Zacks Small-Cap Research

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Lisa Thompson
312-265-9154
lthompson@zacks.com

scr.zacks.com

10 S. Riverside Plaza, Suite 1600, Chicago, IL 60606

O_2Micro International Ltd (OIIM-NASDAQ)

OIIM Applies Notebook Expertise to Smartphones to Grow

Current Recommendation	**Buy**
Prior Recommendation	Hold
Date of Last Change	11/12/2013
Current Price (07/31/2015)	$2.47
12- Month Target Price	**$5.00**

OUTLOOK

O_2Micro International is a fabless semiconductor firm that designs, develops and markets high performance integrated circuits primarily for power management and power saving applications for the LED lighting industry. It recently started providing chips for smartphones, capitalizing on its notebook expertise, as smartphones require even more power. We believe this, combined with stability in the TV and notebook markets, could reignite growth. The company trades at an enterprise value of $6 million, which is below liquidating value.

SUMMARY DATA

52-Week High	**$3.20**
52-Week Low	**$1.90**
One-Year Return (%)	**-20.32**
Beta	**1.09**
Average Daily Volume (sh)	**61,004**
Shares Outstanding (mil)	**27**
Market Capitalization ($mil)	**$69**
Short Interest Ratio (days)	**0.36**
Institutional Ownership (%)	**50**
Insider Ownership (%)	**8**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**-18.8**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**NM**
P/E using 2015 Estimate	**NM**
P/E using 2016 Estimate	**NM**
Zacks Rank	**3**

Risk Level	**Above Average**
Type of Stock	**Small-Value**
Industry	**Elec Comp-Semis**
Zacks Rank in Industry	**19 of 45**

ZACKS ESTIMATES

Revenue
(Non-GAAP fully diluted EPS, in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2013	17 A	19 A	19 A	19 A	74 A
2014	17 A	17 A	15 A	14 A	64 A
2015	13 A	15 A	15 E	17 E	61 E
2016					66 E

Earnings per Share
(EPS is non-GAAP earnings before non-recurring items)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2013	-$0.15 A	-$0.13 A	-$0.14 A	-$0.11 A	-$0.53 A
2014	-$0.08 A	-$0.10 A	-$0.09 A	-$0.09 A	-$0.36 A
2015	-$0.11 A	-$0.09 A	-$0.08 E	-$0.03 E	-$0.31 E
2016					-$0.21 E

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O2Micro's Notebook Expertise Could Lead to Big Sales in Smartphones

O2 Micro's Q2 revenues and earnings were on target with estimates. The company is narrowing the decline in revenues and reducing losses. Revenues were down 16% from $17.4 million to $14.7 million, but more importantly, up 12% sequentially. Gross margins declined to 49.6% from 51.5%, but operating expenses were reduced 13% from $12.1 million to $10.2 million, and the operating loss shrunk from $3.1 million last year to $2.9 million this year. Non-GAAP EPS (ex-stock based compensation) was a loss of $0.09 versus a loss of $0.10 last year.

The company is still on track to resume revenue growth, which could be as soon as Q3 or Q4. While the year over year decline in notebooks continued, sequentially it believes that declines in notebook and TV revenues are over. In fact, TV backlighting grew sequentially and is expected to continue to do so. Trendforce predicts that global notebook shipments will decline 5% in 2015, so this may or may not be true for the industry. At this point **the most important metric for the stock is success in penetrating the smartphone market** where the company should have significant competitive advantages due to its expertise in battery management and power developed in its notebook and portable power businesses. Smartphone shipments are predicted by Trendforce to grow 8.2% with the Chinese manufacturers, O2Micro's current customer base, are expected to grow even faster.

Table 2: Top 5 Chinese Smartphone Brands by Shipments, 1Q15~2Q15

Company	2Q15		1Q15	
	Ranking	Market share	Ranking	Market share
Huawei	1	18.3%	1	18.9%
Xiaomi	2	14.3%	3	14.7%
Lenovo	3	12.7%	2	15.7%
TCL	4	10.0%	4	9.2%
OPPO	5	8.4%	5	8.7%
Others	--	36.3%	--	32.8%
Shipment Total (Unit: K)		125,500		108,600

TRENDFORCE

Note: Data are preliminary and subject to change.
Source: TrendForce, Jul., 2015

The company believes its cash flow breakeven is still $17.5-18.5 million and its earnings breakeven to $20-21 million.

Activists remain in the stock and could spur actions to increase shareholder value, but as if yet we have not seen any different company strategy. It is possible that their presence has accelerated right-sizing actions, but we have not seen evidence of that. Perhaps if the company continues to make progress toward revenue and earnings growth they will be satisfied in lieu of an outright sale of the company.

The key to OIIM is actually performance. The company has cried wolf too many times and must put up numbers and show growth. Increasingly however it seems they may be able to do this based on smartphones and evidenced by design wins in the next generation of high power smartphones (4 core and above) just beginning to dominate the market.

Q3 Should Again be Sequentially Up

This quarter's revenues are again expected to be up sequentially, but may be flat with last year. The company has given a range expectation of $15.0 million to $16.2 million versus $15.4 last year. At any rate we look for the operating loss to be again lessened sequentially and year over year. We are looking for a non-GAAP loss of $0.08 for the quarter versus a loss of $0.09 a year ago.

Smartphones Could Be the Key to Revive Growth

In Q1 the company's first product for power management for the tablet and smartphone market began shipping. It should generate noticeable revenues in Q4. Smartphone volumes dwarf O2Micros's traditional major market, TVs. IDC believes 1.3 billion smartphones were shipped in 2014 versus 200 million televisions, according to Faultline. Additonally, the television market has been falling, in contrast to the high growth of smartphones.

Although revenues from smartphones will build gradually, the huge size of the smartphone market could be the savior of the company. It is pursuing the Chinese-based market and had landed four Tier 2 players in that market. These companies will be building inventory soon for the holiday selling season.

Table 1: Top 5 Global Smartphone Brands by Shipments, 1Q15~2Q15

Company	2Q15		1Q15	
	Ranking	Market share	Ranking	Market share
Samsung	1	26.8%	1	26.8%
Apple	2	16.4%	2	20.5%
Huawei	3	7.6%	3	6.9%
Xiaomi	4	5.9%	6	5.4%
LG	5	5.8%	5	5.5%
Others	--	37.5%	--	34.9%
Shipment Total (Unit: K)		304,090		298,440

Note: Data are preliminary and subject to change.
Source: TrendForce, Jul., 2015

Notebook and Portable Power Management Expertise Applied to Smartphone

Since the smartphone was invented, processing power and battery power have kept increasing to where they are, in effect, notebook computers, where O2Micro has expertise. It is now applying its solutions to handset makers with five separate products.

1. Fast Charging

As batteries get bigger, they also take longer to charge. O2Micro provides an IC used on the motherboard to enable "fast charge" technology.

2. Battery Fuel (Gas) Gauge

The larger the battery, the more accurately it needs to be monitored. Using expertise from the power tool business, O2Mico has a gas gauge that competes well against incumbents like Texas Instruments.

3. Battery to micro USB Type C Connector for On-the-go charging.

A new feature that will be available on a lot of phones next year is a Type C connector for 'on-the-go" charging. It will allow a phone to be hooked up and charge an external device such as a portable hard drive, projector, or the one with the seemingly biggest demand, a set of external speakers. O2Micro has an IC used for this type C connection.

Figure 1: Letv's Le 1 Pro Superphone is the first to market with USB-C.



3. All Three of these Chips in One

4. DC to DC IC for 4-Core and higher

These DC-to-DC products are targeted at the very high-end phones and notebooks. There are many quad-core phones, some octo-core phones and MediaTek is has even introduced a deca-core, the Helio X20, which will succeed the octa-core Helio X10 (MT6795) that's already in several Chinese flagship phones.

VALUATION

Company is Still Valued at Less than Liquidating Value

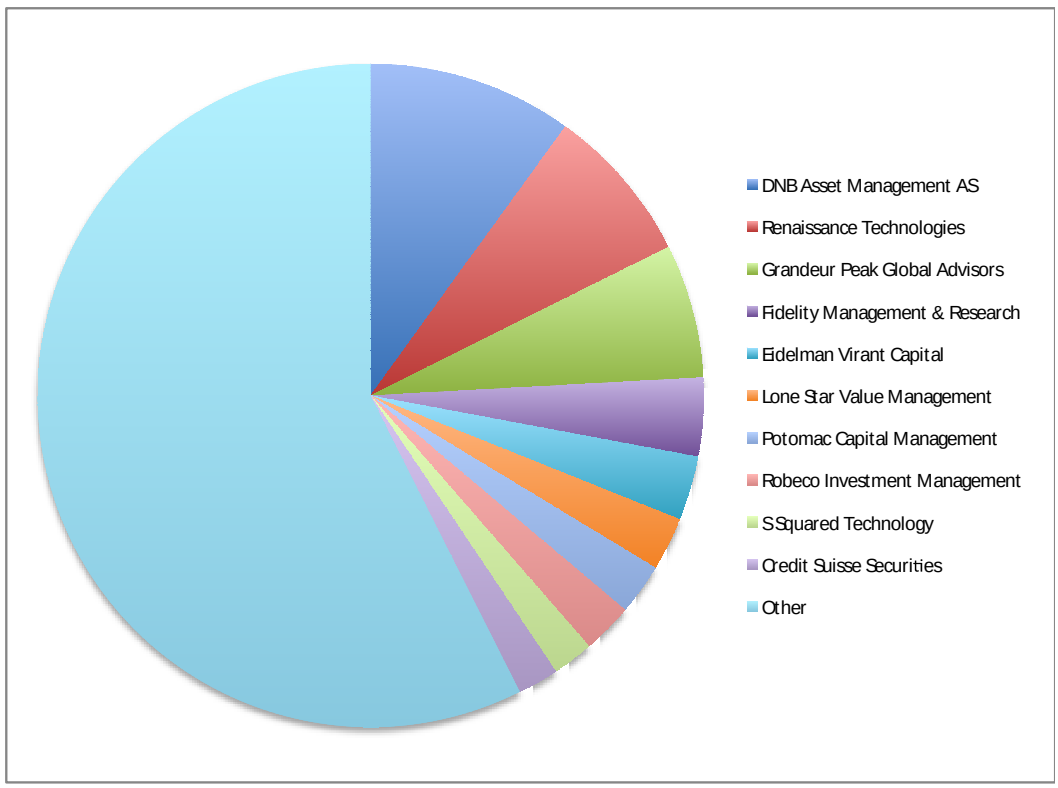
The company trades at an enterprise value of $6 million that is below the value of its remaining real estate. The company is burned $2 million in cash on an operating basis in Q2. It also sold $200,000 in real estate. Next quarter the company should be very closer to cash breakeven.

Were we to use the average enterprise value to trailing twelve-month sales of 3.5 times and apply it to OIIM's current $59 revenue run rate, we would calculate an enterprise value of $206 million. Adding to it $58 million in cash gives us a market cap of $264 million or **$10.10 per share**.

Competitors	EV	TTM Sales	EV/Sales
ISIL	$1,280	$557	2.3
MSCC	3,870	1,220	3.2
MPWR	1,680	296	5.7
CREE	2,020	1,690	1.2
MCHP	8,340	2,150	3.9
LLTC	8,650	1,480	5.8
MXIM	8,910	2,310	3.9
TXN	52,280	13,150	4.0
CRUS	2,110	1,050	2.0
Average			3.5

OWNERSHIP

In the past year, Lone Star, an activist shareholder had bought up to 1.7 million shares. According to a May 2015 filing that stake has been reduced to 0.7 million or 2.6% of the outstanding. The other less-than-5% holders on this chart are as of March 31, 2015.



RISKS

- O_2Micro has exposure several stagnant and declining markets such as TVs and notebooks. It is depending on General LED lighting, battery management, and successful penetration of the smartphone market to give it revenue and margin growth.
- It may be difficult for the company to capture market share in smartphones and tablets as a new entrant in an established field competing primarily with giant Texas Instruments and other larger firms.
- The firm is currently not at breakeven and is cash flow negative and has declining revenues.
- Given its large number of patents, litigation risk is a possibility as the company enforces its patents.

PROJECTED INCOME STATEMENT

	March Q1 14A	June Q2 14A	Sept Q3 14A	Dec Q4 14A	March Q1 15	June Q2 15	Sept Q3 15E	Dec Q4 15E	2012	2013	2014	2015E	2016E
REVENUE													
Net Revenue	16.5	17.4	15.4	14.3	13.1	14.7	15.4	17.3	97.7	73.8	63.6	60.5	66.0
Yr-to-yr Gr.	-5%	-7%	-17%	-25%	-20%	-16%	0%	21%	-21%	-24%	-14%	-5%	9%
OPERATING EXPENSES													
Cost of goods sold	8.0	8.4	7.4	7.0	6.5	7.4	7.5	8.5	44.1	36.4	30.9	30.0	32.0
Gross Margin	8.5	9.0	8.0	7.3	6.6	7.3	7.8	8.8	53.6	37.4	32.7	30.5	34.0
% of Sales	51.5%	51.5%	51.8%	51.0%	50.0%	49.6%	51.0%	51.0%	54.9%	50.7%	51.5%	50.4%	51.5%
R&D	5.1	5.8	5.5	5.6	4.5	3.8	4.6	4.7	34.3	27.0	21.9	17.6	19.6
SG&A	6.5	6.3	6.0	5.8	5.7	6.3	5.9	5.7	34.6	30.9	24.7	23.6	22.8
One-time expenses & Adj.	0.0	0.0	0.0	3.0	0.0	0.0	0.0	0.0	12.7		3.0	0.0	0.0
Tot Operating Exp.	11.6	12.1	11.5	14.4	10.1	10.2	10.5	10.4	81.6	57.9	46.6	41.2	42.4
							3%						
Operating Income	(3.1)	(3.1)	(3.5)	(7.1)	(3.6)	(2.9)	(2.7)	(1.6)	(28.0)	(20.5)	(13.9)	(10.7)	(8.4)
Other Income	0.5	0.1	0.9	1.5	0.6	0.4	0.5	0.4	2.4	2.4	2.9	1.9	2.0
Pretax Income	(2.7)	(3.0)	(2.7)	(5.6)	(3.0)	(2.5)	(2.2)	(1.2)	(25.6)	(18.1)	(10.9)	(8.7)	(6.4)
	-16.1%	-17.0%	-17.5%	-39.1%	-22.6%	-16.7%	-14.0%	-6.8%	-26.2%	-24.5%	-17.2%	-14.5%	-9.7%
Taxes	0.3	0.2	0.3	0.5	0.2	0.3	0.3	0.1	1.1	1.0	1.2	0.9	0.7
Tax Rate	-9.6%	-7.7%	-9.3%	-8.0%	-8.1%	-11.7%	-11.6%	-11.0%	-4.3%	-5.5%	-10.8%	-10.4%	-11.0%
GAAP Net Income	(2.9)	(3.2)	(2.9)	(6.0)	(3.2)	(2.7)	(2.4)	(1.3)	(26.7)	(19.1)	(12.1)	(9.6)	(7.1)
Non-GAAP Net Income						(2.3)	(1.9)						
GAAP EPS-Basic	($0.10)	($0.12)	($0.11)	($0.23)	($0.12)	($0.10)	($0.09)	($0.05)	($0.83)	($0.67)	($0.44)	($0.37)	($0.30)
GAAP EPS-Fully dil.	($0.10)	($0.12)	($0.11)	($0.23)	($0.12)	($0.10)	($0.09)	($0.05)	($0.83)	($0.67)	($0.56)	($0.37)	($0.30)
Non-GAAP	**($0.08)**	**($0.10)**	**($0.09)**	**($0.09)**	**($0.11)**	**($0.09)**	**($0.08)**	**($0.03)**	**($0.33)**	**($0.53)**	**($0.36)**	**($0.31)**	**($0.21)**
Share Out	27.8	27.4	27.2	26.7	26.5	26.1	25.6	25.1	31.0	28.7	27.2	25.8	24.0
Fully diluted shares	27.8	27.4	27.2	26.7	26.5	26.1	25.6	25.1	31.0	28.7	27.2	25.8	24.0
Yr-to-yr Gr.	-0.7%	-1.4%	-0.7%	-1.8%	-5%	-5%	-6%	-6%		-7.5%	-5.1%	-5.2%	-7.0%

BALANCE SHEET

In Thousands $	June 30, 2015	March 31, 2015	June-March % Change
CURRENT ASSETS			
Cash and cash equivalents	$47,506	$45,065	5%
Restricted cash	32	32	0%
Short-term investments	10,734	14,670	-27%
Accounts receivable, net	7,694	6,271	23%
Inventories	8,427	8,215	3%
Prepaid expenses and other current assets	1,146	1,348	-15%
Total current assets	**75,539**	**75,601**	0%
LONG-TERM INVESTMENTS	14,424	14,754	-2%
PROPERTY AND EQUIPMENT, NET	17,163	18,211	-6%
OTHER ASSETS			
Restricted assets			
Intangible assets, net			
Other assets	2,864	2,893	-1%
Total other assets	2,864	2,893	-1%
TOTAL ASSETS	109,990	111,459	-1%
CURRENT LIABILITIES			
Notes and accounts payable	3,901	3,207	22%
Income tax payable	524	620	-15%
Accrued expenses and other current liabilities	4,298	3,347	28%
Total current liabilities	8,723	7,174	22%
OTHER LONG-TERM LIABILITIES			
Accrued pension liabilities	292	292	0%
Other liabilities	270	311	-13%
Total long-term liabilities	562	603	-7%
Total liabilities	9,285	7,777	19%
SHAREHOLDERS EQUITY			
Preference shares at $0.00002 par value per share; Authorized 250,000,000 shares;			
	33	33	0%
Additional paid-in capital	141,050	140,634	0%
Retained earnings (accumulated deficits)	(23,227)	(20,290)	14%
Accumulated other comprehensive income	7,198	6,723	7%
Treasury stock 269,042,350 and 162,072,500 shares as of Dec 31, 2013 and 2012, respectively	(24,349)	(23,218)	5%
Total shareholders equity	100,705	103,882	-3%
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	109,990	111,459	-1%
Cash and equivalents	$58,240	$59,735	-3%
Market value	65,021,370		
Enterprise value	6,749,370		

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Sell/Underperform: The analyst expects the company will underperform the broader U.S. Equity market over the next one to two quarters.

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