Zacks Small-Cap Research

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O2Micro International Ltd (OIIM-NASDAQ)

O2Micro Reports Second Quarter of Revenue Growth—On Track to Profitability Later this Year

Using an industry average value to trailing 12-month sales of 5.5 times, and applying it to OIIM's $60 m Q4 revenue run rate, we would calculate an enterprise value of $282, a market cap of $333 m and a price of **$12.90 per share.**

Current Price (05/09/17)	$2.50
Valuation	**$12.90**

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 $14 million, close the value of its non-cash assets.

SUMMARY DATA

52-Week High	**$2.74**
52-Week Low	**$1.40**
One-Year Return (%)	**70.1**
Beta	**0.37**
Average Daily Volume (sh)	**66,350**
Shares Outstanding (mil)	**26**
Market Capitalization ($mil)	**$64**
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 (%)	**-15.8**
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	15.0 A	15.0 E	16.5 E	18.0 E	65 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	-$0.04 A	-$0.06 E	-$0.01 E	$0.03 E	-$0.08 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 Q1 Revenue Range

Today O2Micro again reported quarterly revenues and earnings slightly better than our estimate. Revenues for the quarter were $15.0 million versus $13.0 million a year ago, up 15%. The company had given revenue range guidance of $14.3 to $15.1 million. Gross margin was 52.7%, much higher than last year's 48.8%.

Operating expenses in the quarter were $9.1 versus $8.6 with more of the increase being in R&D. Operating losses were reduced from $2.3 million to $1.3 million as the company grows revenues back to profitability.

Other income consisted of interest income, rental income, and foreign exchange losses, which totaled an expense of $35,000 versus a gain of $122,000 a year ago.

Non-GAAP net income was a loss of $1.0 million versus a loss of $2.0 million. The company reported non-GAAP EPS loss of $0.04 versus $0.08 last year.

Q2 Forecast

Q2 2017 should again show year over year growth but flattish gross margin due to product mix. There is still a shortage of two components that are holding back some customer orders.

- In high end TVs, there is a shortage of panels 60 inches and higher due to a decision by Foxconn to stop selling them to potential competitors which includes a number of O2Micro's customers. These customers are scrambling to find other suppliers who are having limitations to ramping production. It is hard to predict when this problem might be resolved.

- The other shortage affects smartphones. There is not enough supply of fingerprint recognition IC chips due to 8" wafer capacity at foundries and it is impeding the production of some high-end phones.

The company had expected this to resolve in Q2 but problems are ongoing and it is difficult to determine when a steady state situation will commence.

Revenue guidance for Q2 2017 is a range of $14.4 to $15.6 million and gross margin guidance was 48-51%. Gross margin is down from Q1 strictly due to product mix. Using the midpoints would yield Q2 revenue **of $15 versus $13.2 million, up 13%.** Given the company's guidance on gross margin and expenses, that would yield a non-GAAP EPS loss at $0.06, flat with last year.

O2Micro indicated its current cost structure shows cash breakeven is $15.5-17 million in quarterly revenues and profitability breakeven is still at $17 to $19 million. We are forecasting that the company could reach $18 million in revenue in the fourth quarter. At March 31, 2017, the company still had $50 million in cash and equivalents (or $1.95 per ADS.)

Business Units

As discussed previously the **intelligent lighting** continues to be plagued by the shortage of large panels for some of its customers. As a result some customers cut back orders from O2Micro. Free-dimming products and high power lighting continue to grow and have higher than average margins. The company is still optimistic about the automotive backlighting market the self-driving cars and trucks who will need even larger displays.

Battery management is the company's second largest sector and fastest growing. It 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. E-bike sharing programs are becoming popular through out the world. Newer markets for O2Micro include UPS, solar battery management, and drones.



Computer notebook products are containing to decline with the market contraction. They are unfortunately 90% of the revenues in this segment. Tablet and smartphones, while a small part, continue to grow and win design ins.

VALUATION

Company Has Significant Upside If It Can Grow

The company trades at an enterprise value of $14 million. At the end of Q1 2017, the company had $50.5 million (or $1.95 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 had 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.

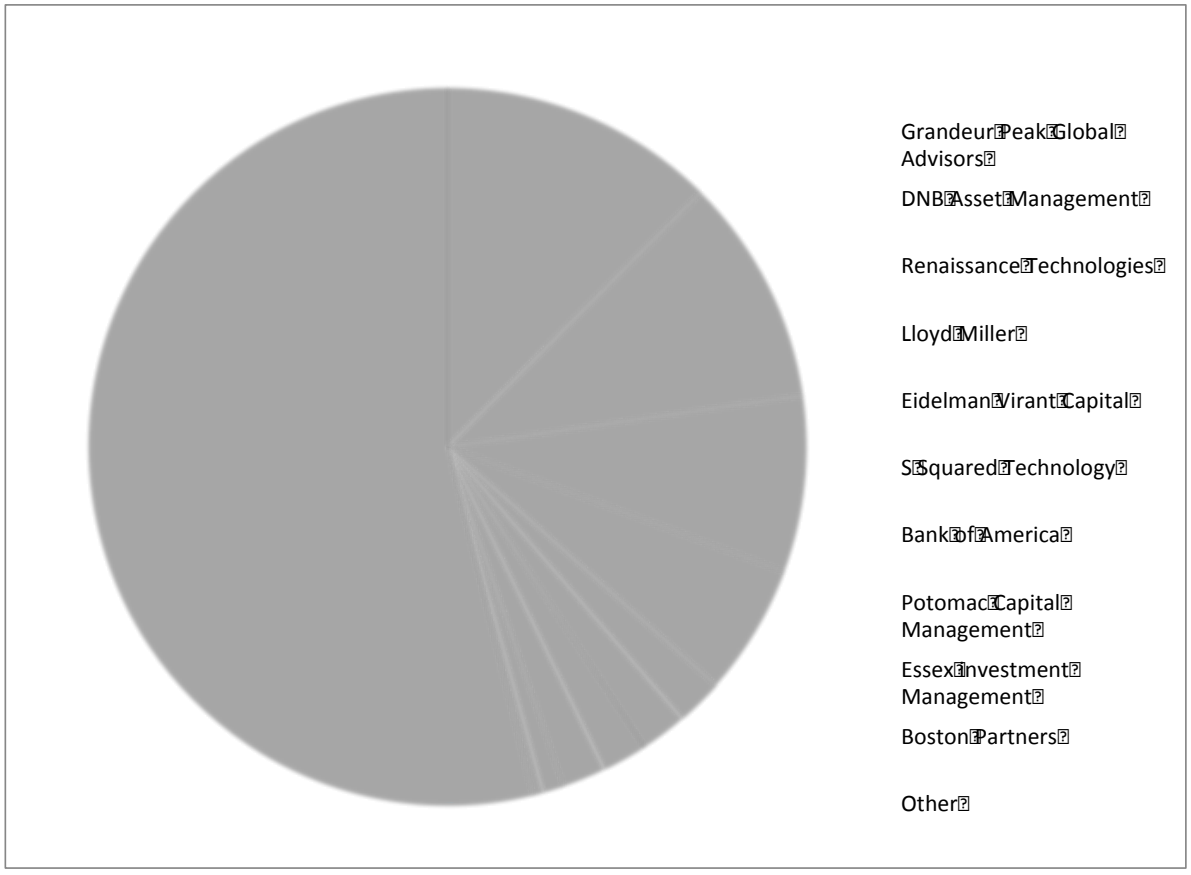
Recently two of the comparable companies we had been using, Intersil and Linear Technology, were acquired. Intersil was acquired by Renesas for $3.2 billion at a valuation of 5.9xs the company's trailing $542.1 million in revenue. Analog Devices acquired linear Technology for $14.8 billion. This is 9.9 times its trailing four quarters of revenue of $1.5 billion.

Were we to use the average enterprise value to trailing twelve-month sales of 4.7 times and apply it to OIIM's trailing $60 million revenue run rate, we would calculate an enterprise value of $282 million. Adding

to it $50.5 million in cash gives us a market cap of $333 million or **$12.90 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
Microsemi	**MSCC**	7,530	1,760	4.3
Monolithic Power Systems	**MPWR**	3,590	405	8.9
Cree Inc.	**CREE**	1,800	1,500	1.2
Microchip Technology	**MCHP**	18,670	3,410	5.5
Maxim	**MXIM**	11,310	2,260	5.0
Texas Instruments	**TXN**	79,470	13,760	5.8
Cirrus Logic	**CRUS**	3,690	1,540	2.4
	Average			4.7

OWNERSHIP



RISKS

- O_2Micro has exposure several stagnant markets such as standard TVs and declining markets such as notebooks and smaller 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.

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 16	March Q1 17	June Q2 17E	Sept Q3 17E	Dec Q4 17E	2015	2016	2017E	2018E
REVENUE																
Net Revenue	13.1	14.7	13.7	13.4	13.0	13.2	14.4	15.9	15.0	15.0	16.5	18.0	54.8	56.6	64.5	74.1
Yr-to-yr Gr.	-20%	-16%	-11%	-7%	-1%	-10%	6%	19%	15%	13%	14%	13%	-14%	3%	14%	15%
OPERATING EXPENSES																
Cost of goods sold	6.5	7.4	6.6	6.6	6.6	6.5	6.8	7.3	7.1	7.5	7.5	7.0	27.1	27.3	29.1	32.8
Gross Margin	6.6	7.3	7.1	6.7	6.3	6.7	7.6	8.6	7.9	7.5	9.0	10.0	27.7	29.2	35.4	41.3
% of Sales	50.0%	49.6%	51.0%	50.4%	48.8%	50.7%	52.6%	54.1%	52.7%	50.0%	54.5%	55.6%	50.5%	51.7%	54.9%	55.7%
R&D	4.5	3.8	4.7	4.8	3.8	3.8	4.0	4.1	4.1	4.3	4.4	4.5	17.8	15.6	17.3	19.3
SG&A	5.7	6.3	5.8	5.5	4.9	5.0	4.7	4.9	5.1	5.1	5.1	5.2	23.3	19.5	20.5	23.2
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	0.0
Tot Operating Exp.	10.1	10.2	10.5	11.4	8.6	8.8	8.7	9.0	9.1	9.4	9.5	9.7	42.3	35.1	37.7	42.5
Operating Income	(3.6)	(2.9)	(3.4)	(4.7)	(2.3)	(2.1)	(1.1)	(0.4)	(1.2)	(1.9)	(0.5)	0.3	(14.6)	(5.9)	(2.4)	(1.2)
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	0.3	0.3
Foreign exchange loss	0.0	(0.2)	0.8	0.0	(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	0.3	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	0.0
Other (rent) - net	0.1	0.2	0.1	0.4	0.2	0.2	0.2	0.3	0.1	0.1	0.1	0.1	0.7	0.9	0.4	1.1
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	0.0
Total other Income	0.6	0.4	1.3	(4.4)	0.1	0.4	2.7	0.7	0.0	0.2	0.2	0.2	(2.0)	3.9	0.5	1.4
Pretax Income	(3.0)	(2.5)	(2.1)	(9.1)	(2.2)	(1.7)	1.6	0.4	(1.2)	(1.8)	(0.3)	0.5	(16.6)	(1.9)	(1.8)	0.2
Pretax margin	-22.6%	-16.7%	-15.1%	-68.1%	-16.8%	-13.1%	11.2%	2.2%	-8.3%	-11.7%	-2.1%	2.7%	-30.3%	-3.4%	-2.9%	0.3%
Taxes	0.2	0.3	0.3	3.8	0.2	0.2	0.3	0.3	0.2	0.3	0.2	0.2	4.6	1.1	0.9	0.7
Tax Rate	-8.1%	-11.7%	-13.9%	-10.9%	-9.2%	-13.7%	17.5%	96.6%	-18.0%	-14.3%	-58.7%	41.6%	-28.0%	-54.9%	-47.2%	284.8%
GAAP Net Income	(3.2)	(2.7)	(2.4)	(12.9)	(2.4)	(2.0)	1.3	0.0	(1.5)	(2.0)	(0.5)	0.3	(21.2)	(3.0)	(2.7)	(0.4)
Non-GAAP Net Income	(2.9)	(2.3)	(1.9)	(2.5)	(2.0)	(1.8)	(0.9)	0.4	(1.0)	(1.6)	(0.1)	0.7	(9.7)	(4.4)	(2.1)	1.2
GAAP EPS-Basic	($0.12)	($0.10)	($0.09)	($0.50)	($0.09)	($0.08)	$0.05	$0.00	($0.06)	($0.08)	($0.02)	$0.01	($0.82)	($0.12)	($0.11)	($0.02)
GAAP EPS-Fully dil.	($0.12)	($0.10)	($0.09)	($0.50)	($0.09)	($0.08)	$0.05	$0.00	($0.06)	($0.08)	($0.02)	$0.01	($0.82)	($0.12)	($0.11)	($0.02)
Non-GAAP	**($0.11)**	**($0.09)**	**($0.07)**	**($0.10)**	**($0.08)**	**($0.06)**	**($0.04)**	**$0.01**	**($0.04)**	**($0.06)**	**($0.01)**	**$0.03**	**($0.37)**	**($0.16)**	**($0.08)**	**$0.05**
Share Out	26.5	26.1	25.9	25.6	25.7	25.7	25.6	25.6	25.8	25.7	25.6	25.5	26.0	25.6	25.7	25.0
Fully diluted shares	26.5	26.1	25.9	25.6	25.7	25.7	25.9	26.1	25.8	25.7	25.6	25.5	26.0	25.6	25.7	25.5
Yr-to-yr Gr.	-5%	-5%	-5%	-4%	-3%	-2%	0%	2%	1%	0%	-1%	-2%	-4.5%	-1.5%	0.2%	-0.7%

BALANCE SHEET

	March 31, 2017	Dec 31, 2016	Mar-Dec % Change	March 31, 2016	Mar-Mar % Change
CURRENT ASSETS					
Cash and cash equivalents	$27,372	$31,332	-12.6%	$35,924	-23.8%
Restricted cash	34	32	6.3%	32	6.3%
Short-term investments	23,124	21,532	7.4%	10,580	118.6%
Accounts receivable, net	6,862	7,205	-4.8%	5,337	28.6%
Inventories	9,577	9,275	3.3%	9,328	2.7%
Prepaid expenses and other current assets	1,384	1,106	25.1%	1,388	-0.3%
Assets held for sale	0	0	0.0%	6,924	-100.0%
Total current assets	**68,353**	**70,482**	-3.0%	**69,513**	-1.7%
LONG-TERM INVESTMENTS	4,253	4,253	0.0%	4,331	-1.8%
PROPERTY AND EQUIPMENT, NET	13,963	13,736	1.7%	14,077	-0.8%
OTHER ASSETS	2,086	2,218	-6.0%	2,375	-12.2%
Total other assets	20,302	20,207	0.5%	20,783	-2.3%
TOTAL ASSETS	88,655	90,689	-2.2%	90,296	-1.8%
CURRENT LIABILITIES					
Notes and accounts payable	3,444	4,329	-20.4%	2,951	16.7%
Income tax payable	153	180	-15.0%	469	-67.4%
Deferred tax liabilities	0	0	0.0%	2,278	-100.0%
Accrued expenses and other current liabilities	3,334	4,102	-18.7%	2,859	16.6%
Total current liabilities	6,931	8,611	-19.5%	8,557	-19.0%
OTHER LONG-TERM LIABILITIES					
Accrued pension liabilities	295	281	5.0%	275	7.3%
Deferred tax liabilities	987	0	0.0%	0	NM
Other liabilities	86	1,013	-91.5%	149	-42.3%
Total long-term liabilities	1,368	1,294	5.7%	424	222.6%
Total liabilities	8,299	9,905	-16.2%	8,981	-7.6%
SHAREHOLDERS EQUITY					
Ordinary shares	33	33	0.0%	33	0.0%
Additional paid-in capital	141,937	142,738	-0.6%	141,646	0.2%
Retained earnings (accumulated deficits)	(42,829)	(41,372)	3.5%	(40,750)	5.1%
Accumulated other comprehensive income	5,136	4,415	16.3%	5,258	-2.3%
Treasury stock	(23,921)	(25,030)	-4.4%	(24,872)	-3.8%
Total shareholders equity	80,356	80,784	-0.5%	81,315	-1.2%
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	88,655	90,689	-2.2%	90,296	-1.8%
Cash and equivalents	$50,496	$52,864	-4.5%	$46,504	8.6%
Change in cash and equivalents	(2,368)	(204)	1060.8%	(5,928)	-60.1%
Market value	64,600,000	67,730,000	-4.6%	35,207,630	83.5%
Enterprise value	14,070,000	14,834,000	-5.2%	(11,328,370)	-224.2%
DSO	42	39	7.7%	37	13.5%
Inventory Days	120	110	9.1%	129	-7.0%

ANNUAL CASH FLOW

	12 Months Ended December 31,			
	2016	2015	2014	2013
OPERATING ACTIVITIES				
Net loss	$(2,986)	$(21,095)	$(15,057)	$(19,099)
Adjustments to reconcile net loss to net cash used in operating activities:				
Depreciation and amortization	1,682	2,446	3,718	4,685
Stock-based compensation	1,606	1,912	2,120	2,609
Loss on asset write-off	0	0	82	
Inventory write-downs	1,527	913	1,538	900
Gain on sale of long-term investments	(948)	(8)	(436)	
Impairment loss on long-term investments	0	4,953	83	
Gain on disposal of property and equipment, net	(1,726)	(738)	(428)	(106)
Deferred income taxes	(1,231)	1,989	78	41
Other, net			(36)	(1)
Changes in operating assets and liabilities:				
Accounts receivable, net	(2,008)	1,592	3,235	(1,251)
Inventories	(1,140)	(1,933)	(2,963)	(200)
Prepaid expenses and other current assets	(6)	191	130	510
Deferred charges	(375)	(416)	(985)	(1,366)
Notes and accounts payable	996	1,202	(2,038)	413
Income tax payable	(2,065)	1,595	412	(124)
Accrued expenses and other current liabilities	(1,064)	(1,039)	577	(1,083)
Accrued pension liabilities	(4)	(11)	(12)	(25)
Other liabilities	(56)	(168)	(346)	(8,893)
Net cash used in operating activities	(7,798)	(8,615)	(10,328)	(22,990)
Acquisition of:				
Short-term investments	(28,797)	(7,128)	(22,346)	(15,496)
Long-term investments	0			(250)
Property and equipment	(673)	(724)	(1,004)	(743)
Decrease (increase) in:				
Restricted assets				10,000
Restricted cash	0	132	(1)	1
Other assets	40	82	116	108
Proceeds from:				
Sale of short-term investments	18,331	16,755	34,333	52,131
Sale of long-term investments	5,999	537	1,304	
Disposal of property and equipment	3,837	3,205	1,982	166
Net cash provided by investing activities	(1,263)	12,859	14,384	45,917
FINANCING ACTIVITIES				
Acquisition of treasury stock	(619)	(3,233)	(4,965)	(8,279)
Proceeds from:				
Exercise of stock options	2	31	44	25
Issuance of ordinary shares under the Employee Stock Purchase Plan	73	180	258	335
Net cash used in financing activities	(544)	(3,022)	(4,663)	(7,919)
EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATE	(262)	(1,092)	(617)	(613)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(9,867)	130	(1,224)	14,395
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE YEAR	41,199	41,069	42,293	27,898
CASH AND CASH EQUIVALENTS AT END OF THE YEAR	31,332	41,199	41,069	42,293
SUPPLEMENTAL DISCLOSURES OF CASH FLOWS				
Cash paid for tax	$4,349	$1,068	$697	$1,064
Cash Flow	(2,076)	(9,628)	(8,420)	(10,971)
Free cash flow	(2,749)	(10,352)	(9,424)	(11,714)

HISTORICAL STOCK PRICE



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