Zacks Small-Cap Research

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O2Micro International Ltd (OIIM-NASDAQ)

OIIM: Raising Estimates as Company Raised Guidance

Using an industry average enterprise value to trailing 12-month sales of 5.3 times, and applying it to OIIM's $58 m Q3 revenue run rate, we would calculate an enterprise value of $307, a market cap of $335 m and a price of **$13.08 per share.**

Current Price (01/03/16)	$1.89
Valuation	**$13.08**

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 just raised revenue and gross margin guidance for Q4 pointing to 17% revenue growth. The company trades at an enterprise value of $6 million, less than the value of its assets. There are activists involved in the stock.

SUMMARY DATA

52-Week High	**$2.07**
52-Week Low	**$1.27**
One-Year Return (%)	**21.0**
Beta	**0.59**
Average Daily Volume (sh)	**63,763**
Shares Outstanding (mil)	**26**
Market Capitalization ($mil)	**$48**
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	**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	15.7 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	-$0.02 E	-$0.19 E
2017					-$0.07 E

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

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WHAT'S NEW

Company Pre-Announces Stronger than Expected Q4 Revenue and Gross Margin

Business is improving at O2Micro even faster than expected due to **particularly good orders in power management and high-end televisions**. Today the company raised both the revenue range and gross margin guidance for the fourth quarter just closed on December 31, 2016. It is now telling investors to expect revenues to be reported in the range of $15.4 to $15.9 million rather than the previous range of $14.7 to $15.6 million. Using the midpoints of these ranges this is an increase of $500,000. The gross margin guidance is now a range of 53-55% versus the previous estimate of 50-52%, significantly higher. In Q3 2016, the gross margin was 52.6%.

In the last conference call the company indicated its current cost structure shows cash breakeven at $15.5-16.5 million in quarterly revenues and profitability breakeven is now at $17 to $18 million. So with this new guidance, the company may well have achieved cash breakeven in Q4 2016. At quarter end, the company had $53.1 million in cash and equivalents (or $2.07 per ADS.)

Last year the company reported Q4 on January 27, 2016, so we expect it might report earnings on the morning of January 25th this year with a 9AM conference call.

Updating the Q4 2016 Forecast

For Q4, the mid-point of the range is now $15.7 million in revenues versus $13.4 million, up 17%. Using higher revenues and higher gross margins we are raising earnings estimates. On a GAAP basis we are now looking for a loss of $0.04 versus a loss of $0.50 last year. Non-GAAP EPS could be a loss of $0.02 versus a loss of $0.10 per share last year. Most important to investors would be cash flow break even. The company only reports its cash flow statement on an annual basis so management will have to tell us if they achieved that in Q4 2016.

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.



VALUATION

Company Has Significant Upside If It Can Grow

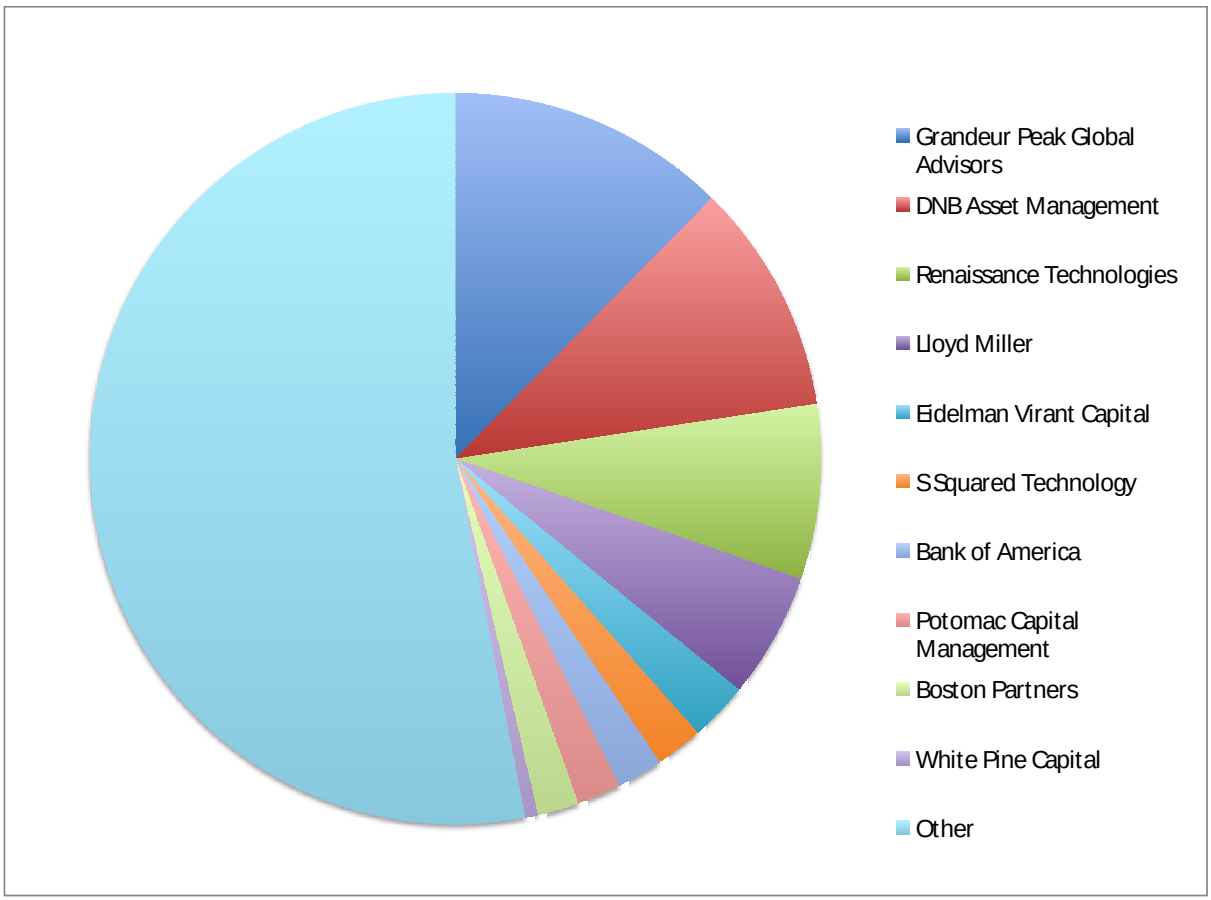
The company trades at an enterprise value of $6 million. At the end of Q3 2016, the company had $53.1 million (or $2.07 per ADS) in cash and equivalents, no debt and valuable real estate in China and California. In California it owns a 37,180 square foot building where it has its USA operations, which was bought for $4.6 million in May 2004 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 5.3 times and apply it to OIIM's Q3 $58 million revenue run rate, we would calculate an enterprise value of $307 million. Adding to it $53.1 million in cash gives us a market cap of $335 million or **$13.08 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.

	Competitors	EV	TTM Sales	EV/Sales
Intersil	**ISIL**	$2,770	$529	5.2
Microsemi	**MSCC**	8,180	1,660	4.9
Monolithic Power Systems	**MPWR**	3,070	372	8.3
Cree Inc.	**CREE**	2,250	1,560	1.4
Microchip Technology	**MCHP**	16,470	2,770	5.9
Linear Technology	**LLTC**	13,470	1,460	9.2
Maxim	**MXIM**	9,870	2,190	4.5
Texas Instruments	**TXN**	73,410	13,140	5.6
Cirrus Logic	**CRUS**	3,510	1,270	2.8
	Average			5.3

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 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	March Q1 17E	June Q2 17E	Sept Q3 17E	Dec Q4 17E	2015	2016E	2017E
REVENUE															
Net Revenue	13.1	14.7	13.7	13.4	13.0	13.2	14.4	15.7	14.0	14.3	15.0	16.7	54.8	56.3	60.0
Yr-to-yr Gr.	-20%	-16%	-11%	-7%	-1%	-10%	6%	17%	8%	8%	4%	7%	-14%	3%	7%
OPERATING EXPENSES															
Cost of goods sold	6.5	7.4	6.6	6.6	6.6	6.5	6.8	7.0	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	8.5	7.4	7.8	8.2	8.7	27.7	29.3	32.0
% of Sales	50.0%	49.6%	51.0%	50.4%	48.8%	50.7%	52.6%	54.0%	52.5%	54.4%	54.4%	52.0%	50.5%	52.0%	53.3%
R&D	4.5	3.8	4.7	4.8	3.8	3.8	4.0	4.3	4.0	4.0	4.0	4.0	17.8	15.8	17.0
SG&A	5.7	6.3	5.8	5.5	4.9	5.0	4.7	5.1	5.0	5.0	5.0	5.0	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	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	9.0	9.0	9.0	9.0	42.3	35.5	36.7
Operating Income	(3.6)	(2.9)	(3.4)	(4.7)	(2.3)	(2.1)	(1.1)	(0.9)	(1.6)	(1.2)	(0.8)	(0.3)	(14.6)	(6.3)	(4.7)
Interest income	0.2	0.2	0.1	0.1	0.1	0.1	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	0.0	0.0	0.0	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	0.0	0.0	0.0	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	0.2	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	0.0	0.0	0.0	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	0.2	0.2	0.2	0.2	(2.0)	3.5	1.0
Pretax Income	(3.0)	(2.5)	(2.1)	(9.1)	(2.2)	(1.7)	1.6	(0.7)	(1.4)	(1.0)	(0.6)	(0.1)	(16.6)	(2.8)	(3.7)
	-22.6%	-16.7%	-15.1%	-68.1%	-16.8%	-13.1%	11.2%	-4.5%	-10.0%	-7.0%	-4.0%	-0.4%	-30.3%	-5.0%	-6.2%
Taxes	0.2	0.3	0.3	3.8	0.2	0.2	0.3	0.2	0.2	0.2	0.2	0.2	4.6	0.9	0.0
Tax Rate	-8.1%	-11.7%	-13.9%	-10.9%	-9.2%	-13.7%	17.5%	-28.4%	-14.3%	-20.1%	-33.3%	-285.7%	-28.0%	-32.8%	-11.0%
GAAP Net Income	(3.2)	(2.7)	(2.4)	(12.9)	(2.4)	(2.0)	1.3	(0.9)	(1.6)	(1.2)	(0.8)	(0.3)	(21.2)	(3.7)	(3.7)
Non-GAAP Net Income	(2.9)	(2.3)	(1.9)	(2.5)	(2.0)	(1.8)	(0.9)	(0.6)	(1.3)	(0.9)	(0.5)	(0.0)	(9.7)	(5.4)	(3.7)
GAAP EPS-Basic	($0.12)	($0.10)	($0.09)	($0.50)	($0.09)	($0.08)	$0.05	($0.04)	($0.06)	($0.05)	($0.03)	($0.01)	($0.82)	($0.15)	($0.15)
GAAP EPS-Fully dil.	($0.12)	($0.10)	($0.09)	($0.50)	($0.09)	($0.08)	$0.05	($0.04)	($0.06)	($0.05)	($0.03)	($0.01)	($0.82)	($0.15)	($0.15)
Non-GAAP	**($0.11)**	**($0.09)**	**($0.07)**	**($0.10)**	**($0.08)**	**($0.06)**	**($0.04)**	**($0.02)**	**($0.05)**	**($0.03)**	**($0.02)**	**$0.01**	**($0.37)**	**($0.19)**	**($0.07)**
Share Out	26.5	26.1	25.9	25.6	25.7	25.7	25.6	25.4	25.3	25.2	25.1	25.0	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	25.3	25.2	25.9	25.0	26.0	25.6	25.4
Yr-to-yr Gr.	-5%	-5%	-5%	-4%	-3%	-2%	0%	-1%	-2%	-2%	0%	-2%	-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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