Zacks Small-Cap Research

January 28, 2016

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)

Q4 Results: Revenue Decline Decelerates, 2016 Could Show Second Half Growth

Current Recommendation	**Buy**
Prior Recommendation	Hold
Date of Last Change	11/12/2013
Current Price (01/27/2016)	$1.34
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 and TV backlighting. It has had declining revenues and losses for the past few years, but recently started providing chips for smartphones. We believe this new market, combined with stability in the TV and notebook markets, could reignite growth. The company trades at a negative enterprise value of $18 million and there are activists involved in the stock, thus far with no results.

SUMMARY DATA

52-Week High	**$2.80**
52-Week Low	**$1.32**
One-Year Return (%)	**-42.2**
Beta	**0.8**
Average Daily Volume (sh)	**56,578**
Shares Outstanding (mil)	**26**
Market Capitalization ($mil)	**$35**
Short Interest Ratio (days)	**2.17**
Institutional Ownership (%)	**46**
Insider Ownership (%)	**8**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**-19.0**
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	**N/A**

Risk Level	**Above Average**
Type of Stock	**Small-Value**
Industry	**Elec Comp-Semis**
Zacks Rank in Industry	**N/A**

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	14 A	13 A	55 A
2016	13 E	14 E	15 E	15 E	57 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 A	-$0.10 A	-$0.38 A
2016	-$0.09 E	-$0.07 E	-$0.05 E	-$0.05 E	-$0.20 E

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WHAT'S NEW

Revenue Decline Decelerates And Should Stabilize

Despite once again showing declining revenues in the fourth quarter of 2015, O2Micro has managed to slow the revenue declines over the past four quarters. While Q4 2014 showed a -25% year over year decline, Q1 2015 was -20%, Q2 -16%, Q3 -11% and Q4 was -7%. The company believes quarterly revenues may have bottomed at $13.1 million in Q1 2015, and is expecting revenues in Q1 2016 in the range of $12.7 million or $13.6 million, the mid-point of which is $13.2 million.

Q4 Earnings Show Large One-Time Write-Offs Masking Earnings (Loss) Beat

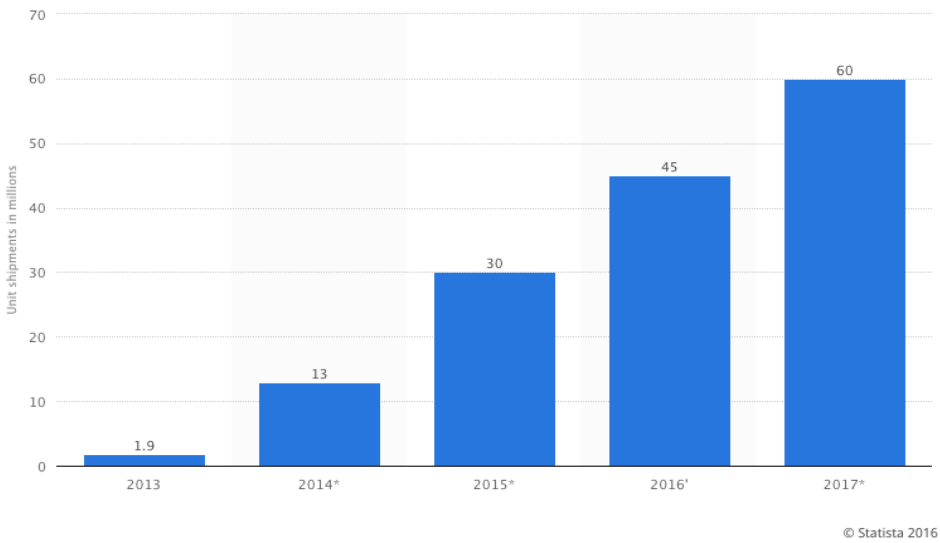
O2Micro released earnings that were better than our expectations but were masked by one-time write-offs that were not called out in the press release. There were three one-time items: employee reduction expense of $1.1 million, a write-down of a long-term asset of $4.9 million, and a tax accrual of $3.8 million. Excluding these items, the **non-GAAP EPS was a loss of $0.10, better than the loss of $0.16 we were expecting**.

The long-term asset that was impaired was an investment in Sigurd Microelectronics (Cayman) Co., Ltd. that was valued on the December 31, 2014 balance sheet at $7.2 million. It was written down by $4.9 million. Sigurd had labor problems and high costs in its factory in Wuxi and decided to shut it down entirely and move it. It is currently shut down. When it is moved and business begins again O2Micro, may adjust the value upwards.

The tax accrual was for taxes that will be due if and when the parent company moves some of the cash from its subsidiaries--taking from retained earnings and redistributing to the parent in the Caymans. This is expected to happen in 2016. The cash is being moved because of the Taiwan currency and amount of accumulated depreciation at the subsidiaries.

Revenues came in at $13.4 million versus $14.3 million, down 7% year over year and 2% sequentially. Business was particularly strong in battery management as more and more appliances and tools become untethered from electrical cords and as lead battery users move to lithium. Backlighting seems to be stabilized as 4k TVs, that use more units and generate more revenue per TV set, grow as a portion of the total TV market. By the end of 2017, most 50-inch-and-larger TVs worldwide will feature 4K resolution, according to IHS Inc. General LED lighting also continues to grow for the company.

Graph 1. Worldwide 4k TV Market in Million of Units



The non-GAAP net loss came in at a $2.5 million, which was an improvement from the $3.4 million loss last quarter and versus our expectation of a loss of $4.2 million. Non-GAAP EPS would have been a loss of $0.10 rather than the reported GAAP loss of $0.50, versus a non-GAAP loss of $0.09 last year and a loss of $0.07 last quarter.

2016 Forecasts

We are maintaining our revenue estimate for 2016 but decreasing the loss per share from $0.25 to $0.20 due to better than expected expense control, rather than improved revenues. The expected pick up in revenues from smartphones has not yet materialized, as the initial handsets using O2Micro chips did not sell as well as expected due to the slowdown in China and competition. O2Micro has design wins with several Tier 2 smartphone manufacturers and has commenced shipments to a global Tier 2 smartphone manufacturer. Hopefully the smartphone business will pick up as other customers and additional handset models are added. The company is having good success in battery management, and as more and more appliances and devices become portable, O2Micro should thrive. They are showing success in tools, vacuums and e-bikes-- especially as they move to lithium from lead batteries.

Lithium battery powered e-bike



O2Micro's Smartphone 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.

4. All Three of these Chips in One

5. 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 has a Negative Enterprise Value

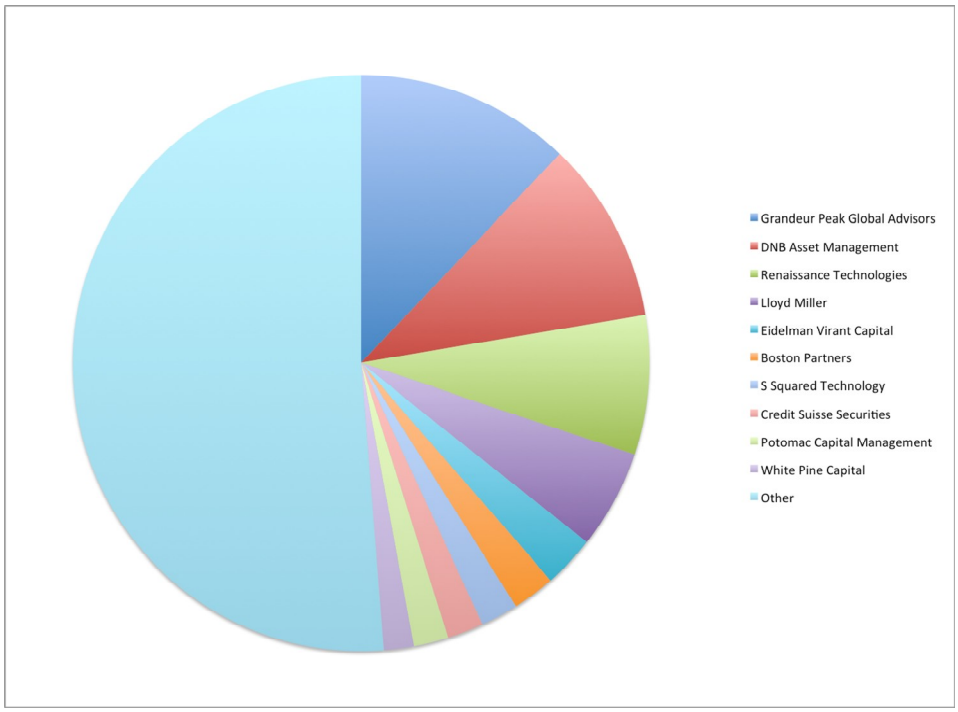
The company trades at a negative enterprise value of $18 million. The company burned $1.6 million in cash in Q4, not including $279,000 in capital expenditures. The company has $52.4 million (or $2.05 per share) in cash, no debt and valuable real estate in China and California. Activists have tried to encourage a transaction with an acquirer but the company has no interest in a sale. In addition to cash the company has valuable real estate and long-term investments in other technology companies.

Were we to use the average enterprise value to trailing twelve-month sales of 3.8 times and apply it to OIIM's Q3 $54 revenue run rate, we would calculate an enterprise value of $201 million. Adding to it $52 million in cash gives us a market cap of $253 million or **$9.88 per share**. This is down since last quarter as revenues declined and comparable multiples also declined.

Competitors	EV	TTM Sales	EV/Sales
ISIL	$1,330	$526	2.5
MSCC	3,710	1,250	3.0
MPWR	2,190	322	6.8
CREE	2,430	1,650	1.5
MCHP	9,670	2,150	4.5
LLTC	8,740	1,440	6.1
MXIM	8,500	2,230	3.8
TXN	52,830	13,080	4.0
CRUS	1,810	1,140	1.6
Average			3.8

OWNERSHIP

There are a number of activist hedge funds still involved in the stock as shown below.



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 and volume sales to 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.
- Despite years of declining business the company has not been able to right size itself into a profitable entity. Activists have taken a position and encouraged the company to seek a sale or more drastic cost cutting action to realize value for shareholders. However to date this effort has not been successful and may never be.

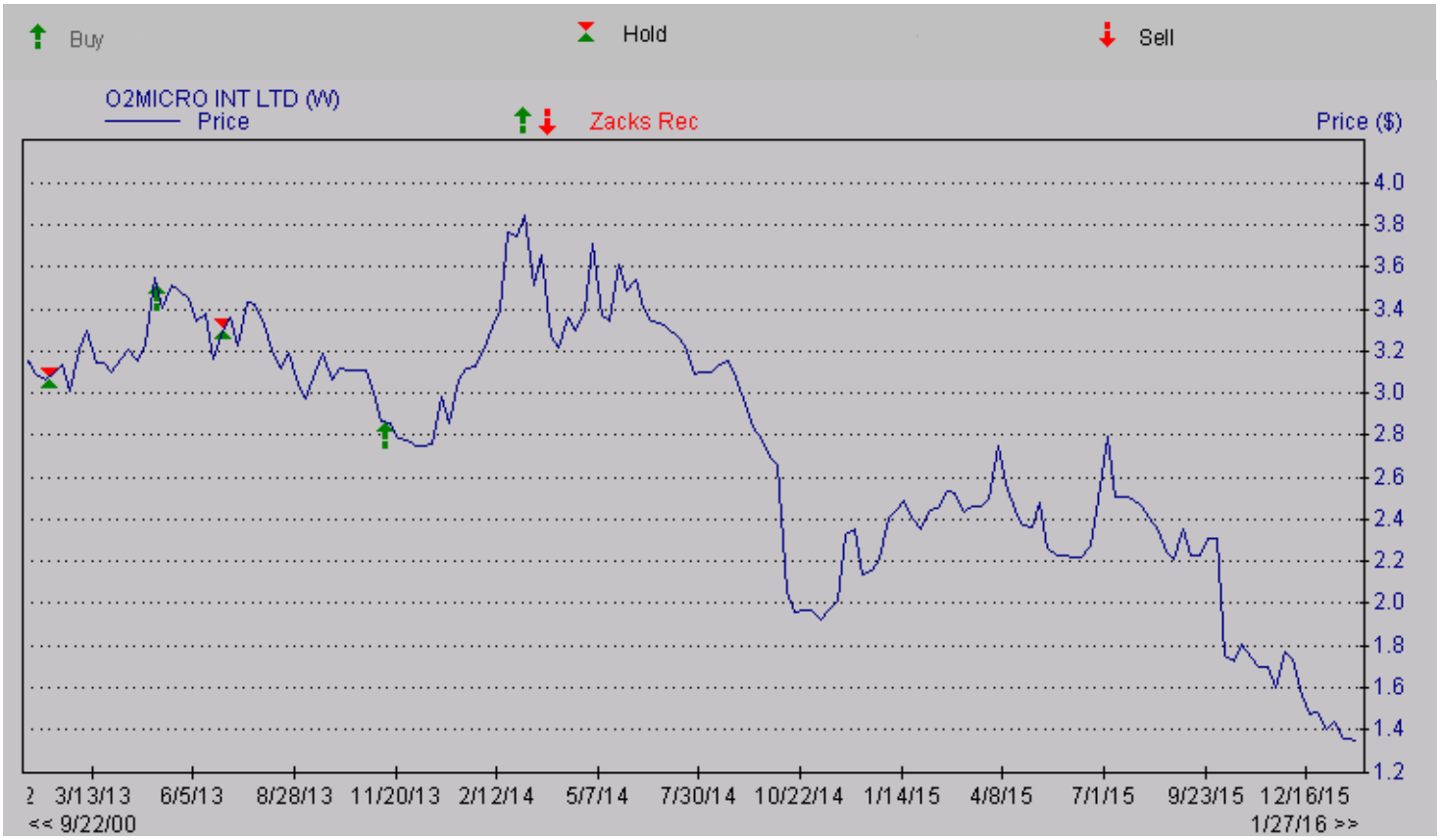
PROJECTED INCOME STATEMENT

	Dec Q4 14A	March Q1 15	June Q2 15	Sept Q3 15	Dec Q4 15	March Q1 16E	June Q2 16E	Sept Q3 16E	Dec Q4 16E	2014	2015	2016E
REVENUE												
Net Revenue	14.3	13.1	14.7	13.7	13.4	12.7	13.8	15.1	15.0	63.6	54.8	56.6
Yr-to-yr Gr.	-25%	-20%	-16%	-11%	-7%	-3%	-6%	10%	12%	-14%	-14%	3%
OPERATING EXPENSES												
Cost of goods sold	7.0	6.5	7.4	6.6	6.6	6.6	7.1	7.0	7.0	30.9	27.1	27.7
Gross Margin	7.3	6.6	7.3	7.1	6.7	6.1	6.7	7.6	7.5	32.7	27.7	28.9
% of Sales	51.0%	50.0%	49.6%	51.0%	50.4%	48.0%	48.6%	50.0%	50.0%	51.5%	50.5%	51.1%
R&D	5.6	4.5	3.8	4.7	4.8	4.3	4.3	4.3	4.4	21.9	17.8	17.3
SG&A	5.8	5.7	6.3	5.8	5.5	4.8	4.9	5.0	5.0	24.7	23.3	19.7
One-time expenses & Adj.	3.0	0.0	0.0	0.0	1.1	0.0	0.0	0.0	0.0	3.0	1.1	0.0
Tot Operating Exp.	14.4	10.1	10.2	10.5	11.4	9.0	9.2	9.3	9.4	46.6	42.3	36.9
Operating Income	(7.1)	(3.6)	(2.9)	(3.4)	(4.7)	(2.9)	(2.5)	(1.8)	(1.9)	(13.9)	(14.6)	(8.0)
Interest income		0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1		0.7	0.4
Foreign exchange loss		0.0	(0.2)	0.8	0.0	0.0	0.0	0.0	0.0		0.7	0.0
Gain on sale of real estate		0.3	0.2	0.3	0.0	0.0	0.0	0.0	0.0		0.8	0.0
Other - net		0.1	0.2	0.1	0.4	0.4	0.4	0.4	0.4		0.7	1.6
Impairment loss on long term investments		0.0	0.0	0.0	(5.0)	0.0	0.0	0.0	0.0		(5.0)	
Total other Income	1.5	0.6	0.4	1.3	(4.4)	0.5	0.5	0.5	0.5	2.9	(2.0)	2.0
Pretax Income	(5.6)	(3.0)	(2.5)	(2.1)	(9.1)	(2.4)	(2.0)	(1.3)	(1.4)	(10.9)	(16.6)	(6.0)
	-39.1%	-22.6%	-16.7%	-15.1%	-68.1%	-18.8%	-14.5%	-8.3%	-9.3%	-17.2%	-30.3%	-10.6%
Taxes	0.5	0.2	0.3	0.3	3.8	0.3	0.3	0.3	0.3	1.2	4.6	1.0
Tax Rate	-8.0%	-8.1%	-11.7%	-13.9%	-10.9%	-11.0%	-11.0%	-11.0%	-11.0%	-10.8%	-28.0%	-11.0%
GAAP Net Income	(6.0)	(3.2)	(2.7)	(2.4)	(12.9)	(2.6)	(2.3)	(1.5)	(1.7)	(12.1)	(21.2)	(7.0)
Non-GAAP Net Income		(2.9)	(2.3)	(1.9)	(2.5)	(2.2)	(1.8)	(1.1)	(1.2)		(9.7)	(6.3)
GAAP EPS-Basic	($0.23)	($0.12)	($0.10)	($0.09)	($0.50)	($0.10)	($0.09)	($0.06)	($0.07)	($0.44)	($0.82)	($0.28)
GAAP EPS-Fully dil.	($0.23)	($0.12)	($0.10)	($0.09)	($0.50)	($0.10)	($0.09)	($0.06)	($0.07)	($0.56)	($0.82)	($0.28)
Non-GAAP	**($0.09)**	**($0.11)**	**($0.09)**	**($0.07)**	**($0.10)**	**($0.09)**	**($0.07)**	**($0.05)**	**($0.05)**	**($0.36)**	**($0.37)**	**($0.20)**
Share Out	26.7	26.5	26.1	25.9	25.6	25.4	25.2	25.0	24.8	27.2	26.0	25.1
Fully diluted shares	26.7	26.5	26.1	25.9	25.6	25.4	25.2	25.0	24.8	27.2	26.0	25.1
Yr-to-yr Gr.	-1.8%	-5%	-5%	-5%	-4%	-4%	-3%	-3%	-3%	-5.1%	-4.5%	-3.5%

BALANCE SHEET

	Dec 31, 2015	Sept. 30, 2015
CURRENT ASSETS		
Cash and cash equivalents	$41,199	$43,261
Restricted cash	31	30
Short-term investments	11,233	11,721
Accounts receivable, net	5,197	6,980
Inventories	9,662	9,214
Prepaid expenses and other current assets	1,126	1,218
Assets held for sale	1,956	
Total current assets	**70,404**	**72,424**
LONG-TERM INVESTMENTS	9,304	14,257
PROPERTY AND EQUIPMENT, NET	14,011	15,683
OTHER ASSETS		
Total other assets	2,489	2,692
TOTAL ASSETS	96,208	105,056
CURRENT LIABILITIES		
Notes and accounts payable	3,333	3,539
Income tax payable	2,245	749
Accrued expenses and other current liabilities	7,102	4,188
Total current liabilities	12,680	8,476
OTHER LONG-TERM LIABILITIES		
Accrued pension liabilities	272	270
Other liabilities	139	184
Total long-term liabilities	411	454
Total liabilities	13,091	8,930
SHAREHOLDERS EQUITY		
Preference shares at $0.00002 par value per share; Authorized 250,000,000 shares;	33	33
Additional paid-in capital	141,886	141,470
Retained earnings (accumulated deficits)	(38,386)	(25,589)
Accumulated other comprehensive income	4,824	5,020
Treasury stock	(25,240)	(24,808)
Total shareholders equity	83,117	96,126
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	96,208	105,056
Cash and equivalents	$52,432	$54,982
Market value	35,736,480	43,246,320
Enterprise value	(16,726,520)	(11,765,680)
AR	41	48
DSO	148	121

HISTORICAL ZACKS RECOMMENDATIONS



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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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