UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 25, 2006

OR

o **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	**95-1934119**
(State or other jurisdiction of Incorporation or Organization)	*(I.R.S. Employer Identification No.)*
12367 Crosthwaite Circle, Poway, California	**92064-6817**
(Address of principal executive offices)	*(Zip Code)*

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

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

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

Large accelerated filer o Accelerated filer ☑ Non-accelerated filer o

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

As of March 25, 2006 the Registrant had 22,550,196 shares of its $1.00 par value common stock outstanding.

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Item 1.

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

	March 25, 2006 (Unaudited)	December 31, 2005 *
ASSETS		
Current assets:		
Cash and cash equivalents	$ 29,915	$ 38,747
Short-term investments	100,990	100,202
Accounts receivable, less allowance for doubtful accounts of $1,465 in 2006 and $1,317 in 2005	56,179	47,156
Inventories:		
Raw materials and purchased parts	28,035	24,656
Work in process	13,032	12,276
Finished goods	9,382	7,900
	50,449	44,832
Deferred income taxes	22,010	19,775
Other current assets	5,485	5,905
Total current assets	265,028	256,617
Property, plant and equipment, at cost:		
Land and land improvements	8,352	7,978
Buildings and building improvements	27,168	25,925
Machinery and equipment	31,994	31,289
	67,514	65,192
Less accumulated depreciation and amortization	(34,497)	(33,412)
Net property, plant and equipment	33,017	31,780
Deferred income taxes	2,288	2,232
Goodwill	12,835	9,597
Other intangible assets, net of accumulated amortization of $2,281 in 2006 and $2,084 in 2005	8,299	6,553
Other assets	153	198
	$ 321,620	$ 306,977
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 13,291	$ 7,726
Accrued compensation and benefits	10,117	13,538
Accrued warranty	6,912	4,633
Customer advances	2,776	2,810
Deferred profit	16,048	13,816
Income taxes payable	6,354	3,876
Other accrued liabilities	3,520	3,923
Total current liabilities	59,018	50,322
Accrued retiree medical benefits	1,468	1,443
Deferred income taxes	4,850	5,087
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, 22,550 shares issued and outstanding in 2006 and 22,380 shares in 2005	22,550	22,380
Paid-in capital	41,661	37,717
Retained earnings	192,295	190,225
Accumulated other comprehensive loss	(222)	(197)
Total stockholders' equity	256,284	250,125
	$ 321,620	$ 306,977

* Derived from December 31, 2005 audited financial statements.

The accompanying notes are an integral part of these statements.

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

	Three Months Ended March 25, 2006	Three Months Ended March 26, 2005
Net sales	$ 58,251	$ 44,396
Cost and expenses:		
Cost of sales	37,568	26,468
Research and development	7,777	6,680
Selling, general and administrative	9,069	7,307
	54,414	40,455
Income from operations	3,837	3,941
Interest income	1,386	690
Income before income taxes	5,223	4,631
Income tax provision (benefit)	1,800	(1,900)
Net income	$ 3,423	$ 6,531
Income per share:		
Basic	$ 0.15	$ 0.30
Diluted	$ 0.15	$ 0.30
Weighted average shares used in computing income per share:		
Basic	22,500	21,633
Diluted	23,025	22,108
Cash dividends declared per share	$ 0.06	$ 0.05

The accompanying notes are an integral part of these statements.

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

	Three Months Ended March 25, 2006	Three Months Ended March 26, 2005
Cash flows from operating activities:		
Net income	$ 3,423	$ 6,531
Adjustments to reconcile net income to net cash provided from operating activities:		
Depreciation and amortization	1,515	1,206
Share-based compensation expense	805	—
Deferred income taxes	(2,508)	—
Increase in accrued retiree medical benefits	25	39
Excess tax benefits from stock options exercised	(825)	—
Changes in current assets and liabilities, net of effects from purchase of Unigen assets:		
Accounts receivable	(7,081)	3,168
Inventories	(2,202)	757
Refundable income taxes	—	(1,893)
Other current assets	119	(42)
Accounts payable	1,437	(1,249)
Customer advances	(34)	264
Deferred profit	2,118	11
Income taxes payable, including excess stock option exercise benefit	3,303	—
Accrued compensation, warranty and other liabilities	(1,586)	(2,492)
Net cash provided from (used for) operating activities	(1,491)	6,300
Cash flows from investing activities, net of effects from purchase of Unigen assets:		
Purchases of short-term investments	(56,894)	(24,485)
Sales and maturities of short-term investments	56,062	19,322
Purchases of property, plant and equipment	(824)	(836)
Payment for purchase of Unigen assets	(7,700)	—
Other assets	47	5
Net cash used for investing activities	(9,309)	(5,994)
Cash flows from financing activities:		
Issuance of stock, net	2,484	418
Excess tax benefits from stock options exercised	825	—
Cash dividends	(1,341)	(1,082)
Net cash provided from (used for) financing activities	1,968	(664)
Net decrease in cash and cash equivalents	(8,832)	(358)
Cash and cash equivalents at beginning of period	38,747	59,591
Cash and cash equivalents at end of period	$ 29,915	$ 59,233
Supplemental disclosure of cash flow information:		
Cash paid (received) during the period for:		
Income taxes, net of refunds	$ 1,007	$ (7)
Inventory capitalized as capital assets	$ 106	$ 430
Dividends declared but not yet paid	$ 1,353	$ 1,082

The accompanying notes are an integral part of these statements.

Cohu, Inc.
Notes to Unaudited Condensed Consolidated Financial Statements
March 25, 2006

1. Summary of Significant Accounting Policies

Basis of Presentation

Our fiscal years are based on a 52- or 53-week period ending on the last Saturday in December. The condensed consolidated balance sheet at December 31, 2005 has been derived from our audited financial statements at that date. The condensed consolidated interim financial statements as of March 25, 2006 and for the three-month periods ending March 25, 2006 (also referred to as “the first quarter of fiscal 2006”) and March 26, 2005 (also referred to as “the first quarter of fiscal 2005”) are unaudited. However, in management’s opinion, these financial statements reflect all adjustments (consisting only of normal, recurring items) necessary to provide a fair presentation of our financial position, results of operations and cash flows for the periods presented. Both the first quarter of fiscal 2006 and 2005 were comprised of twelve weeks.

Our interim results are not necessarily indicative of the results that should be expected for the full year. For a better understanding of Cohu, Inc. and our financial statements, we recommend reading these condensed consolidated interim financial statements in conjunction with our audited financial statements for the year ended December 31, 2005, which are included in our 2005 Annual Report on Form 10-K, filed with the U. S. Securities and Exchange Commission (“SEC”). In the following notes to our interim condensed consolidated financial statements, Cohu, Inc. is referred to as “Cohu”, “we”, “our” and “us”.

Risks and Uncertainties

We are subject to a number of risks and uncertainties that may significantly impact our future operating results. Certain of these risks and uncertainties are discussed under “Trends, Risks and Uncertainties” in the accompanying Management’s Discussion and Analysis of Financial Condition and Results of Operations included in this Form 10-Q. Understanding these risks and uncertainties is integral to the review of our interim condensed consolidated financial statements.

Share-Based Compensation

On January 1, 2006, we adopted the provisions of Financial Accounting Standards Board (“FASB”) Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*, (“ Statement No. 123R”) and SEC Staff Accounting Bulletin No. 107, *Share-Based Payment*, (“SAB 107”) requiring the measurement and recognition of all share-based compensation under the fair value method.

During the first quarter of fiscal 2006, we began recognizing share-based compensation, under Statement No. 123R, for all awards granted during the first quarter of fiscal 2006 and for the unvested portion of previous award grants based on each award’s grant date fair value. We implemented Statement No. 123R using the modified prospective transition method. Under this transition method our financial statements and related information presented, pertaining to periods prior to our adoption of Statement No. 123R, have not been adjusted to reflect fair value of share-based compensation expense.

We estimate the fair value of each share-based award on the grant date using the Black-Scholes valuation model. To facilitate our adoption of Statement No. 123R, we applied the provisions of SAB 107 in developing our methodologies to estimate our Black-Scholes model inputs. Option valuation models, including Black-Scholes, 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 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. 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. Due to a limited amount of historical option exercise data related to options with a five-year contractual term we adopted SAB 107’s simplified method for estimating the expected term of share-based awards granted in the first quarter of fiscal 2006. Statement No. 123R also requires that estimated forfeitures be included as a part of the grant date expense estimate. We used historical data to estimate expected employee behaviors related to option exercises and forfeitures. Prior to our adoption of Statement No. 123R, we reduced pro-forma share-based compensation expense, presented in the notes to our financial statements, for actual forfeitures as they occurred.

Cohu, Inc.
Notes to Unaudited Condensed Consolidated Financial Statements
March 25, 2006

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

Employee Stock Options

	Three Months Ended	
	March 25, 2006	March 26, 2005
Dividend yield	1.2%	1.0%
Expected volatility	47.8%	60.0%
Risk-free interest rate	4.5%	3.7%
Expected term of options	3.8 years	4.0 years
Weighted-average grant date fair value per share	$ 7.73	$ 7.75

Employee Stock Purchase Plan

	Three Months Ended	
	March 25, 2006	March 26, 2005
Dividend yield	1.2%	1.0%
Expected volatility	39.4%	42.4%
Risk-free interest rate	4.3%	2.75%
Expected term of options	0.5 years	0.5 years
Weighted-average grant date fair value per share	$ 6.20	$ 4.00

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

	Three Months Ended	
	March 25, 2006	March 26, 2005
Cost of sales	$ 90	$ —
Research and development	227	—
Selling, general and administrative	488	—
Total share-based compensation	805	—
Income tax benefit	(97)	—
Total share-based compensation, net of tax	$ 708	$ —

Prior to our adoption of Statement No. 123R, we presented all tax benefits resulting from the exercise of stock options as operating cash inflows in our consolidated statements of cash flows, in accordance with the provisions of the Emerging Issues Task Force ("EITF") Issue No. 00-15, *Classification in the Statement of Cash Flows of the Income Tax Benefit Received by a Company upon Exercise of a Nonqualified Employee Stock Option*. Statement No. 123R requires the benefit of tax deductions in excess of the compensation cost recognized for those options to be classified as financing cash inflows rather than operating cash inflows, on a prospective basis.

At March 25, 2006, excluding a reduction for forfeitures, we had approximately $6.5 million of pre-tax unrecognized compensation cost related to unvested share-based awards. That cost is expected to be recognized over a weighted-average period of approximately 2 years.

Prior to the first quarter of fiscal 2006, we accounted for share-based awards to employees under Accounting Principles Board Opinion Number 25, *Accounting for Stock Issued to Employees*, ("APB 25"). Under APB 25, no stock-based employee compensation cost was reflected in our consolidated statements of income, as all options granted under our share-based compensation plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The proforma information presented in the following table illustrates the effect on net income and net income per share if we had applied the fair value recognition provisions of FASB Statement No. 123, *Accounting for Stock-Based Compensation*, as amended by FASB Statement No. 148, *Accounting for Stock-Based Compensation – Transition and Disclosure*, to stock-based employee compensation for the first quarter of fiscal 2005:

Cohu, Inc.
Notes to Unaudited Condensed Consolidated Financial Statements
March 25, 2006

(in thousands, except per share amounts)	Three months ended March 26, 2005
Net income, as reported	$ 6,531
Less: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effect	(1,030)
Pro forma net income	$ 5,501
Net income per share:	
Basic-as reported	$ 0.30
Basic-pro forma	$ 0.25
Diluted-as reported	$ 0.30
Diluted-pro forma	$ 0.25

Income Per Share

Income per share is computed in accordance with FASB Statement No. 128, *Earnings per Share*. Basic income per share is computed using the weighted average number of common shares outstanding during each period. Diluted income per share includes the dilutive effect of common shares potentially issuable upon the exercise of stock options utilizing the treasury stock method. For purposes of computing diluted income per share, stock options with exercise prices that exceed the average fair market value of our common stock for the period are excluded. For the three months ended March 25, 2006, options to purchase approximately 178,000 shares of common stock were excluded from the computation. For the three months ended March 26, 2005, options to purchase approximately 793,000 shares of common stock were excluded from the computation. The following table reconciles the denominators used in computing basic and diluted income per share:

	Three months ended	
(in thousands)	March 25, 2006	March 26, 2005
Weighted average common shares outstanding	22,500	21,633
Effect of dilutive stock options	525	475
	23,025	22,108

Revenue Recognition

Our revenue recognition policy is disclosed in Note 1 of the Notes to Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2005. As more fully described in that policy, revenue from products that have not previously satisfied customer acceptance is recognized upon customer acceptance. The gross profit on sales that are not recognized is generally recorded as deferred profit and reflected as a current liability in the consolidated balance sheet.

In April 2003, our Broadcast Microwave Services subsidiary was awarded an $8.5 million contract from the United Arab Emirates (“UAE”) Armed Services to provide microwave communications equipment for a command center and infrastructure system for border security. The contract, which utilizes our most advanced microwave communications technology that has not previously been installed in an application of this size and complexity, requires that 40% of the total contract price be paid after the system has been fully accepted by the customer. As a result of these factors and the inability to make reasonably dependable estimates of progress toward completion and acceptance, we will recognize all revenue and related costs under this contract in the period the system is accepted by the customer. In the fourth quarter of 2005, BMS received notification that the customer had approved an amendment to the original contract increasing the total value of the contract to $8.9 million. Under the terms of the amendment BMS will provide certain additional equipment and services. Through March 25, 2006, we had shipped inventory with a sales value of $8.9 million and deferred costs of approximately $6.6 million resulting in deferred profit of approximately $2.3 million under the contract. In addition, at March 25, 2006 we had unbilled accounts receivable of approximately $3.6 million. We have also provided the customer with a standby letter of credit which was reduced from $2.6 million to $1.0 million during the first quarter of fiscal 2006. At March 25, 2006, approximately $1.0 million may be drawn upon, by the UAE, if BMS does not fulfill the terms of the contract. While customer acceptance and final contract payment has taken longer than anticipated, we believe that such acceptance and payment will be received. However, in the event BMS is unable to obtain customer acceptance of the system, the receivables may need to be written off and the customer might seek a refund of the $5.3 million in payments made under the contract, which could materially impact our results of operations.

At March 25, 2006, we had deferred revenue totaling approximately $36.2 million and deferred profit of $16.0 million. At December 31, 2005, we had deferred revenue totaling approximately $30.7 million and deferred profit of $13.8 million.

Retiree Medical Benefits

We provide post-retirement health benefits to certain executives and directors under a noncontributory plan. The net periodic benefit cost incurred during the first quarter of fiscal 2006 and 2005 was not significant.

Recent Accounting Pronouncements

There have been no material changes to the recent accounting pronouncements as previously reported in our Annual Report on Form 10-K for the fiscal year ended December 31, 2005.

2. Strategic Technology Transactions and Goodwill

Unigen Acquisition

On December 29, 2005, we entered into an exclusive, perpetual, irrevocable, world-wide, royalty-free license for certain patents with Unisys Corporation ("Unysis") for a one-time cash payment of $5.0 million. On March 16, 2006, we purchased certain intellectual property, fixed assets, inventory and a customer contract of Unisys' Unigen operation ("Unigen"). The results of Unigen's operations have been included in our consolidated financial statements since that date. Unigen developed, manufactured and marketed advanced thermal solutions for use in semiconductor test and burn-in.

Included in the assets we acquired were the patents licensed from Unisys in December 2005 and, as a result, these two transactions have been combined for purposes of allocating the total purchase price to the assets acquired. The purchase price of this acquisition was approximately $17.2 million, and was funded primarily by our cash reserves ($7.7 million), cash previously paid in December 2005 for the patent license and a deposit on the acquisition ($5.3 million), other acquisition costs ($0.2 million) and certain Unigen liabilities assumed ($0.1 million). We also recorded a $4.0 million liability for amounts owed to Unisys for inventory we acquired. The acquisition was considered a business in accordance with EITF 98-3, "*Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business*" ("EITF 98-3"), and the total cost of the acquisition was allocated to the assets acquired and liabilities assumed based on their respective fair values in accordance with Statement No. 141. All assets are expected to be fully deductible for tax purposes. The goodwill was assigned to our semiconductor equipment segment.

The preliminary allocation of purchase price to the acquired assets and assumed liabilities was as follows *(in thousands)*:

Current assets	$ 5,464
Fixed assets	1,625
Intangible assets	6,980
Goodwill	3,238
Total assets acquired	17,307
Current liabilities assumed	(142)
Net assets acquired	$ 17,165

Amounts allocated to other intangible assets are being amortized on a straight-line basis over their estimated useful lives currently estimated at five years. Pro forma results of operations have not been presented because the effect of the acquisition was not material. The purchase price allocation presented as of March 25, 2006 is preliminary and we expect to finalize the purchase price and related allocations during the second quarter of 2006 and, as a result, adjustments to the amounts noted above are possible.

Cohu, Inc.
Notes to Unaudited Condensed Consolidated Financial Statements
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KryoTech Acquisition

On May 6, 2005, we purchased substantially all the assets and operations of KryoTech, Inc. ("KryoTech"). The results of KryoTech's operations have been included in the consolidated financial statements since that date. KryoTech, based in West Columbia, South Carolina, designed, developed manufactured and marketed advanced thermal solutions for electronic systems and products, including semiconductor equipment. Consummation of the acquisition terminated our joint development project with KryoTech and eliminated all minimum purchase obligations.

The purchase price of this acquisition was approximately $3.6 million, and was funded primarily by our cash reserves ($2.9 million). The purchase price also included the payment of the outstanding principal balance and accrued interest on the promissory note with KryoTech ($0.5 million), other acquisition costs ($0.2 million) and certain KryoTech liabilities assumed ($0.5 million). The acquisition was considered a business in accordance with EITF 98-3, and the total cost of the acquisition was allocated to the assets acquired and liabilities assumed based on their respective fair values in accordance with Statement No. 141. All assets are expected to be fully deductible for tax purposes. The goodwill was assigned to our semiconductor equipment segment.

The allocation of the purchase price to the acquired assets and assumed liabilities was as follows *(in thousands)*:

Current assets	$ 740
Fixed assets	54
Intangible assets	1,950
Backlog	90
Goodwill	1,257
Total assets acquired	4,091
Current liabilities assumed	(461)
Net assets acquired	$ 3,630

Amounts allocated to other intangible assets are being amortized on a straight-line basis over their estimated useful lives of three years. Pro forma results of operations have not been presented because the effect of the acquisition was not material.

Purchased intangible assets, subject to amortization, were as follows:

(in thousands)	March 25, 2006		December 31, 2005	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Unigen technology	$ 6,980	$ 35	$ —	$ —
Patent license	—	—	5,037	—
KryoTech technology	1,950	596	1,950	434
BMS technology	1,650	1,650	1,650	1,650
	$ 10,580	$ 2,281	$ 8,637	$ 2,084

Amortization expense related to purchased and other intangible assets was approximately $0.2 million for the first quarter of fiscal 2006, and approximately $0.1 million in the first quarter of fiscal 2005. As of March 25, 2006, we expect amortization expense in future periods to be as follows: remainder of 2006 – $1,547,000; 2007 – $2,063,000; 2008 – $1,629,000; 2009 – $1,413,000; 2010 – $1,413,000, 2011 – $234,000.

Cohu, Inc.
Notes to Unaudited Condensed Consolidated Financial Statements
March 25, 2006

3. Employee Stock Benefit Plans

Employee Stock Purchase Plan — The Cohu, Inc. 1997 Employee Stock Purchase Plan ("the Plan") provides for the issuance of a maximum of 1,000,000 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.

Stock Options — Under our stock option plans, options may be granted to employees 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 become exercisable one-fourth annually beginning one year after the grant date and expire five to ten years from the grant date. On May 10, 2005, our stockholders approved the Cohu, Inc. 2005 Equity Incentive Plan (the "2005 Equity Plan"). The 2005 Equity Plan replaced the 1998 Stock Option Plan, the 1996 Outside Directors Stock Option Plan, the 1996 Stock Option Plan and the 1994 Stock Option Plan (collectively the "Predecessor Plans"). No further awards will be granted under the Predecessor Plans. At March 25, 2006 approximately 791,000 shares were available for future grants under the 2005 Equity Plan.

Stock option activity under our share-based compensation plans for the first quarter of fiscal 2006 was as follows:

(in thousands, except per share data)	Shares	Weighted Average Exercise Price
Outstanding, January 1, 2006	2,504	$ 15.66
Granted	7	$ 19.85
Exercised	(170)	$ 14.58
Canceled	(20)	$ 17.17
Outstanding, March 25, 2006	2,321	$ 15.74
Options exercisable at March 25, 2006	1,274	$ 15.28

Information about stock options outstanding at March 25, 2006 is as follows *(options in thousands)*:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	*Number Outstanding*	Approximate Weighted Average *Remaining Life (Years)*	*Exercise Price*	*Number Exercisable*	Weighted Average *Exercise Price*
$7.69 – $11.66	256	5.6	$ 11.20	174	$ 10.98
$12.07 – $13.88	396	3.7	$ 13.10	384	$ 13.08
$14.00 – $14.68	240	6.2	$ 14.46	206	$ 14.49
$15.04 – $17.30	687	8.6	$ 15.63	129	$ 15.77
$17.44 – $18.20	274	6.5	$ 17.83	171	$ 18.00
$18.24 – $18.35	323	7.7	$ 18.35	129	$ 18.35
$18.50 – $35.00	136	4.6	$ 22.87	72	$ 23.82
$38.81 – $38.81	9	4.0	$ 38.81	9	$ 38.81
	2,321	6.6	$ 15.74	1,274	$ 15.28

The aggregate intrinsic value of options exercised during the period ended March 25, 2006 and outstanding and exercisable at March 25, 2006 was approximately $2.2 million, $11.8 million and $7.2 million, respectively.

4. Comprehensive Income

Comprehensive income represents all non-owner changes in stockholders' equity and consists of, on an after-tax basis where applicable, the following:

(in thousands)	Three months ended March 25, 2006	Three months ended March 26, 2005
Net income	$ 3,423	$ 6,531
Change in unrealized loss on investments	(25)	(120)
Comprehensive income	$ 3,398	$ 6,411

Cohu, Inc.
Notes to Unaudited Condensed Consolidated Financial Statements
March 25, 2006

Accumulated other comprehensive loss totaled $222,000 and $197,000 at March 25, 2006 and December 31, 2005, respectively, and was attributed to after-tax unrealized losses and gains on investments.

5. Income Taxes

The income tax provision (benefit) included in the statements of income for the three months ended March 25, 2006 and March 26, 2005, is based on the estimated annual effective tax rate for the entire year. These estimated effective tax rates are subject to adjustment in subsequent quarterly periods as our estimates of pretax income for the year are increased or decreased. The effective tax rate of 34.5% for the three months ended March 25, 2006 is less than the U.S. federal statutory rate primarily due to state research and development tax credits and export sales benefits offset by the effects of Statement No. 123R that does not allow deferred tax benefits to be recognized on compensation expense related to incentive stock options.

Our income tax credit in 2005 was, in part, the result of research tax credits and export sales benefits. In addition, in March 2005, the Internal Revenue Service completed a routine examination of our consolidated tax returns for the period 2000 through 2002. The examination resulted in no assessment related to our tax returns as filed. Consequently, approximately $3.0 million of accrued taxes related to the examined years were reversed with a corresponding credit to income tax expense in the quarter ended March 26, 2005.

We have derived significant tax benefits from export sales. As a result of the American Jobs Creation Act of 2004, the export sales benefit derived from the Extraterritorial Income Exclusion ("ETI") was repealed subject to a phase-out that limits the full tax benefit to 60% in 2006. The ETI benefit was replaced with a deduction for domestic manufacturing activities subject to a phase-in beginning in 2005. The future tax benefits we derive from the domestic manufacturing deduction will likely be less than those from ETI.

The federal research credit expired on December 31, 2005. Legislation to retroactively reinstate the credit is pending in the U.S. Congress, however it was not enacted and signed into law as of March 25, 2006. Accordingly, no benefit from the federal research credit has been included in estimating the 2006 effective tax rate. If Congress retroactively reinstates the research credit the effect of the credit will be reflected in the computation of the annual effective tax rate beginning as of the first period that includes the enactment date of the legislation.

6. Geographic Consolidation

On April 10, 2003, we announced that our Delta Design, Inc. subsidiary was relocating its Littleton, Massachusetts operation to its headquarters facility in Poway, California. The consolidation was substantially completed in March 2004. There were no charges to operations recorded during the first quarter of fiscal 2006 or 2005, respectively. Cumulative charges to operations for severance and other exit costs for the period April 10, 2003 to March 25, 2006, were approximately $1.1 million.

We are currently attempting to sell our Littleton manufacturing facility which we believe has a current fair value in excess of the $3.2 million carrying value at March 25, 2006.

The following table reconciles amounts accrued and paid under the consolidation plan.

Three months ended March 25, 2006 *(in thousands)*	Severance and other payroll	Other exit costs	Total
Liability at January 1, 2006	$ 273	$ —	$ 273
Costs accrued	—	—	—
Amounts paid or charged	(31)	—	(31)
Liability at March 25, 2006	$ 242	—	$ 242

Cohu, Inc.
Notes to Unaudited Condensed Consolidated Financial Statements
March 25, 2006

Three months ended March 26, 2005 *(in thousands)*	Severance and other payroll	Other exit costs	Total
Liability at January 1, 2005	$ 285	$ —	$ 285
Costs accrued	—	—	—
Amounts paid or charged	(25)	—	(25)
Liability at March 25, 2006	$ 260	—	$ 260

7. Industry Segments

We have four reportable segments as defined by FASB Statement No. 131, "*Disclosures about Segments of an Enterprise and Related Information*". Our reportable segments are business units that offer different products and are managed separately because each business requires different technology and marketing strategies. The following is a summary of our significant accounts and balances by segment, reconciled to consolidated totals. Intersegment sales were not significant in any period.

(in thousands)	Three months ended March 25, 2006	Three months ended March 26, 2005
Net sales by segment:		
Semiconductor equipment	$ 49,309	$ 37,250
Television cameras	3,598	3,786
Metal detection	1,481	1,933
Microwave communications	3,863	1,427
Total consolidated net sales and net sales for reportable segments	$ 58,251	$ 44,396
Segment profit (loss):		
Semiconductor equipment	5,503	5,885
Television cameras	(789)	(428)
Metal detection	(249)	26
Microwave communications	232	(786)
Profit for reportable segments	4,697	4,697
Other unallocated amounts:		
Corporate expenses	(860)	(756)
Interest income	1,386	690
Income before income taxes	$ 5,223	$ 4,631

(in thousands)	March 25, 2006	December 31, 2005
Total assets by segment:		
Semiconductor equipment	$ 135,826	$ 115,689
Television cameras	9,221	9,883
Metal detection	4,085	4,397
Microwave communications	14,457	13,919
Total assets for reportable segments	163,589	143,888
Corporate, principally cash and investments and deferred taxes	158,031	163,089
Total consolidated assets	$ 321,620	$ 306,977

8. Contingencies

We are occasionally involved in various legal proceedings, lawsuits, examinations by various tax authorities and claims that have arisen in the ordinary course of our businesses. Although the outcome of such legal proceedings, claims and examinations cannot be predicted with certainty, we do not believe any such matters exist at this time that will have a material adverse effect on our financial position or results of our operations.

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9. Guarantees

Our products are generally sold with a 12-month to 36-month warranty period following sale or installation. Parts and labor are covered under the terms of the warranty agreement. The warranty provision is based on historical and projected experience by product and configuration.

Changes in accrued warranty during the first fiscal quarter of 2006 and 2005 were as follows (*in thousands*) :

	2006	2005
Balance at beginning of period	$ 4,633	$ 4,209
Warranty expense accruals	4,762	1,054
Warranty payments	(2,512)	(1,172)
Warranty liability assumed	29	—
Balance at end of period	$ 6,912	$ 4,091

Warranty expense in the first fiscal quarter of 2006 was impacted by higher than expected costs associated with supporting certain customer test handler applications and a more conservative estimate of future handler support costs.

During the ordinary course of business, from time-to-time, we provide standby letters of credit to certain parties. As of March 25, 2006, the maximum potential amount of future payments that Cohu could be required to make under these standby letters of credit is approximately $1.0 million. We have not recorded any liability in connection with these guarantee arrangements beyond that required to appropriately account for the underlying transaction being guaranteed. We do not believe, based on historical experience and information currently available, that it is probable that any amounts will be required to be paid under these arrangements.

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

OVERVIEW

Our primary business activity involves the development, manufacture, marketing, sale and servicing of test handling equipment for the global semiconductor industry. This business is significantly dependent on capital expenditures by semiconductor manufacturers and test subcontractors, which in turn are dependent on the current and anticipated market demand for semiconductors and electronics equipment which are subject to significant cyclical trends in demand. Changes in the semiconductor, electronics, computer and telecommunications industries, as well as rapidly shifting global economic conditions, have had and will continue to have a significant impact on our businesses.

In the first six months of 2004, our semiconductor equipment business, as well as the semiconductor equipment industry generally, saw significantly improved order bookings and backlog, an indication that a three-year industry downturn had possibly ended. However, in the second half of 2004, our orders declined and business conditions in the semiconductor equipment industry appeared to be weakening. In 2005 this trend reversed, and during the year ended December 31, 2005, our semiconductor equipment business saw a significant increase in order bookings that accounted for our consolidated order growth, from $46.1 million in the fourth quarter of 2004 to $71.4 million in the fourth quarter of 2005, and our sales in each of the four quarters of 2005 increased from the fourth quarter of 2004.

As we begin 2006, demand for our semiconductor equipment has remained level with the fourth quarter of 2005. During the first quarter of fiscal 2006 deferred profit increased approximately $2.2 million to $16.0 million. The increase in deferred profit is primarily the result of additional revenue deferrals associated with Delta's sales of semiconductor equipment products, including those acquired from KryoTech and Unigen, which as of March 25, 2006 are awaiting customer acceptance.

Our operating results in the last three years have been impacted by charges to cost of sales related to excess, obsolete and lower of cost or market inventory issues. These charges totaled approximately $16.6 million during the three-year period ended December 31, 2005 (approximately $0.5 million for the first quarter of fiscal 2006) and were primarily the result of decreases in customer forecasts, competitive conditions in the test handler industry and, to a lesser extent, changes in our sales product mix as a result of new product introductions. Exposures related to inventories are common in the semiconductor equipment industry due to the narrow customer base, the custom nature of the products and inventory and the shortened product life cycles caused by rapid changes in semiconductor manufacturing technology. Increased competition, particularly in the last several years, has also negatively impacted our gross margins on certain products and we believe it is likely these conditions will exist for the foreseeable future.

Our other operating costs consist of research and development ("R&D") and selling, general and administrative expenses ("SG&A"). Both R&D and SG&A expense increased in 2005, due to increased business volume and investment in development programs.

Our non-semiconductor equipment businesses have comprised approximately 20% of our revenues during the last three years. During 2005 we saw improved results in our metal detection and microwave communications businesses. The results of our television camera business deteriorated, primarily due to a decline in customer demand for our board-level cameras.

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Our financial condition is strong with significant cash and short-term investments and no long-term debt. During the three-year period ended March 25, 2006 we generated $27.2 million of net cash from operating activities and total cash and investments have increased from $103.1 million at March 31, 2003 to $130.9 million at March 25, 2006.

Our management team uses several performance metrics to manage our various businesses. These metrics, which tend to focus on near-term forecasts due to the limited order backlog in our businesses, include (i) order bookings and backlog for the most recently completed quarter and the forecast for the next quarter; (ii) inventory levels and related excess exposures typically based on the next twelve month's forecast; (iii) gross margin and other operating expense trends; and (iv) industry data and trends noted in various publicly released sources. Due to the short-term nature of our order backlog that historically has represented about three months of business and the inherent volatility of the semiconductor equipment business, our past performance is frequently not indicative of future operating results or cash flows.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of our financial condition and results of operations are 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. On an on-going basis, we evaluate our estimates, including those related to bad debts, inventories, intangible assets, income taxes, warranty obligations and contingencies and litigation. We base our estimates on historical experience, forecasts and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates under different assumptions or conditions. We believe the following critical accounting policies, that are more fully described in our Consolidated Financial Statements included in Item 15 of our Annual Report on Form 10-K for the fiscal year ended December 31, 2005, affect the significant judgments and estimates used in the preparation of our consolidated financial statements.

Share-Based Compensation: On January 1, 2006, we adopted the provisions of Statement No.123R and SAB 107 requiring the measurement and recognition of all share-based compensation under the fair value method. During the first quarter of fiscal 2006, we began recognizing share-based compensation, under Statement No. 123R, for all awards granted during the first quarter of fiscal 2006 and for the unvested portion of previous award grants based on each award's grant date fair value. We implemented Statement No. 123R using the modified prospective transition method. Under this transition method our financial statements and related information presented, pertaining to periods prior to our adoption of Statement No. 123R, have not been adjusted to reflect fair value of share-based compensation expense.

We estimate the fair value of each share-based award on the grant date using the Black-Scholes valuation model. To facilitate our adoption of Statement No. 123R, we applied the provisions of SAB 107 in developing our methodologies to estimate our Black-Scholes model inputs. Option valuation models, including Black-Scholes, 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 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. 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. Due to a limited amount of historical option exercise data related to options with a five-year contractual term we adopted SAB 107's simplified method for estimating the expected term of share-based awards granted in the first quarter of fiscal 2006. Statement No. 123R also requires that estimated forfeitures be included as a part of the grant date estimate. We used historical data to estimate expected employee behaviors related to option exercises and forfeitures. Prior to our adoption of Statement No. 123R, we reduced pro-forma share-based compensation expense, presented in the notes to our financial statements, for actual forfeitures as they occurred.

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. For arrangements containing multiple elements, the revenue relating to the undelivered elements is deferred at estimated fair value until delivery of the deferred elements.

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: 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 or more favorable 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.

Income Taxes: We estimate our liability for income taxes based on the various jurisdictions where we conduct business. This requires us to estimate our actual current tax exposure and to assess temporary differences that result from differing treatment of certain items for tax and accounting purposes. These differences result in deferred tax assets and liabilities that are reflected in the consolidated balance sheet. The net 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 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 and any valuation allowance to be recorded against net deferred tax assets. Our gross deferred tax asset balance as of March 25, 2006 was $24.3 million, with a valuation allowance of $1.8 million for state tax credit and loss carryforwards. The deferred tax assets consist primarily of deductible temporary differences, tax credit and net operating loss carryforwards.

Intangible Assets: At March 25, 2006, intangible assets other than goodwill were evaluated for impairment using undiscounted cash flows expected to result from the use of the assets as required by FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, ("Statement No. 144"), and we concluded there was no impairment loss. We are required to assess goodwill impairment using the methodology prescribed by FASB Statement No. 142, *Goodwill and Other Intangible Assets*, ("Statement No. 142"). Statement No. 142 requires that goodwill be tested for impairment on an annual basis and more frequently in certain circumstances. The required annual goodwill impairment test is performed as of October 1st of each year. We did not recognize any goodwill impairment as a result of performing this annual test in 2005.

Contingencies: We are subject to certain contingencies that arise in the ordinary course of our businesses. In accordance with FASB Statement No. 5, *Accounting for Contingencies*, ("Statement No. 5") we 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, as defined in Statement No. 5 and the amount of the loss or impairment is reasonably estimable, we accrue a charge to operations in the period such conditions become known.

Recent Accounting Pronouncements: There have been no material changes to the recent accounting pronouncements as previously reported in our Annual Report on Form 10-K for the fiscal year ended December 31, 2005.

RESULTS OF OPERATIONS

The following table summarizes certain operating data as a percentage of net sales for the three-month periods ended March 25, 2006 and March 26, 2005.

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	Three months ended 2006	2005
Net sales	100.0%	100.0%
Cost of sales	(64.5)	(59.6)
Gross margin	35.5	40.4
Research and development expense	(13.3)	(15.0)
Selling, general and administrative expense	(15.6)	(16.5)
Income from operations	6.6%	8.9%

First Fiscal Quarter 2006 Compared to First Fiscal Quarter 2005

Net Sales

Our net sales increased 31.2% to $58.3 million in 2006, compared to net sales of $44.4 million in 2005. Sales of semiconductor test handling equipment in the first fiscal quarter of 2006 increased 32.4% from the comparable 2005 period and accounted for 84.6% of consolidated net sales in 2006 versus 83.9% in 2005. The primary reason for the increase in sales of our semiconductor equipment business was strong customer demand for our advanced thermal semiconductor test handlers and our general purpose test handlers.

Sales of television cameras and other equipment accounted for 6.2% of net sales in 2006 and decreased 5.0% when compared to the same period of 2005, while the combined sales of metal detection and microwave equipment accounted for 9.2% of net sales in 2006. During the first fiscal quarter of 2006 sales of metal detection equipment decreased 23.4% and sales of microwave equipment increased 170.7% when compared to 2005. The decrease in sales experienced by our television camera business was primarily attributable to a decline in demand for our products from foreign and domestic original equipment manufacturers. The decline in sales of our metal detection business was a result of lower demand for our security and consumer metal detection products during the first quarter of fiscal 2006. The increase in sales by our microwave communications business was primarily attributable to increased demand from law enforcement agencies and the result of the timing of revenue recognition pursuant to accounting rules.

At March 25, 2006, we had deferred revenue totaling approximately $36.2 million and deferred profit of $16.0 million. At December 31, 2005, we had deferred revenue totaling approximately $30.7 million and deferred profit of $13.8 million. The increase in deferred revenue is primarily the result of additional revenue deferrals associated with Delta's sales of new semiconductor equipment products, including those acquired from KryoTech and Unigen, which are awaiting customer acceptance as of March 25, 2006.

Gross margin

Gross margin as a percentage of net sales decreased to 35.5% in 2006 from 40.4% in 2005, primarily as a result of lower margins in our semiconductor equipment business. Within our semiconductor equipment segment, margins decreased in 2006, primarily as a result of higher than expected costs associated with supporting certain customer test handler applications and a more conservative estimate of future handler support costs. Additionally, during the first quarter of fiscal 2006 gross margin was impacted by approximately $0.1 million in share-based compensation expense that was recorded as a result of our adoption of Statement No. 123R.

During the first fiscal quarter of 2006, we saw a decline in orders for our advanced thermal semiconductor test handlers and an increase in orders for our high-speed test handlers and burn-in products compared to the fourth quarter of 2005. Our high-speed test handlers and burn-in products have significantly lower gross margins than our advanced thermal test handlers. If this shift in product mix continues, our gross margin percentage in the second half of fiscal 2006 will be negatively impacted.

We compute the majority of our excess and obsolete inventory reserve requirements using a one-year inventory usage forecast. During the first quarter of fiscal 2006 and 2005, we recorded net charges to cost of sales of approximately $0.5 million and $1.2 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 our known exposures at March 25, 2006, reductions in customer forecasts or continued modifications to products, as a result of our failure to meet specifications or other customer requirements, will result in additional charges to operations that could negatively impact our gross margin in future periods. Conversely, if our actual inventory usage is greater than our forecasted usage, our gross margin in future periods may be favorably impacted.

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Research and Development Expense

R&D expense as a percentage of net sales was 13.3% in 2006, compared to 15.0% in 2005, increasing in absolute dollars from $6.7 million in 2005 to $7.8 million in 2006. The increase in R&D was primarily the result of higher R&D labor and material costs for product development in our semiconductor equipment, television camera and microwave communication businesses. Additionally, during the first quarter of fiscal 2006 we recorded approximately $0.2 million in share-based compensation expense as a result of our adoption of Statement No. 123R.

Selling, General and Administrative Expense

SG&A expense as a percentage of net sales decreased to 15.6% in 2006, from 16.5% in 2005, increasing in absolute dollars from $7.3 million in 2005 to $9.1 million in 2006. The increase in SG&A expense was primarily related to increased business volume including increases in headcount. Additionally, during the first quarter of fiscal the 2006 we recorded approximately $0.5 million in share-based compensation expense as a result of our adoption of Statement No. 123R.

Interest Income

Interest income was approximately $1.4 million and $0.7 million in 2006 and 2005, respectively. The increase in interest income resulted from an increase in our average cash and cash equivalents and investment balances and an increase in interest rates.

Income Taxes

The provision (benefit) for income taxes expressed as a percentage of pre-tax income was 34.5% in 2006 and (41.0)% in 2005. The income tax provision (benefit) included in the statements of income for the three months ended March 25, 2006 and March 26, 2005, is based on the estimated annual effective tax rate for the entire year. These estimated effective tax rates are subject to adjustment in subsequent quarterly periods as our estimates of pretax income for the year are increased or decreased. The effective tax rate of 34.5% for the three months ended March 25, 2006 is less than the U.S. federal statutory rate primarily due to state research and development tax credits and export sales benefits offset by the effects of Statement No. 123R that does not allow deferred tax benefits to be recognized on compensation expense related to incentive stock options.

Our income tax credit in 2005 was, in part, the result of research tax credits and export sales benefits. In addition, in March 2005, the Internal Revenue Service completed a routine examination of our consolidated tax returns for the period 2000 through 2002. The examination resulted in no assessment related to our tax returns as filed. Consequently, approximately $3.0 million of accrued taxes related to the examined years were reversed with a corresponding credit to income tax expense in the quarter ended March 26, 2005.

We have derived significant tax benefits from export sales. As a result of the American Jobs Creation Act of 2004, the export sales benefit derived from the ETI was repealed subject to a phase-out that limits the full tax benefit to 60% in 2006. The ETI benefit was replaced with a deduction for domestic manufacturing activities subject to a phase-in beginning in 2005. The future tax benefits we derive from the domestic manufacturing deduction will likely be less than those from ETI.

The federal research credit expired on December 31, 2005. Legislation to retroactively reinstate the credit is pending in the U.S. Congress, however it was not enacted and signed into law as of March 25, 2006. Accordingly, no benefit from the federal research credit has been included in estimating the 2006 effective tax rate. If Congress retroactively reinstates the research credit the effect of the credit will be reflected in the computation of the annual effective tax rate beginning as of the first period that includes the enactment date of the legislation.

Other Items

In April 2003, our Broadcast Microwave Services subsidiary was awarded an $8.5 million contract from the UAE Armed Services to provide microwave communications equipment for a command center and infrastructure system for border security. The contract, which utilizes our most advanced microwave communications technology that has not previously been installed in an application of this size and complexity, requires that 40% of the total contract price be paid after the system has been fully accepted by the customer. As a result of these factors and the inability to make reasonably dependable estimates of progress toward completion and acceptance, we will recognize all revenue and related costs under this contract in the period the system is accepted by the customer. In the fourth quarter of 2005, BMS received notification that the customer had approved an amendment to the original contract increasing the total value of the contract to $8.9 million. Under the terms of the amendment BMS will provide certain additional equipment and services. Through March 25, 2006, we had shipped inventory with a sales value of $8.9 million and deferred costs of approximately $6.6 million resulting in deferred profit of approximately $2.3 million under the contract. In addition, at March 25, 2006 we had unbilled accounts receivable of approximately $3.6 million. We have also provided the customer with a standby letter of credit which was reduced from $2.6 million to $1.0 million during the first quarter of fiscal 2006. At March 25, 2006, approximately $1.0 million may be drawn upon, by the UAE, if BMS does not fulfill the terms of the contract. While customer acceptance and final contract payment has taken longer than anticipated, we believe that such acceptance and payment will be received. However, in the event BMS is unable to obtain customer acceptance of the system, the receivables may need to be written off and the customer might seek a refund of the $5.3 million in payments made under the contract, which could materially impact our results of operations.

As a result of the factors set forth above, our net income was $3.4 million in 2006, compared to net income of $6.5 million in 2005.

LIQUIDITY AND CAPITAL RESOURCES

Our business is dependent on capital expenditures by semiconductor manufacturers and OEM's that are, in turn, dependent on the current and anticipated market demand for semiconductors. Demand for semiconductors is cyclical. In response to this cyclicality, in the past we have implemented cost reduction programs aimed at aligning our ongoing operating costs with our currently expected revenues over the near term. These cost management initiatives have included consolidating facilities, reductions to headcount and reduced spending. The cyclical nature of our industry makes estimates of future revenues, results of operations and net cash flows difficult.

Our primary historical source of liquidity and capital resources is cash flow generated by our operations. While we maintain a credit facility, we have not used this as a source of cash. We use cash to fund growth in our operating assets, including accounts receivable and inventory, and to fund new products and product enhancements primarily through research and development.

Liquidity

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

(in thousands)	March 25, 2006	December 31, 2005	Increase (Decrease)	Percentage Change
Cash, cash equivalents and investments	$ 130,905	$ 138,949	$ (8,044)	(5.8)%
Working capital	206,010	206,295	(285)	(0.0)%

Cash Flows

Operating Activities: Our net cash flows used for operating activities in the first quarter of fiscal 2006 totaled $1.5 million. The major components of cash flows provided by operating activities were net income of $3.4 million, offset by depreciation and amortization of $1.5 million, non cash share-based compensation expense of $0.8 million, an increase in deferred tax assets of $2.5 million, tax benefits from stock options exercised of $0.8 million, and other net changes in current assets. The net change in current assets and liabilities included increases in accounts receivable and inventories of $7.1 million and $2.2 million, respectively. The increase in accounts receivable was primarily attributable to the timing of cash collections and the increase in inventory was, in part, attributable to inventory acquired in the Unigen transaction.

Investing Activities: Our net cash used for investing activities in 2006 totaled $9.3 million and was primarily the result of $56.9 million cash used for purchases of short-term investments; partially offset by $56.1 million in net proceeds from sales and maturities of short-term investments. Our other expenditures, in the first fiscal quarter of 2006 were $8.5 million and include the purchase of Unigen assets for $7.7 million, and purchases of property, plant and equipment of $0.8 million. The acquisition of the Unigen assets was a strategic transaction to strengthen the portfolio of thermal products, patents and know-how within our semiconductor equipment business. The purchases of property, plant and equipment were primarily made to support activities in our semiconductor equipment business and consisted primarily of equipment used in engineering, manufacturing and related functions.

Financing Activities: Our net cash provided from financing activities included $2.5 million received from the issuance of stock upon the exercise of stock options, and the tax benefits from stock options exercised of $0.8 million, offset by $1.3 million for the payment of dividends.

Capital Resources

In June 2005, we renewed our $5.0 million unsecured bank line of credit bearing interest at the bank's prime rate. The line of credit will expire in July 2006, and requires that we maintain specified minimum levels of net worth, limits the amount of our capital expenditures and requires us to meet certain other financial covenants. We are currently in compliance with these covenants. No borrowings were outstanding at March 25, 2006; however, $1.0 million of the credit facility was allocated to standby letters of credit at March 25, 2006, leaving the balance of $4.0 million available for future borrowings.

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

Contractual Obligations And Off-Balance Sheet Arrangements

Contractual Obligations: Our significant contractual obligations consist of operating leases and have not changed materially from those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2005.

Purchase Commitments: From time to time, we enter into commitments with our vendors 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 do not have significant agreements for the purchase of raw materials or other goods specifying minimum quantities or set prices that exceed our expected requirements for the next three months.

Off-Balance Sheet Arrangements: During the ordinary course of business, we provide standby letters of credit instruments to certain parties as required. As of March 25, 2006, the maximum potential amount of future payments that we could be required to make under these standby letters of credit was approximately $1.0 million. No liability has been recorded in connection with these arrangements beyond those required to appropriately account for the underlying transaction being guaranteed. We do not believe, based on historical experience and information currently available, that it is probable that any amounts will be required to be paid under these arrangements.

TRENDS, RISKS AND UNCERTAINTIES

The semiconductor industry we serve is highly volatile and unpredictable.

Visibility into our markets is limited. Our operating results are substantially dependent on our semiconductor equipment business. This capital equipment business is in turn 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 manufacturers and semiconductor 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 the years ended December 31, 2005, 2004, and 2003, we recorded pretax inventory-related charges of approximately $6.2 million, $5.8 million, $4.6 million, respectively, primarily as a result of changes in customer forecasts.

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

A relatively small number of customers historically have been responsible for a significant portion of our net sales. In the year ended December 31, 2005, three customers of the semiconductor equipment segment accounted for 63% (54% in 2004, and 58% in 2003) of our net sales. During the past five years, the percentage of our sales derived from each of these and other significant customers has varied greatly. Such variations are due to changes in the customers’ business 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, outsourcing final semiconductor test to test subcontractors that are not our customers or other factors, would adversely impact our business, financial condition and results of operations. Furthermore, the concentration of our revenues in a limited number of large customers may cause significant fluctuations in our future annual and quarterly 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 an inordinately large number of participants resulting in intense competitive pricing pressures. Future competition may include companies that do not currently supply test handlers. The Japanese and Korean markets for test handling equipment are large and represent a significant percentage of the worldwide market. During the last five years we have had only limited sales to Japanese and Korean customers who have historically purchased test handling equipment from Asian suppliers. Some of our competitors have substantially greater financial, engineering, manufacturing and customer support capabilities and offer more extensive product offerings than Cohu. In addition, there are emerging semiconductor equipment companies that provide or may provide innovative technology incorporated in products that may compete favorably 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 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 of KryoTech and Unigen, 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 test handling methodologies and the custom nature of our inventory parts increases the risk that our established products and related inventory may become obsolete, resulting in significant excess and obsolete inventory exposure. This increased exposure resulted in significant charges to operations during each of the years in the three-year period ended December 31, 2005. 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 test handling 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 test handler 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 test handling 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 new integrated circuit test handling 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 semiconductor test handler products that are capable of achieving broad market acceptance. As a result, we might not accurately assess the semiconductor industry's future test handler 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 handler 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 test handlers. In addition, as is common with semiconductor equipment, our after sale support and warranty costs have been significantly higher with new test handlers 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.

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 to determine 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.

We are exposed to risks associated with acquisitions and investments.

We have made, and may in the future make, acquisitions of, or significant investments in, businesses with complementary products, services and/or technologies. Acquisitions and investments involve numerous risks, including, but not limited to:

- difficulties and increased costs in connection with integration of the personnel, operations, technologies and products of acquired businesses;
- diversion of management's attention from other operational matters;
- the potential loss of key employees of 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.

Additionally, such acquisitions or investments may result in immediate charges to operating results. 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.

We have taken remedial measures to address previous slowdowns in the semiconductor equipment industry that may affect our ability to be competitive.

In the past, we have taken remedial measures to address the slowdown in the market for our products. In particular, we reduced our workforce, delayed salary increases, reduced senior executives' pay, implemented furloughs, reduced expense budgets and announced facility consolidations including Delta Design's Columbus, Ohio and Littleton, Massachusetts operations into our Poway, California facility. Each of these measures could have long-term effects on our business by reducing our pool of technical talent, decreasing or slowing improvements in our products and making it more difficult for us to respond to our customer's needs.

Our backlog is limited and may not accurately reflect future business activity.

Our order backlog has historically represented approximately three months of business. Due to the possibility of customer changes in delivery schedules, cancellation of orders, potential delays in product shipments, difficulties in obtaining inventory parts from suppliers, failure to satisfy customer acceptance requirements and the inability to recognize revenue under accounting requirements, our backlog at any point in time may not be representative of sales in any future period. Furthermore, all orders are subject to cancellation or rescheduling by the customer with limited penalty. A reduction in backlog during any particular period could have a material adverse effect on our business, financial condition and results of operations. In addition, our backlog at March 25, 2006, may not be a reliable indicator of revenues in future periods due to delayed delivery dates or customer requested changes to delivery schedules, order cancellations and delays in recognizing revenue due to accounting requirements.

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

The semiconductor equipment industry is characterized by dramatic and sometimes volatile changes in demand for its products. Changes in product demand result from a number of factors including the semiconductor industry's continually changing and unpredictable capacity requirements and changes in integrated circuit design and packaging. Sudden changes in demand for semiconductor equipment have a significant impact on our operations. Typically, we reduce and increase our workforce, particularly in manufacturing, based on customer demand for our products. These changes in workforce levels place enormous demands on our employees, operations and infrastructure since newly hired personnel rarely possess the expertise and level of experience of current employees. Additionally, these transitions divert management time and attention from other activities and adversely impact employee morale. We have in the past and may in the future experience difficulties, particularly in manufacturing, in training and recruiting the large number of additions to our workforce. The volatility in headcount and business levels, combined with the cyclical nature of the semiconductor industry, may require that we invest substantial amounts in new operational and financial systems, procedures and controls. We may not be able to successfully adjust our systems, facilities and production capacity to meet our customers' changing requirements. The inability to meet such requirements will have an adverse impact on our business, financial position and results of operations.

We do not participate in the gravity-feed and DRAM test handler markets.

Pick-and-place handlers used in DRAM applications account for a significant portion of the worldwide test handler market and our market share in the DRAM segment is negligible. In addition, gravity-feed test handlers are used in numerous non DRAM applications and continue to represent a significant portion of the worldwide test handler market. Because we do not participate in the DRAM and/or gravity-feed market segments, our total available sales market is limited.

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

We are a global corporation with offices and subsidiaries around the world to support our sales and services to the global semiconductor industry and, as such, we face risks in doing business abroad that we do not face domestically. Certain aspects inherent in transacting business internationally could negatively impact our operating results, including:

- costs and difficulties in staffing and managing international operations;
- unexpected changes in regulatory requirements;
- difficulties in enforcing contractual and intellectual property rights;
- longer payment cycles;

- local political and economic conditions;
- potentially adverse tax consequences, including restrictions on repatriating earnings and the threat of “double taxation”; and
- fluctuations in currency exchange rates, which can affect demand 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.

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.

We cannot provide assurance that we will continue to declare dividends at all or in any particular amounts.

We intend to continue to pay quarterly dividends subject to capital availability and periodic determinations that cash dividends are in the best interest of the 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, creation and expansion of sales distribution channels, investments and acquisitions, legal risks and stock repurchases.

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, and certain of these patent rights are licensed from third parties and we may not be able to negotiate extensions of any such licenses that have or may expire and these rights may cease to provide significant competitive advantages. 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.

During the year ended December 31, 2005, 75.4% of our total net sales were exported to foreign countries, including 85.4% of the sales in the semiconductor equipment segment. 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 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.

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 San Diego, California, where the majority of our personnel are located, is very 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.

Our non-semiconductor equipment businesses have experienced little or no growth and have generated significant losses.

We develop, manufacture and sell products used in closed circuit television, metal detection and microwave communications applications. These products are sold in highly competitive markets and many competitors are segments of large, diversified companies with substantially greater financial, engineering, marketing, manufacturing and customer support capabilities than Cohu. In addition, there are smaller companies that provide or may provide innovative technology in products that may compete favorably against our own products. We have seen a significant decline in the operating results of these businesses over the last several years with increasing losses and the future prospects for certain of these businesses remain uncertain. We may not be able to continue to compete successfully in these businesses.

New accounting rules may impact our future operating results.

A change in accounting standards or a change in existing taxation rules can have a significant effect on our reported results. New accounting pronouncements and taxation rules and varying interpretations of accounting pronouncements have occurred and may occur in the future. These new accounting pronouncements and taxation rules may adversely affect our reported financial results or the way we conduct our business.

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:

- timing of orders from customers and shipments to customers;
- inability to recognize revenue due to accounting requirements;
- impact of foreign currency exchange rates on the price of our products in international locations;
- inventory writedowns; and
- inability to deliver solutions as expected by our customers.

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 generally. This could cause the market price of our stock to decline, perhaps significantly.

We have experienced significant volatility in our stock price.

A variety of factors may cause the price of our stock to be volatile. In recent years, the stock market in general, and the market for shares of high-technology companies in particular, including ours, have experienced extreme price fluctuations, which have often been unrelated to the operating performance of affected companies. During the last three years the price of our common stock has ranged from $13.69 to $29.48. The price of our stock may be more volatile than other companies due to, among other factors, the unpredictable and cyclical nature of the semiconductor industry, our significant customer concentration, intense competition in the test handler industry, our limited backlog making earnings predictability difficult 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.

Recently enacted and future changes in securities laws and regulations have increased our costs.

Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new SEC regulations and Nasdaq National Market rules, are creating challenges for all publicly-held companies. We are committed to maintaining high standards of corporate governance and public disclosure. As a result, our efforts to comply with evolving laws, regulations and standards have resulted in, and are likely to continue to result in, increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities. In particular, our efforts to maintain compliance with Section 404 of the Sarbanes-Oxley Act of 2002 and the related regulations regarding our required assessment of our internal controls over financial reporting and our external auditors' audit of that assessment has required the commitment of significant financial and managerial resources. We expect these efforts to require the continued commitment of significant resources. Further, our board members, chief executive officer and chief financial officer could face an increased risk of personal liability in connection with the performance of their duties. As a result, we may have difficulty attracting and retaining qualified board members and executive officers, which could harm our business.

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

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 an operation in the Philippines that fabricates certain component parts used in our semiconductor test handlers. These regions are known for being vulnerable to natural disasters and other risks, such as earthquakes, tsunamis, fires, floods and Avian (bird) flu, which at times have disrupted the local economies. A significant earthquake or tsunami could materially affect operating results. We are not insured for most losses and business interruptions of this kind, and do not presently have redundant, multiple site capacity in the event of a natural disaster. In the event of such disaster, our business would suffer. Furthermore, BMS is currently involved in a significant contract with the United Arab Emirates. Continued terrorist attacks or threats in this region may cause geopolitical instability that may have an adverse effect on our ability to successfully satisfy customer acceptance requirements and recognize revenue under the contract, which could materially impact our results of operations and financial condition.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Interest rate risk.

At March 25, 2006 our investment portfolio includes fixed-income securities with a fair value of approximately $101.0 million. These securities are subject to interest rate risk and will decline in value if interest rates increase. Due to the relatively short duration of our investment portfolio, an immediate ten percent change in interest rates (e.g. 3.00% to 3.30%) would have no material impact on our financial condition or results of operations.

Foreign currency exchange risk.

We generally conduct business, including sales to foreign customers, in U.S. dollars and as a result we have limited foreign currency exchange rate risk. Monetary assets and liabilities of our foreign operations are not significant. The effect of an immediate ten percent change in foreign exchange rates would not have a material impact on our financial condition or results of operations.

Item 4. Controls and Procedures.

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

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

During the last fiscal quarter, there have been no changes in the Company’s internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

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Part II OTHER INFORMATION

Item 1. Legal Proceedings

The information set forth above under Note 8 contained in the "Notes to Unaudited Condensed Consolidated Financial Statements" is incorporated herein by reference.

Item 1A. Risk Factors

A description of the risk factors associated with our business is included under "Trends, Risks and Uncertainties" in "Management's Discussion and Analysis of Financial Condition and Results of Operations", contained in Item 2 of Part I of this report. This description includes any material changes to and supersedes the description of the risk factors associated with our business previously disclosed in Item 1A. of our 2005 Annual Report on Form 10-K and is incorporated herein by reference.

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

Recent Sales of Unregistered Securities

None

Issuer Purchases of Equity Securities

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits.

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 for the quarterly period ended June 30, 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. Report on Form 8-K filed with the Securities and Exchange Commission on December 12, 1996
4.1	Rights Agreement dated November 15, 1996, between Cohu, Inc. and ChaseMellon Shareholder Services, L.L.C., incorporated herein by reference from the Cohu, Inc. Report on Form 8-K filed December 12, 1996, Exhibit 4.1
31.1	Certification pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002
31.2	Certification pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

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

	COHU, INC.
	(Registrant)
Date: April 21, 2006	/s/ James A. Donahue
	James A. Donahue
	President & Chief Executive Officer
Date: April 21, 2006	/s/ John H. Allen
	John H. Allen
	Vice President, Finance & Chief Financial Officer

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EXHIBIT INDEX

Exhibit No.	Description
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Exhibit 31.1

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

I, James A. Donahue, certify that:

1. I have reviewed this Form 10-Q of Cohu, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant’s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant’s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: April 21, 2006

/s/ James A. Donahue

James A. Donahue
President and Chief Executive Officer

Exhibit 31.2

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

I, John H. Allen, certify that:

1. I have reviewed this Form 10-Q of Cohu, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 21, 2006

/s/ John H. Allen
John H. Allen
Vice President Finance & Chief Financial Officer

Exhibit 32.1

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

In connection with the accompanying Quarterly Report of Cohu, Inc. (the “Company”) on Form 10-Q for the fiscal quarter ended March 25, 2006 (the “Report”), I, James A. Donahue, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, based on my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: April 21, 2006

/s/ James A. Donahue

James A. Donahue,
President and Chief Executive Officer

Exhibit 32.2

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

In connection with the accompanying Quarterly Report of Cohu, Inc. (the “Company”) on Form 10-Q for the fiscal quarter ended March 25, 2006 (the “Report”), I, John H. Allen, Vice President Finance & Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, based on my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: April 21, 2006

/s/ John H. Allen

John H. Allen,
Vice President Finance & Chief Financial Officer