Zacks Small-Cap Research

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# O2Micro International Ltd (OIIM-NASDAQ)

## OIIM: Revenue Growth Returns, Next Target is Profits

Using an industry average enterprise value to trailing 12-month sales of 5.2 times, and applying it to OIIM's $58 m Q3 revenue run rate, we would calculate an enterprise value of $302, a market cap of $329 m and a price of **$12.84 per share.**

| | |
|---|---|
| Current Price (11/01/16) | $1.77 |
| **Valuation** | **$12.84** |

## OUTLOOK

$O_2$Micro 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 just reported revenue growth for the first time since 2013 showing a possible inflection point. The company trades at a negative enterprise value of $7.3 million, far less than the value of its assets. There are activists involved in the stock.

## SUMMARY DATA

| | |
|---|---|
| **52-Week High** | **$1.92** |
| **52-Week Low** | **$1.27** |
| **One-Year Return (%)** | **0.6** |
| **Beta** | **0.54** |
| **Average Daily Volume (sh)** | **19,713** |
| **Shares Outstanding (mil)** | **26** |
| **Market Capitalization ($mil)** | **$45** |
| **Short Interest Ratio (days)** | **N/A** |
| **Institutional Ownership (%)** | **41** |
| **Insider Ownership (%)** | **8** |
| **Annual Cash Dividend** | **$0.00** |
| **Dividend Yield (%)** | **0.00** |
| **5-Yr. Historical Growth Rates** | |
| **Sales (%)** | **-18.1** |
| **Earnings Per Share (%)** | **N/A** |
| **Dividend (%)** | **N/A** |
| **P/E using TTM EPS** | **N/M** |
| **P/E using 2016 Estimate** | **N/M** |
| **P/E using 2017 Estimate** | **N/M** |
| **Zacks Rank** | **N/A** |

| | |
|---|---|
| **Risk Level** | **Average** |
| **Type of Stock** | **Small-Value** |
| **Industry** | **Elec Comp-Semis** |

## 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 | 13.2 A | 14.4 A | 15.2 E | 56 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 | -$0.06 A | -$0.04 A | -$0.04 E | -$0.21 E |
| 2017 | | | | | -$0.07 E |

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

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## WHAT'S NEW

### Revenue Growth Returns, When Will Profits?

O2Micro reported **Q3 2016 revenues of $14.4 million versus $13.7 million** a year ago, within the company's guidance. More importantly, revenue grew year over year for the first time since Q4 2013 and guidance for Q4 is for revenues in the range of up 2-8% sequentially (or $14.7 to $15.6 million) versus $13.4 last year. This means another quarter of revenue growth no matter where in the range they fall.

Its current cost structure now shows cash breakeven at $15.5-16.5 million in quarterly revenues. This is a revenue reduction of $1 million since last quarter. Profitability breakeven is now at $17 to $18 million down from $18.5-9.5 million last quarter. At quarter end, the company had $53.1 million in cash and equivalents (or $2.07 per ADS) up $5.6 million from Q2. Cash increased because of the sale of some real estate in Shanghai, combined with the sale of some long-term investments in the quarter despite **negative EBITDA of $297,000 and capital expenditure expenses of $210,000**.

**Revenue Breakdown**

| | Q2 2016 | Q3 2016 |
|---|---|---|
| **Consumer** | 50-55 | 50-55 |
| **Computer** | 10-15 | 10-15 |
| **Industrial** | 35-40 | 30-35 |
| **Communications** | <5 | <5 |

In Q3 2016, gross margin was 52.6% versus 51.0% last year and 50.7% in Q2 2016. The company expects gross margins to be in the range of 50%- 52% with some quarterly variation due to product mix. Management has given Q4 gross margin guidance of 51-53%, higher than Q3 guidance was.

R&D was $4.1 million, down $600,000 from last year, and SG&A came in at $4.7 versus $5.8 million. This was a total expense reduction of $1.8 million, reducing operating losses to $1.1 million in 2016 versus $3.4 million in 2015. The company has guided to operating expenses in a range of $8.9 million to $10.0 million in Q4 2016, a mid-point decline of $2 million from Q4 2015.

Interest income was down to $71,000 versus $139,000 last year in line with Q2 2016.

Currency exchange caused a gain of $200,000 versus last year's loss of $800,000.

In last year's other income number there was sale of real estate netting a gain of $268,000. In the 2016 September quarter, the company booked a gain of $1.7 million from the sale of some Shanghai real estate, and $523,00 from the sale of a long-term investment. In Q4 the company is considering selling more of its long-term investments, which, if sold, could contribute another $500,000 to $600,000 to other income in that quarter.

Taxes paid were $282,000 versus $287,000.

The GAAP net income was $1.3 million versus $2.4 million or $0.05 versus a loss of $0.09. There were and average of 25.9 million fully diluted shares in the quarter and the company bought 53,288 RSUs.

On a **non-GAAP basis the company reported a loss of $0.04 in Q2 2016 versus a loss of $0.07** a year ago. In our calculation we take out all the non-core operating income and losses such as sales of real estate, long-term investments, and rental income.

**Business Units**

The largest business unit**, intelligent lighting** is showing growth. It is growing its sales of backlighting for 4K TVs and entering mass production for a major OEM. It also has additional designs wins and sees further growth. In the automotive backlighting market the company is also seeing more design wins. In general lighting there has been growth of its unique free-dimming product and in the high power lighting area.

**Battery management** continues its excellent year over year and the company expects further growth in 2017 and beyond as the industry increases it use of lithium ion batteries. O2Micro is expanding its product offering with less expensive solutions as well as targeting more complex products. Examples of end use products are power tools, e-bikes, e-vehicles, and vacuums. In addition the UPS market is also moving to lithium ion batteries and O2Micro is selling to this newer market.




**Smartphones and tablets** continue to be the biggest opportunity. So far, the company has been disappointed with sales. The expected ramp was delayed by supply chain problems in China, which had to deal with a shortage of displays and ICs. As this is resolved, sales should be back on track. The company is particularly encouraged by prospects for its **Fast Charge solution**, which is getting a lot of attention from prospective customers. As high-end phones such as the Samsung Galaxy 7 move to 4M fast charging, with higher energy and density, there is a threat of heat, fire, and explosion. O2Micro has experience in this area from its work in laptops and notebooks and has been marketing its solution for this issue. While O2Micro has not talked to Samsung, nor has Samsung revealed a workaround for its problem, O2Micro has been offering its patented products to other vendors seeking to add Fast Charge to their phones.

**Q4 2016 Forecast**

For Q4, the mid-point of the range is $15.2 million in revenues versus $13.4 million, up 13%. With increased spending due to some deferred R&D, we expect the operating loss to be the more than Q3, but half the loss of Q4 215. On a GAAP basis we are looking for a loss of $0.06 versus a loss of $0.50 last year. Non-GAAP EPS could be a loss of $0.04 versus a loss of $0.10 per share last year.

## VALUATION

**Company Has Significant Upside If It Can Grow**

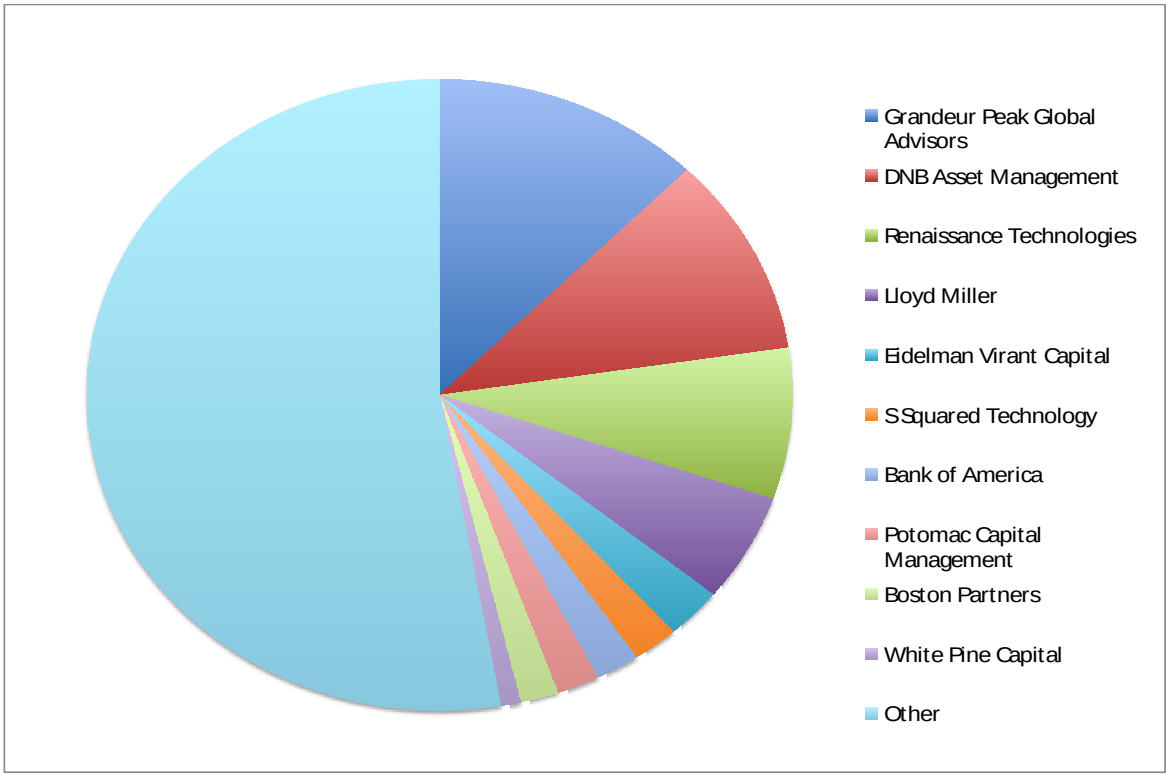
The company trades at a negative enterprise value of $7.3 million. The company has $53.1 million (or $2.07 per ADS) in cash and equivalents, no debt and valuable real estate in China and California. In California it owns a 37,180 square foot building where it has its USA operations, which was bought for $4.6 million in May 2004. It also owns other real estate in China. It also has long-term investments in other companies. 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 5.2 times and apply it to OIIM's Q3 $58 million revenue run rate, we would calculate an enterprise value of $301 million. Adding to it $53.1 million in cash gives us a market cap of $329 million or **$12.84 per share**. We believe that once the company shows sustainable revenue growth while continuing to cut losses, the market should afford it a valuation closer to this price. Year over year revenue growth should occur again next quarter.

| | Competitors | EV | TTM Sales | EV/Sales |
|---|---|---|---|---|
| Intersil | **ISIL** | $2,740 | $529 | 5.2 |
| Microsemi | **MSCC** | 6,840 | 1,530 | 4.5 |
| Monolithic Power Systems | **MPWR** | 2,850 | 357 | 8.0 |
| Cree Inc. | **CREE** | 1,780 | 1,560 | 1.1 |
| Microchip Technology | **MCHP** | 15,770 | 2,440 | 6.5 |
| Linear Technology | **LLTC** | 13,170 | 1,460 | 9.0 |
| Maxim | **MXIM** | 10,110 | 2,190 | 4.6 |
| Texas Instruments | **TXN** | 69,990 | 13,140 | 5.3 |
| Cirrus Logic | **CRUS** | 3,490 | 1,270 | 2.7 |
| | **Average** | | | 5.2 |

## OWNERSHIP

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




## RISKS

- $O_2$Micro has exposure several stagnant and declining markets such as standard TVs and notebooks. It is depending on free dimming and high power LED lighting, 4K TVs, battery management, and successful penetration of and volume sales to the smartphone market to give it meaningful 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 only started to grow revenues after years of declines.

- 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 16 | Sept Q3 16 | Dec Q4 16E | 2015 | 2016E | 2017E |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **REVENUE** | | | | | | | | | | | |
| Net Revenue | 13.1 | 14.7 | 13.7 | 13.4 | 13.0 | 13.2 | 14.4 | 15.2 | 54.8 | 55.8 | 60.0 |
| Yr-to-yr Gr. | -20% | -16% | -11% | -7% | -1% | -10% | 6% | 13% | -14% | 2% | 7% |
| **OPERATING EXPENSES** | | | | | | | | | | | |
| Cost of goods sold | 6.5 | 7.4 | 6.6 | 6.6 | 6.6 | 6.5 | 6.8 | 7.0 | 27.1 | 27.0 | 28.0 |
| Gross Margin | 6.6 | 7.3 | 7.1 | 6.7 | 6.3 | 6.7 | 7.6 | 7.9 | 27.7 | 28.8 | 32.0 |
| % of Sales | 50.0% | 49.6% | 51.0% | 50.4% | 48.8% | 50.7% | 52.6% | 52.0% | 50.5% | 51.6% | 53.3% |
| R&D | 4.5 | 3.8 | 4.7 | 4.8 | 3.8 | 3.8 | 4.0 | 4.3 | 17.8 | 15.8 | 17.0 |
| SG&A | 5.7 | 6.3 | 5.8 | 5.5 | 4.9 | 5.0 | 4.7 | 5.1 | 23.3 | 19.7 | 19.7 |
| One-time expenses & Adj. | 0.0 | 0.0 | 0.0 | 1.1 | 0.0 | 0.0 | 0.0 | 0.0 | 1.1 | 0.0 | 0.0 |
| Tot Operating Exp. | 10.1 | 10.2 | 10.5 | 11.4 | 8.6 | 8.8 | 8.7 | 9.4 | 42.3 | 35.5 | 36.7 |
| **Operating Income** | (3.6) | (2.9) | (3.4) | (4.7) | (2.3) | (2.1) | (1.1) | (1.5) | (14.6) | (6.7) | (4.7) |
| 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) | (0.3) | 0.2 | 0.0 | 0.7 | (0.3) | 0.0 |
| Gain on sale of real estate | 0.3 | 0.2 | 0.3 | 0.0 | 0.0 | 0.0 | 1.7 | 0.0 | 0.8 | 1.7 | 0.0 |
| Other - net | 0.1 | 0.2 | 0.1 | 0.4 | 0.2 | 0.2 | 0.2 | 0.2 | 0.7 | 0.8 | 0.2 |
| Gain/loss on long term investments | 0.0 | 0.0 | 0.0 | (5.0) | 0.0 | 0.4 | 0.5 | 0.0 | (5.0) | 0.9 | 0.0 |
| Total other Income | 0.6 | 0.4 | 1.3 | (4.4) | 0.1 | 0.4 | 2.7 | 0.2 | (2.0) | 3.5 | 1.0 |
| **Pretax Income** | (3.0) | (2.5) | (2.1) | (9.1) | (2.2) | (1.7) | 1.6 | (1.3) | (16.6) | (3.3) | (3.7) |
| | -22.6% | -16.7% | -15.1% | -68.1% | -16.8% | -13.1% | 11.2% | -8.4% | -30.3% | -5.9% | -6.2% |
| Taxes | 0.2 | 0.3 | 0.3 | 3.8 | 0.2 | 0.2 | 0.3 | 0.2 | 4.6 | 0.9 | 0.0 |
| Tax Rate | -8.1% | -11.7% | -13.9% | -10.9% | -9.2% | -13.7% | 17.5% | -15.8% | -28.0% | -28.0% | -11.0% |
| **GAAP Net Income** | (3.2) | (2.7) | (2.4) | (12.9) | (2.4) | (2.0) | 1.3 | (1.5) | (21.2) | (4.2) | (3.7) |
| Non-GAAP Net Income | (2.9) | (2.3) | (1.9) | (2.5) | (2.0) | (1.8) | (0.9) | (1.2) | (9.7) | (5.9) | (3.7) |
| GAAP EPS-Basic | ($0.12) | ($0.10) | ($0.09) | ($0.50) | ($0.09) | ($0.08) | $0.05 | ($0.06) | ($0.82) | ($0.16) | ($0.15) |
| GAAP EPS-Fully dil. | ($0.12) | ($0.10) | ($0.09) | ($0.50) | ($0.09) | ($0.08) | $0.05 | ($0.06) | ($0.82) | ($0.16) | ($0.15) |
| **Non-GAAP** | **($0.11)** | **($0.09)** | **($0.07)** | **($0.10)** | **($0.08)** | **($0.06)** | **($0.04)** | **($0.04)** | **($0.37)** | **($0.21)** | **($0.07)** |
| Share Out | 26.5 | 26.1 | 25.9 | 25.6 | 25.7 | 25.7 | 25.6 | 25.4 | 26.0 | 25.6 | 25.4 |
| Fully diluted shares | 26.5 | 26.1 | 25.9 | 25.6 | 25.7 | 25.7 | 25.9 | 25.4 | 26.0 | 25.6 | 25.4 |
| Yr-to-yr Gr. | -5% | -5% | -5% | -4% | -3% | -2% | 0% | -1% | -4.5% | -1.7% | -0.7% |

## BALANCE SHEET

| | Sept 30, 2016 | June 30, 2016 | % Change |
|---|---|---|---|
| **CURRENT ASSETS** | | | |
| Cash and cash equivalents | $27,426 | $37,475 | -26.8% |
| Restricted cash | 32 | 32 | 0.0% |
| Short-term investments | 25,642 | 10,028 | 155.7% |
| Accounts receivable, net | 6,597 | 6,880 | -4.1% |
| Inventories | 8,502 | 9,216 | -7.7% |
| Prepaid expenses and other current assets | 1,393 | 1,464 | -4.8% |
| Assets held for sale | 0 | 1,956 | -100.0% |
| **Total current assets** | **69,592** | **67,051** | 3.8% |
| | | | |
| LONG-TERM INVESTMENTS | 4,253 | 4,861 | -12.5% |
| PROPERTY AND EQUIPMENT, NET | 13,841 | 13,904 | -0.5% |
| **OTHER ASSETS** | 2,108 | 2,231 | -5.5% |
| Total other assets | 20,202 | 20,996 | -3.8% |
| TOTAL ASSETS | 89,794 | 88,047 | 2.0% |
| | | | |
| **CURRENT LIABILITIES** | | | |
| Notes and accounts payable | 3,771 | 2,746 | 37.3% |
| Income tax payable | 266 | 334 | -20.4% |
| Deferred tax liabilities | 921 | 1,030 | -10.6% |
| Accrued expenses and other current liabilities | 3,131 | 3,244 | -3.5% |
| Total current liabilities | 8,089 | 7,354 | 10.0% |
| | | | |
| **OTHER LONG-TERM LIABILITIES** | | | |
| Accrued pension liabilities | 277 | 272 | 1.8% |
| Other liabilities | 84 | 122 | -31.1% |
| Total long-term liabilities | 361 | 394 | -8.4% |
| Total liabilities | 8,450 | 7,748 | 9.1% |
| | | | |
| **SHAREHOLDERS EQUITY** | | | |
| | | | |
| Ordinary shares | 33 | 33 | 0.0% |
| Additional paid-in capital | 142,388 | 142,038 | 0.2% |
| Retained earnings (accumulated deficits) | (41,384) | (42,716) | -3.1% |
| Accumulated other comprehensive income | 5,334 | 5,928 | -10.0% |
| Treasury stock | (25,027) | (24,984) | 0.2% |
| Total shareholders equity | 81,344 | 80,299 | 1.3% |
| TOTAL LIABILITIES AND SHAREHOLDERS EQUITY | 89,794 | 88,047 | 2.0% |
| | | | |
| Cash and equivalents | $53,068 | $47,503 | 11.7% |
| Change in cash and equivalents | $5,565 | $999 | 457.1% |
| Market value | 45,807,600 | 43,644,100 | 5.0% |
| Enterprise value | (7,292,400) | (3,890,900) | 87.4% |
| DSO | 42 | 42 | 0.0% |
| Inventory Days | 116 | 128 | -9.4% |

## ANNUAL CASH FLOW

| | 12 Months Ended December 31, | | |
|---|---|---|---|
| | 2015 | 2014 | 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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