believe we will require significant financial resources to offer a broad range of products, maintain customer support and service centers worldwide and to invest in research and development of new products. Failure to introduce new products in a timely manner or the introduction by competitors of products with actual or perceived advantages could result in a loss of competitive position and reduced sales of existing products. No assurance can be given that we will continue to compete successfully throughout the world.

Backlog

Our backlog of unfilled orders for products, was \$65.1 million at December 31, 2016 and \$66.5 million at December 26, 2015.

Backlog is generally expected to be shipped within the next twelve months. Our backlog at any point in time may not be representative of actual sales in any future period due to the possibility of customer changes in delivery schedules, cancellation of orders, potential delays in product shipments, difficulties in obtaining parts from suppliers, failure to satisfy customer acceptance requirements resulting in the inability to recognize revenue under accounting requirements. Furthermore, many orders are subject to cancellation or rescheduling by the customer with limited or no penalty. A reduction in backlog during any period could have a material adverse effect on our business, financial

condition and results of operations.

Manufacturing and Raw Materials

Our principal manufacturing operations are currently located in Malacca, Malaysia (handlers); Poway, California (thermal subsystems); Laguna, Philippines (kits and contactors); Kolbermoor, Germany (handlers); Osaka, Japan (contactors).

Many of the components and subassemblies we utilize are standard products, although some items are made to our specifications. Certain components are obtained or are available from a limited number of suppliers. We seek to reduce our dependence on sole and limited source suppliers, however in some cases the complete or partial loss of certain of these sources could have a material adverse effect on our operations while we attempt to locate and qualify replacement suppliers.

Patents and Trademarks

Our technology is protected by various intellectual property laws including patent, license, trademark, copyright and trade secret laws. In addition, we believe that, due to the rapid pace of technological change in the semiconductor equipment industry, the successful manufacture and sale of our products also depends upon our experience, technological know-how, manufacturing and marketing skills and speed of response to sales opportunities. In the absence of patent protection, we would be vulnerable to competitors who attempt to copy or imitate our products or processes. We believe our intellectual property has value and we have in the past and will in the future take actions we deem appropriate to protect such property from misappropriation. However, there can be no assurance such actions will provide meaningful protection from competition. Protecting our intellectual property rights or defending against claims brought by other holders of such rights, either directly against us or against customers we have agreed to indemnify, would likely be expensive and time consuming and could have a material adverse effect on our operations.

Research and Development

Research and development activities are carried on in our various subsidiaries and are directed toward development of new products and equipment, as well as enhancements to existing products and equipment. Our total research and development expense was \$34.8 million in 2016, \$33.1 million in 2015 and \$36.0 million in 2014.

We work closely with our customers to make improvements to our existing products and in the development of new products. We expect to continue to invest heavily in research and development and must manage product transitions successfully as introductions of new products could adversely impact sales of existing products.

Environmental Laws

Our business is subject to numerous federal, state, local and international environmental laws. On occasion, we have been notified by local authorities of instances of noncompliance with local and/or state environmental laws. We believe we are in compliance with applicable federal, state, local and international regulations. Compliance with foreign, federal, state and local laws that have been enacted or adopted regulating the discharge of materials into the environment or otherwise relating to the protection of the environment and the prevention of climate change have not had a material effect and are not expected to have a material effect upon our capital expenditures, results of operations or our competitive position. However, future changes in regulations may require expenditures that could adversely impact earnings in future years.

Executive Officers of the Registrant

The following sets forth the names, ages, positions and offices held by all executive officers of Cohu as of February 16, 2017. Executive Officers serve at the discretion of the Board of Directors, until their successors are appointed.

| Name | Age | Position |
|------------------|------------|---|
| Luis A. Müller | 47 | President and Chief Executive Officer |
| Jeffrey D. Jones | 55 | Vice President, Finance and Chief Financial Officer |
| John H. Allen | 65 | Vice President, Administration |
| Hock W. Chiang | 59 | Vice President, Global Sales & Service |

Dr. Müller joined Delta in 2005 as Director of Engineering. In July 2008, Dr. Müller was promoted to the position of Vice President of the High Speed Handling Group for Delta and in January 2009 he was named Managing Director of Rasco. In January 2011, Dr. Müller was appointed President of Cohu's Semiconductor Equipment Group. Effective December 28, 2014, Dr. Müller was promoted to President and Chief Executive Officer of Cohu and was appointed to Cohu's Board of Directors.

Mr. Jones joined Delta in 2005 as Vice President Finance and Controller. In November 2007, Mr. Jones was named Vice President, Finance and Chief Financial Officer of Cohu. Prior to joining Delta, Mr. Jones, was a consultant from 2004 to 2005 and Vice President and General Manager of the Systems Group at SBS Technologies, Inc., a designer and manufacturer of embedded computer products, from 1998 to 2003. Prior to SBS Technologies, Mr. Jones was an Audit Manager for Coopers & Lybrand (now PriceWaterhouseCoopers).

Mr. Allen has been employed by Cohu since June 1995. He was Director of Finance until September 1995 when he was promoted to Vice President, Finance and he was then appointed Chief Financial Officer in October 1995. In November 2007, Mr. Allen was named Vice President, Administration. Prior to joining Cohu, Mr. Allen held various positions with Ernst & Young LLP from 1976 until June 1995 and had been a partner with that firm since 1987.

Mr. Chiang has been employed by Cohu since October 2012 as Vice President, Global Sales and Service. Prior to joining Cohu, Mr. Chiang served as a Director for AXElite Technology Corporation. Additionally, from 1995 through 2011, Mr. Chiang held a variety of positions at Teradyne, Inc. ("Teradyne") including Director – Asia SOC Marketing & New Business Development, Managing Director of Teradyne's Singapore and China operations and Director of Worldwide Field Total Quality Management.

Employees

Including headcount additions arising from our acquisition of Kita, as of January 4, 2017, we had approximately 1,800 employees. Our employee headcount has fluctuated in the last five years primarily due to the volatile business conditions in the semiconductor equipment industry, the acquisitions of Ismeca and Kita, and the divestiture of Broadcast Microwave Services and Cohu Electronics. Our employees in the United States and most locations in Asia are not covered by collective bargaining agreements, however, certain employees at Rasco's facility in Kolbermoor, Germany, are represented by a works council, employees at Ismeca's facility La Chaux-de-Fonds, Switzerland are members of the micro-technology and Swiss watch trade union and certain employees in Ismeca's China operation belong to local trade unions. We have not experienced any work stoppages and consider our relations with our employees to be good. We believe that a great part of our future success will depend on our continued ability to attract and retain qualified employees. Competition for the services of certain personnel, particularly those with technical skills, is intense. There can be no assurance that we will be able to attract, hire, assimilate and retain a sufficient number of qualified employees.

Available Information

Our web site address is www.cohu.com. We make available free of charge, on or through our web site, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports, as soon as reasonably practicable after such material is electronically filed with the Securities and Exchange Commission. Our Code of Business Conduct and Ethics and other documents related to our corporate governance is also posted on our web site at www.cohu.com/investors/corporategovernance. Information contained on our web site is not deemed part of this report.

Item 1A. Risk Factors.

Set forth below and elsewhere in this report on Form 10-K and in other documents we file with the SEC, are risks and uncertainties that could cause actual results to differ materially from the results expressed or implied by the forward-looking statements contained in this Annual Report. Before deciding to purchase, hold or sell our common stock, you should carefully consider the risks described below in addition to the other cautionary statements and risks described elsewhere, and the other information contained, in this Annual Report on Form 10-K. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also affect our business. If any of these known or unknown risks or uncertainties actually occurs with material adverse effects on Cohu, our business, financial condition and results of operations could be seriously harmed. The trading price of our common stock could decline due to any of these risks, and you may lose all or part of your investment.

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

We have made, and may in the future make, acquisitions of, or significant investments in, businesses with complementary products, services and/or technologies such as our acquisition of Kita, which was completed on January 4, 2017. Acquisitions and investments involve numerous risks, including, but not limited to:

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

We may be required to finance future acquisitions and investments through a combination of borrowings, proceeds from equity or debt offerings and the use of cash, cash equivalents and short-term investments.

Mergers, acquisitions and investments are inherently risky and the inability to effectively manage these risks could materially and adversely affect our business, financial condition and results of operations. At December 31, 2016, we had goodwill and net purchased intangible assets balances of \$58.8 million and \$17.8 million, respectively. These amounts exclude the impact of our acquisition of Kita, which was completed subsequent to our fiscal year end. We expect our goodwill and purchased intangible asset balances will increase as a result of this transaction.

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

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

We are exposed to 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 are in the process of transitioning our manufacturing to Asia. Our inability to manage multiple manufacturing sites during this transition and to secure raw materials meeting our quality, cost and other requirements, or failures by our suppliers to perform, could harm our sales, service levels and reputation.

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

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

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

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

The semiconductor industry we serve is highly volatile and unpredictable.

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

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

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

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

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

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

emerging semiconductor equipment companies that provide or may provide innovative technology incorporated in products that may compete successfully against our products. We expect our competitors to continue to improve the design and performance of their current products and introduce new products with improved performance capabilities. Our failure to introduce new products in a timely manner, the introduction by our competitors of products with perceived or actual advantages, or disputes over rights to use certain intellectual property or technology could result in a loss of our competitive position and reduced sales of, or margins on our existing products. We believe that competitive conditions in the semiconductor test handler market have intensified over the last several years. This intense competition has adversely impacted our product average selling prices and gross margins on certain products. If we are unable to reduce the cost of our existing products and successfully introduce new lower cost products we expect these competitive conditions to negatively impact our gross margin and operating results in the foreseeable future.

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

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

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

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

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

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

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

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

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

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

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

The 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 have a significant impact on our operations. We have in the past and may in the future experience difficulties, particularly in manufacturing, in training and recruiting the large number of additions to our workforce. The volatility in headcount and business levels, combined with the seasonal nature of the semiconductor industry, may require that we invest substantial amounts in new operational and financial systems, procedures and controls. We may not be able to successfully adjust our systems, facilities and production capacity to meet our customers' changing requirements. The inability to meet such requirements will have an adverse impact on our business, financial position and results of

operations.

The loss of key personnel could adversely impact our business.

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

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

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

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

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

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

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

In addition, in October 2015, the Organization for Economic Co-operation and Development (OECD) issued its reports on the 15 focus areas identified in its Action Plan on Base Erosion and Profit Shifting ("BEPS"). Some BEPS

measures will require treaty based or legislative action by countries. The final impact of BEPS on Cohu's income tax provision and liability is currently not quantifiable and is likely to result in additional recordkeeping and administrative cost to implement certain of its requirements.

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

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

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

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

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

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

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

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

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

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

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

We have experienced significant volatility in our stock price.

A variety of factors may cause the price of our stock to be volatile. In recent years, the stock market in general, and the market for shares of high-technology companies in particular, including ours, have experienced extreme price fluctuations, which have often been unrelated to the operating performance of affected companies. During the three-year period ended December 31, 2016 the price of our common stock has ranged from \$14.43 to \$9.14. The price of our stock may be more volatile than the stock of other companies due to, among other factors, the unpredictable 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.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

Certain information concerning our principal properties at December 31, 2016, is set forth below:

| Location | Approximate Sq. Footage | Ownership |
|---|------------------------------------|------------------|
| Poway, California ⁽¹⁾ | 147,000 | Leased |
| Kolbermoor, Germany | 40,000 | Owned |
| Malacca, Malaysia | 84,000 | Leased |
| Calamba City, Laguna, Philippines | 51,000 | Leased |
| La Chaux-de-Fonds, Switzerland | 34,000 | Leased |
| Osaka, Japan ⁽²⁾ | 67,000 | Owned |
| Attleboro, Massachusetts ⁽²⁾ | 7,000 | Leased |

Cohu Corporate offices. On December 4, 2015, we completed the sale of our headquarters facility located in Poway, California. In December 2016, our leased space decreased to approximately 147,000 square feet of the (1) Poway facility. Additional information related to the sale-leaseback of the Poway facility is included in Note 13, "Sale-leaseback of Poway Facility" in Part IV, Item 15(a) of this Form 10-K.

(2) Locations were acquired on January 4, 2017, in conjunction with the purchase of Kita, see Note 2, "Subsequent Event", included in Part IV, Item 15(a) of this Form 10-K.

In addition to the locations listed above, we lease other properties primarily for sales and service offices in various locations. We believe our facilities are suitable for their respective uses and are adequate for our present needs.

Item 3. Legal Proceedings.

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, examinations and claims is inherently uncertain. While there can be no assurance, at the present time we do not believe that the resolution of the matters described above will have a material adverse effect on our assets, financial position or results of operations.

Item 4. Mine Safety Disclosures

Not applicable.

PART II**Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.****(a) Market Information**

Cohu, Inc. stock is traded on the NASDAQ Global Select Market under the symbol "COHU". The following table sets forth the high and low sales prices as reported on the NASDAQ Global Select Market during the last two years.

| | Fiscal 2016 | | Fiscal 2015 | |
|----------------|-------------|---------|-------------|---------|
| | High | Low | High | Low |
| First Quarter | \$12.93 | \$10.87 | \$12.10 | \$10.28 |
| Second Quarter | \$12.60 | \$10.49 | \$13.84 | \$10.17 |
| Third Quarter | \$12.00 | \$10.01 | \$13.49 | \$9.14 |
| Fourth Quarter | \$14.43 | \$10.72 | \$13.43 | \$9.38 |

Holdings

At February 16, 2017, Cohu had 440 stockholders of record.

Dividends

We have paid consecutive quarterly dividends since 1977 and, as discussed below, expect to continue doing so. Cash dividends, per share, declared in 2016 and 2015 were as follows:

| | Fiscal 2016 | Fiscal 2015 |
|----------------|----------------|----------------|
| First Quarter | \$0.06 | \$0.06 |
| Second Quarter | \$0.06 | \$0.06 |
| Third Quarter | \$0.06 | \$0.06 |
| Fourth Quarter | \$0.06 | \$0.06 |

Total \$0.24 \$0.24

We intend to continue to pay quarterly dividends subject to capital availability and periodic determinations by our Board of Directors that cash dividends are in the best interests of our stockholders. Our dividend policy may be affected by, among other items, our views on potential future capital requirements, including those related to research and development, investments and acquisitions, legal risks and stock repurchases.

Equity Compensation Plan Information

The following table summarizes information with respect to equity awards under Cohu's equity compensation plans at December 31, 2016 (*in thousands, except per share amounts*):

| Plan category | Number of securities to be issued upon exercise of outstanding options, warrants and rights (a) (1) | Weighted average exercise price of outstanding options, warrants and rights (b) (2) | Number of securities available for future issuance under equity compensation plans (excluding securities reflected in column (a))(c) (3) |
|--|---|---|--|
| Equity compensation plans approved by security holders | 3,127 | \$ 10.79 | 2,554 |
| Equity compensation plans not approved by security holders | - 3,127 | - \$ 10.79 | - 2,554 |

(1) Includes options, restricted stock units ("RSUs") and performance stock units ("PSUs") outstanding under Cohu's equity incentive plans. No stock warrants or other rights were outstanding as of December 31, 2016.

(2) The weighted average exercise price of outstanding options, warrants and rights does not take RSUs and PSUs into account as RSUs and PSUs have a de minimus purchase price.

(3) Includes 700,484 shares of common stock reserved for future issuance under the Cohu 1997 Employee Stock Purchase Plan.

For further details regarding Cohu's equity compensation plans, see Note 6, "Employee Benefit Plans", included in Part IV, Item 15(a) of this Form 10-K.

Comparative Stock Performance Graph

The information contained in this Stock Performance Graph section shall not be deemed to be “soliciting material” or “filed” with the SEC or subject to the liabilities of Section 18 of the Exchange Act except to the extent that Cohu specifically incorporates it by reference into a document filed under the Securities Act or the Exchange Act.

The graph below compares the cumulative total stockholder return on the common stock of Cohu for the last five fiscal years with the cumulative total return on custom Peer Group Indexes and a NASDAQ Market Index over the same period (assuming the investment of \$100 in Cohu’s common stock, Peer Group Index and NASDAQ Market Index on December 31, 2011 and reinvestment of all dividends). The custom Peer Group Index is comprised of the peer group companies associated with our performance stock units issued under our equity incentive plan. In 2016 the custom Peer Group Index was comprised of Advanced Energy Industries Inc., Advantest Corp, ASM Pacific Technology Ltd, Axcelis Technologies Inc., BE Semiconductor Industries NV, Brooks Automation Inc., Cabot Microelectronics Corp, Camtek Ltd, Electro Scientific Industries Inc., FormFactor Inc., Kulicke and Soffa Industries Inc., Micronics Japan Co Ltd, MKS Instruments Inc., Nanometrics Inc., Photronics Inc., Rudolph Technologies Inc., Teradyne Inc., Ultra Clean Holdings Inc., Ultratech Inc., Veeco Instruments Inc. and Xcerra Corp. In 2015 the custom Peer Group Index was comprised of Advanced Energy Industries Inc., Advantest Corp, ASM Pacific Technology Ltd, Axcelis Technologies Inc., BE Semiconductor Industries NV, Brooks Automation Inc., Cabot Microelectronics Corp, Camtek Ltd, Electro Scientific Industries Inc., FormFactor Inc., Kulicke and Soffa Industries Inc., MKS Instruments Inc., Nanometrics Inc., Photronics Inc., Rudolph Technologies Inc., Teradyne Inc., Tessa Technologies Inc., Ultra Clean Holdings Inc., Ultratech Inc. and Xcerra Corp. This peer group is revised annually to reflect acquisitions and to include additional equivalent companies in the semiconductor equipment market to ensure a sufficiently large number of companies in the peer group composition to enable a meaningful comparison of our stock performance.

| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|-----------------|-------|-------|-------|-------|-------|-------|
| Cohu, Inc. | \$100 | \$94 | \$93 | \$113 | \$125 | \$137 |
| NASDAQ Index | \$100 | \$116 | \$165 | \$189 | \$200 | \$217 |
| 2015 Peer Group | \$100 | \$116 | \$130 | \$152 | \$141 | \$198 |
| 2016 Peer Group | \$100 | \$118 | \$137 | \$152 | \$138 | \$192 |

Item 6. Selected Financial Data.

The following selected financial data should be read in conjunction with Cohu's Consolidated Financial Statements and notes thereto included in Part IV, Item 15(a) and with management's discussion and analysis of financial condition and results of operations, included in Part II, Item 7. In June 2015, we sold our mobile microwave communications equipment business and in June 2014, we sold our video camera business. The operating results of these businesses are being presented as discontinued operations for all periods presented. Additional information related to the sale of these businesses is included in Note 4, "Discontinued Operations" in Part IV, Item 15(a) of this Form 10-K. On December 31, 2012, we purchased Ismeca Semiconductor Holding SA ("Ismeca") and the results of its operations have been included in our Consolidated Financial Statements since that date.

All amounts presented below exclude any impact from the acquisition of Kita, which was completed on January 4, 2017, subsequent to the end of fiscal 2016. See Note 2, "Subsequent Event", included in Part IV, Item 15(a) of this Form 10-K.

| Years Ended, <i>(in thousands, except per share data)</i> | Dec. 31 2016 ⁽¹⁾ | Dec. 26 2015 | Dec. 27 2014 | Dec. 28 2013 | Dec. 29 2012 |
|---|--------------------------------|-----------------|-----------------|-----------------|-----------------|
| Consolidated Statement of Operations Data: | | | | | |
| Net sales | \$282,084 | \$269,654 | \$316,629 | \$214,511 | \$179,449 |
| Income (loss) from continuing operations ⁽²⁾ | \$3,260 | \$5,792 | \$14,780 | \$(28,548) | \$(11,255) |
| Net income (loss) | \$3,039 | \$250 | \$8,708 | \$(33,418) | \$(12,243) |
| Income (loss) from continuing operations - basic | \$0.12 | \$0.22 | \$0.58 | \$(1.15) | \$(0.46) |
| Income (loss) from continuing operations - diluted | \$0.12 | \$0.22 | \$0.57 | \$(1.15) | \$(0.46) |
| Net income (loss) - basic | \$0.11 | \$0.01 | \$0.34 | \$(1.34) | \$(0.50) |
| Net income (loss) - diluted | \$0.11 | \$0.01 | \$0.33 | \$(1.34) | \$(0.50) |
| Cash dividends per share, paid quarterly | \$0.24 | \$0.24 | \$0.24 | \$0.24 | \$0.24 |
| Consolidated Balance Sheet Data: | | | | | |
| Total Consolidated Assets | \$345,512 | \$345,346 | \$344,765 | \$345,423 | \$334,873 |
| Working Capital | \$176,460 | \$171,272 | \$142,194 | \$125,837 | \$184,703 |

(1) The year ended December 31, 2016 consists of 53 weeks. All other years in the table above are comprised of 52 weeks.

(2) Income from continuing operations for the year ended December 26, 2015 includes a gain on the sale of facility totaling \$3.2 million.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.**OVERVIEW**

Cohu is a leading supplier of semiconductor test and inspection handlers, micro-electro mechanical system (MEMS) test modules, test contactors and thermal sub-systems used by global semiconductor manufacturers and test subcontractors. Our business is significantly dependent on capital expenditures by semiconductor manufacturers and test subcontractors, which in turn is dependent on the current and anticipated market demand for semiconductors that is subject to seasonal trends. We expect that the semiconductor equipment industry will continue to be seasonal and volatile in part because consumer electronics, the principal end market for integrated circuits, is a highly dynamic industry and demand has traditionally fluctuated.

Orders for semiconductor test and assembly equipment as reported by Semiconductor Equipment and Materials International (SEMI) increased sequentially each month from October 2015 through January 2016 followed by declining orders in February and March 2016. The downward order momentum within the back-end equipment segment ceased in March 2016 with global orders for equipment increasing during the second quarter reaching a peak in June and then declining throughout the second half of the year until rebounding in December. Our net sales in 2016 were up 4.6% from 2015 and benefitted from demand for equipment for testing devices used in mobile, automotive and computing applications. We monitor our customers' test floors, and equipment utilization increased slightly at the end of the year. Looking ahead, we see momentum in the automotive and mobile markets and are optimistic about the long-term prospects for the semiconductor equipment industry due to the increasing technological functionality of mobile devices, growing integrated circuit and LED content in automobiles and consumer products, and expanding applications in industrial. We are focused on growing our market share in the mobility, automotive and solid state markets and expanding into the test contacting and wafer level package test markets.

Application of Critical Accounting Estimates and Policies

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

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

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

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

adjustment. On shipments where sales are not recognized, gross profit is generally recorded as deferred profit in our consolidated balance sheet, representing the difference between the receivable recorded and the inventory shipped.

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

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.

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

Income Taxes: We estimate our liability for income taxes based on the various jurisdictions where we conduct business. This requires us to estimate our (i) current taxes; (ii) temporary differences that result from differing treatment of certain items for tax and accounting purposes and (iii) unrecognized tax benefits. Temporary differences result in deferred tax assets and liabilities that are reflected in the consolidated balance sheet. The deferred tax assets are reduced by a valuation allowance if, based upon all available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. Establishing, reducing or increasing a valuation allowance in an accounting period generally results in an increase or decrease in tax expense in the statement of operations. We must make significant judgments to determine the provision for income taxes, deferred tax assets and liabilities, unrecognized tax benefits and any valuation allowance to be recorded against deferred tax assets. Our gross deferred tax asset balance as of December 31, 2016 was approximately \$47.3 million, with a valuation allowance of approximately \$44.7 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 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 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, Purchased Intangible Assets and Other 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 is no impairment as of October 1, 2016 as we determined that the estimated fair values of our reporting units exceeded their carrying values on that date. Other events and changes in circumstances may also require goodwill to be tested for impairment between annual measurement dates. As of December 31, 2016 we do not believe there have been any events or circumstances that would require us to perform an interim goodwill impairment review. In the event we determine that an interim goodwill impairment review is required, in a future period, the review may result in an impairment charge, which would have a negative impact on our results of operations.

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

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

Share-based Compensation: Share-based compensation expense related to stock options is recorded based on the fair value of the award on its grant date, which we estimate using the Black-Scholes valuation model. Share-based compensation expense related to restricted stock unit awards is calculated based on the market price of our common stock on the grant date, reduced by the present value of dividends expected to be paid on our common stock prior to vesting of the restricted stock unit. Share-based compensation on performance stock units with market-based goals is calculated using a Monte Carlo simulation model on the date of the grant. Share-based compensation for the year ended December 31, 2016 was impacted by our adoption of Accounting Standards Update (“ASU”) No. 2016-09, Compensation - Stock Compensation (Topic 718): *Improvements to Employee Share-Based Payment Accounting* (ASU 2016-09) in the fourth quarter of 2016. For further information regarding our adoption of ASU 2016-09 please see Note 1, “Recent Accounting Pronouncements” in Part IV, Item 15(a) of this Form 10-K.

Recent Accounting Pronouncements: For a description of accounting changes and recent accounting pronouncements, including the expected dates of adoption and estimated effects, if any, on our Consolidated Financial Statements, see Note 1, "Recent Accounting Pronouncements" in Part IV, Item 15(a) of this Form 10-K.

RESULTS OF OPERATIONS

In June 2015, we sold our mobile microwave communications equipment business and in June 2014, we sold our video camera business. The operating results of these businesses are being presented as discontinued operations and all prior period amounts have been reclassified. Unless otherwise indicated, the discussion below covers the comparative results from continuing operations.

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

| | 2016 | 2015 | 2014 |
|-------------------------------------|---------|---------|---------|
| Net sales | 100.0% | 100.0% | 100.0% |
| Cost of sales | (66.4) | (67.0) | (66.5) |
| Gross margin | 33.6 | 33.0 | 33.5 |
| Research and development | (12.4) | (12.3) | (11.4) |
| Selling, general and administrative | (19.3) | (19.0) | (16.0) |
| Gain on sale of facility | - | 1.2 | - |

Income from operations 1.9 % 2.9 % 6.1 %

2016 Compared to 2015

Net Sales

Cohu's consolidated net sales increased 4.6% from \$269.7 million in 2015 to \$282.1 million in 2016. Our consolidated net sales in 2016 are up from 2015 and reflect the improving business conditions in the semiconductor industry and demand for equipment for testing devices used in mobile, automotive and computing applications.

Gross Margin

Gross margin consists of net sales less cost of sales. Cost of sales consists primarily of the materials, assembly and test labor and overhead from operations. Our gross margin can fluctuate due to a number of factors, including, but not limited to, the mix of products sold, product support costs, increase to inventory reserves or the sale of previously reserved inventory and utilization of manufacturing capacity. Our gross margin, as a percentage of net sales, increased to 33.6% in 2016 from 33.0% in 2015.

We compute the majority of our excess and obsolete inventory reserve requirements using a one-year inventory usage forecast. During 2016 and 2015, we recorded net charges to cost of sales of approximately \$1.1 million and \$2.4 million, respectively, for excess and obsolete inventory. While we believe our reserves for excess and obsolete inventory and lower of cost or market concerns are adequate to cover known exposures at December 31, 2016, reductions in customer forecasts or continued modifications to products, as a result of our failure to meet specifications or other customer requirements, may result in additional charges to operations that could negatively impact our gross margin in future periods.

Research and Development Expense (“R&D Expense”)

R&D expense consists primarily of salaries and related costs of employees engaged in ongoing research, product design and development activities, costs of engineering materials and supplies and professional consulting expenses. Our future operating results depend, to a considerable extent, on our ability to maintain a competitive advantage in the products we provide, and historically we have maintained our commitment to investing in R&D in order to be able to continue to offer new products to our customers. R&D expense in 2016 was \$34.8 million, or 12.4% of net sales, increasing from \$33.1 million, or 12.3% of net sales in 2015. New product development programs resulted in higher R&D labor and material expense being incurred in 2016. These increased costs were partially offset by \$1.6 million of development cost reimbursements received under a cost-sharing arrangement entered into with a customer in the first quarter of 2016.

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

SG&A expense consists primarily of salaries and benefit costs of employees, commission expense for independent sales representatives, product promotion and costs of professional services. SG&A expense as a percentage of net sales increased to 19.3% in 2016, from 19.0% in 2015, increasing from \$51.2 million in 2015 to \$54.3 million in 2016. Our SG&A expense in 2016 was higher as a result of increased business volume, and during the year we incurred \$1.8 million of costs associated with our acquisition of Kita. SG&A expense in 2016 also includes \$0.6 million of expense related to a reduction of an indemnification receivable related to an uncertain tax position recorded in the Ismecca acquisition. In connection with this reduction we also booked a corresponding amount as a credit to our income tax provision and, as a result, the impact of this reduction on net income was zero. Employee share based compensation expense was \$0.4 million higher in 2016, driven primarily by the number of employee stock options and restricted and performance share awards subject to vesting during the period and the corresponding valuation that was established on the date of grant. Costs incurred in connection with transitioning our manufacturing to Asia and employee severance were \$1.4 million and \$1.0 million in 2016 and 2015, respectively.

Over the last two years our SG&A expense has benefitted from the strengthening of the U.S. Dollar, which resulted in the recognition of \$2.6 million and \$1.4 million in foreign currency transaction gains in 2016 and 2015, respectively.

Gain on Sale of Facility

On December 4, 2015, we completed the sale of our headquarters facility located in Poway, California for \$34.1 million. After payment of commissions and other fees associated with the sale we realized net cash proceeds of \$33.3 million, which resulted in a total gain of \$18.5 million. We accounted for this transaction in accordance with ASC subtopic 840-40, *Sale-leaseback transactions*, and recognized a gain on the completion of the sale totaling \$3.2 million. The portion of the gain not recognized at the time the sale was completed has been deferred and is being recognized on a straight-line basis over the 10-year term of the lease in line with the recognition of rental expense related to the lease. During 2016, we amortized \$2.0 million of the deferred gain to income.

Income Taxes

The income tax provision expressed as a percentage of pre-tax income in 2016 and 2015 was 45.7% and 27.6%, respectively. The income tax provision for the years ended December 31, 2016 and December 26, 2015 differs from the U.S. federal statutory rate primarily due to releases from statute expirations, non-deductible transaction costs, tax credits, changes in the valuation allowance on our deferred tax assets, foreign income taxed at different rates and other factors.

Companies are required to assess whether a valuation allowance should be recorded against their deferred tax assets (“DTAs”) based on the consideration of all available evidence, using a “more likely than not” realization standard. The four sources of taxable income that must be considered in determining whether DTAs will be realized are, (1) future reversals of existing taxable temporary differences (i.e. offset of gross deferred tax assets against gross deferred tax liabilities); (2) taxable income in prior carryback years, if carryback is permitted under the tax law; (3) tax planning strategies and (4) future taxable income exclusive of reversing temporary differences and carryforwards.

In assessing whether a valuation allowance is required, significant weight is to be given to evidence that can be objectively verified. We have evaluated our DTAs each reporting period, including an assessment of our cumulative income or loss over the prior three-year period and future periods, to determine if a valuation allowance was required. A significant negative factor in our assessment was Cohu's three-year cumulative U.S. loss history at the end of various fiscal periods including 2016.

As a result of our cumulative, three-year U.S. GAAP pretax loss from continuing operations of approximately \$17.6 million at the end of 2016, and our U.S. loss in 2016, we were unable to conclude at December 31, 2016 that it was “more likely than not” that our U.S. DTAs would be realized. We will evaluate the realizability of our DTAs at the end of each quarterly reporting period in 2017 and, should circumstances change, it is possible the remaining valuation allowance, or a portion thereof, will be reversed in a future period.

Our valuation allowance on our DTAs at December 31, 2016 and December 26, 2015 was approximately \$44.7 million and \$42.3 million, respectively. The remaining gross DTAs for which a valuation allowance was not recorded are realizable primarily through future reversals of existing taxable temporary differences. As the realization of DTAs is determined by tax jurisdiction, the deferred tax liabilities recorded as part of the 2008 acquisition of Rasco, a German corporation, and the fiscal 2013 acquisition of Ismeca, a Swiss Corporation, were not a source of taxable income in assessing the realization of our DTAs in the U.S.

For a full reconciliation of our effective tax rate to the U.S. federal statutory rate and further explanation of our provision for income taxes, see Note 7, “Income Taxes”, included in Part IV, Item 15(a) of this Form 10-K, which is incorporated herein by reference.

Income from Continuing Operations and Net Income

As a result of the factors set forth above, our income from continuing operations was \$3.3 million in 2016, compared to \$5.8 million in 2015. Including the results of our discontinued operations, our net income in 2016 was \$3.0 million as compared to \$0.3 million in 2015.

2015 Compared to 2014

Net Sales

Cohu's consolidated net sales decreased 14.8% from \$316.6 million in 2014 to \$269.7 million in 2015 as a result of decreased global demand for back-end semiconductor test and assembly equipment, consistent with the broader market.

Gross Margin

Our gross margin, as a percentage of net sales, decreased to 33.0% in 2015 from 33.5% in 2014. During 2015 and 2014, we recorded net charges to cost of sales of approximately \$2.4 million and \$2.6 million, respectively, for excess and obsolete inventory.

R&D Expense

R&D expense in 2015 was \$33.1 million, or 12.3% of net sales, decreasing from \$36.0 million, or 11.4% of net sales in 2014. The reduction in 2015 was a result of the completion of certain development programs, as planned, and headcount reductions.

SG&A Expense

SG&A expense as a percentage of net sales increased to 19.0% in 2015, from 16.0% in 2014, increasing from \$50.6 million in 2014 to \$51.2 million in 2015. We have benefitted from the strengthening of the U.S. Dollar, which resulted in the recognition of \$1.4 million and \$2.0 million in foreign currency gains in 2015 and 2014 respectively. We incurred \$1.0 million and \$1.4 million of costs in connection with transitioning our manufacturing to Asia and employee severance, in 2015 and 2014, respectively. In 2015 we recognized an additional \$1.1 million of employee share based compensation expense. This amount was driven primarily by the number of employee stock options and restricted and performance share awards subject to vesting during the period and the corresponding valuation that was established on the date of grant.

Gain on Sale of Facility

On December 4, 2015, we completed the sale of our headquarters facility located in Poway, California for \$34.1 million. After payment of commissions and other fees associated with the sale we realized net cash proceeds of \$33.3 million, which resulted in a total gain of \$18.5 million. We accounted for this transaction in accordance with ASC subtopic 840-40, *Sale-leaseback transactions*, and recognized a gain on the completion of the sale totaling \$3.2 million. The portion of the gain not recognized at the time the sale was completed has been deferred and is being recognized on a straight-line basis over the 10-year term of the lease in line with the recognition of rental expense related to the lease.

Income Taxes

The income tax provision expressed as a percentage of pre-tax income in 2015 and 2014 was 27.6% and 23.9%, respectively. The income tax provision for the years ended December 26, 2015 and December 27, 2014 differs from the U.S. federal statutory rate primarily due to tax credits, changes in the valuation allowance on our deferred tax assets, foreign income taxed at different rates and other factors.

Income from Continuing Operations and Net Income

As a result of the factors set forth above, our income from continuing operations was \$5.8 million in 2015, compared to \$14.8 million in 2014. Including the results of our discontinued operations, our net income in 2015 was \$0.3 million as compared to \$8.7 million in 2014.

LIQUIDITY AND CAPITAL RESOURCES

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

Our primary historical source of liquidity and capital resources has been cash flow generated by our operations and we manage our business to maximize operating cash flows as our primary source of liquidity. We use cash to fund

growth in our operating assets and to fund new products and product enhancements primarily through research and development. We believe that our sources of liquidity will be sufficient to satisfy our anticipated cash requirements through at least the next 12 months. Our liquidity could be negatively affected by a decrease in demand for our products. In addition, we may make acquisitions or increase our capital expenditures and may need to raise additional capital through debt or equity financing to provide for greater flexibility to fund these activities. Additional financing may not be available or on terms favorable to us.

Liquidity

Working Capital: The following summarizes our cash, cash equivalents, short-term investments and working capital at December 31, 2016 and December 26, 2015:

| <i>(in thousands)</i> | 2016 | 2015 | Increase | Percentage Change | |
|---|-----------|-----------|----------|----------------------|---|
| Cash, cash equivalents and short-term investments | \$128,035 | \$117,022 | \$11,013 | 9 | % |
| Working capital | \$176,460 | \$171,272 | \$5,188 | 3 | % |

As of December 31, 2016, \$68.9 million of our cash and cash equivalents was held by our foreign subsidiaries. If these funds are needed for our operations in the U.S., we may be required to accrue and pay U.S. taxes or foreign withholding taxes if we repatriate these funds. U.S. income taxes have not been provided on approximately \$49 million of accumulated undistributed earnings of certain foreign subsidiaries, as we currently intend to indefinitely reinvest these earnings in operations outside the U.S. We repatriated \$17.4 million from our Singapore subsidiary in 2016 due to the reduction in business activity of that operation. Our intent is to continue to indefinitely reinvest the remaining funds in our foreign operations and we have no current plans that would require us to repatriate these funds to the U.S. It is not practicable to estimate the amount of tax that might be payable if some or all of such earnings were to be remitted.

Cash Flows

Operating Activities: Cash provided by operating activities consists of net income adjusted for non-cash expenses and changes in operating assets and liabilities. Adjustments include the loss from our divestiture of BMS, depreciation expense on property, plant and equipment, amortization of intangible assets, share-based compensation expense, and deferred income taxes. Our net cash flows provided by operating activities in 2016 totaled \$24.5 million compared to \$21.5 million in 2015. Cash provided by operating activities also was impacted by changes in current assets and liabilities which included increases in accounts receivable of \$4.6 million, accounts payable of \$5.7 million and deferred profit of \$3.3 million and decreases in inventories of \$4.6 million and income taxes payable of \$2.0 million. The increase in accounts receivable resulted from increased business volume and a sequential increase in product shipments in the fourth quarter of 2016. The increase in accounts payable resulted from increased business volume in the fourth quarter of 2016 and the timing of payments made to our suppliers. Deferred profit increased as a result of the deferral of revenue related to equipment shipments in accordance with our revenue recognition policy. Inventories decreased as a result of product shipments and improved inventory and supply chain management and income taxes payable decreased as a result of payments made.

Investing Activities: Investing cash flows consist primarily of cash used for capital expenditures in support of our business, purchases of investments, proceeds from investment maturities, business acquisitions, asset disposals and business divestitures. Our net cash used in investing activities in 2016 totaled \$32.9 million and was primarily the result of \$50.6 million in cash used for purchases of short-term investments offset by \$20.2 million in net proceeds from sales and maturities of short-term investments. We invest our excess cash, in an attempt to seek the highest available return while preserving capital, in short-term investments since excess cash may be required for a business-related purpose. Additions to property, plant and equipment in 2016 were \$3.5 million and were made to support our operating and development activities.

Financing Activities: Cash used in financing activities consisted of amounts distributed to our stockholders in the form of cash dividends. During 2016, we paid dividends totaling \$6.4 million, or \$0.24 per common share. On February 16, 2017 we announced a cash dividend of \$0.06 per share on our common stock, payable on April 14, 2017 to stockholders of record as of February 28, 2017. We intend to continue to pay quarterly dividends subject to capital availability and periodic determinations by our Board of Directors that cash dividends are in the best interests of our stockholders. Partially offsetting cash used in the payment of dividends were the net proceeds from the issuance of our common stock under our equity incentive and employee stock purchase plans, which totaled \$0.4 million during 2016. We issue stock options and maintain an employee stock purchase plan as components of our overall employee compensation.

Capital Resources

We have a secured letter of credit facility (the “Secured Facility”) under which Bank of America, N.A., has agreed to administer the issuance of letters of credit on behalf of Cohu and our subsidiaries. The Secured Facility requires us to maintain deposits of cash or other approved investments, which serve as collateral, in amounts that approximate our outstanding standby letters of credit. As of December 31, 2016, no amounts were outstanding under standby letters of credit. Our wholly owned subsidiary Ismeca Semiconductor Holdings SA (“Ismeca”) has agreements with Credit Suisse and UBS (the “Ismeca Facility”) under which they administer lines of credit on behalf of Ismeca. Total borrowings available under the Ismeca Facility are 2.5 million Swiss Francs and at December 31, 2016 no amounts were outstanding.

We expect that we will continue to make capital expenditures to support our business and we anticipate that present working capital will be sufficient to meet our operating requirements for at least the next twelve months.

Contractual Obligations

The following table summarizes our significant contractual obligations at December 31, 2016, and the effect such obligations are expected to have on our liquidity and cash flows in future periods. This table excludes amounts already recorded on our balance sheet as current liabilities at December 31, 2016. Amounts excluded include our liability for unrecognized tax benefits that totaled approximately \$10.1 million at December 31, 2016. We are currently unable to provide a reasonably reliable estimate of the amount or period(s) the cash settlement of this liability may occur.

| <i>(in thousands)</i> | 2017 | 2018 | 2019 | 2020 | 2021 | Thereafter | Total |
|---------------------------------|---------|---------|---------|---------|---------|------------|----------|
| Non-cancelable operating leases | \$3,051 | \$2,527 | \$2,237 | \$2,259 | \$2,299 | \$ 8,695 | \$21,068 |

The table above does not include pension, post-retirement benefit and warranty obligations because it is not certain when these liabilities will be funded. For additional information regarding our pension and post-retirement benefits obligations see Note 6, “Employee Benefit Plans” and for more information on our contractual obligations, see Note 10, “Guarantees” in Part IV, Item 15(a) of this Form 10-K.

Commitments to contract manufacturers and suppliers. 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 December 31, 2016, no amounts were outstanding under standby letters of credit.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

Investment and Interest Rate Risk.

At December 31, 2016, our investment portfolio included short-term, fixed-income investment securities with a fair value of approximately \$32.0 million. These securities are subject to interest rate risk and will likely decline in value if interest rates increase. Our future investment income may fall short of expectations due to changes in interest rates or we may suffer losses in principal if we are forced to sell securities that decline in market value due to changes in interest rates. As we classify our short-term securities as available-for-sale, no gains or losses are recognized due to changes in interest rates unless such securities are sold prior to maturity or declines in fair value are determined to be other-than-temporary. Due to the relatively short duration of our investment portfolio, an immediate ten percent change in interest rates would have no material impact on our financial condition or results of operations.

We evaluate our investments periodically for possible other-than-temporary impairment by reviewing factors such as the length of time and extent to which fair value has been below cost basis, the financial condition of the issuer and our ability and intent to hold the investment for a period of time sufficient for anticipated recovery of market value. As of December 31, 2016, we had \$26.6 million investments with loss positions. We evaluated the nature of these investments, credit worthiness of the issuer and the duration of these impairments and concluded that these losses were temporary and we have the ability and intent to hold these investments to maturity.

Foreign Currency Exchange Risk.

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

Fluctuations in currency exchange rates also impact the U.S. Dollar amount of our net investment in foreign operations. The assets and liabilities of our foreign subsidiaries are translated into U.S. Dollars at the exchange rates in effect at the fiscal year-end balance sheet date. Income and expense accounts are translated at an average exchange rate during the year which approximates the rates in effect at the transaction dates. The resulting translation adjustments are recorded in stockholders' equity as a component of accumulated other comprehensive income. As a result of fluctuations in certain foreign currency exchange rates in relation to the U.S. Dollar as of December 31, 2016 compared to December 26, 2015, our stockholders' equity decreased by \$5.8 million as a result of the foreign currency translation.

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 December 31, 2016 would result in an approximate \$16.2 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 December 31, 2016 would result in an approximate \$16.2 million negative translation adjustment recorded in other comprehensive income within stockholders' equity.

Item 8. Financial Statements and Supplementary Data.

The information required by this Item is included in Part IV, Item 15(a).

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

Item 9A. Controls and Procedures.

Conclusion Regarding the Effectiveness 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 conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Based on this evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were effective as of December 31, 2016, the end of the period covered by this annual report.

Management’s Annual Report on Internal Control Over Financial Reporting - Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework). Based on our evaluation under the framework in *Internal Control - Integrated Framework*, our management concluded that our internal control over financial reporting was effective as of December 31, 2016.

Ernst & Young LLP, the independent registered public accounting firm that audited the Consolidated Financial Statements included in this Annual Report on Form 10-K, has also audited the effectiveness of our internal control over financial reporting as of December 31, 2016, as stated in their report which is included herein.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

Cohu, Inc.

We have audited Cohu, Inc.'s internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). Cohu, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may

deteriorate.

In our opinion, Cohu, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Cohu, Inc. as of December 31, 2016 and December 26, 2015, and the related consolidated statements of income, comprehensive loss, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2016 of Cohu, Inc. and our report dated March 2, 2017 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

San Diego, California

March 2, 2017

Changes in Internal Control Over Financial Reporting – There have been no changes in our internal control over financial reporting that occurred during the fourth quarter of 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information.

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance.

The information under the heading “Executive Officers of the Registrant” in Part I, Item 1 of this Form 10-K is incorporated by reference in this section. The other information required by this item is hereby incorporated by reference to the Company’s definitive proxy statement, which will be filed with the Securities and Exchange Commission (“SEC”) within 120 days after the close of fiscal 2016.

Code of Business Conduct and Code of Ethics

Cohu has adopted a code of business conduct and ethics for directors, officers and employees. The code is available on the Investor Relations section of our website at www.cohu.com. We intend to make all required disclosures concerning any amendments to, or waivers from, our code of ethics on our website.

Corporate Governance Guidelines and Certain Committee Charters

Cohu has adopted Corporate Governance Guidelines as well as charters for its Audit, Compensation and Nominating and Governance Committees. These documents are available on the Investor Relations section of our website at www.cohu.com.

The information on our website is not incorporated by reference in or considered to be a part of this Annual Report on Form 10-K.

Item 11. Executive Compensation.

Information regarding Executive Compensation is hereby incorporated by reference to the Company's definitive proxy statement, which will be filed with the SEC within 120 days after the close of fiscal 2016.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Information regarding Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters is hereby incorporated by reference to the Company's definitive proxy statement, which will be filed with the SEC within 120 days after the close of fiscal 2016.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

Information regarding Certain Relationships and Related Transactions, and Director Independence is hereby incorporated by reference to the Company's definitive proxy statement, which will be filed with the SEC within 120 days after the close of fiscal 2016.

Item 14. Principal Accounting Fees and Services.

Information regarding the Principal Accounting Fees and Services is hereby incorporated by reference to the Company's definitive proxy statement, which will be filed with the SEC within 120 days after the close of fiscal 2016.

PART IV**Item 15. Exhibits, Financial Statement Schedules.**

(a) The following documents are filed as part of, or incorporated by reference into, this Annual Report on Form 10-K.

(1) Financial Statements

The following Consolidated Financial Statements of Cohu, Inc., including the report thereon of Ernst & Young LLP, are included in this Annual Report on Form 10-K beginning on page 30:

| <u>Description</u> | <u>Form 10-K Page Number</u> |
|---|----------------------------------|
| Consolidated Balance Sheets at December 31, 2016 and December 26, 2015 | 30 |
| Consolidated Statements of Income for each of the three years in the period ended December 31, 2016 | 31 |
| Consolidated Statements of Comprehensive Loss for each of the three years in the period ended December 31, 2016 | 32 |
| Consolidated Statements of Stockholders' Equity for each of the three years in the period ended December 31, 2016 | 33 |
| Consolidated Statements of Cash Flows for each of the three years in the period ended December 31, 2016 | 34 |
| Notes to Consolidated Financial Statements | 35 |
| Report of Independent Registered Public Accounting Firm | 55 |

(2) Financial Statement Schedule

Schedule II – Valuation and Qualifying Accounts 59

All other financial statement schedules have been omitted because the required information is not applicable or not present in amounts sufficient to require submission of the schedule, or because the information required is included in

the Consolidated Financial Statements or the notes thereto.

(3) Exhibits

The exhibits listed under Item 15(b) hereof are filed with, or incorporated by reference into, this Annual Report on Form 10-K.

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

| | December 31, 2016 | December 26, 2015 |
|--|-------------------------|-------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$96,045 | \$115,370 |
| Short-term investments | 31,990 | 1,652 |
| Accounts receivable, net | 63,019 | 59,832 |
| Inventories: | | |
| Raw materials and purchased parts | 23,037 | 24,423 |
| Work in process | 17,599 | 20,124 |
| Finished goods | 4,866 | 6,801 |
| | 45,502 | 51,348 |
| Other current assets | 8,593 | 6,261 |
| Total current assets | 245,149 | 234,463 |
| Property plant and equipment, net | 18,234 | 19,000 |
| Goodwill | 58,849 | 60,264 |
| Intangible assets, net | 17,835 | 25,297 |
| Other assets | 5,445 | 6,322 |
| | \$345,512 | \$345,346 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$31,444 | \$27,290 |
| Accrued compensation and benefits | 14,770 | 15,628 |
| Accrued warranty | 3,737 | 3,785 |
| Deferred profit | 6,886 | 3,730 |
| Income taxes payable | 1,920 | 4,195 |
| Other accrued liabilities | 9,932 | 8,563 |
| Total current liabilities | 68,689 | 63,191 |
| Accrued retirement benefits | 15,673 | 15,397 |
| Noncurrent deferred gain on sale of facility | 11,689 | 13,142 |
| Deferred income taxes | 5,852 | 6,954 |
| Noncurrent income tax liabilities | 6,375 | 6,761 |
| Other accrued liabilities | 1,765 | 1,764 |
| Commitments and contingencies | | |

Stockholders' equity:

| | | |
|---|-----------|-----------|
| Preferred stock, \$1 par value; 1,000 shares authorized, none issued | - | - |
| Common stock, \$1 par value; 60,000 shares authorized, 26,842 shares issued and outstanding in 2016 and 26,240 shares in 2015 | 26,842 | 26,240 |
| Paid-in capital | 111,950 | 105,516 |
| Retained earnings | 124,559 | 128,153 |
| Accumulated other comprehensive loss | (27,882) | (21,772) |
| Total stockholders' equity | 235,469 | 238,137 |
| | \$345,512 | \$345,346 |

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

| | Years ended | | |
|--|-------------------------|-------------------------|-------------------------|
| | December 31, 2016 | December 26, 2015 | December 27, 2014 |
| Net sales | \$282,084 | \$269,654 | \$316,629 |
| Cost and expenses: | | | |
| Cost of sales | 187,256 | 180,616 | 210,657 |
| Research and development | 34,841 | 33,107 | 36,018 |
| Selling, general and administrative | 54,322 | 51,170 | 50,551 |
| Gain on sale of facility | - | (3,198) | - |
| | 276,419 | 261,695 | 297,226 |
| Income from operations | 5,665 | 7,959 | 19,403 |
| Interest income | 342 | 44 | 30 |
| Income from continuing operations before taxes | 6,007 | 8,003 | 19,433 |
| Income tax provision | 2,747 | 2,211 | 4,653 |
| Income from continuing operations | 3,260 | 5,792 | 14,780 |
| Loss from discontinued operations, net of tax | (221) | (5,542) | (6,072) |
| Net income | \$3,039 | \$250 | \$8,708 |
| Income (loss) per share: | | | |
| Basic: | | | |
| Income from continuing operations | \$0.12 | \$0.22 | \$0.58 |
| Loss from discontinued operations | (0.01) | (0.21) | (0.24) |
| Net income | \$0.11 | \$0.01 | \$0.34 |
| Diluted: | | | |
| Income from continuing operations | \$0.12 | \$0.22 | \$0.57 |
| Loss from discontinued operations | (0.01) | (0.21) | (0.24) |
| Net income | \$0.11 | \$0.01 | \$0.33 |
| Weighted average shares used in computing income (loss) per share: | | | |
| Basic | 26,659 | 26,057 | 25,393 |
| Diluted | 27,480 | 26,788 | 26,006 |

COHU, INC.**CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS***(in thousands)*

| | Years ended | | |
|--|-------------------------|-------------------------|-------------------------|
| | December 31, 2016 | December 26, 2015 | December 27, 2014 |
| Net income | \$3,039 | \$250 | \$8,708 |
| Other comprehensive loss, net of tax | | | |
| Foreign currency translation adjustments | (5,789) | (11,000) | (14,107) |
| Adjustments related to postretirement benefits | (316) | (58) | (3,258) |
| Change in unrealized gain/loss on investments | (5) | - | - |
| Other comprehensive loss, net of tax | (6,110) | (11,058) | (17,365) |
| Comprehensive loss | \$(3,071) | \$(10,808) | \$(8,657) |

COHU, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(in thousands, except par value and per share amounts)

| | Common stock \$1 par value | Paid-in capital | Retained earnings | Accumulated other comprehensive loss | Total |
|---|-------------------------------------|--------------------|----------------------|---|-----------|
| Balance at December 28, 2013 | \$25,080 | \$89,883 | \$131,546 | \$ 6,651 | \$253,160 |
| Net income | - | - | 8,708 | - | 8,708 |
| Changes in cumulative translation adjustment | - | - | - | (14,107) | (14,107) |
| Adjustments related to postretirement benefits, net of tax | - | - | - | (3,258) | (3,258) |
| Cash dividends - \$0.24 per share | - | - | (6,102) | - | (6,102) |
| Exercise of stock options | 237 | 1,764 | - | - | 2,001 |
| Shares issued under employee stock purchase plan | 139 | 1,001 | - | - | 1,140 |
| Shares issued for restricted stock units vested | 353 | (353) | - | - | - |
| Repurchase and retirement of stock | (117) | (1,133) | - | - | (1,250) |
| Share-based compensation expense | - | 6,776 | - | - | 6,776 |
| Balance at December 27, 2014 | 25,692 | 97,938 | 134,152 | (10,714) | 247,068 |
| Net income | - | - | 250 | - | 250 |
| Changes in cumulative translation adjustment | - | - | - | (11,000) | (11,000) |
| Adjustments related to postretirement benefits, net of tax | - | - | - | (58) | (58) |
| Cash dividends - \$0.24 per share | - | - | (6,249) | - | (6,249) |
| Exercise of stock options | 175 | 1,335 | - | - | 1,510 |
| Shares issued under employee stock purchase plan | 123 | 977 | - | - | 1,100 |
| Shares issued for restricted stock units vested | 377 | (377) | - | - | - |
| Repurchase and retirement of stock | (127) | (1,250) | - | - | (1,377) |
| Share-based compensation expense | - | 6,893 | - | - | 6,893 |
| Balance at December 26, 2015 | 26,240 | 105,516 | 128,153 | (21,772) | 238,137 |
| Cumulative effect of accounting change ^(a) | - | 249 | (249) | - | - |
| Net income | - | - | 3,039 | - | 3,039 |
| Changes in cumulative translation adjustment | - | - | - | (5,789) | (5,789) |
| Adjustments related to postretirement benefits, net of tax | - | - | - | (316) | (316) |
| Changes in unrealized gains and losses on investments, net of tax | - | - | - | (5) | (5) |
| Cash dividends - \$0.24 per share | - | - | (6,384) | - | (6,384) |
| Exercise of stock options | 101 | 694 | - | - | 795 |
| Shares issued under employee stock purchase plan | 111 | 959 | - | - | 1,070 |
| Shares issued for restricted stock units vested | 581 | (581) | - | - | - |
| Repurchase and retirement of stock | (191) | (2,030) | - | - | (2,221) |
| Share-based compensation expense | - | 7,143 | - | - | 7,143 |
| Balance at December 31, 2016 | \$26,842 | \$111,950 | \$124,559 | \$ (27,882) | \$235,469 |

Cumulative effect of accounting change relates to our adoption of ASU 2016-09. Please refer to Note 1 of the Consolidated Financial Statements for further detail on the adoption of this accounting standard.

(a)

COHU, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

| | Years ended | | |
|--|-------------------|-------------------|-------------------|
| | December 31, 2016 | December 26, 2015 | December 27, 2014 |
| Cash flows from operating activities: | | | |
| Net income | \$3,039 | \$250 | \$8,708 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Loss on disposal of microwave equipment segment | 221 | 3,573 | - |
| Gain on sale of facility | - | (3,198) | - |
| Gain on disposal of video camera segment | - | - | (4,434) |
| Operating cash flows of discontinued operations | - | (1,039) | 9,466 |
| Depreciation and amortization | 10,412 | 11,273 | 12,607 |
| Share-based compensation expense | 7,143 | 6,755 | 6,388 |
| Accrued retiree benefits | 672 | 2,185 | 787 |
| Deferred income taxes | (1,065) | 222 | 832 |
| Other assets | 415 | (326) | - |
| Loss on disposal and impairment of fixed assets | 31 | 311 | - |
| Other accrued liabilities | 162 | 127 | - |
| Changes in current assets and liabilities, excluding effects from acquisitions and divestitures: | | | |
| Accounts receivable | (4,617) | 8,970 | (18,656) |
| Inventories | 4,608 | (5,743) | (3,401) |
| Accrued compensation, warranty and other liabilities | (1,544) | (3,740) | 6,218 |
| Accounts payable | 5,678 | 3,376 | 139 |
| Deferred profit | 3,309 | (3,108) | 2,181 |
| Other current assets | (1,959) | 2,420 | (1,294) |
| Income taxes payable | (1,957) | (828) | 137 |
| Net cash provided by operating activities | 24,548 | 21,480 | 19,678 |
| Cash flows from investing activities, excluding effects from acquisitions and divestitures: | | | |
| Purchases of short-term investments | (50,568) | (656) | (1,000) |
| Sales and maturities of short-term investments | 20,230 | 155 | 1,045 |
| Net cash received from sale of facility and assets | 874 | 33,314 | - |
| Purchases of property, plant and equipment | (3,452) | (6,586) | (1,457) |
| Net cash received from disposition of microwave equipment segment | - | 4,881 | - |
| Net cash received from sale of video camera segment | - | - | 10,258 |
| Investing cash flows of discontinued operations | - | (74) | (209) |
| Net cash provided by (used in) investing activities | (32,916) | 31,034 | 8,637 |
| Cash flows from financing activities: | | | |
| Cash dividends paid | (6,351) | (6,215) | (6,067) |

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| | | | |
|---|-----------|------------|-----------|
| Net cash provided by (used in) issuance of common stock through employee equity incentive plans | (356) | 1,233 | 1,891 |
| Net cash used in financing activities | (6,707) | (4,982) | (4,176) |
| Effect of exchange rate changes on cash and cash equivalents | (4,250) | (3,047) | (4,922) |
| Net increase (decrease) in cash and cash equivalents | (19,325) | 44,485 | 19,217 |
| Cash and cash equivalents at beginning of year | 115,370 | 70,885 | 51,668 |
| Cash and cash equivalents at end of year | \$96,045 | \$ 115,370 | \$ 70,885 |
| Supplemental disclosure of cash flow information: | | | |
| Cash paid (refunded) during the year for income taxes | \$6,808 | \$ (253) | \$ 971 |
| Inventory capitalized as capital assets | \$201 | \$315 | \$ 1,166 |
| Dividends declared but not yet paid | \$1,606 | \$ 1,573 | \$ 1,539 |
| Capitalized facility under build-to-suit lease | - | \$ 682 | - |

COHU, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Basis of Presentation – Cohu, Inc. (“Cohu”, “we”, “our” and “us”), through our wholly owned subsidiaries, is a provider of semiconductor test equipment. Our Consolidated Financial Statements include the accounts of Cohu and our wholly owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (“GAAP”) requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates.

Our fiscal years are based on a 52- or 53-week period ending on the last Saturday in December. Our current fiscal year which ended on December 31, 2016 consisted of 53 weeks. Our fiscal years ending on December 26, 2015 and December 27, 2014 each consisted of 52 weeks.

Discontinued Operations – On June 10, 2015, we sold our mobile microwave communications equipment business, Broadcast Microwave Services, Inc. (“BMS”) and on June 6, 2014, we completed the sale of our video camera business, Cohu Electronics. The operating results of BMS and Cohu Electronics are being presented as discontinued operations and all prior period amounts have been reclassified accordingly. See Note 4, “Discontinued Operations” for additional information. Unless otherwise indicated, all amounts herein relate to continuing operations.

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 per share includes the dilutive effect of common shares potentially issuable upon the exercise of stock options, vesting of outstanding restricted stock units and issuance of stock under our employee stock purchase plan using the treasury stock method. In loss periods, potentially dilutive securities are excluded from the per share computations due to their anti-dilutive effect. For purposes of computing diluted income per share, stock options with exercise prices that exceed the average fair market value of our common stock for the period are excluded. For the years ended December 31, 2016, December 26, 2015 and December 27, 2014 approximately 697,000, 875,000 and 1,771,000 shares of our common stock were excluded from the computation, respectively.

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

| <i>(in thousands)</i> | 2016 | 2015 | 2014 |
|---|--------|--------|--------|
| Weighted average common shares outstanding | 26,659 | 26,057 | 25,393 |
| Effect of dilutive stock options and restricted stock units | 821 | 731 | 613 |
| | 27,480 | 26,788 | 26,006 |

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.

Cash, Cash Equivalents and Short-term Investments – Highly liquid investments with insignificant interest rate risk and original maturities of three months or less are classified as cash and cash equivalents. Investments with maturities greater than three months are classified as short-term investments. All of our short-term investments are classified as available-for-sale and are reported at fair value, with any unrealized gains and losses, net of tax, recorded in the statement of comprehensive loss. We manage our cash equivalents and short-term investments as a single portfolio of highly marketable securities. We have the ability and intent, if necessary, to liquidate any of our investments in order to meet the liquidity needs of our current operations during the next 12 months. Accordingly, investments with contractual maturities greater than one year have been classified as current assets in the accompanying consolidated balance sheets.

COHU, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Fair Value of Financial Instruments – The carrying amounts of our financial instruments, including cash and cash equivalents, accounts receivable, accounts payable and accrued expenses, approximate fair value due to the short maturities of these financial instruments.

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

Trade accounts receivable are presented net of allowance for doubtful accounts of \$0.1 million at December 31, 2016 and \$0.1 million at December 26, 2015. Our customers primarily include semiconductor manufacturers and semiconductor test subcontractors located throughout many areas of the world. While we believe that our allowance for doubtful accounts is adequate and represents our best estimate of potential loss exposure at December 31, 2016, 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 market. 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 market values are below our costs. Charges to cost of sales for excess and obsolete inventories aggregated \$1.1 million, \$2.4 million, and \$2.6 million in 2016, 2015 and 2014, respectively.

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*):

| | December 31, 2016 | December 26, 2015 |
|--|-------------------------|-------------------------|
| Land and land improvements | \$4,079 | \$4,607 |
| Buildings and building improvements | 7,967 | 8,971 |
| Machinery and equipment | 35,157 | 31,888 |
| | 47,203 | 45,466 |
| Less accumulated depreciation and amortization | (28,969) | (26,466) |
| Property, plant and equipment, net | \$ 18,234 | \$ 19,000 |

Depreciation expense was \$3.5 million in 2016, \$4.2 million in 2015 and \$4.8 million 2014.

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, Purchased Intangible Assets and Other 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.

COHU, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

We conduct our annual impairment test as of October 1st of each year, and determined there was no impairment as of October 1, 2016 as we determined that the estimated fair values of our reporting units exceeded their carrying values on that date. Other events and changes in circumstances may also require goodwill to be tested for impairment between annual measurement dates. As of December 31, 2016 we do not believe there have been any events or circumstances that would require us to perform an interim goodwill impairment review. In the event we determine that an interim goodwill impairment review is required, in a future period, the review may result in an impairment charge, which would have a negative impact on our results of operations.

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

Product Warranty – Product warranty costs are accrued in the period sales are recognized. Our products are generally sold with standard warranty periods, which differ by product, ranging from 12- to 36-months. Parts and labor are typically covered under the terms of the warranty agreement. Our warranty expense accruals are based on historical and estimated costs by product and configuration. From time-to-time we offer customers extended warranties beyond the standard warranty period. In those situations the revenue relating to the extended warranty is deferred at its estimated fair value and recognized on a straight-line basis over the contract period. Costs associated with our extended warranty contracts are expensed as incurred.

Income Taxes – We assess our income tax positions and record tax benefits for all years subject to examination based upon management's evaluation of the facts, circumstances and information available at the reporting dates. For those tax positions where it is more-likely-than-not that a tax benefit will be sustained, we have recorded the largest amount of tax benefit with a greater than 50 percent likelihood of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. For those income tax positions where it is not more-likely-than-not that a tax benefit will be sustained, no tax benefit has been recognized in the financial statements. Where applicable, associated interest and penalties have also been recognized and recorded, net of federal and state tax benefits, in income tax expense.

Contingencies and Litigation – We assess the probability of adverse judgments in connection with current and threatened litigation. We would accrue the cost of an adverse judgment if, in our estimation, the adverse outcome is probable and we can reasonably estimate the ultimate cost.

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

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

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

On shipments where sales are not recognized, gross profit is generally recorded as deferred profit in our consolidated balance sheet representing the difference between the receivable recorded and the inventory shipped. In certain instances where customer payments are received prior to product shipment, the customer's payments are recorded as customer advances. At December 31, 2016, we had total deferred revenue of approximately \$9.3 million and deferred profit of \$6.9 million. At December 26, 2015, we had total deferred revenue of approximately \$5.0 million and deferred profit of \$3.7 million.

Advertising Costs – Advertising costs are expensed as incurred and were not material for all periods presented.

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

Foreign Currency Translation – Assets and liabilities of our wholly owned foreign subsidiaries that use the U.S. Dollar as their functional currency are re-measured using exchange rates in effect at the end of the period, except for nonmonetary assets, such as inventories and property, plant and equipment, which are re-measured using historical exchange rates. Revenues and costs are re-measured using average exchange rates for the period, except for costs related to those balance sheet items that are re-measured using historical exchange rates. Gains and losses on foreign currency transactions are recognized as incurred. Certain of our foreign subsidiaries have designated the local currency as their functional currency and, as a result, their assets and liabilities are translated at the rate of exchange at the balance sheet date, while revenue and expenses are translated using the average exchange rate for the period. During the years ended December 31, 2016, December 26, 2015 and December 27, 2014 we recognized

approximately \$2.6 million \$1.4 million and \$2.0 million, respectively, of foreign exchange gains that are included in our consolidated statement of income. Cumulative translation adjustments resulting from the translation of the financial statements are included as a separate component of stockholders' equity.

Comprehensive Loss – Our accumulated other comprehensive loss totaled approximately \$27.9 million at December 31, 2016 and \$21.8 million at December 26, 2015 and was attributed to, net of income taxes where applicable: foreign currency adjustments resulting from the translation of certain accounts into U.S. Dollars, unrealized losses and gains on investments and adjustments to accumulated postretirement benefit obligations. The U.S. Dollar strengthened relative to certain foreign currencies in countries where we have operations as of December 31, 2016 compared to December 26, 2015. Consequently, our comprehensive loss increased by \$5.8 million as a result of the foreign currency translation. In the previous year, strengthening of the U.S. Dollar led to an increase in our comprehensive loss of \$11.0 million. Additional information related to accumulated other comprehensive loss, on an after-tax basis is included in Note 11.

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Recent Accounting Pronouncements

Recently Adopted Accounting Pronouncements – In March 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2016-09, Compensation - Stock Compensation (Topic 718): *Improvements to Employee Share-Based Payment Accounting* (ASU 2016-09). While the effective date of ASU 2016-09 is for fiscal years beginning after December 15, 2016, earlier adoption is permitted and we adopted the amendments in ASU 2016-09 during the fourth quarter of fiscal 2016. This standard simplifies or clarifies several aspects of the accounting for equity-based payment awards, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. Certain of these changes are required to be applied retrospectively, while other changes are required to be applied prospectively.

The impact of the adoption of ASU 2016-09 resulted in the following:

We elected to eliminate the use of an estimated forfeiture rate and recognize actual forfeitures as they occur. We adopted this amendment on a modified retrospective basis and, as a result, we recorded a \$0.2 million cumulative effect adjustment to retained earnings at December 27, 2015, the first day of our fiscal 2016.

We excluded the excess tax benefits from the assumed proceeds available to repurchase shares in the computation of our diluted earnings per share for the year ended December 31, 2016. The effect of this change on our diluted earnings per share was not significant.

Recently Issued Accounting Pronouncements – 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 an entity should recognize an impairment charge for the amount by which the carrying amount of goodwill exceeds the reporting unit's fair value, not to exceed the carrying amount of goodwill. This guidance is effective for annual and any interim impairment tests in fiscal years beginning after December 15, 2019. We do not expect this guidance to have any impact on our Consolidated Financial Statements.

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

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

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

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

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In July 2015, the FASB issued ASU No. 2015-11, *Simplifying the Measurement of Inventory*. Under this guidance, inventory should be measured at the lower of cost and net realizable value. Subsequent measurement is unchanged for inventory measured using LIFO or the retail inventory method. This guidance is effective for interim and annual reporting periods beginning after December 15, 2016. We do not expect this guidance to have a material impact on our Consolidated Financial Statements.

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

2. Subsequent Events

On January 4, 2017, we completed the acquisition of all of the outstanding share capital of Kita Manufacturing Co., LTD. and Kita USA, Inc. (together “Kita”) (the “Acquisition”), pursuant to a Share Purchase Agreement dated November 15, 2016, by and among Kita and its shareholders, Rasco GmbH, a wholly owned subsidiary of the Company and Cohu (the “Purchase Agreement”). Kita, headquartered in Osaka, Japan, and with operations in Attleboro, Massachusetts and Kyoto, Japan, designs, manufactures and sells spring probe contacts used in final test contactors, probe cards, PCB test boards and connectors sold to customers worldwide. The aggregate purchase price was approximately \$21.1 million, comprised of an initial cash payment of \$15.0 million and the assumption of operating and expansion debt totaling approximately \$6.1 million, net of cash acquired. To the extent actual working capital and net debt as of the closing is later determined to be different than the estimates, the purchase price will be adjusted accordingly. The Purchase Agreement also provides for up to \$3.0 million of contingent earn-out cash payments based on certain growth targets for revenue and profitability. In connection with the Acquisition, we incurred approximately \$1.8 million in acquisition related costs, which were expensed as selling, general and administrative costs during the

year ended December 31, 2016.

3. Goodwill and Purchased Intangible Assets

Changes in the carrying value of goodwill during the years ended December 31, 2016 and December 26, 2015 were as follows (*in thousands*):

| | Total |
|-----------------------------|-----------|
| | Goodwill |
| Balance December 27, 2014 | \$ 63,132 |
| Impact of currency exchange | (2,868) |
| Balance December 26, 2015 | 60,264 |
| Impact of currency exchange | (1,415) |
| Balance December 31, 2016 | \$ 58,849 |

COHU, INC.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

| | December 31, 2016 | | | December 26, 2015 | | |
|-------------------|-----------------------|--------------------------|-------------------------------|-----------------------|--------------------------|--|
| | Gross Carrying Amount | Accumulated Amortization | Remaining Useful Life (years) | Gross Carrying Amount | Accumulated Amortization | |
| Rasco technology | \$25,785 | \$ 25,785 | - | \$26,904 | \$ 23,776 | |
| Ismeca technology | 26,191 | 13,241 | 4.0 | 27,043 | 10,329 | |
| Trade names | 5,353 | 468 | 13.7 | 5,547 | 92 | |
| | \$57,329 | \$ 39,494 | | \$59,494 | \$ 34,197 | |

Changes in the carrying values of purchased intangible assets presented above are a result of the impact of fluctuation in currency exchange rates.

Amortization expense related to purchased intangible assets was approximately \$6.9 million in 2016, \$7.0 million in 2015 and \$7.8 million in 2014. As of December 31, 2016, we expect amortization expense in future periods to be as follows: 2017 - \$3.6 million; 2018 - \$3.6 million; 2019 - \$3.6 million; 2020 - \$3.5 million 2021 - \$0.4 million; and thereafter \$3.1 million.

4. Discontinued Operations

In 2015, we sold all of the outstanding stock of BMS for \$4.9 million in cash and up to \$2.5 million of contingent cash consideration. In 2014, we sold substantially all the assets of our video camera business, Cohu Electronics for \$10.3 million comprised of \$9.5 million in cash, \$0.5 million in contingent consideration and a working capital adjustment. Our decision to sell these two non-core businesses 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 long-term contingent consideration receivable that has been classified as Level 3 in the fair value hierarchy. See Note 5, "Financial Instruments Measured at Fair Value" for additional information on the three-tier fair value hierarchy. The contingent consideration represents the estimated fair value of future payments we are due based on BMS achieving annual revenue targets in certain years as specified in the sale

agreement. We determine the value of the contingent consideration using a Monte Carlo simulation model with changes to the fair value of the contingent consideration being recognized in discontinued operations. At December 31, 2016 and December 26, 2015, the fair value of the receivable totaled \$0.3 million and \$0.5 million, respectively.

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

| | December 31, 2016 | December 26, 2015 | December 27, 2014 |
|-------------------------------------|-------------------------|-------------------------|-------------------------|
| Net sales: | | | |
| Microwave equipment segment | \$ - | \$ 6,965 | \$ 16,694 |
| Video camera segment | - | - | 5,460 |
| | \$ - | \$ 6,965 | \$ 22,154 |
| Operating loss before income taxes: | | | |
| Microwave equipment segment | \$ - | \$ (1,963) | \$ (10,305) |
| Video camera segment | - | - | (242) |
| | - | (1,963) | (10,547) |
| Loss from sale of BMS | (221) | (3,573) | - |
| Gain from sale of Cohu Electronics | - | - | 4,434 |
| Loss before taxes | (221) | (5,536) | (6,113) |
| Income tax provision | - | 6 | (41) |
| Loss, net of tax | \$ (221) | \$ (5,542) | \$ (6,072) |

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

5. 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*):

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

| | At December 26, 2015 | | | |
|------------------------------|----------------------|------------------------|-------------------------|----------------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| Foreign government security | \$650 | \$ - | \$ - | \$ 650 |
| Bank certificates of deposit | 1,002 | - | - | 1,002 |

\$1,652 \$ - \$ - \$ 1,652

- As of December 31, 2016, the cost and fair value of investments with loss positions were approximately \$26.6 million. We evaluated the nature of these investments, credit worthiness of the issuer and the duration of these impairments to determine if an other-than-temporary decline in fair value had occurred and concluded that these losses were temporary and we have the ability and intent to hold these investments to maturity.
- (1) 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.
- (2)

Effective maturities of short-term investments at December 31, 2016, were as follows:

| <i>(in thousands)</i> | Amortized | Estimated |
|--|-----------|------------|
| | Cost | Fair Value |
| Due in one year or less | \$ 31,372 | \$ 31,367 |
| Due after one year through three years | 623 | 623 |
| | \$ 31,995 | \$ 31,990 |

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.

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

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

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

6. Employee Benefit Plans

Defined Contribution Retirement Plans – We maintain a defined contribution 401(k) retirement savings plan covering all salaried and hourly U.S. employees. Participation is voluntary and participants' contributions are based on their eligible compensation. We match contributions of participants at 50% of up to 6% of salary contributed, up to various statutory limits. In 2016 we made matching contributions to the plan of \$0.6 million. In both 2015 and 2014 we made contributions to the plan of \$0.7 million.

Defined Benefit Retirement Plans – As a result of the acquisition of Ismeca effective December 31, 2012, we took over the Ismeca Europe Semiconductor BVG Pension Plan in Switzerland (“the Swiss Plan”) and the following discussion only relates to the Swiss Plan.

Net periodic benefit cost of the Swiss Plan was as follows:

| <i>(in thousands)</i> | 2016 | 2015 | 2014 |
|---------------------------|-------|---------|-------|
| Service cost | \$868 | \$856 | \$749 |
| Interest cost | 245 | 311 | 491 |
| Expected return on assets | (147) | (193) | (343) |
| Settlements | - | 235 | - |
| Net periodic costs | \$966 | \$1,209 | \$897 |

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The following table sets forth the projected benefit obligation, the fair value of plan assets, the funded status and the liability we have recorded in our consolidated balance sheet related to the Swiss Plan:

| <i>(in thousands)</i> | 2016 | 2015 |
|--|------------|------------|
| Change in projected benefit obligation: | | |
| Benefit obligation at beginning of year | \$(25,483) | \$(26,027) |
| Service cost | (868) | (856) |
| Interest cost | (245) | (311) |
| Actuarial loss | (796) | (660) |
| Participant contributions | (719) | (672) |
| Benefits paid | (214) | 296 |
| Plan change | - | 558 |
| Settlements | - | 2,199 |
| Foreign currency exchange adjustment | 826 | (10) |
| Benefit obligation at end of year | (27,499) | (25,483) |
| Change in plan assets: | | |
| Fair value of plan assets at beginning of year | 14,716 | 15,603 |
| Return on assets, net of actuarial loss | 189 | 277 |
| Employer contributions | 719 | 672 |
| Participant contributions | 719 | 672 |
| Benefits paid | 214 | (296) |
| Settlements | - | (2,199) |
| Foreign currency exchange adjustment | (480) | (13) |
| Fair value of plan assets at end of year | 16,077 | 14,716 |
| Net liability at end of year | \$(11,422) | \$(10,767) |

At December 31, 2016 and December 26, 2015, the Swiss Plan's net liability is included in noncurrent accrued retirement benefits. Amounts recognized in accumulated other comprehensive income net of tax related to the Swiss Plan consisted of an unrecognized net actuarial loss totaling \$2.4 million at December 31, 2016 and \$1.8 million at December 26, 2015.

Weighted-average actuarial assumptions used to determine the projected benefit obligation under the Swiss Plan are as follows:

| | 2016 | 2015 |
|-----------------------|-------|-------|
| Discount rate | 0.7 % | 1.0 % |
| Compensation increase | 1.5 % | 1.8 % |

Weighted-average assumptions used to determine net periodic benefit cost of the Swiss Plan are as follows:

| | 2016 | 2015 | 2014 |
|--------------------------|-------|-------|-------|
| Discount rate | 1.0 % | 1.3 % | 2.3 % |
| Rate of return on Assets | 1.0 % | 1.3 % | 2.3 % |
| Compensation increase | 1.8 % | 1.8 % | 2.0 % |

During 2017 employer and employee contributions to the Swiss Plan are expected to total \$0.7 million. Estimated benefit payments are expected to be as follows: 2017 - \$0.7 million; 2018 - \$0.7 million; 2019 - \$0.8 million; 2020 - \$1.0 million; 2021 - \$1.0 million; and \$5.2 million thereafter through 2026.

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As is customary with Swiss pension plans, the assets of the plan are invested in a collective fund with multiple employers. We have no investment authority over the assets of the plan that are held and invested by a Swiss insurance company. Investment holdings are made with respect to Swiss laws and target allocations for plan assets are 71% debt securities and cash, 14% real estate investments, 9% alternative investments and 6% equity securities. The valuation of the collective fund assets as a whole is a Level 3 measurement; however the individual investments of the fund are generally Level 1 (equity securities), Level 2 (fixed income) and Level 3 (real estate and alternative) investments. We determine the fair value of the plan assets based on information provided by the collective fund, through review of the collective fund's annual financial statements. See Note 5, "Financial Instruments Measured at Fair Value" for additional information on the three-tier fair value hierarchy.

We maintain other defined benefit plans for employees located outside the U.S. for which the majority of the obligations and net periodic benefit cost were determined to be immaterial for all periods presented.

Retiree Medical Benefits – We provide post-retirement health benefits to certain executives and directors under a noncontributory plan. The net periodic benefit cost was \$0.1 million in both 2016 and 2015 compared to a net periodic benefit income of \$0.1 million in 2014. We fund benefits as costs are incurred and as a result there are no plan assets.

The weighted average discount rate used in determining the accumulated post-retirement benefit obligation was 3.9% in 2016, 4.2% in 2015 and 3.8% in 2014. The annual rates of increase of the cost of health benefits was assumed to be 7.7% in 2017. This rate was then assumed to decrease 0.3% per year to 4.9% in 2026 and remain level thereafter. A one percent increase (decrease) in health care cost trend rates would increase (decrease) the 2016 net periodic benefit cost by approximately \$18,000 (\$14,000) and the accumulated post-retirement benefit obligation as of December 31, 2016, by approximately \$338,000 (\$283,000).

Contributions to the post-retirement health benefit plan are expected to total \$0.1 million in 2017. Estimated benefit payments are expected to be as follows: 2017 - \$0.1 million; 2018 - \$0.1 million; 2019 - \$0.1 million; 2020 - \$0.1 million; 2021 - \$0.1 million and \$0.7 million thereafter through 2026.

The following table sets forth the post-retirement benefit obligation, funded status and the liability we have recorded in our consolidated balance sheets:

| <i>(in thousands)</i> | 2016 | 2015 |
|---|-----------|-----------|
| Accumulated benefit obligation at beginning of year | \$2,649 | \$2,428 |
| Interest cost | 109 | 90 |
| Actuarial (gain) loss | (185) | 187 |
| Benefits paid | (83) | (56) |
| Accumulated benefit obligation at end of year | 2,490 | 2,649 |
| Plan assets at end of year | - | - |
| Funded status | \$(2,490) | \$(2,649) |

Deferred Compensation – The Cohu, Inc. Deferred Compensation Plan allows certain of our officers to defer a portion of their current compensation. We have purchased life insurance policies on the participants with Cohu as the named beneficiary. Participant contributions, distributions and investment earnings and losses are accumulated in a separate account for each participant. At December 31, 2016, the payroll liability to participants, included in accrued compensation and benefits in the consolidated balance sheet, was approximately \$2.4 million and the cash surrender value of the related life insurance policies included in other current assets was approximately \$2.2 million. At December 26, 2015, the liability totaled \$2.6 million and the corresponding assets were \$2.3 million.

Employee Stock Purchase Plan – The Cohu, Inc. 1997 Employee Stock Purchase Plan (“the Plan”) provides for the issuance of a maximum of 2,650,000 shares of our common stock. Under the Plan, eligible employees may purchase shares of common stock through payroll deductions. The price paid for the common stock is equal to 85% of the fair market value of our common stock on specified dates. During the last three years we issued shares under the Plan as follows: 2016 - 110,579; 2015 - 122,528 and 2014 - 138,831. At December 31, 2016, there were 700,484 shares reserved for issuance under the Plan.

Stock Options – At December 31, 2016, a total of 1,853,509 shares were available for future equity grants under the Cohu, Inc. 2005 Equity Incentive Plan (“the 2005 Plan”). Under the 2005 Plan stock options may be granted to employees, consultants and outside directors to purchase a fixed number of shares of our common stock at prices not less than 100% of the fair market value at the date of grant. Options generally vest and become exercisable after one year or in four annual increments beginning one year after the grant date and expire ten years from the grant date. We have historically issued new shares of Cohu common stock upon share option exercise.

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Stock option activity under our share-based compensation plans was as follows:

| | 2016 | | 2015 | | 2014 | |
|--|--------|--------------------|--------|--------------------|--------|--------------------|
| | Shares | Wt. Avg. Ex. Price | Shares | Wt. Avg. Ex. Price | Shares | Wt. Avg. Ex. Price |
| <i>(in thousands, except per share data)</i> | | | | | | |
| Outstanding, beginning of year | 1,965 | \$ 11.25 | 2,435 | \$ 11.67 | 3,086 | \$ 11.93 |
| Granted | - | \$- | 10 | \$ 10.98 | 10 | \$ 12.58 |
| Exercised | (101) | \$ 7.89 | (175) | \$ 8.65 | (237) | \$ 8.43 |
| Cancelled | (223) | \$ 16.19 | (305) | \$ 16.07 | (424) | \$ 15.37 |
| Outstanding, end of year | 1,641 | \$ 10.79 | 1,965 | \$ 11.25 | 2,435 | \$ 11.67 |
| Options exercisable at year end | 1,537 | \$ 10.85 | 1,673 | \$ 11.47 | 1,901 | \$ 12.08 |

The aggregate intrinsic value of options exercised was \$0.5 million in 2016 and \$0.7 million in both 2015 and 2014. At December 31, 2016, the aggregate intrinsic value of options outstanding, vested and expected to vest and exercisable was \$5.6 million.

Information about stock options outstanding at December 31, 2016 is as follows (*options in thousands*):

| Range of Exercise Prices | Options Outstanding | | | Options Exercisable | |
|--------------------------|---------------------|--|--------------------|---------------------|--------------------|
| | Number Outstanding | Approximate Wt. Avg. Remaining Life (in years) | Wt. Avg. Ex. Price | Number Exercisable | Wt. Avg. Ex. Price |
| \$7.32 - \$10.58 | 1,089 | 4.4 | \$ 8.92 | 1,002 | \$ 8.87 |
| \$10.59 - \$15.50 | 466 | 3.2 | \$ 14.08 | 449 | \$ 14.20 |
| \$15.51 - \$20.73 | 86 | 3.2 | \$ 16.55 | 86 | \$ 16.55 |
| | 1,641 | 4.0 | \$ 10.79 | 1,537 | \$ 10.85 |

Restricted Stock Units – Under our equity incentive plans, restricted stock units may be granted to employees, consultants and outside directors. Restricted stock units vest over a one-year, two-year or a four-year period from the

date of grant. Prior to vesting, restricted stock units do not have dividend equivalent rights, do not have voting rights and the shares underlying the restricted stock units are not considered issued and outstanding. New shares of our common stock will be issued on the date the restricted stock units vest net of the 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 December 31, 2016.

Restricted stock unit activity under our share-based compensation plans was as follows:

| | 2016 | | 2015 | | 2014 | |
|--|--------|------------------------------|--------|------------------------------|--------|------------------------------|
| | Units | Wt. Avg. Fair Value | Units | Wt. Avg. Fair Value | Units | Wt. Avg. Fair Value |
| <i>(in thousands, except per share data)</i> | | | | | | |
| Outstanding, beginning of year | 1,078 | \$9.93 | 1,026 | \$9.54 | 887 | \$9.46 |
| Granted | 471 | \$11.25 | 482 | \$10.54 | 497 | \$10.07 |
| Released | (409) | \$9.90 | (339) | \$9.63 | (315) | \$10.16 |
| Cancelled | (57) | \$10.25 | (91) | \$9.82 | (43) | \$9.41 |
| Outstanding, end of year | 1,083 | \$10.50 | 1,078 | \$9.93 | 1,026 | \$9.54 |

COHU, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Equity-Based Performance Stock Units – We grant performance stock units (“PSUs”) to certain senior executives as a part of our long-term equity compensation program. The performance criteria for the PSUs granted in 2016 and 2015 is based on a combination of the Company’s annualized Total Shareholder Return (“TSR”) for the performance period and the relative performance of the Company’s TSR compared with the annualized TSR of certain peer companies for the performance period. The PSU awards granted in 2014 had a one-year performance period after which the number of shares of our common stock earned, if any, was determined, subject to certain adjustments resulting from the performance of our TSR relative to a pre-selected comparator group over the two-year period following the date of grant. The number of shares of common stock that will ultimately be issued to settle PSUs granted over the last three years is as follows:

| Year Granted | Range of Awards | | | Performance Criteria Period (in years) |
|--------------|-----------------|---|------|--|
| 2016 | 25% | - | 200% | 3 |
| 2015 | 25% | - | 200% | 2 |
| 2014 | 0% | - | 150% | 2 |

PSUs granted in 2016 vest 100% on the third anniversary of their grant and PSUs granted in 2015 and 2014 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 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 PSUs outstanding at December 31, 2016.

PSU activity under our share-based compensation plans was as follows:

| | 2016 | | 2015 | | 2014 | |
|--|-------|---------------------|-------|---------------------|-------|---------------------|
| | Units | Wt. Avg. Fair Value | Units | Wt. Avg. Fair Value | Units | Wt. Avg. Fair Value |
| <i>(in thousands, except per share data)</i> | | | | | | |

| | | | | | | |
|--------------------------------|-------|---------|------|---------|------|---------|
| Outstanding, beginning of year | 376 | \$10.80 | 334 | \$10.49 | 238 | \$9.32 |
| Granted | 222 | \$11.38 | 156 | \$10.69 | 208 | \$11.34 |
| Released | (172) | \$11.27 | (38) | \$9.52 | (38) | \$9.52 |
| Cancelled | (23) | \$8.75 | (76) | \$9.86 | (74) | \$9.59 |
| Outstanding, end of year | 403 | \$11.04 | 376 | \$10.80 | 334 | \$10.49 |

Share-based Compensation – We estimate the fair value of each share-based award on the grant date using the Black-Scholes and the Monte Carlo simulation valuation models. Option valuation models require the input of highly subjective assumptions and changes in the assumptions used can materially affect the grant date fair value of an award. These assumptions for the Black-Scholes model include the risk-free rate of interest, expected dividend yield, expected volatility, and the expected life of the award. The risk-free rate of interest is based on the U.S. Treasury rates appropriate for the expected term of the award as of the grant date. Expected dividends are based primarily on historical factors related to our common stock. Expected volatility is based on historic weekly stock price observations of our common stock during the period immediately preceding the share-based award grant that is equal in length to the award's expected term. We believe that historical volatility is the best estimate of future volatility. Expected life of the award is based on historical option exercise data. The Monte Carlo simulation model incorporates assumptions for the risk-free interest rate, Cohu and the selected peer group price volatility, the correlation between Cohu and the selected index, and dividend yields. Share-based compensation expense related to restricted stock unit awards is calculated based on the market price of our common stock on the date of grant, reduced by the present value of dividends expected to be paid on our common stock prior to vesting of the restricted stock unit.

COHU, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following weighted average assumptions were used to value share-based awards granted:

| | | | |
|--|----------|--------|--------|
| <i>Employee Stock Purchase Plan</i> | 2016 | 2015 | 2014 |
| Dividend yield | 2.0 % | 2.2 % | 2.4 % |
| Expected volatility | 31.2 % | 35.3 % | 35.3 % |
| Risk-free interest rate | 0.3 % | 0.1 % | 0.1 % |
| Expected term (years) | 0.5 | 0.5 | 0.5 |
| Weighted-average grant date fair value per share | \$2.82 | \$2.71 | \$2.52 |
| <i>Employee Stock Options</i> | 2016 (1) | 2015 | 2014 |
| Dividend yield | N/A | 2.1 % | 2.0 % |
| Expected volatility | N/A | 39.1 % | 42.5 % |
| Risk-free interest rate | N/A | 1.6 % | 1.9 % |
| Expected term (years) | N/A | 5.9 | 5.9 |
| Weighted-average grant date fair value per share | N/A | \$3.46 | \$4.39 |
| <i>Restricted Stock Units</i> | 2016 | 2015 | 2014 |
| Dividend yield | 2.0 % | 2.1 % | 2.2 % |
| <i>Performance Stock Units</i> | 2016 | 2015 | 2014 |
| Dividend yield | 2.0 % | 2.1 % | 2.2 % |

(1) There were no employee stock options granted in 2016.

Reported share-based compensation is classified in the Consolidated Financial Statements as follows:

| | | | |
|---|---------|---------|---------|
| <i>(in thousands)</i> | 2016 | 2015 | 2014 |
| Cost of sales | \$398 | \$566 | \$491 |
| Research and development | 1,292 | 1,092 | 1,858 |
| Selling, general and administrative | 5,453 | 5,097 | 4,039 |
| Share-based compensation of continuing operations | 7,143 | 6,755 | 6,388 |
| Discontinued operations | - | 138 | 388 |
| Income tax benefit | (269) | (249) | (204) |
| Total share-based compensation, net of tax | \$6,874 | \$6,644 | \$6,572 |

We elected to early adopt ASU 2016-09 in the fourth quarter of 2016, which among other items, provides an accounting policy election to account for forfeitures as they occur, rather than based on an estimate of expected forfeitures. We elected to account for forfeitures as they occur and therefore, share-based compensation expense for the year ended December 31, 2016 has been calculated based on actual forfeitures in our consolidated statement of income, rather than our previous approach where the expense was net of estimated forfeitures determined at the grant date. The net cumulative effect of this change was recognized as a \$0.2 million increase to paid-in capital and a decrease to retained earnings as of December 27, 2015. Share-based compensation expense for the years ended December 26, 2015 and December 27, 2014 was recorded net of estimated forfeitures.

At December 31, 2016, we had approximately \$0.1 million of pre-tax unrecognized compensation cost related to unvested stock options which is expected to be recognized over a weighted-average period of approximately 0.5 years.

At December 31, 2016, we had approximately \$9.3 million of pre-tax unrecognized compensation cost related to unvested restricted stock units and performance stock units which is expected to be recognized over a weighted-average period of approximately 2.3 years.

COHU, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

7. Income Taxes

Significant components of the provision (benefit) for income taxes for continuing operations are as follows:

| <i>(in thousands)</i> | 2016 | 2015 | 2014 |
|-----------------------|---------|---------|----------|
| Current: | | | |
| U.S. Federal | \$ 11 | \$ 5 | \$(307) |
| U.S. State | 8 | 28 | 40 |
| Foreign | 3,793 | 1,956 | 4,088 |
| Total current | 3,812 | 1,989 | 3,821 |
| Deferred: | | | |
| U.S. Federal | 91 | 89 | 112 |
| U.S. State | 47 | 49 | (17) |
| Foreign | (1,203) | 84 | 737 |
| Total deferred | (1,065) | 222 | 832 |
| | \$2,747 | \$2,211 | \$4,653 |

Income (loss) before income taxes from continuing operations consisted of the following:

| <i>(in thousands)</i> | 2016 | 2015 | 2014 |
|-----------------------|------------|------------|----------|
| U.S. | \$(13,420) | \$(5,214) | \$1,076 |
| Foreign | 19,427 | 13,217 | 18,357 |
| Total | \$6,007 | \$8,003 | \$19,433 |

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting and tax purposes. Significant components of our deferred tax assets and liabilities were as follows:

| <i>(in thousands)</i> | 2016 | 2015 |
|---|---------|---------|
| Deferred tax assets: | | |
| Inventory, receivable and warranty reserves | \$5,868 | \$8,207 |
| Net operating loss carryforwards | 11,681 | 7,605 |
| Tax credit carryforwards | 13,715 | 12,291 |

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| | | |
|---|------------|------------|
| Accrued employee benefits | 5,002 | 4,993 |
| Deferred profit and gain on facility sale | 5,412 | 6,084 |
| Stock-based compensation | 4,189 | 4,443 |
| Acquisition basis differences | 1,334 | 1,544 |
| Other | 103 | 265 |
| Gross deferred tax assets | 47,304 | 45,432 |
| Less valuation allowance | (44,731) | (42,289) |
| Total deferred tax assets | 2,573 | 3,143 |
| Deferred tax liabilities: | | |
| Depreciation and fixed asset related | 53 | 227 |
| Acquisition basis differences | 7,423 | 8,904 |
| Other | 662 | 563 |
| Total deferred tax liabilities | 8,138 | 9,694 |
| Net deferred tax liabilities | \$(5,565) | \$(6,551) |

Companies are required to assess whether a valuation allowance should be recorded against their deferred tax assets (“DTAs”) based on the consideration of all available evidence, using a “more likely than not” realization standard. The four sources of taxable income that must be considered in determining whether DTAs will be realized are, (1) future reversals of existing taxable temporary differences (i.e. offset of gross deferred tax assets against gross deferred tax liabilities); (2) taxable income in prior carryback years, if carryback is permitted under the tax law; (3) tax planning strategies and (4) future taxable income exclusive of reversing temporary differences and carryforwards.

COHU, INC.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

In assessing whether a valuation allowance is required, significant weight is to be given to evidence that can be objectively verified. We have evaluated our DTAs each reporting period, including an assessment of our cumulative income or loss over the prior three-year period and future periods, to determine if a valuation allowance was required. A significant negative factor in our assessment was Cohu's three-year cumulative U.S. loss history at the end of various fiscal periods including 2016.

As a result of our cumulative, three-year U.S. GAAP pretax loss from continuing operations of approximately \$17.6 million at the end of 2016, and our U.S. loss in 2016, we were unable to conclude at December 31, 2016 that it was "more likely than not" that our U.S. DTAs would be realized. We will evaluate the realizability of our DTAs at the end of each quarterly reporting period in 2017 and should circumstances change it is possible the remaining valuation allowance, or a portion thereof, will be reversed in a future period.

Our valuation allowance on our DTAs at December 31, 2016 and December 26, 2015 was approximately \$44.7 million and \$42.3 million, respectively. The remaining gross DTAs for which a valuation allowance was not recorded are realizable through future reversals of existing taxable temporary differences.

As the realization of DTAs is determined by tax jurisdiction, the deferred tax liabilities recorded as part of the 2008 acquisition of Rasco, a German corporation, and the fiscal 2013 acquisition of Ismeca, a Swiss Corporation, were not a source of taxable income in assessing the realization of our DTAs in the U.S.

The reconciliation of income tax computed at the U.S. federal statutory tax rate to the provision for income taxes for continuing operations is as follows:

| <i>(in thousands)</i> | 2016 | 2015 | 2014 |
|--|---------|---------|---------|
| Tax provision at U.S. 35% statutory rate | \$2,102 | \$2,801 | \$6,802 |
| State income taxes, net of federal tax benefit | 168 | (152) | 119 |
| Settlements, adjustments and releases from statute expirations | (312) | (104) | (65) |
| Federal tax credits | (183) | (221) | (244) |
| Stock-based compensation on which no tax benefit provided | 168 | 156 | 160 |
| Change in valuation allowance | 2,430 | 2,181 | 437 |
| Non-deductible transaction costs | 463 | - | - |
| Foreign income taxed at different rates | (2,378) | (2,601) | (2,151) |

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| | | | |
|------------|---------|---------|---------|
| Other, net | 289 | 151 | (405) |
| | \$2,747 | \$2,211 | \$4,653 |

State income taxes, net of federal benefit, have been reduced by research tax credits totaling approximately \$0.2 million, \$0.4 million and \$0.5 million in 2016, 2015 and 2014, respectively.

At December 31, 2016, we had federal, state and foreign net operating loss carryforwards of approximately \$31.0 million, \$22.2 million and \$0.2 million, respectively, that expire in various tax years beginning in 2018 through 2036 or have no expiration date. We also have federal and state tax credit carryforwards at December 31, 2016 of approximately \$8.2 million and \$13.6 million, respectively, certain of which expire in various tax years beginning in 2017 through 2036 or have no expiration date. The federal and state loss and credit carryforwards are subject to annual limitations under Sections 382 and 383 of the Internal Revenue Code and applicable state tax law.

U.S. income taxes have not been provided on approximately \$49 million of accumulated undistributed earnings of certain foreign subsidiaries, as we currently intend to indefinitely reinvest these earnings in operations outside the U.S. We repatriated \$17.4 million from our Singapore subsidiary in 2016 due to the reduction in business activity of that operation. Our intent is to continue to indefinitely reinvest the remaining funds in our foreign operations and we have no current plans that would require us to repatriate these funds to the U.S. It is not practicable to estimate the amount of tax that might be payable if some or all of such earnings were to be remitted.

COHU, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

We have certain tax holidays with respect to our operations in Malaysia and the Philippines. These holidays require compliance with certain conditions and expire at various dates through 2023. The impact of these holidays was an increase in net income of approximately \$1.0 million or \$0.04 per share in 2016, \$0.8 million, or \$0.03 per share, in 2015 and not significant in 2014.

A reconciliation of our gross unrecognized tax benefits, excluding accrued interest and penalties, is as follows:

| <i>(in thousands)</i> | 2016 | 2015 | 2014 |
|---|----------|----------|----------|
| Balance at beginning of year | \$10,444 | \$10,841 | \$10,483 |
| Gross additions for tax positions of current year | 125 | 215 | 761 |
| Gross additions for tax positions of prior years | 58 | 248 | 365 |
| Reductions due to lapse of the statute of limitations | (446) | (243) | (587) |
| Foreign exchange rate impact | (106) | (617) | (181) |
| Balance at end of year | \$10,075 | \$10,444 | \$10,841 |

If the unrecognized tax benefits at December 31, 2016 are ultimately recognized, approximately \$5.2 million (\$5.6 million at December 26, 2015) would result in a reduction in our income tax expense and effective tax rate. It is reasonably possible that our gross unrecognized tax benefits as of December 31, 2016 could decrease in 2017 by approximately \$0.8 million as a result of the expiration of certain statutes of limitations.

We recognize interest and penalties related to unrecognized tax benefits in income tax expense. Cohu had approximately \$1.2 million and \$1.4 million accrued for the payment of interest and penalties at December 31, 2016 and December 26, 2015, respectively. Interest expense, net of accrued interest reversed, was not significant in 2016, \$0.1 million in 2015 and not significant in 2014.

Our U.S. federal and state income tax returns for years after 2012 and 2011, respectively, remain open to examination, subject to the statute of limitations. Net operating loss and credit carryforwards arising prior to these years are also open to examination if and when utilized. The statute of limitations for the assessment and collection of income taxes related to our foreign tax returns varies by country. In the foreign countries where we have significant operations these time periods generally range from four to ten years after the year for which the tax return is due or the tax is assessed.

8. Segment and Geographic Information

We applied the provisions of ASC 280, which sets forth a management approach to segment reporting, 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 their similarities in customer base, economic characteristics, and the nature of products and services provided and, as a result we report in one segment, semiconductor equipment. As a result, the financial information disclosed herein materially represents all of the financial information related to our semiconductor equipment segment.

During the last three years, the following customers comprised 10% or greater of our consolidated net sales:

| | 2016 | 2015 | 2014 |
|--|-------|-------|-------|
| Intel | 17.2% | 18.0% | 15.7% |
| NXP Semiconductors N.V. ⁽¹⁾ | 13.7% | 11.4% | 11.4% |

⁽¹⁾ *The merger of NXP Semiconductors N.V. and Freescale Semiconductor, Ltd. was completed on December 7, 2015. Sales to these customers have been combined for all periods presented.*

COHU, INC.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

Net sales to customers, attributed to countries based on product shipment destination, were as follows:

| <i>(in thousands)</i> | 2016 | 2015 | 2014 |
|-----------------------|-----------|-----------|-----------|
| Malaysia | \$85,956 | \$60,776 | \$73,818 |
| China | 60,291 | 52,589 | 51,662 |
| United States | 35,204 | 50,704 | 72,266 |
| Rest of the World | 100,633 | 105,585 | 118,883 |
| Total, net | \$282,084 | \$269,654 | \$316,629 |

Geographic location of our property, plant and equipment and other long-lived assets was as follows:

| <i>(in thousands)</i> | 2016 | 2015 |
|---------------------------------------|----------|----------|
| <i>Property, plant and equipment:</i> | | |
| United States | \$2,398 | \$3,054 |
| Germany | 6,674 | 6,882 |
| Philippines | 4,167 | 4,171 |
| Malaysia | 4,067 | 4,165 |
| Rest of the World | 928 | 728 |
| Total, net | \$18,234 | \$19,000 |

Goodwill and other intangible assets:

| | | |
|-------------------|----------|----------|
| Germany | \$26,892 | \$31,337 |
| Switzerland | 18,264 | 22,444 |
| United States | 17,242 | 17,241 |
| Malaysia | 6,775 | 6,995 |
| Singapore | 6,558 | 6,558 |
| Rest of the World | 953 | 986 |
| Total, net | \$76,684 | \$85,561 |

9. Commitments and Contingencies

We lease certain of our facilities and equipment under non-cancelable operating leases. Rental expense was \$4.4 million in 2016 and \$1.8 million in both 2015 and 2014. The increase in rent expense in 2016 was a result of the sale lease-back of our headquarters facility on December 4, 2015. See Note 13, "Sale-leaseback of Poway Facility" for additional information.

Future minimum lease payments at December 31, 2016 are as follows:

| <i>(in thousands)</i> | 2017 | 2018 | 2019 | 2020 | 2021 | Thereafter | Total |
|---------------------------------|---------|---------|---------|---------|---------|------------|----------|
| Non-cancelable operating leases | \$3,051 | \$2,527 | \$2,237 | \$2,259 | \$2,299 | \$ 8,695 | \$21,068 |

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, at the present time we do not believe that the resolution of the matters described above will have a material adverse effect on our assets, financial position or results of operations.

COHU, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

10. GuaranteesAccrued Warranty

Changes in accrued warranty during the three-year period ended December 31, 2016 was as follows:

| <i>(in thousands)</i> | 2016 | 2015 | 2014 |
|-----------------------|---------|---------|---------|
| Beginning balance | \$4,886 | \$5,848 | \$4,673 |
| Warranty accruals | 6,088 | 6,747 | 6,176 |
| Warranty payments | (6,624) | (7,709) | (5,001) |
| Ending balance | \$4,350 | \$4,886 | \$5,848 |

Accrued warranty amounts expected to be incurred after one year are included in noncurrent other accrued liabilities in the consolidated balance sheet. These amounts total \$0.6 million at December 31, 2016 and \$1.1 million at December 26, 2015.

Lines of Credit

Our wholly owned Ismeca subsidiary has two available lines of credit which provide it with borrowings of up to a total of 2.5 million Swiss Francs. At December 31, 2016 and December 26, 2015 no amounts were outstanding under the lines of credit.

11. Accumulated Other Comprehensive Loss

Components of other comprehensive loss, on an after-tax basis, were as follows:

(in thousands)

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| | Before Tax amount | Tax (Expense) Benefit | Net of Tax Amount |
|--|-------------------------|-----------------------------|-------------------------|
| Year ended December 27, 2014 | | | |
| Foreign currency translation adjustments | \$(14,107) | \$ - | \$(14,107) |
| Adjustments related to postretirement benefits | (3,809) | 551 | (3,258) |
| Other comprehensive income (loss) | \$(17,916) | \$ 551 | \$(17,365) |
| Year ended December 26, 2015 | | | |
| Foreign currency translation adjustments | \$(11,000) | \$ - | \$(11,000) |
| Adjustments related to postretirement benefits | (24) | (34) | (58) |
| Other comprehensive income (loss) | \$(11,024) | \$ (34) | \$(11,058) |
| Year ended December 31, 2016 | | | |
| Foreign currency translation adjustments | \$(5,789) | \$ - | \$(5,789) |
| Adjustments related to postretirement benefits | (429) | 113 | (316) |
| Change in unrealized gain/loss on investments | (5) | - | (5) |
| Other comprehensive income (loss) | \$(6,223) | \$ 113 | \$(6,110) |

Components of accumulated other comprehensive loss, net of tax, at the end of each period are as follows:

| <i>(in thousands)</i> | 2016 | 2015 |
|--|------------|------------|
| Accumulated net currency translation adjustments | \$(25,116) | \$(19,327) |
| Accumulated net adjustments related to postretirement benefits | (2,761) | (2,445) |
| Accumulated net unrealized gain/loss on investments | (5) | - |
| Total accumulated other comprehensive loss | \$(27,882) | \$(21,772) |

12. Related Party Transactions

At December 31, 2016 certain of our cash and short-term investments were held and managed by BlackRock, Inc. which owns 11.5% of our outstanding common stock as reported in its Form 13-G filing made with the Securities and Exchange Commission on January 12, 2017.

COHU, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENT

13. Sale-leaseback of Poway Facility

On December 4, 2015, we completed the sale of our headquarters facility located in Poway, California (the “Poway Facility”) for \$34.1 million. After payment of commissions and other fees associated with the sale we realized net cash proceeds of approximately \$33.3 million which resulted in a total gain of \$18.5 million. Concurrent with the closing of the sale, we entered into a lease, with a ten-year term through 2025, that provides for base rent of approximately \$1.6 million per annum, with 3% annual adjustments for inflation and a pro rata share of property operating costs. The lease covers approximately 43% of the Poway Facility. This lease also contains two five-year renewal options.

We accounted for this transaction in accordance with ASC subtopic 840-40, *Sale-leaseback transactions*, and recognized a gain on the sale-leaseback totaling \$3.2 million for the year ended December 26, 2015. The remaining \$15.3 million portion of the gain not recognized at the time of sale was deferred and is being recognized on a straight-line basis over the 10-year lease term in line with the recognition of rental expense related to the lease. During the year ended December 31, 2016 we amortized \$2.0 million of the deferred gain to income.

14. Quarterly Financial Data (Unaudited)

| Quarter <i>(in thousands, except per share data)</i> | | First (a) | Second (a) | Third (a) | Fourth (a) | Year |
|---|------|-----------------|------------|-----------|------------|------------|
| Net sales: | 2016 | \$ 65,778 | \$ 76,353 | \$ 69,259 | \$ 70,694 | \$ 282,084 |
| | 2015 | \$ 63,447 | \$ 75,211 | \$ 67,512 | \$ 63,484 | \$ 269,654 |
| Gross profit: | 2016 | (b) \$ 19,282 | \$ 26,739 | \$ 23,280 | \$ 25,527 | \$ 94,828 |
| | 2015 | \$ 20,145 | \$ 25,702 | \$ 22,794 | \$ 20,397 | \$ 89,038 |
| Income (loss) from continuing operations | 2016 | (b) \$ (1,691) | \$ 2,517 | \$ 128 | \$ 2,306 | \$ 3,260 |
| | 2015 | \$ (1,720) | \$ 3,887 | \$ 1,335 | \$ 2,290 | \$ 5,792 |
| Net income (loss) | 2016 | (b) \$ (1,691) | \$ 2,462 | \$ 179 | \$ 2,089 | \$ 3,039 |
| | 2015 | \$ (2,740) | \$ (72) | \$ 1,113 | \$ 1,949 | \$ 250 |
| Income (loss) per share (c): | | | | | | |

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Basic:

| | | | | | | | |
|--|------|-----|------------|---------|---------|---------|---------|
| Income (loss) from continuing operations | 2016 | (b) | \$ (0.06) | \$ 0.09 | \$ 0.01 | \$ 0.09 | \$ 0.12 |
| | 2015 | | \$ (0.07) | \$ 0.15 | \$ 0.05 | \$ 0.09 | \$ 0.22 |
| Net income (loss) | 2016 | (b) | \$ (0.06) | \$ 0.09 | \$ 0.01 | \$ 0.08 | \$ 0.11 |
| | 2015 | | \$ (0.11) | \$ 0.00 | \$ 0.04 | \$ 0.07 | \$ 0.01 |

Diluted:

| | | | | | | | |
|--|------|-----|------------|---------|---------|---------|---------|
| Income (loss) from continuing operations | 2016 | (b) | \$ (0.06) | \$ 0.09 | \$ 0.01 | \$ 0.08 | \$ 0.12 |
| | 2015 | | \$ (0.07) | \$ 0.15 | \$ 0.05 | \$ 0.08 | \$ 0.22 |
| Net income (loss) | 2016 | (b) | \$ (0.06) | \$ 0.09 | \$ 0.01 | \$ 0.08 | \$ 0.11 |
| | 2015 | | \$ (0.11) | \$ 0.00 | \$ 0.04 | \$ 0.07 | \$ 0.01 |

(a) All quarters presented above were comprised of 13 weeks, except for the fourth quarter ended December 31, 2016 which was comprised of 14 weeks.

As a result of the adoption of ASU 2016-09, in the fourth quarter of 2016, certain amounts in the first three (b)quarters have been restated as if the new accounting guidance was adopted starting with the first day of our 2016 fiscal year. The impact of these restatements was not significant.

(c) The sum of the four quarters may not agree to the year total due to rounding within a quarter and the inclusion or exclusion of common stock equivalents.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

Cohu, Inc.

We have audited the accompanying consolidated balance sheets of Cohu, Inc. as of December 31, 2016 and December 26, 2015, and the related consolidated statements of income, comprehensive loss, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2016. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Cohu, Inc. at December 31, 2016 and December 26, 2015, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2016, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Cohu, Inc.'s internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated March 2, 2017 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

San Diego, California

March 2, 2017

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**Index
to Exhibits**

15. (b) The following exhibits are filed as part of, or incorporated into, the 2016 Cohu, Inc. Annual Report on Form 10-K:

Exhibit No. Description

- | | |
|--------|--|
| 2.1 | Share Purchase Agreement dated November 15, 2016 by and among Cohu, Inc. (and certain of its subsidiaries), Kita Manufacturing Co., LTD. and the Shareholders of Kita Manufacturing Co., LTD. incorporated herein by reference to Exhibit 2.1 from the Cohu, Inc. Current Report on Form 8-K filed with the Securities and Exchange Commission on January 10, 2017 |
| 3.1 | Amended and Restated Certificate of Incorporation of Cohu, Inc. incorporated herein by reference to Exhibit 3.1(a) from the Cohu, Inc. Form 10-Q filed with the Securities and Exchange Commission on July 19, 1999 |
| 3.1(a) | Certificate of Amendment of Amended and Restated Certificate of Incorporation of Cohu, Inc. incorporated herein by reference from the Cohu, Inc. Form S-8 filed June 30, 2000, Exhibit 4.1(a) |
| 3.2 | Amended and Restated Bylaws of Cohu, Inc. incorporated herein by reference to Exhibit 3.2 from the Cohu, Inc. Current Report on Form 8-K filed with the Securities and Exchange Commission on December 12, 1996 |
| 10.1 | Amended Cohu, Inc. 2005 Equity Incentive Plan incorporated herein by reference to Exhibit 10.1 from the Cohu, Inc. Current Report on Form 8-K filed with the Securities and Exchange Commission on May 13, 2015* |
| 10.2 | Amended Cohu, Inc. 1997 Employee Stock Purchase Plan, incorporated herein by reference to Exhibit 10.2 from the Cohu, Inc. Current Report on Form 8-K filed with the Securities and Exchange Commission on May 13, 2015* |
| 10.3 | Cohu, Inc. Deferred Compensation Plan (as amended and restated) incorporated herein by reference to Exhibit 10.1 from the Cohu, Inc. Current Report on Form 8-K filed with the Securities and Exchange Commission on December 29, 2008* |
| 10.4 | Form of employee restricted stock unit agreement for use with restricted stock units granted pursuant to the Cohu, Inc. 2005 Equity Incentive Plan incorporated herein by reference to Exhibit 10.1 from the Cohu, Inc. Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on August 4, 2015* |
| 10.5 | Form of non-employee director restricted stock unit agreement for use with restricted stock units granted pursuant to the Cohu, Inc. 2005 Equity Incentive Plan incorporated herein by reference to Exhibit 10.2 from the Cohu, Inc. Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on August 4, 2015* |
| 10.6 | Form of non-employee director restricted stock unit deferral election form for use with restricted stock units granted pursuant to the Cohu, Inc. 2005 Equity Incentive Plan incorporated herein by reference to |

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Exhibit 10.3 from the Cohu, Inc. Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on August 4, 2015*

10.7 Non-employee director fee deferral election form incorporated herein by reference to Exhibit 10.4 from the Cohu, Inc. Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on August 4, 2015*

10.8 Form of deferred stock agreement for shares granted pursuant to the Cohu, Inc. 2005 Equity Incentive Plan incorporated herein by reference to Exhibit 10.5 from the Cohu, Inc. Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on August 4, 2015*

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- 10.9 Form of stock option agreement for use with stock options granted pursuant to the Cohu, Inc. 2005 Equity Incentive Plan incorporated herein by reference to Exhibit 10.6 from the Cohu, Inc. Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on August 4, 2015*
- 10.10 Intel Corporation Purchase Agreement Capital Equipment, Goods and Services, dated April 30, 2012, by and between Delta Design, Inc. and Intel Corporation incorporated herein by reference to Exhibit 99.1 from the Cohu, Inc. Current Report on Form 8-K/A filed August 1, 2012
- 10.11 Form of Indemnity Agreement, incorporated by reference to Exhibit 10.1 from the Cohu, Inc. Current Report on Form 8-K filed July 28, 2008*
- 10.12 Cohu, Inc. Retiree Health Benefits Agreement (as amended) incorporated herein by reference to Exhibit 10.2 from the Cohu, Inc. Current Report on Form 8-K filed with the Securities and Exchange Commission on December 29, 2008*
- 10.13 Cohu, Inc. Change in Control Agreement incorporated herein by reference to Exhibit 10.3 from the Cohu, Inc. Current Report on Form 8-K filed with the Securities and Exchange Commission on December 29, 2008*
- 10.14 Lease agreement dated December 4, 2015 by and between CT Crosthwaite I, LLC and Cohu, Inc. incorporated herein by reference to Exhibit 10.14 from the Cohu, Inc. Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 23, 2016
- 21 Subsidiaries of Cohu, Inc.
- 23 Consent of Independent Registered Public Accounting Firm
- 31.1 Certification pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002 for Luis A. Müller
- 31.2 Certification pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002 for Jeffrey D. Jones
- 32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 for Luis A. Müller
- 32.2 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 for Jeffrey D. Jones
- 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

* Management contract or compensatory plan or arrangement

Item 16. Form 10-K Summary.

None

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

Date: March 2, 2017

By: /s/ Luis A. Müller
 Luis A. Müller
 President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| <u>Signature</u> | <u>Title</u> | <u>Date</u> |
|--|---|--------------------|
| /s/ James A. Donahue James A. Donahue | Chairman of the Board, Director | March 2, 2017 |
| /s/ Luis A. Müller Luis A. Müller | President and Chief Executive Officer, Director (Principal Executive Officer) | March 2, 2017 |
| /s/ Jeffrey D. Jones Jeffrey D. Jones | Vice President, Finance and Chief Financial Officer (Principal Financial and Accounting Officer) | March 2, 2017 |
| /s/ William E. Bendush William E. Bendush | Director | March 2, 2017 |
| /s/ Steven J. Bilodeau Steven J. Bilodeau | Director | March 2, 2017 |
| /s/ Andrew M. Caggia Andrew M. Caggia | Director | March 2, 2017 |
| /s/ Robert L. Ciardella Robert L. Ciardella | Director | March 2, 2017 |
| /s/ Karl H. Funke Karl H. Funke | Director | March 2, 2017 |

COHU, INC.

SCHEDULE II

VALUATION AND QUALIFYING ACCOUNTS

(in thousands)

| Description | Balance at Beginning of Year | Additions (Reductions) Not Charged to Expense | Additions (Reductions) Charged (Credited) to Expense | Deductions/ Write-offs | Balance at End of Year | |
|--|------------------------------------|---|--|---------------------------|------------------------------|-----------|
| Allowance for doubtful accounts: | | | | | | |
| Year ended December 27, 2014 | \$ 330 | \$ (1 |) ⁽¹⁾ | \$ (126 |) \$ 24 | \$ 179 |
| Year ended December 26, 2015 | \$ 179 | \$ 1 | (1) | \$ 19 | \$ 128 | \$ 71 |
| Year ended December 31, 2016 | \$ 71 | \$ (4 |) ⁽¹⁾ | \$ 13 | \$ (1 |) \$ 81 |
| Reserve for excess and obsolete inventories: | | | | | | |
| Year ended December 27, 2014 | \$ 35,221 | \$ (762 |) ⁽¹⁾ | \$ 2,624 | \$ 9,232 | \$ 27,851 |
| Year ended December 26, 2015 | \$ 27,851 | \$ (648 |) ⁽¹⁾ | \$ 2,409 | \$ 2,959 | \$ 26,653 |
| Year ended December 31, 2016 | \$ 26,653 | \$ 1,789 | (2) | \$ 1,125 | \$ 8,082 | \$ 21,485 |

All amounts presented above have been restated to exclude the impact of our discontinued operations.

(1) Changes in reserve balances resulting from foreign currency impact.

(2) Changes in reserve balances resulting from foreign currency impact and reclassifications from other reserves.