Zacks Small-Cap Research

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O2Micro International Ltd (OIIM-NASDAQ)

OIIM: Zacks Company Report – Q1 2016 – So Close, But No Cigar on Revenue Growth

Using an average enterprise value to trailing 12-month sales of 4.1 times and applying it to OIIM's Q1 $52 revenue run rate, we would calculate an enterprise value of $211million and a market cap of $247 million or value of **$9.60 per share.**

Current Price (05/04/16)	$1.43
Valuation	**$9.60**

OUTLOOK

O_2Micro International is a fabless semiconductor firm that designs, develops and markets high performance integrated circuits primarily for power management and battery management for TV backlighting, LED lighting, and portable tools and appliances. It has had declining revenues and losses for the past few years, but may have reached stability and potential revenue growth in the second half of 2016. The company trades at an enterprise value of $850,000, far less than the value of its real estate. There are activists involved in the stock, thus far with no results.

SUMMARY DATA

52-Week High	**$2.80**
52-Week Low	**$1.27**
One-Year Return (%)	**-40.4**
Beta	**0.67**
Average Daily Volume (sh)	**13,986**
Shares Outstanding (mil)	**26**
Market Capitalization ($mil)	**$37**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**43**
Insider Ownership (%)	**8**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**-18.9**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2016 Estimate	**-3.4**
P/E using 2017 Estimate	**-5.2**
Zacks Rank	**N/A**

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

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2014	16.5 A	17.4 A	15.4 A	14.3 A	64 A
2015	13.1 A	14.7 A	13.7 A	13.4 A	55 A
2016	13.0 A	13.5 E	15.0 E	15.0 E	57 E
2017					60 E

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

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2014	-$0.08 A	-$0.10 A	-$0.09 A	-$0.09 A	-$0.36 A
2015	-$0.11 A	-$0.09 A	-$0.07 A	-$0.10 A	-$0.37 A
2016	-$0.08 A	-$0.05 E	-$0.05 E	-$0.05 E	-$0.23 E
2017					$0.08 E

Zacks Projected EPS Growth Rate - Next 5 Years % **N/A**

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WHAT'S NEW

So Close, But No Cigar, on Revenue Growth in Q1…

O2Micro reported Q1 2016 revenues of $13.0 million versus $13.1 a year ago that were slightly higher than our estimate, but lower than the mid-range of the company guidance. Despite once again showing declining revenues in the first quarter of 2016, O2Micro managed to slow the revenue decline to just 1%. Over the past five quarters the company has managed to report decelerating revenue declines (Q4 2014 showed a -25% year over year decline, Q1 2015 was -20%, Q2 -16%, Q3 -11%, Q4 -7%, and Q1 -1%.) However the company is now expecting revenues for Q2 2016 in the range of $13.0 million to $14.0 million, the mid-point of which is $13.5 million which would be a year over year decline of 8%, albeit up sequentially. Just as we thought we had turned the corner, hopes are dashed. Will the company ever begin to show growth?

... However Losses Were Reduced

In Q1 2016 gross margin was 48.8% versus 50% last year and 50.4% in Q4. Mostly this was due to product mix, but also lower volumes. The company is now focusing on the high-end of a few markets where it has expertise and patent protection and hopes to earn higher margins. This is particularly in TV backlighting where the emphasis is on 4K televisions, and LED where patents in free dimming and high power general lighting provide better profitability. Management has given Q2 gross margin guidance of 49-51%.

R&D was $3.8 million versus $4.5 million in the quarter, and SG&A came in at $4.9 versus $5.7 million. This was a total expense reduction of $1.5 million, reducing operating losses to $2.3 million versus $3.6 million. The company has guided to operating expenses in a range of $8.5 million to $9.5 million in Q2 2016, a mid-point decline of $900,000 million from Q2 2015. R&D spending was particularly low in Q1 because some development projects were pushed off into Q2 and that low spending is not expected going forward. It is expected to be back up at $4.0-$4.5 per quarter for the rest of the year.

Interest income was down to $77,000 versus $237,000 last year as cash balances declined.

Currency exchange caused a loss of $204,000 versus last year's gain of $9,000.

In last year's number there was sale of real estate in Q1 2015 netting a gain of $298,000. In this June quarter, the company has already booked a gain of $413,000 from the sale of X-FAB stock. And in Q3 it tells us to expect a one-time gain on the sale of one unit of a Shanghai office park of $1.6 million yielding additional cash of $3.6 million.

Taxes paid were $201,000 versus $241,000.

The GAAP net loss was $2.4 million versus $3.2 million or a loss of $0.09 versus a loss of $0.12. Shares outstanding were 25.5 versus 26.7 as the company continues to buy back stock.

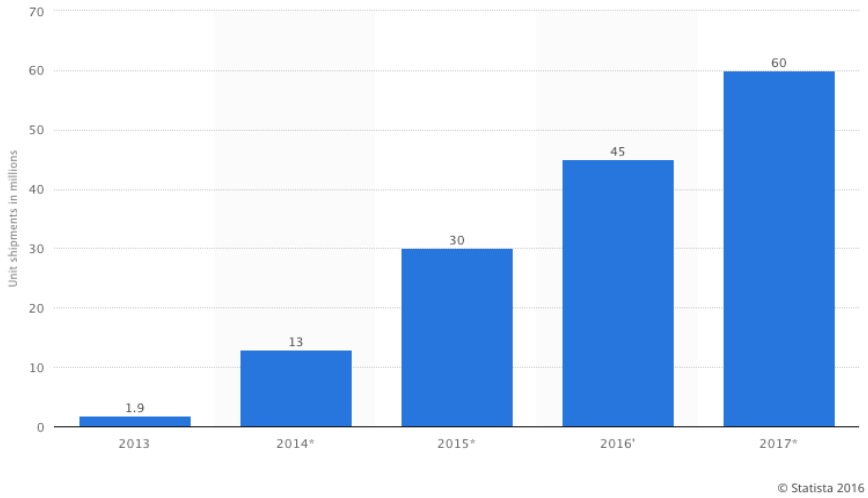
On a non-GAAP basis the company reported a loss of $0.08 in Q1 2016 versus a loss of $0.11 a year ago.

Business continues strong in battery management as more and more appliances and tools become untethered from electrical cords and as lead battery users move to lithium. The company believes that this group can be 20-25% of total revenues in 2016, which should bring up overall margins as battery products have a 60% gross margin.

Backlighting suffered some decline but seems to be stabilizing as 4k TVs, that use more units and generate more revenue per TV set, grow as a portion of the total TV market despite the decline in computer monitors. By the end of 2017, most 50-inch-and-larger TVs worldwide will feature 4K resolution, according

to IHS Inc. LED lighting also continues to grow for the company as the company takes the strategy to pursue dimmable LED and high end industrial where patents help them and quality is more important.

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



Q2 2016 Forecast

For Q2 we are going with the mid-point of the range and using $3.5 million in revenues versus $14.7 million down 8%. The majority of this decline is due to the company decision to stop pursuing the low-end general LED lighting business due to its low margins and cutthroat competition. They instead are focusing on free dimming products, where they have patents and higher end industrial lighting where quality matters. As a result this loss of revenue should not impact profitability. With slightly higher revenues and slightly higher gross margin we are expecting a quarter slightly better than Q1 and am looking for non-GAAP EPS loss of $0.05 versus a loss of $0.09 last year.

Also in Q2 the company plans to report a one-time gain on the sale of all of its stock in X-FAB. In April it received $5.4 million cash from this sale and booked a profit of $413,000.

2016 Forecasts

We are maintaining our revenue estimate for 2016 and tweaking our EPS to $0.23. 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 but the company is not betting on the smartphone market this year.

The company is however having good success in battery management, and as more and more appliances and devices become portable, O2Micro should thrive and overall margins should increase. They are showing success in tools, vacuums and e-bikes-- especially as customers move to lithium from lead batteries.

Dyson V6 Cord Free Vacuum



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.

VALUATION

Company Valuation Makes it Practically Free

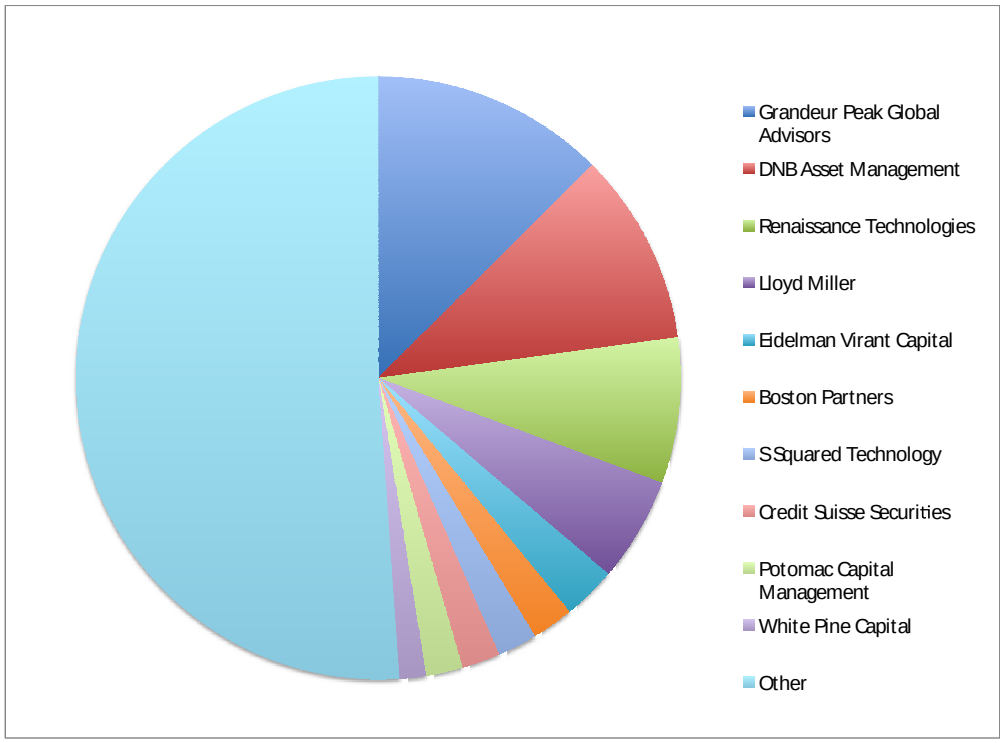
The company trades at an enterprise value of $850,000. The company has $35.9 million (or $1.40 per share) in cash, no debt and valuable real estate in China and California. In California it owns a 37,180 square foot building where it has its USA operations, which was bought for $4.6 million in May 2004. In Shanghai it owns a 30,448 square foot facility, which was bought for $7.1 million in October 2005. It also owns other real estate in China. Activists have tried to encourage a transaction with an acquirer but the company has no interest in a sale.

Were we to use the average enterprise value to trailing twelve-month sales of 4.1 times and apply it to OIIM's Q1 $52 revenue run rate, we would calculate an enterprise value of $211 million. Adding to it $35.9 million in cash gives us a market cap of $247 million or **$9.61 per share**. We believe that once the company shows some revenue growth while continuing to cut losses, the market will afford it a valuation closer to this price.

	Competitors	EV	TTM Sales	EV/Sales
Intersil	**ISIL**	$1,310	$522	2.5
Microsemi	**MSCC**	4,510	1,270	3.6
Monolithic Power Systems	**MPWR**	2,320	333	7.0
Cree Inc.	**CREE**	2,000	1,650	1.2
Microchip Technology	**MCHP**	11,330	2,160	5.2
Linear Technology	**LLTC**	9,270	1,440	6.4
Maxim	**MXIM**	9,560	2,230	4.3
Texas Instruments	**TXN**	58,430	13,000	4.5
Cirrus Logic	**CRUS**	2,200	1,190	1.8
	Average			4.1

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

	March Q1 15	June Q2 15	Sept Q3 15	Dec Q4 15	March Q1 16	June Q2 16E	Sept Q3 16E	Dec Q4 16E	2014	2015	2016E	2017E
REVENUE												
Net Revenue	13.1	14.7	13.7	13.4	13.0	13.5	15.0	15.0	63.6	54.8	56.5	60.0
Yr-to-yr Gr.	-20%	-16%	-11%	-7%	-1%	-8%	10%	12%	-14%	-14%	3%	6%
OPERATING EXPENSES												
Cost of goods sold	6.5	7.4	6.6	6.6	6.6	6.7	7.0	7.0	30.9	27.1	27.4	28.0
Gross Margin	6.6	7.3	7.1	6.7	6.3	6.8	7.5	7.5	32.7	27.7	29.1	32.0
% of Sales	50.0%	49.6%	51.0%	50.4%	48.8%	50.1%	50.0%	50.0%	51.5%	50.5%	51.5%	53.3%
R&D	4.5	3.8	4.7	4.8	3.8	4.3	4.3	4.4	21.9	17.8	16.8	17.0
SG&A	5.7	6.3	5.8	5.5	4.9	4.8	4.8	4.9	24.7	23.3	19.3	19.3
One-time expenses & Adj.	0.0	0.0	0.0	1.1	0.0	0.0	0.0	0.0	3.0	1.1	0.0	0.0
Tot Operating Exp.	10.1	10.2	10.5	11.4	8.6	9.0	9.1	9.3	46.6	42.3	36.1	36.3
Operating Income	(3.6)	(2.9)	(3.4)	(4.7)	(2.3)	(2.2)	(1.6)	(1.8)	(13.9)	(14.6)	(7.0)	(4.3)
Interest income	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1		0.7	0.3	0.0
Foreign exchange loss	0.0	(0.2)	0.8	0.0	(0.2)	0.0	0.0	0.0		0.7	-0.2	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	0.0
Other - net	0.1	0.2	0.1	0.4	0.2	0.6	1.6	0.0		0.7	2.5	0.2
Impairment loss on long term investme	0.0	0.0	0.0	(5.0)	0.0	0.0	0.0	0.0		(5.0)	0.0	0.0
Total other Income	0.6	0.4	1.3	(4.4)	0.1	0.7	1.7	0.1	2.9	(2.0)	2.6	1.0
Pretax Income	(3.0)	(2.5)	(2.1)	(9.1)	(2.2)	(1.5)	0.0	(1.7)	(10.9)	(16.6)	(4.4)	(3.3)
	-22.6%	-16.7%	-15.1%	-68.1%	-16.8%	-11.4%	0.2%	-11.5%	-17.2%	-30.3%	-7.8%	-5.5%
Taxes	0.2	0.3	0.3	3.8	0.2	0.2	0.2	0.2	1.2	4.6	0.8	0.0
Tax Rate	-8.1%	-11.7%	-13.9%	-10.9%	-9.2%	-12.9%	540.5%	-11.6%	-10.8%	-28.0%	-18.1%	-11.0%
GAAP Net Income	(3.2)	(2.7)	(2.4)	(12.9)	(2.4)	(1.7)	(0.2)	(1.9)	(12.1)	(21.2)	(5.2)	(3.3)
Non-GAAP Net Income	(2.9)	(2.3)	(1.9)	(2.5)	(2.0)	(1.9)	(1.3)	(1.5)		(9.7)	(6.7)	(3.3)
GAAP EPS-Basic	($0.12)	($0.10)	($0.09)	($0.50)	($0.09)	($0.07)	($0.01)	($0.08)	($0.44)	($0.82)	($0.21)	($0.13)
GAAP EPS-Fully dil.	($0.12)	($0.10)	($0.09)	($0.50)	($0.09)	($0.07)	($0.01)	($0.08)	($0.56)	($0.82)	($0.21)	($0.13)
Non-GAAP	**($0.11)**	**($0.09)**	**($0.07)**	**($0.10)**	**($0.08)**	**($0.05)**	**($0.05)**	**($0.06)**	**($0.36)**	**($0.37)**	**($0.24)**	**($0.05)**
Share Out	26.5	26.1	25.9	25.6	25.7	25.5	25.3	25.1	27.2	26.0	25.4	25.1
Fully diluted shares	26.5	26.1	25.9	25.6	25.7	25.5	25.3	25.1	27.2	26.0	25.4	25.1
Yr-to-yr Gr.	-5%	-5%	-5%	-4%	-3%	-2%	-2%	-2%	-5.1%	-4.5%	-2.4%	-1.2%

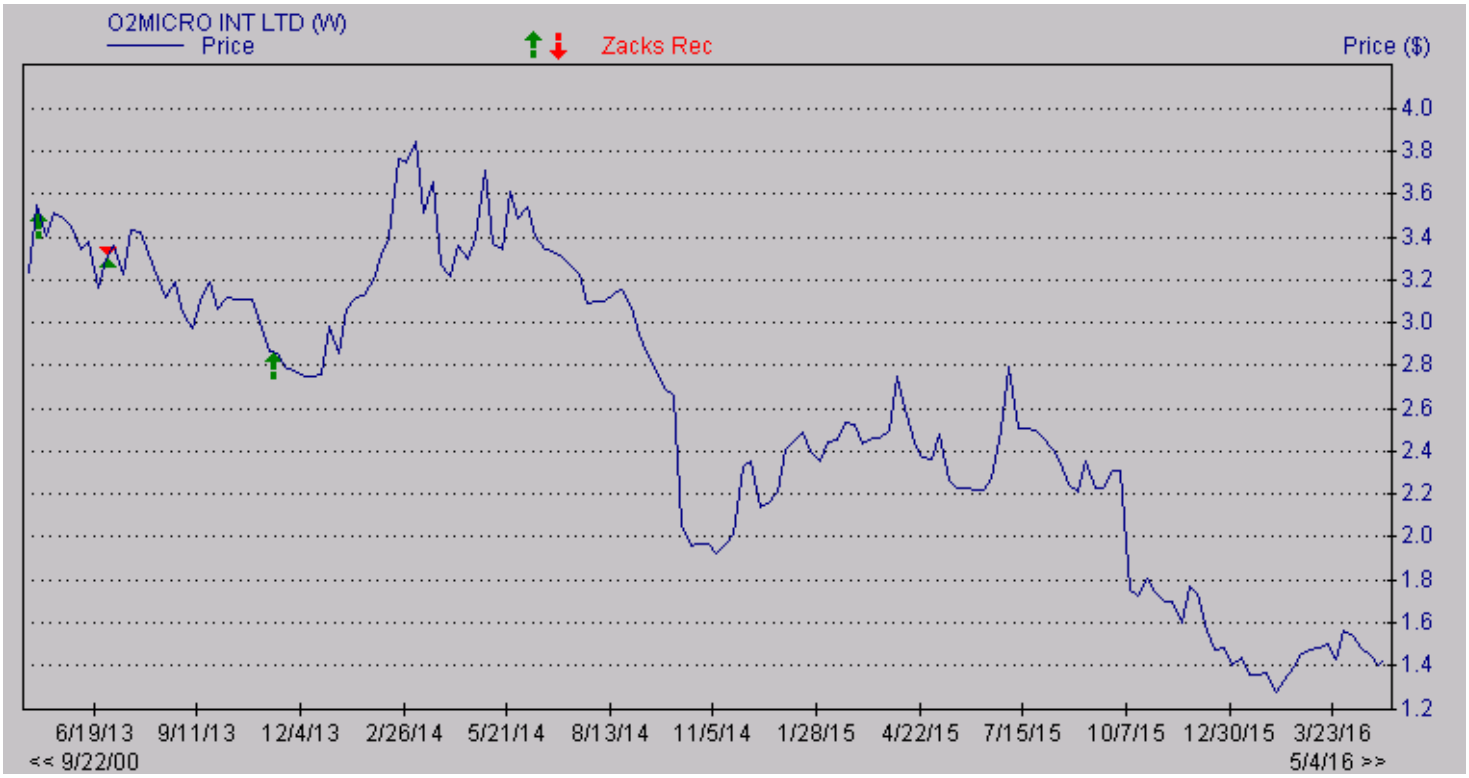
BALANCE SHEET

	March 31, 2015	Dec 31, 2015	March-Dec % Change
CURRENT ASSETS			
Cash and cash equivalents	$35,924	$41,199	-12.8%
Restricted cash	32	31	3.2%
Short-term investments	10,580	11,233	-5.8%
Accounts receivable, net	5,337	5,197	2.7%
Inventories	9,328	9,662	-3.5%
Prepaid expenses and other current assets	1,388	1,126	23.3%
Assets held for sale	6,924	1,956	254.0%
Total current assets	**69,513**	**70,404**	-1.3%
LONG-TERM INVESTMENTS	4,331	9,304	-53.5%
PROPERTY AND EQUIPMENT, NET	14,077	14,011	0.5%
OTHER ASSETS	2,375	2,489	-4.6%
Total other assets	20,783	25,804	-19.5%
TOTAL ASSETS	90,296	96,208	-6.1%
CURRENT LIABILITIES			
Notes and accounts payable	2,951	3,333	-11.5%
Income tax payable	469	2,245	-79.1%
Deferred tax liabilities	2,278		
Accrued expenses and other current liabilities	2,859	7,102	-59.7%
Total current liabilities	8,557	12,680	-32.5%
OTHER LONG-TERM LIABILITIES			
Accrued pension liabilities	275	272	1.1%
Other liabilities	149	139	7.2%
Total long-term liabilities	424	411	3.2%
Total liabilities	8,981	13,091	-31.4%
SHAREHOLDERS EQUITY			
Preference shares at $0.00002 par value per share; Authorized 250,000,000 shares;			
	33	33	0.0%
Additional paid-in capital	141,646	141,886	-0.2%
Retained earnings (accumulated deficits)	(40,750)	(38,386)	6.2%
Accumulated other comprehensive income	5,258	4,824	9.0%
Treasury stock	(24,872)	(25,240)	-1.5%
Total shareholders equity	81,315	83,117	-2.2%
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	90,296	96,208	-6.1%
Cash and equivalents	$46,504	$52,432	-11.3%
Market value	35,207,630	34,700,640	1.5%
Enterprise value	(11,328,370)	(17,762,360)	-36.2%
DSO	37	41	-9.8%
Inventory Days	129	148	-12.8%

ANNUAL CASH FLOW

Consolidated Statements of Cash Flows - USD ($) $ in Thousands	12 Months Ended Dec. 31, 2015	Dec. 31, 2014	Dec. 31, 2013
OPERATING ACTIVITIES			
Net loss	$ (21,095)	$ (15,057)	$ (19,099)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	2,446	3,718	4,685
Stock-based compensation	1,912	2,120	2,609
Loss on asset write-off		82	
Inventory write-downs	913	1,538	900
Gain on sale of long-term investments	(8)	(436)	
Impairment loss on long-term investments	4,953	83	
Gain on disposal of property and equipment, net	(738)	(428)	(106)
Deferred income taxes	1,989	78	41
Other, net		(36)	(1)
Changes in operating assets and liabilities:			
Accounts receivable, net	1,592	3,235	(1,251)
Inventories	(1,933)	(2,963)	(200)
Prepaid expenses and other current assets	191	130	510
Deferred charges	(416)	(985)	(1,366)
Notes and accounts payable	1,202	(2,038)	413
Income tax payable	1,595	412	(124)
Accrued expenses and other current liabilities	(1,039)	577	(1,083)
Accrued pension liabilities	(11)	(12)	(25)
Other liabilities	(168)	(346)	(8,893)
Net cash used in operating activities	(8,615)	(10,328)	(22,990)
Acquisition of:			
Short-term investments	(7,128)	(22,346)	(15,496)
Long-term investments			(250)
Property and equipment	(724)	(1,004)	(743)
Decrease (increase) in:			
Restricted assets			10,000
Restricted cash	132	(1)	1
Other assets	82	116	108
Proceeds from:			
Sale of short-term investments	16,755	34,333	52,131
Sale of long-term investments	537	1,304	
Disposal of property and equipment	3,205	1,982	166
Net cash provided by investing activities	12,859	14,384	45,917
FINANCING ACTIVITIES			
Acquisition of treasury stock	(3,233)	(4,965)	(8,279)
Proceeds from:			
Exercise of stock options	31	44	25
Issuance of ordinary shares under the Employee Stock Purchase Plan	180	258	335
Net cash used in financing activities	(3,022)	(4,663)	(7,919)
EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATE	(1,092)	(617)	(613)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	130	(1,224)	14,395
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE YEAR	41,069	42,293	27,898
CASH AND CASH EQUIVALENTS AT END OF THE YEAR	41,199	41,069	42,293
SUPPLEMENTAL DISCLOSURES OF CASH FLOWS			
Cash paid for tax	$ 1,068	$ 697	$ 1,064
Cash Flow	(9,628)	(8,420)	(10,971)
Free cash flow	(10,352)	(9,424)	(11,714)

HISTORICAL STOCK PRICE



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