Zacks Small-Cap Research

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Lisa Thompson
312-265-9517
lthompson@zacks.com

scr.zacks.com

10 S. Riverside Plaza, Chicago, IL 60606

O2Micro International Ltd (OIIM-NASDAQ)

Q4 Revenues Up 19% and Should Continue to Grow With Sales of TV and Battery Powered Products

Using an industry average value to trailing 12-month sales of 5.5 times, and applying it to OIIM's $64 m Q4 revenue run rate, we would calculate an enterprise value of $352, a market cap of $405 m and a price of **$15.53 per share.**

Current Price (01/25/16)	$2.50
Valuation	**$15.53**

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 has just reported two quarters of revenue growth and a quarter of positive non-GAAP earnings. The company trades at an enterprise value of $15 million, close the value of its non-cash assets. There are activists involved in the stock.

SUMMARY DATA

52-Week High	**$2.74**
52-Week Low	**$1.27**
One-Year Return (%)	**86.6**
Beta	**0.59**
Average Daily Volume (sh)	**169,160**
Shares Outstanding (mil)	**26**
Market Capitalization ($mil)	**$68**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**40**
Insider Ownership (%)	**8**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**-17.2**
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	**Above 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)
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	15.9 A	57 A
2017	14.7 E	15.0 E	16.5 E	18.0 E	64 E
2018					74 E

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

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
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	$0.01 A	-$0.16 A
2017	-$0.05 E	-$0.03 E	$0.00 E	$0.03 E	-$0.04 E
2018					$0.05 E

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

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WHAT'S NEW

Company Reports High End of Expected Q4 Revenue Range

Since our last report earlier this month, when O2Micro raised guidance for this just reported Q4, its stock has moved up 43%. Investors have become more confident that the company has turned the corner to growth. Additionally, the stock has almost doubled since last year this time.

Today O2Micro reported its Q4 2016 quarter today and actuals were better than our estimate. Revenues for the quarter were $15.9 million versus $13.4 million a year ago, up 19%. The company had given revenue range guidance of $15.4 to $15.9 million. Gross margin was 54.1%, an improvement of four percentage points since Q4 2015 and the highest in years.

More importantly the company believes that Q1 2017 should show continued year over year growth and improved year over year gross margin. Q1 is a seasonally weak quarter every year as much of the company's product goes into consumer products that have heavy purchasing at Christmas, especially TVs. This year in particular there is expected to be an inventory correction for TVs due to the recent shortage of displays available to manufacturers. O2Micro sent their product to the TV manufacturers they were not able to build TVs; the company believes it will take until the end of Q1 to work off the problem. We do not believe this to be an issue in Q2 and the affect of the adjustment is already reflexed in the guidance the company gave for Q1 2017.

Revenue guidance for Q1 2017 is a range of $14.3 to $15.1 million and gross margin guidance was 51-53%. Gross margin is down from Q4 due to revenue level and product mix. Using the midpoints would yield Q1 revenue of $14.7 versus $13.0 million, up 13%.

Yesterday the company indicated its current cost structure shows cash breakeven is still at $15.5-16.5 million in quarterly revenues and profitability breakeven is still at $17 to $18 million. Clearly Q1 should be below those numbers. At quarter end, the company still had $53 million in cash and equivalents (or $2.07 per ADS.), the same as last quarter.

On an EPS basis the company beat our estimates**.** On a GAAP basis we were looking for a loss of $0.04 versus a loss of $0.50 last year. The company reported $0.00. On a non-GAAP, ex-stock based compensation, we were looking for a loss of $0.02 versus a loss of $0.10 per share last year, but the **company reported a positive $0.02**. This is the first positive non-GAAP quarter in years.

The company has not yet released its cash flow statement for the year.

The company ended the year showing annual growth of 3%, a huge milestone, and it reduced its operating loss by $7.6 million. With the revenue growth shown this quarter the company is now poised to reach its breakeven goals without future expense cuts.

We have published estimates for the quarters of 2017 and raised our full year estimate to $64 million in revenues, up 14% (from $60 million) and are projecting a non-GAAP loss at $0.04. Since plateauing sales to the TV market, we are more confident that the company will grow more in line with its end markets. Especially encouraging is second half growth in smartphones and new end market penetration of automotive and even drones.

Our new 2018 estimate is for $74 million and earnings of $0.05 on a non-GAAP (ex- stock based compensation) basis.

Business Units

The largest business unit**, intelligent lighting** continues to show growth. Particularly strong are sales of backlighting for 4K TVs. The company has entered mass production for a major OEM and there are more design wins and other OEMs are beginning to ramp. Free-dimming products continue to grow as well as the high power lighting area. In the automotive backlighting market the company is also seeing more design wins. Automotive telematics is another good growth area particularly for self driving cars as displays are getting bigger as cameras move from just one on the rear of the car to full 360 degree vision.

Battery management continues its excellent growth as the industry increases it use of lithium ion batteries. Examples of end use products are power tools, e-bikes, e-vehicles, and vacuums. Newer markets for O2Micro include UPS, solar battery management, and even drones.



VALUATION

Company Has Significant Upside If It Can Grow

The company trades at an enterprise value of $15 million. At the end of Q4 2016, the company had $52.9 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 and believe it is now worth approximately $7 million. 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 and due to restrictions it is difficult to force one.

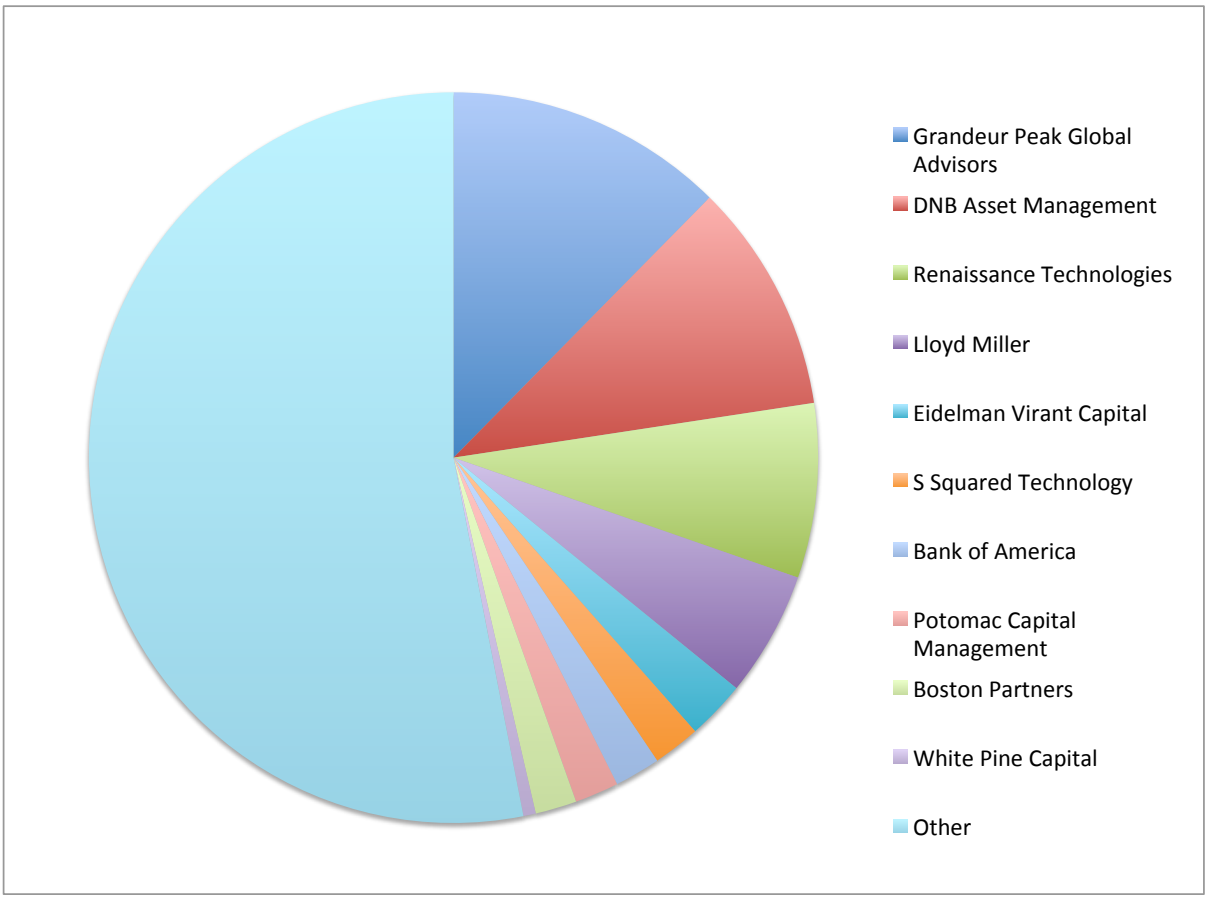
Were we to use the average enterprise value to trailing twelve-month sales of 5.5 times and apply it to OIIM's Q4 $64 million revenue run rate, we would calculate an enterprise value of $352 million. Adding to it $52.9 million in cash gives us a market cap of $405 million or **$15.53 per share**. We 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. Based on company guidance, the company will have year over year revenue growth again next quarter, making it three quarters in a row.

	Competitors	EV	TTM Sales	EV/Sales
Intersil	**ISIL**	$2,770	$529	5.2
Microsemi	**MSCC**	8,470	1,660	5.1
Monolithic Power Systems	**MPWR**	3,330	372	9.0
Cree Inc.	**CREE**	2,360	1,560	1.5
Microchip Technology	**MCHP**	17,070	2,770	6.2
Linear Technology	**LLTC**	13,720	1,480	9.3
Maxim	**MXIM**	10,670	2,190	4.9
Texas Instruments	**TXN**	76,170	13,140	5.8
Cirrus Logic	**CRUS**	3,620	1,270	2.9
	Average			5.5

OWNERSHIP

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



RISKS

- O_2Micro has exposure several stagnant markets such as standard TVs and declining markets such as notebooks and monitors. 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 GAAP breakeven, is still 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.

PROJECTED INCOME STATEMENT

	March Q1 16	June Q2 16	Sept Q3 16	Dec Q4 16	March Q1 17E	June Q2 17E	Sept Q3 17E	Dec Q4 17E	2015	2016	2017E	2018E
REVENUE												
Net Revenue	13.0	13.2	14.4	15.9	14.7	15.0	16.5	18.0	54.8	56.6	64.2	73.8
Yr-to-yr Gr.	-1%	-10%	6%	19%	13%	13%	14%	13%	-14%	3%	14%	15%
OPERATING EXPENSES												
Cost of goods sold	6.6	6.5	6.8	7.3	7.0	6.9	7.5	7.0	27.1	27.3	28.4	32.1
Gross Margin	6.3	6.7	7.6	8.6	7.7	8.1	9.0	10.0	27.7	29.2	35.8	41.7
% of Sales	48.8%	50.7%	52.6%	54.1%	52.1%	54.0%	54.5%	55.6%	50.5%	51.7%	55.7%	56.5%
R&D	3.8	3.8	4.0	4.1	4.3	4.3	4.4	4.5	17.8	15.6	17.5	19.8
SG&A	4.9	5.0	4.7	4.9	5.1	5.1	5.1	5.2	23.3	19.5	20.4	23.1
One-time expenses & Adj.	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.1	0.0	0.0	0.0
Tot Operating Exp.	8.6	8.8	8.7	9.0	9.4	9.4	9.5	9.7	42.3	35.1	37.9	42.8
Operating Income	(2.3)	(2.1)	(1.1)	(0.4)	(1.7)	(1.3)	(0.5)	0.3	(14.6)	(5.9)	(2.2)	(1.2)
Interest income	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.7	0.3	0.3	0.3
Foreign exchange loss	(0.2)	(0.3)	0.2	0.4	(0.2)	0.0	0.0	0.0	0.7	0.1	(0.2)	0.0
Gain on sale of real estate	0.0	0.0	1.7	0.0	0.0	0.0	0.0	0.0	0.8	1.7	0.0	0.0
Other (rent) - net	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.7	0.9	1.1	1.1
Gain/loss on long term investments	0.0	0.4	0.5	0.0	0.0	0.0	0.0	0.0	(5.0)	0.9	0.0	0.0
Total other Income	0.1	0.4	2.7	0.7	0.2	0.4	0.4	0.4	(2.0)	3.9	1.2	1.4
Pretax Income	(2.2)	(1.7)	1.6	0.4	(1.6)	(0.9)	(0.1)	0.7	(16.6)	(1.9)	(0.9)	0.3
Pretax margin	-16.8%	-13.1%	11.2%	2.2%	-10.6%	-6.1%	-0.7%	3.7%	-30.3%	-3.4%	-1.4%	0.4%
Taxes	0.2	0.2	0.3	0.3	0.2	0.2	0.2	0.2	4.6	1.1	0.8	0.6
Tax Rate	-9.2%	-13.7%	17.5%	96.6%	-12.9%	-21.9%	-181.8%	30.3%	-28.0%	-54.9%	-87.5%	206.9%
GAAP Net Income	(2.4)	(2.0)	1.3	0.0	(1.8)	(1.1)	(0.3)	0.5	(21.2)	(3.0)	(1.7)	(0.3)
Non-GAAP Net Income	(2.0)	(1.8)	(0.9)	0.4	(1.4)	(0.7)	0.1	0.9	(9.7)	(4.4)	(1.1)	1.3
GAAP EPS-Basic	($0.09)	($0.08)	$0.05	$0.00	($0.07)	($0.04)	($0.01)	$0.02	($0.82)	($0.12)	($0.07)	($0.01)
GAAP EPS-Fully dil.	($0.09)	($0.08)	$0.05	$0.00	($0.07)	($0.04)	($0.01)	$0.02	($0.82)	($0.12)	($0.07)	($0.01)
Non-GAAP	**($0.08)**	**($0.06)**	**($0.04)**	**$0.01**	**($0.05)**	**($0.03)**	**$0.00**	**$0.03**	**($0.37)**	**($0.16)**	**($0.04)**	**$0.05**
Share Out	25.7	25.7	25.6	25.6	25.5	25.4	25.3	25.2	26.0	25.6	25.4	25.0
Fully diluted shares	25.7	25.7	25.9	26.1	26.0	25.9	25.8	25.7	26.0	25.6	25.8	25.5
Yr-to-yr Gr.	-3%	-2%	0%	2%	1%	1%	-1%	-2%	-4.5%	-1.5%	0.6%	-1.2%

BALANCE SHEET

	Dec 31, 2016	Sept 30, 2016	% Change
CURRENT ASSETS			
Cash and cash equivalents	$31,332	$27,426	14.2%
Restricted cash	32	32	0.0%
Short-term investments	21,532	25,642	-16.0%
Accounts receivable, net	7,205	6,597	9.2%
Inventories	9,275	8,502	9.1%
Prepaid expenses and other current assets	1,106	1,393	-20.6%
Assets held for sale	0	0	
Total current assets	**70,482**	**69,592**	1.3%
LONG-TERM INVESTMENTS	4,253	4,253	0.0%
PROPERTY AND EQUIPMENT, NET	13,736	13,841	-0.8%
OTHER ASSETS	2,218	2,108	5.2%
Total other assets	20,207	20,202	0.0%
TOTAL ASSETS	90,689	89,794	1.0%
CURRENT LIABILITIES			
Notes and accounts payable	4,329	3,771	14.8%
Income tax payable	180	266	-32.3%
Deferred tax liabilities	0	921	-100.0%
Accrued expenses and other current liabilities	4,102	3,131	31.0%
Total current liabilities	8,611	8,089	6.5%
OTHER LONG-TERM LIABILITIES			
Accrued pension liabilities	281	277	1.4%
Other liabilities	1,013	84	1106.0%
Total long-term liabilities	1,294	361	258.4%
Total liabilities	9,905	8,450	17.2%
SHAREHOLDERS EQUITY			
Ordinary shares	33	33	0.0%
Additional paid-in capital	142,738	142,388	0.2%
Retained earnings (accumulated deficits)	(41,372)	(41,384)	0.0%
Accumulated other comprehensive income	4,415	5,334	-17.2%
Treasury stock	(25,030)	(25,027)	0.0%
Total shareholders equity	80,784	81,344	-0.7%
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	90,689	89,794	1.0%
Cash and equivalents	$52,864	$53,068	-0.4%
Change in cash and equivalents	($204)	$5,565	-103.7%
Market value	67,730,000	59,265,200	14.3%
Enterprise value	14,834,000	6,165,200	140.6%
DSO	39	42	-7.1%
Inventory Days	110	116	-5.2%

ANNUAL CASH FLOW – 2016 Not Yet Available

	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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