Zacks Small-Cap Research

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O_2Micro International Ltd (OIIM-NASDAQ)

Weak Worldwide Demand for TVs Hurts Business

Current Recommendation	**Buy**
Prior Recommendation	Hold
Date of Last Change	11/12/2013
Current Price (11/04/2015)	$1.67
12- Month Target Price	**$5.00**

OUTLOOK

O_2Micro International is a fabless semiconductor firm that designs, develops and markets high performance integrated circuits primarily for power management and power saving applications for the LED lighting industry. It recently started providing chips for smartphones, capitalizing on its notebook expertise. We believe this, if combined with stability in the TV and notebook markets, could reignite growth. The company trades at a negative enterprise value of -$12 million and there are activists involved in the stock, thus far with no results.

SUMMARY DATA

52-Week High	**$2.80**
52-Week Low	**$1.67**
One-Year Return (%)	**-14.36**
Beta	**0.71**
Average Daily Volume (sh)	**59,267**
Shares Outstanding (mil)	**26**
Market Capitalization ($mil)	**$46**
Short Interest Ratio (days)	**1.45**
Institutional Ownership (%)	**47**
Insider Ownership (%)	**8**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**-18.8**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**NM**
P/E using 2015 Estimate	**NM**
P/E using 2016 Estimate	**NM**
Zacks Rank	**N/A**

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

ZACKS ESTIMATES

Revenue
(Non-GAAP fully diluted EPS, in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2013	17 A	19 A	19 A	19 A	74 A
2014	17 A	17 A	15 A	14 A	64 A
2015	13 A	15 A	14 A	13 E	54 E
2016	13 A	14 A	15 A	15 A	57 E

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

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2013	-$0.15 A	-$0.13 A	-$0.14 A	-$0.11 A	-$0.53 A
2014	-$0.08 A	-$0.10 A	-$0.09 A	-$0.09 A	-$0.36 A
2015	-$0.11 A	-$0.09 A	-$0.08 A	-$0.16 E	-$0.44 E
2016	-$0.11 E	-$0.07 E	-$0.07 E	-$0.06 E	-$0.25 E

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Now Almost No One is Buying TVs

O2Micro released earnings that were in line with its guidance released in October. Revenues came in at $13.7 million versus $15.4 million, down 11% year over year and 7% sequentially. The company's guidance for Q4 was no better. In fact, it expects revenues to be sequentially flat to down 7% for the fourth quarter as TV demand falls worldwide. It cited Corning's (GLW) comments on its Q3 conference call. Corning management said "weakening economies, particularly in China, and the stronger dollar impacted business. For example, TV demand is weaker. TV growth in China has slowed. TV demand in Europe, Latin America, and Middle East Africa is softer due to the effect of the stronger dollar on retail prices and continued economic uncertainty. We **expect worldwide TV unit sell-through to be down slightly** versus last year." It also expects "smartphone sales in China to be flat versus last year."

None of this bodes well for any pick up of business at O2Micro. As the number and price of chips per television increases for the company, any progress may only negate the decline in units. True growth might only occur when 4K and higher TV sales start to be meaningful, and that does not look to be any time soon. In part this is because there is very little content available at that resolution, combined with high prices for these televisions. Additionally, due to weaker demand for smartphones, new models with features offered by OIIM, such as type C connectors will be slower to roll out.

Operating income came in at a loss of $3.4 million versus our expectation of a loss of $3.6 million. There were two one-time items in non-operating expenses: a sale of one seventh of the real estate in Shinju for a gain on sale of $258,000 and the other a foreign exchange gain of $834,000. These helped reduce the pretax loss to $2.1 million. If we were to take out these two items plus the stock-based compensation, non-GAAP EPS would have been a loss of $0.12 rather than the reported non-GAAP loss of $0.07.

We are cutting revenue forecasts for Q4 even further as our last cut was too optimistic given management's initial Q4 guidance. We are going to use the low end of the range of $12.7 million for our estimate in the hopes that there will be no need to cut again as the quarter progresses and orders don't come in. We see no signs that global demand will turn around any time soon, and feel that there is no compelling reason to upgrade to 4K TVs (other than Christmas) as there is little to see in 4K, at least in the US.

We are cutting EPS forecasts for both Q4 and 2016. If revenues do come in at $12.7 million, non-GAAP EPS will be near a loss of $0.16 without any help from foreign exchange gains. Q4 will be particularly painful, as the company will need to right size once again. We have put a $3 million one-time charge in the forecast, much like last year's fourth quarter. We know the company wants to build its R&D capabilities in smartphones, but we question if it can afford that and still reach cash break-even without eliminating some R&D in its less profitable or even declining businesses.

2016 Forecasts

Due to the state of the global economy we are reducing out estimate for 2016. The company is still heavily dependent on the television market and large screen and high-end televisions in particular, sales of which will help the company grow, as more chips of higher value will be embedded in these televisions. Since approximately half of the company's sales are here, and the units are declining, just staying even should be a chore. The rest of the business (except for laptops and tablets) continues to progress so we do expect some growth next year. We are reducing revenues to $57 million and a loss of $0.25. Hopefully if the company starts shipping to smartphone manufacturers in volume, we will able to raise, rather than lower, numbers.

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.

Figure 1: Letv's Le 1 Pro Superphone is the first to market with USB-C.



3. All Three of these Chips in One

4. DC to DC IC for 4-Core and higher

These DC-to-DC products are targeted at the very high-end phones and notebooks. There are many quad-core phones, some octo-core phones and MediaTek is has even introduced a deca-core, the Helio X20, which will succeed the octa-core Helio X10 (MT6795) that's already in several Chinese flagship phones.

VALUATION

Company has a Negative Enterprise Value

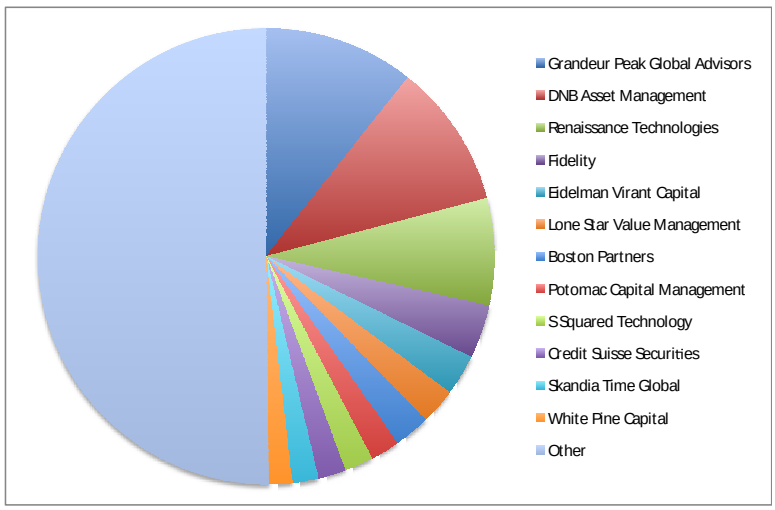
The company trades at a negative enterprise value of $11.8 million. The company burned $2 million in cash in Q3 net of property sales and not including $236,000 in capital expenditures. The company has $2.13 in cash, no debt and valuable real estate in China and California. Activists have tried to encourage 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 4.2 times and apply it to OIIM's Q3 $55 revenue run rate, we would calculate an enterprise value of $229 million. Adding to it $55 million in cash gives us a market cap of $284 million or **$10.95 per share**.

Competitors	EV	TTM Sales	EV/Sales
ISIL	$1,590	$541	2.9
MSCC	4,240	1,220	3.5
MPWR	2,250	322	7.0
CREE	2,320	1,630	1.4
MCHP	10,640	2,150	4.9
LLTC	9,680	1,450	6.7
MXIM	11,110	2,290	4.9
TXN	59,670	13,080	4.6
CRUS	2,020	1,140	1.8
Average			4.2

OWNERSHIP

In the past year, Lone Star, an activist shareholder had bought up to 1.7 million shares. According to a May 2015 filing that stake has been reduced to 0.7 million or 2.6% of the outstanding. There are still a number of hedge funds involved it 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.

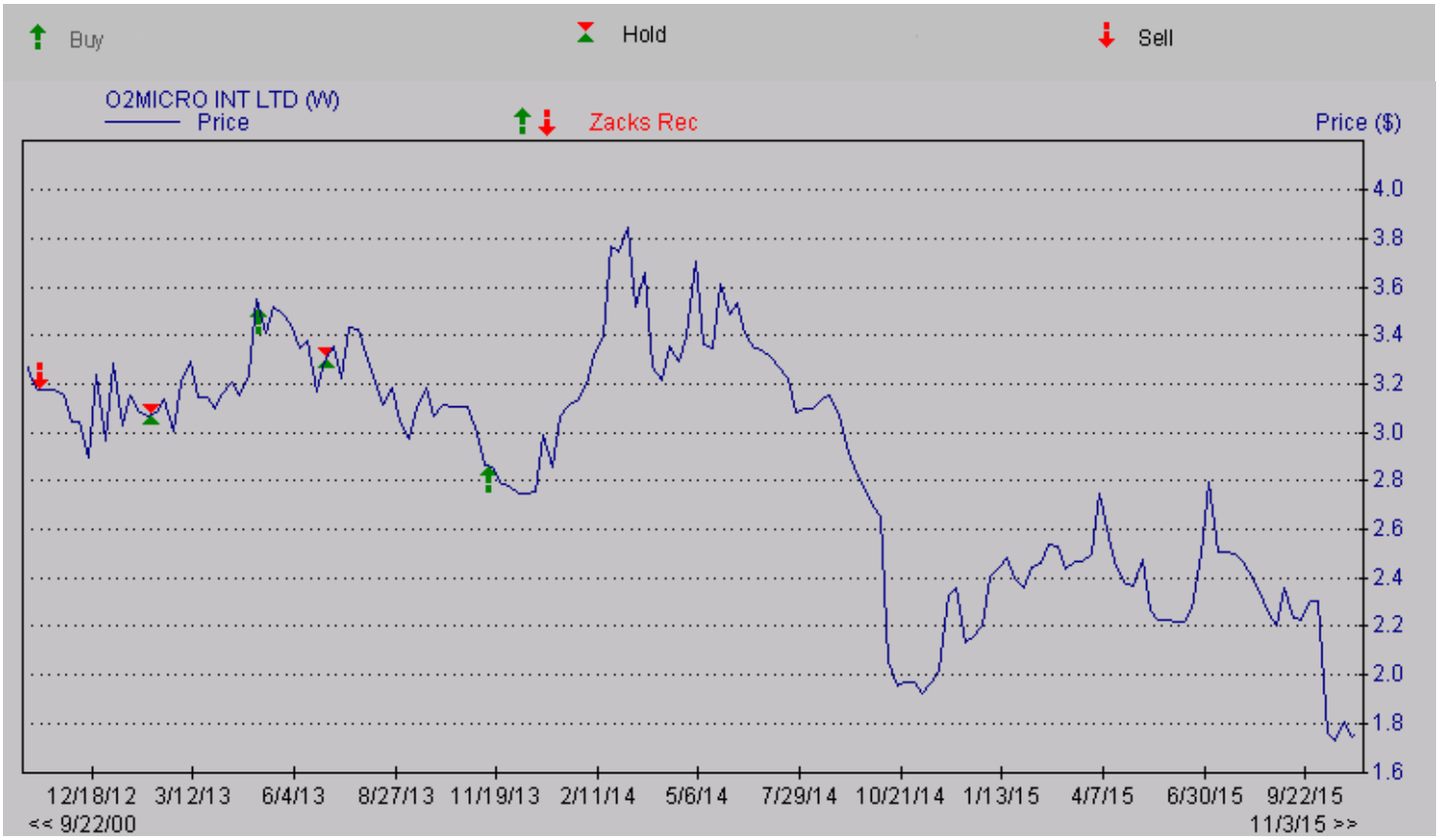
PROJECTED INCOME STATEMENT

	Dec Q4 14A	March Q1 15	June Q2 15	Sept Q3 15	Dec Q4 15E	March Q1 16E	June Q2 16E	Sept Q3 16E	Dec Q4 16E	2014	2015E	2016E
REVENUE												
Net Revenue	14.3	13.1	14.7	13.7	12.7	12.5	14.0	15.0	15.0	63.6	54.2	56.5
Yr-to-yr Gr.	-25%	-20%	-16%	-11%	-11%	-5%	-5%	10%	18%	-14%	-15%	4%
OPERATING EXPENSES												
Cost of goods sold	7.0	6.5	7.4	6.6	6.2	6.1	6.8	7.0	7.0	30.9	26.7	26.9
Gross Margin	7.3	6.6	7.3	7.1	6.5	6.4	7.2	7.7	7.7	32.7	27.4	29.6
% of Sales	51.0%	50.0%	49.6%	51.0%	51.0%	51.2%	51.4%	51.0%	51.0%	51.5%	50.7%	52.4%
R&D	5.6	4.5	3.8	4.7	4.8	4.7	4.7	4.7	4.7	21.9	17.8	18.8
SG&A	5.8	5.7	6.3	5.8	6.1	4.9	4.9	4.9	4.9	24.7	23.9	19.6
One-time expenses & Adj.	3.0	0.0	0.0	0.0	3.0	0.0	0.0	0.0	0.0	3.0	3.0	0.0
Tot Operating Exp.	14.4	10.1	10.2	10.5	13.9	9.6	9.6	9.6	9.6	46.6	44.7	38.4
								0%				
Operating Income	(7.1)	(3.6)	(2.9)	(3.4)	(7.4)	(3.2)	(2.4)	(2.0)	(2.0)	(13.9)	(17.2)	(8.8)
Interest income		0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1		0.7	0.6
Foreign exchange loss		0.0	(0.2)	0.8	0.0	0.0	0.0	0.0	0.0		0.7	0.0
Gain on sale of real estate		0.3	0.2	0.3	0.3	0.3	0.3	0.0	0.0		1.0	0.5
Other - net		0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1		0.4	0.3
Other Income	1.5	0.6	0.4	1.3	0.5	0.5	0.5	0.2	0.2	2.9	2.9	1.4
Pretax Income	(5.6)	(3.0)	(2.5)	(2.1)	(6.9)	(2.7)	(1.9)	(1.7)	(1.7)	(10.9)	(14.4)	(7.4)
	-39.1%	-22.6%	-16.7%	-15.1%	-54.2%	-21.7%	-13.7%	-11.6%	-11.6%	-17.2%	-26.5%	-13.1%
Taxes	0.5	0.2	0.3	0.3	0.8	0.3	0.2	0.2	0.2	1.2	1.6	0.9
Tax Rate	-8.0%	-8.1%	-11.7%	-13.9%	-10.9%	-11.0%	-11.0%	-11.0%	-11.0%	-10.8%	-10.9%	-11.0%
GAAP Net Income	(6.0)	(3.2)	(2.7)	(2.4)	(7.6)	(3.0)	(2.1)	(1.9)	(1.9)	(12.1)	(15.9)	(8.3)
Non-GAAP Net Income		(2.9)	(2.3)	(1.9)	(4.2)	(2.6)	(1.7)	(1.5)	(1.5)		(11.4)	(7.2)
GAAP EPS-Basic	($0.23)	($0.12)	($0.10)	($0.09)	($0.30)	($0.12)	($0.09)	($0.08)	($0.08)	($0.44)	($0.61)	($0.33)
GAAP EPS-Fully dil.	($0.23)	($0.12)	($0.10)	($0.09)	($0.30)	($0.12)	($0.09)	($0.08)	($0.08)	($0.56)	($0.61)	($0.33)
Non-GAAP	**($0.09)**	**($0.11)**	**($0.09)**	**($0.07)**	**($0.16)**	**($0.11)**	**($0.07)**	**($0.07)**	**($0.06)**	**($0.36)**	**($0.44)**	**($0.25)**
Share Out	26.7	26.5	26.1	25.9	25.4	25.2	25.0	24.8	24.6	27.2	26.0	24.9
Fully diluted shares	26.7	26.5	26.1	25.9	25.4	25.2	25.0	24.8	24.6	27.2	26.0	24.9
Yr-to-yr Gr.	-1.8%	-5%	-5%	-5%	-5%	-5%	-4%	-4%	-3%	-5.1%	-4.7%	-4.1%

BALANCE SHEET

In Thousands $	Sept. 30, 2015	June 30, 2015	Sept-June % Change
CURRENT ASSETS			
Cash and cash equivalents	$43,261	$47,506	-9%
Restricted cash	30	32	-6%
Short-term investments	11,721	10,734	9%
Accounts receivable, net	6,980	7,694	-9%
Inventories	9,214	8,427	9%
Prepaid expenses and other current assets	1,218	1,146	6%
Total current assets	**72,424**	**75,539**	-4%
LONG-TERM INVESTMENTS	14,257	14,424	-1%
PROPERTY AND EQUIPMENT, NET	15,683	17,163	-9%
OTHER ASSETS			
Total other assets	2,692	2,864	-6%
TOTAL ASSETS	105,056	109,990	-4%
CURRENT LIABILITIES			
Notes and accounts payable	3,539	3,901	-9%
Income tax payable	749	524	43%
Accrued expenses and other current liabilities	4,188	4,298	-3%
Total current liabilities	8,476	8,723	-3%
OTHER LONG-TERM LIABILITIES			
Accrued pension liabilities	270	292	-8%
Other liabilities	184	270	-32%
Total long-term liabilities	454	562	-19%
Total liabilities	8,930	9,285	-4%
SHAREHOLDERS EQUITY			
Preference shares at $0.00002 par value per share; Authorized 250,000,000 shares;			
	33	33	0%
Additional paid-in capital	141,470	141,050	0%
Retained earnings (accumulated deficits)	(25,589)	(23,227)	10%
Accumulated other comprehensive income	5,020	7,198	-30%
Treasury stock 269,042,350 and 162,072,500 shares as of Dec 31, 2013 and 2012, respectively	(24,808)	(24,349)	2%
Total shareholders equity	96,126	100,705	-5%
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	105,056	109,990	-4%
Cash and equivalents	$54,982	$58,240	-6%
Market value	43,246,320	59,015,380	-27%
Enterprise value	(11,765,680)	743,380	-1683%
AR	48	47	2%
DSO	121	95	27%

HISTORICAL ZACKS RECOMMENDATIONS



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