Zacks Small-Cap Research

May 26, 2015

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O_2Micro International Ltd (OIIM-NASDAQ)

OIIM: Smartphone Chip Sales Could Return the Company to Growth

Current Recommendation	**Buy**
Prior Recommendation	Hold
Date of Last Change	11/12/2013
Current Price (05/25/2015)	$2.23
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. The company trades at cash. It also has $20-30 m in investments in real estate other companies and is below liquidating value. Shareholder activists have taken notice and we hope for this to spur change and increase shareholder value in advance of revenue growth.

SUMMARY DATA

52-Week High	**$3.62**
52-Week Low	**$1.90**
One-Year Return (%)	**-38.32**
Beta	**1.24**
Average Daily Volume (sh)	**114,089**
Shares Outstanding (mil)	**27**
Market Capitalization ($mil)	**$59**
Short Interest Ratio (days)	**0.91**
Institutional Ownership (%)	**50**
Insider Ownership (%)	**8**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**-18.4**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2015 Estimate	**N/A**
P/E using 2016 Estimate	**N/A**
Zacks Rank	**2**

Risk Level	**Above Average**
Type of Stock	**Small-Value**
Industry	**Elec Comp-Semis**
Zacks Rank in Industry	**9 of 44**

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 E	15 E	17 E	60 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	-$0.08 E	-$0.05 E	-$0.02 E	-$0.27 E
2016					-$0.24 E

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WHAT'S NEW

Stabilized Markets and New Smartphone Penetration Could Lead to Growth

O2 Micro's Q1 revenues and earnings were on target although again showing declining revenues and earnings. Revenues were down 20% from $16.5 million to $13.1 million. Gross margins decline to 50% from 51.5% and operating expenses only declined 13%, leading to greater losses. Non-GAAP EPS was a loss of $0.11 versus a loss of $0.08, clearly going in the wrong direction.

The company believes that declines in notebook and TV revenues are over and it is having success in other product lines to move back to growth possibly by Q4.

The company maintained the belief its cash flow breakeven is $17-18 million and its earnings breakeven to $20-21 million but this quarter's reported revenues of $13.1 million puts it further away from its goal rather than closer.

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. The company remains undervalued as an acquisition candidate even with its declining revenues based solely on its owned assets.

Investors can look either to change at the company, a bid from another company, or long term investors could wait until next year to find out if the company can develop meaningful revenues from smartphones and tablets.

Q2 Should be Sequentially Up

This quarter revenues are expected to be up sequentially but will once again be down year over year. We are looking for revenues of $14.5 a decline of 17% year over year. Losses should decline with this added volume and a further reduction in operating expenses. We are looking for a loss of $0.08 for the quarter versus a loss of $0.10 a year ago.

Smartphones Could Revive Growth

In Q1 the company's first product for power management for the tablet and smartphone market began shipping. 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 two Tier 2 players in that market.

Table 1: Top Ten Smartphone Vendors Based on Market Share

Rankings	2013 Company	Market Share	2014 Company	Market Share	2015 Company	Market Share (F)
1	Samsung	32.5%	Samsung	28.0%	Samsung	26.6%
2	Apple	16.6%	Apple	16.4%	Apple	16.4%
3	Lenovo	4.9%	Lenovo + Motorola	7.9%	Lenovo	7.4%
4	Huawei	4.4%	LG	6.0%	Huawei	6.6%
5	LG	4.3%	Huawei	5.9%	Xiaomi	6.5%
6	Sony	4.1%	Xiaomi	5.2%	LG	6.1%
7	Coolpad	3.6%	Coolpad	4.2%	TCL	4.1%
8	ZTE	3.2%	Sony	3.9%	Coolpad	4.0%
9	Nokia	3.0%	ZTE	3.1%	ZTE	3.4%
10	RIM	2.5%	TCL	2.7%	Sony	3.1%
	Others	20.9%	Others	16.7%	Others	15.8%
Shipment Total (Unit:M)		**927.2**		**1,166.9**		**1,290.3**

Source: Trendforce, Jan., 2015

In general, the Chinese manufacturers are taking market share from Samsung and other countries and O2 plans to stay in the Chinese market for now. In China, domestic companies Xiaomi and Huawei are number one and three in market share, with 12.8% and 10.2% respectively, according Strategy Analytics. Apple with 10.9% of the market takes the number two spot. We believe that O2Micro is pursuing design activity at the Chinese tier 1 vendors, Huawei and Xiaomi, and may have even landed a design win at the former. While being designed into the novel Amazon phone was interesting, these high volume vendors will be where a business is built.

In this market, the company competes almost exclusively with TI, who has almost 75% market share. O2Micro believes its products have some advantages. It has a chip that combines three of TI's chips in one, making a solution less expensive and smaller. It has a chip, designed for the power tool industry that is more accurate. It also has a number of chips for different uses that TI does not sell making it easier for manufacturers to deal with one, rather than multiple, vendors.

News of design wins at these top tier players could begin to move the stock, even before revenues ramp meaningfully next year.

VALUATION

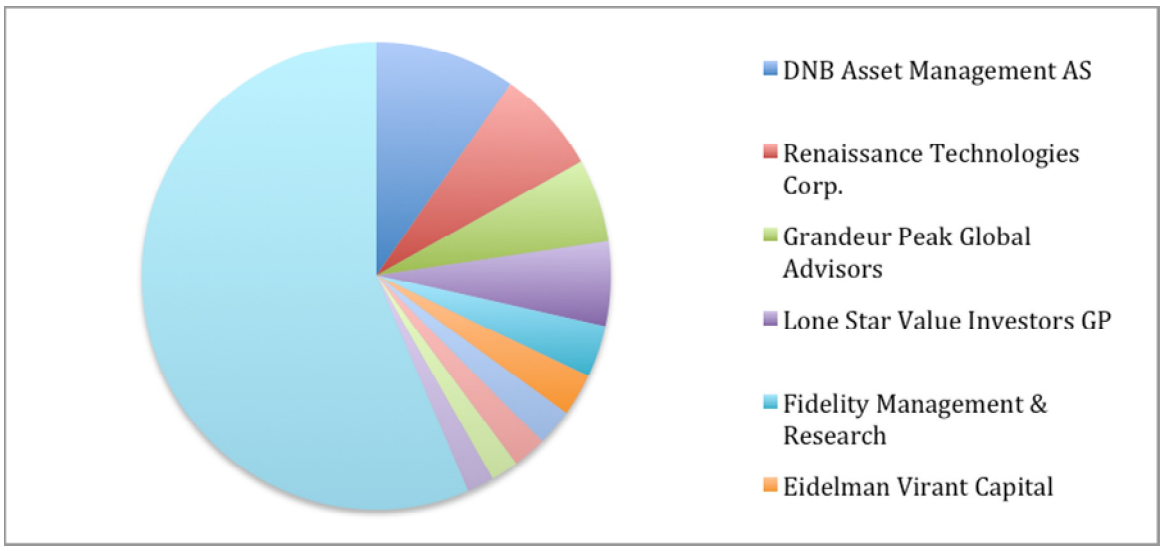
Balance Sheet Assets are Still Worth More than $100 Million

The company is now trading at its cash value. Additionally, the company still has $20-30 million in other assets, so is below its liquidation value on assets alone.

Were we to use the average enterprise value to trailing twelve-month sales of 4.2 times and apply it to OIIM's current $52 revenue run rate, we would calculate an enterprise value of $218 million. Adding to it $60 million in cash gives us a market cap of $278 million or **$10.50 per share**.

Competitors	EV	TTM Sales	EV/Sales
ISIL	$1,710	$563	3.0
MSCC	3,910	1,190	3.3
MPWR	1,870	296	6.3
CREE	2,960	1,690	1.8
MCHP	10,170	2,100	4.8
LLTC	10,450	1,460	7.2
MXIM	9,450	2,400	3.9
TXN	58,480	13,210	4.4
CRUS	2,160	811	2.7
Average			4.2

OWNERSHIP



RISKS

- O_2Micro has exposure several stagnant and declining markets such as TVs and notebooks. It is depending on General LED lighting and battery management to give it revenue and margin growth near term and long term on penetrating the smartphone and tablet market.

- 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.

- The firm is currently not at breakeven and is cash flow negative and has declining revenues.

- Given the large number of patents litigation risk is a possibility as the company enforces its patents.

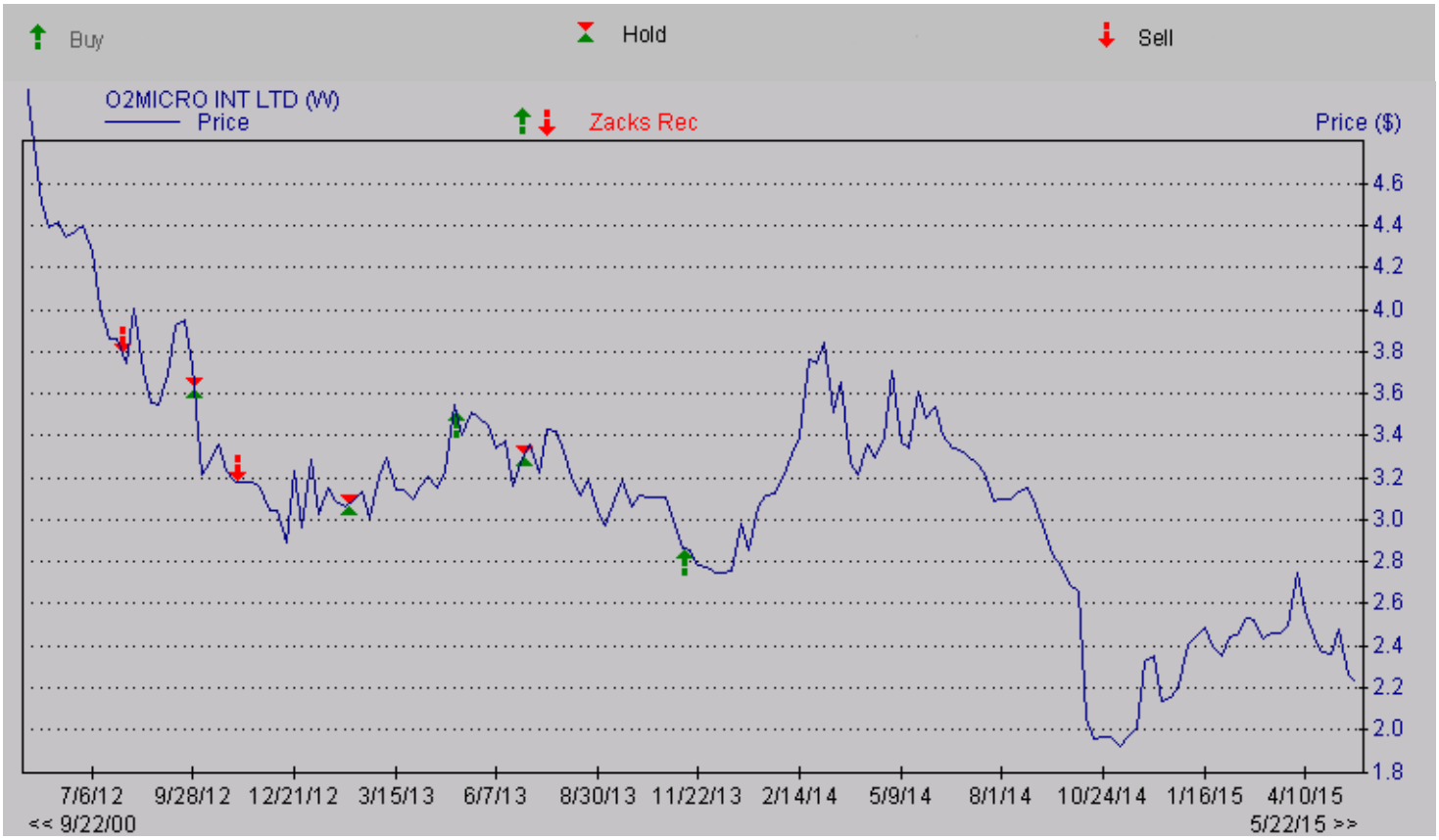
PROJECTED INCOME STATEMENT

	March Q1 14A	June Q2 14A	Sept Q3 14A	Dec Q4 14A	March Q1 15	June Q2 15E	Sept Q3 15E	Dec Q4 15E	2012	2013	2014	2015E	2016E
REVENUE													
Net Revenue	16.5	17.4	15.4	14.3	13.1	14.5	15.4	17.3	97.7	73.8	63.6	60.3	66.0
Yr-to-yr Gr.	-5%	-7%	-17%	-25%	-20%	-17%	0%	21%	-21%	-24%	-14%	-5%	9%
OPERATING EXPENSES													
Cost of goods sold	8.0	8.4	7.4	7.0	6.5	7.5	7.5	8.5	44.1	36.4	30.9	30.1	32.0
Gross Margin	8.5	9.0	8.0	7.3	6.6	7.0	7.8	8.8	53.6	37.4	32.7	30.2	34.0
% of Sales	51.5%	51.5%	51.8%	51.0%	50.0%	48.0%	51.0%	51.0%	54.9%	50.7%	51.5%	50.1%	51.5%
R&D	5.1	5.8	5.5	5.6	4.5	4.5	4.6	4.7	34.3	27.0	21.9	18.3	21.0
SG&A	6.5	6.3	6.0	5.8	5.7	5.7	5.7	5.7	34.6	30.9	24.7	22.8	22.0
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	10.3	10.4	81.6	57.9	46.6	41.0	43.0
							1%						
Operating Income	(3.1)	(3.1)	(3.5)	(7.1)	(3.6)	(3.2)	(2.5)	(1.6)	(28.0)	(20.5)	(13.9)	(10.8)	(9.0)
Other Income	0.5	0.1	0.9	1.5	0.6	0.8	0.8	0.6	2.4	2.4	2.9	2.9	2.0
Pretax Income	(2.7)	(3.0)	(2.7)	(5.6)	(3.0)	(2.4)	(1.6)	(1.0)	(25.6)	(18.1)	(10.9)	(8.0)	(7.0)
	-16.1%	-17.0%	-17.5%	-39.1%	-22.6%	-16.7%	-10.6%	-5.5%	-26.2%	-24.5%	-17.2%	-13.2%	-10.6%
Taxes	0.3	0.2	0.3	0.5	0.2	0.2	0.2	0.1	1.1	1.0	1.2	0.7	0.7
Tax Rate	-9.6%	-7.7%	-9.3%	-8.0%	-8.1%	-9.5%	-9.3%	-9.3%	-4.3%	-5.5%	-10.8%	-8.9%	-9.3%
GAAP Net Income	(2.9)	(3.2)	(2.9)	(6.0)	(3.2)	(2.7)	(1.8)	(1.0)	(26.7)	(19.1)	(12.1)	(8.7)	(7.7)
Non-GAAP Net Income													
GAAP EPS-Basic	($0.10)	($0.12)	($0.11)	($0.23)	($0.12)	($0.10)	($0.07)	($0.04)	($0.83)	($0.67)	-$0.44	-$0.34	-$0.32
GAAP EPS-Fully dil.	($0.10)	($0.12)	($0.11)	($0.23)	($0.12)	($0.10)	($0.07)	($0.04)	($0.83)	($0.67)	($0.56)	($0.34)	($0.32)
Non-GAAP	**($0.08)**	**($0.10)**	**($0.09)**	**($0.09)**	**($0.11)**	**($0.08)**	**($0.05)**	**($0.02)**	**($0.33)**	**($0.53)**	**($0.36)**	**($0.27)**	**($0.24)**
Share Out	27.8	27.4	27.2	26.7	26.5	26.0	25.5	25.0	31.0	28.7	27.2	25.8	24.0
Fully diluted shares	27.8	27.4	27.2	26.7	26.5	26.0	25.5	25.0	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%	-5.5%	-7.0%

BALANCE SHEET

In Thousands $	March 31, 2015	Dec 31, 2014	March-Dec % Change
CURRENT ASSETS			
Cash and cash equivalents	$45,065	$41,069	10%
Restricted cash	32	164	-80%
Short-term investments	14,670	21,481	-32%
Accounts receivable, net	6,271	6,789	-8%
Inventories	8,215	8,642	-5%
Prepaid expenses and other current assets	1,348	1,308	3%
Total current assets	**75,601**	**79,453**	-5%
LONG-TERM INVESTMENTS	14,754	14,754	0%
PROPERTY AND EQUIPMENT, NET	18,211	19,363	-6%
OTHER ASSETS			
Restricted assets			
Intangible assets, net			
Other assets	2,893	3,168	-9%
Total other assets	2,893	3,168	-9%
TOTAL ASSETS	111,459	116,738	-5%
CURRENT LIABILITIES			
Notes and accounts payable	3,207	2,131	50%
Income tax payable	620	650	-5%
Accrued expenses and other current liabilities	3,347	6,049	-45%
Total current liabilities	7,174	8,830	-19%
OTHER LONG-TERM LIABILITIES			
Accrued pension liabilities	292	333	-12%
Other liabilities	311	309	1%
Total long-term liabilities	603	642	-6%
Total liabilities	7,777	9,472	-18%
SHAREHOLDERS EQUITY			
Preference shares at $0.00002 par value per share; Authorized 250,000,000 shares;	33	33	0%
Additional paid-in capital	140,634	141,229	0%
Retained earnings (accumulated deficits)	(20,290)	(17,291)	17%
Accumulated other comprehensive income	6,723	6,768	-1%
Treasury stock 269,042,350 and 162,072,500 shares as of Dec 31, 2013 and 2012, respectively	(23,218)	(23,473)	-1%
Total shareholders equity	103,882	107,266	-3%
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$111,459	$116,738	-5%

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