O2MICRO INTERNATIONAL LTD
Form 20-F
May 24, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 20-F

(Mark One)

[ ] Registration statement pursuant to Section 12(b) or 12(g) of the Securities Exchange Act of 1934

or

[x] Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2009

or

[ ] Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

or

[ ] Shell company report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
Date of event requiring this shell company report

Commission file number: 0-30910

O2MICRO INTERNATIONAL LIMITED
(Exact Name of Registrant as Specified in Its Charter)

The Cayman Islands
(Jurisdiction of Incorporation or Organization)

Grand Pavilion Commercial Centre, West Bay Road
P.O. Box 32331 Grand Cayman KY1-1209, Cayman Islands
(Address of Principal Executive Offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange On Which Registered
American Depositary Shares	NASDAQ Global Select Market
Ordinary Shares, par value $0.00002 per share	Cayman Islands Stock Exchange

Securities registered or to be registered pursuant to Section 12(g) of the Act:
None
(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:
None
(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

As of December 31, 2009, there were 1,809,461,200 ordinary shares, par value US$0.00002 per share, outstanding.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes [ ] No [x]

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.
Yes [x] No [ ]

Note – Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes [x] No [ ]
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes [ ] No [x]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer [ ] Accelerated filer [x] Non-accelerated filer [ ]

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP [x] International Financial Reporting Standards as issued by the International Accounting Standards Board [ ] Other [ ]

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 [ ] Item 18 [ ]

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ] No [x]

TABLE OF CONTENTS

PART I

PART II

PART III

Certain Definitions and Conventions

In this Annual Report on Form 20-F (“Annual Report”), references to “$” and “dollars” are to United States dollars. Percentages and certain amounts contained herein have been rounded for ease of presentation. Any discrepancies in any table between totals and the sums of amounts listed are due to rounding.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report contains statements of a forward-looking nature. These statements are made under the "safe harbor" provisions of the U.S. Private Securities Litigation Reform Act of 1995. You can identify these forward-looking statements by terminology such as "may," "will," "expects," "should," "could," "plans," "intends," "anticipates," "believes," "estimates," "predicts," "potential" or "continue" or the negative of these terms and other comparable terminology. These forward-looking statements include, without limitation, statements regarding our expectation to target and design products for specific applications, to increase expenses for personnel and new product development, to protect our technology and to expand our product offerings, our anticipation that sales to a relatively small number of customers will continue to account for significant portion of net sales, our expectation that we will need to expand our facilities to accommodate the growth in our personnel, our expectation that non-U.S. operations and sales will continue to grow and account for a substantial percentage of our net sales, our expectation that competition for qualified personnel will remain intense, our expectation that we will continue to incur substantial legal expenses that vary with the level of activity in legal proceedings, our statements regarding the growing popularity of thinner displays, mobile computing and portable devices, and the emergence and continued development of the Internet and wireless communications networks, our belief that we participate in large and growing markets, our belief that potential future growth in the LCD television market, especially units with larger-size panels, represents an attractive growth opportunity for us, our belief that manufacturers are turning to innovative new semiconductor technologies to manage the available power source capacity more efficiently, our belief that there is an increasing need for higher levels of system integration, our belief in the need for mixed-signal and analog integrated circuits specifically designed to optimize the power system usage in devices, our belief in the need to use advanced design methodologies to allow manufacturers to achieve rapid time-to-market with their new products, our expectation that our markets will be dominated by a small number of major brand name companies, our expectation that we will experience the highest sales volume in the third and fourth quarter of each year, our ability to develop and introduce products in a timely manner to meet customer demands, our expectation that analog and mixed-signal circuits have substantially longer life-cycles than digital integrated circuits, our ability to take advantage of cost-efficiencies associated with the "fabless" semiconductor business model, that we expect that our gross profit as a percentage of net sales will continue to fluctuate in the future as a result of the stages of our products in their life cycles, variations in our product mix, the timing of our product introductions and specific product manufacturing costs, our future gross profit, our expectation that gross margin on products we sell will typically decline over the life of the products, our expectation that research and development expenses as a percentage of net sales will continue to fluctuate, our expectation to continue development of innovative technologies and processes, and continued expansion and investment of our engineering, research and development resources, our expectation to continue to invest significant resources into research and development in the future, our expectations regarding the outcome of litigation matters and their effects on us, our belief that our cash generated from operations, together with the liquidity provided by existing cash, cash equivalents balances and short-term investment will be sufficient to meet our capital requirements for at least the next 12 months, our belief that our research and development staffing will increase in the next 12 months primarily due to expansion of existing design centers, our intention to continue expanding research and development operations, our intention to expand the scope of our international operations, our expectation that semiconductor companies will increasingly be subject to infringement claims as the number of products and competitors in the semiconductor industry grows, our belief that we operate in compliance with all applicable transfer pricing laws in all of the jurisdictions in which we operate, our anticipation that we will not declare any dividend in the foreseeable future, our belief that our system-level expertise and extensive experience with power management systems allow us to develop proprietary solutions and foster long-term relationships with our customers, our intention

to continue to evaluate additional investment opportunities in our supply chain, our belief that our current facilities are adequate for our needs for the foreseeable future, and that any additional space required will be available to us on commercially reasonable terms, our intentions to acquire additional real estate for future operations, our expectation that our results of operations or cash flows will not be affected to any significant degree by a sudden short-term change in market interest rates, our intention to diversify our customer base and market focus by providing new products used in particular markets, our statements regarding the effect of adoption of certain accounting policies, our expectation that our ADSs will satisfy the "readily tradeable" requirement, our expectation not to become a passive foreign investment company in the future, our intention to use the cash we have raised and conduct our business to reduce the risk of classification as a passive foreign investment company, our statements regarding the withdrawal of ordinary shares from the Main Board of the Stock Exchange of Hong Kong Limited ("SEHK"), that we expect to retain our existing primary listing of American Depositary Share ("ADS") on the NASDAQ Global Select Market ("NASDAQ") in the United States for the foreseeable future. These forward-looking statements are based on our current assumptions and beliefs in light of the information currently available to us. Actual results, levels of activity, performance or achievements may differ materially from those expressed or implied in these forward-looking statements for a variety of reasons, including: changes in demand for devices that use our products; market conditions in the semiconductor industry and the economy as a whole; the stages of our products in their life cycles, variations, expansions or reductions in the mix of our product offerings, the timing of our product introductions, changes in employment rates, changes in availability and cost of facilities,

unpredictability of and inability to control the outcome or timing of litigation, changes in applicable laws or accounting standards, potential delisting of our ADSs or ordinary shares from existing exchanges, specific product manufacturing costs, increased competition, introduction of new competitors or competing technologies and the increase of unexpected expenses, and such other factors discussed under “Key Information - Risk Factors,” "Operating and Financial Review and Prospects" and elsewhere in this Annual Report. We assume no obligation to update or revise any forward-looking information, whether as a result of new information, future events or otherwise. You are cautioned not to place undue reliance on these forward-looking statements which apply only as of the date of this Annual Report.

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

SELECTED CONSOLIDATED FINANCIAL DATA

The selected consolidated financial data for the years ended December 31, 2007, 2008 and 2009, and the selected consolidated financial data as of December 31, 2008 and 2009, set forth below, are derived from our audited consolidated financial statements included herein, and should be read in conjunction with, and are qualified in their entirety by reference to, these consolidated financial statements, including the notes to these consolidated financial statements and “Item 5. Operating and Financial Review and Prospects” included elsewhere in this Annual Report. The selected consolidated financial data for the years ended December 31, 2005 and 2006 and the selected consolidated financial data as of December 31, 2005 and 2006, set forth below, are derived from our audited consolidated financial statements and related notes which do not appear in this Annual Report. Our consolidated financial statements are prepared and presented in accordance with accounting principles generally accepted in the United States of America.

	Years Ended December 31				
	2005	2006	2007	2008	2009
	(in thousands, except per share data)				
Consolidated Statement of Income Data:					
Net sales	$ 105,552	$ 124,915	$ 165,540	$ 138,825	$ 127,498
Cost of sales	40,741	56,772	71,099	58,110	52,020
Gross profit	64,811	68,143	94,441	80,715	75,478
Operating expenses (income):					
Research and development	25,421	31,751	34,624	37,424	33,017
Selling, general and administrative	30,453	40,171	45,560	39,003	45,049
Goodwill impairment	-	-	-	2,782	-
Write-off of prepayments to foundry services	-	-	-	2,942	-
Litigation income	-	-	(9,364)	(2,000)	-
Stock Exchange of Hong Kong listing expenses	2,460	786	-	-	-

Total operating expenses	58,334	72,708	70,820	80,151	78,066
Income (loss) from operations	6,477	(4,565)	23,621	564	(2,588)
Non-operating income (expenses)–net	2,704	2,858	2,819	(12,133)	1,373
Income (loss) before income tax	9,181	(1,707)	26,440	(11,569)	(1,215)
Income tax expense (benefit)	1,034	(2,450)	1,456	2,240	1,602
Net income (loss)	8,147	743	24,984	(13,809)	(2,817)
Earnings (loss) per share (1):					
Basic	-	-	0.01	(0.01)	-
Diluted	-	-	0.01	NA	NA
Shares used to compute basic earnings (loss) per share (1):	1,961,168	1,932,575	1,905,725	1,862,831	1,840,995
Shares used to compute diluted earnings per share (1):	1,997,459	1,946,896	1,943,785	1,862,831	1,840,995
Earnings (loss) per ADS (2):					
Basic	0.21	0.02	0.66	(0.37)	(0.08)

Diluted	-	-	0.01	NA	NA
Shares used to compute basic earnings (loss) per share (1):	1,961,168	1,932,575	1,905,725	1,862,831	1,840,995
Shares used to compute diluted earnings per share (1):	1,997,459	1,946,896	1,943,785	1,862,831	1,840,995
Earnings (loss) per ADS (2):					
Basic	0.21	0.02	0.66	(0.37)	(0.08)
Diluted	0.20	0.02	0.64	NA	NA
ADS equivalents used to compute basic earnings (loss) per ADS (2):	39,223	38,652	38,115	37,257	36,820
ADS equivalents used to compute diluted earnings per ADS(2):	39,949	38,938	38,876	37,257	36,820

	December 31,				
	2005	2006	2007	2008	2009
	(in thousands)				
Consolidated Balance Sheet Data:					
Cash and cash equivalents	$46,375	$45,438	$52,597	$31,844	$38,831
Short-term investments	55,653	19,697	28,650	72,344	74,502
Working capital	117,942	90,865	118,777	122,006	124,022
Total assets	199,655	197,020	228,412	193,273	197,314
Long-term liabilities, excluding current portion	-	455	730	878	968
Net assets	175,896	173,511	204,179	179,780	179,444
Ordinary shares and additional paid-in capital	138,275	140,262	144,982	141,821	142,715

(1) All share information has been adjusted retroactively to reflect the 50-for-1 share split effected on November 25, 2005.

(2) Fifty ordinary shares equal one ADS

CAPITALIZATION AND INDEBTEDNESS

Not applicable.

REASONS FOR THE OFFER AND USE OF PROCEEDS

Not applicable.

RISK FACTORS

We wish to caution readers that the following important factors, and those important factors described in other reports submitted to, or filed with, the Securities and Exchange Commission, among other factors, could affect our actual results and could cause our actual results to differ materially from those expressed in any forward-looking statements made by us or on our behalf and that such factors may adversely affect our business and financial status and therefore the value of your investment:

If the markets for consumer electronics, computers, industrial or communications products do not grow substantially or even decrease, our net sales may be harmed.

Our business focuses on designing, developing and marketing high performance integrated circuits for manufacturers of products for the consumer electronics, computer, industrial and communications markets. As many

of the leading sellers of these products have an intermediary manufacture their products or those portions of their products containing our components, we currently derive substantially all of our product revenues from sales to these intermediaries or their suppliers. We have also targeted and are designing products for applications such as LCD monitors, LCD televisions, notebook computers, Internet security, mobile phones, energy efficient technology relating to sophisticated batteries and LED lighting, GPS and portable media players, such as portable DVD players. We believe that the important factors driving growth in these markets have been the growing popularity of thinner displays, mobile computing and portable devices, and the emergence and continued development of the Internet and wireless communications networks. If demand for products using LCDs or other devices using our products declines, or does not grow as quickly as we anticipate, our customers may experience lower demand for their products that use our products, which may cause our net sales to suffer. We cannot be certain that the markets for these products will continue to grow or that a significant slowdown in these markets will not occur.

Fluctuations in our quarterly operating results due to factors such as changes in the demand for electronic devices that utilize our products could adversely affect the trading price of our ADSs.

If our quarterly operating results fail to meet the expectations of securities analysts, the trading price of our ADSs could be adversely affected. Our quarterly operating results have varied substantially in the past and may vary substantially in the future depending upon a number of factors described below and elsewhere in this Risk Factors section, including many factors that are beyond our control. These factors include changes in demand for devices that use our products; market conditions in the highly cyclical semiconductor industry and the economy as a whole; the timing and cancellation of customer orders; the level of orders received that can be shipped in a quarter; the availability of third party semiconductor foundry, assembly and test capacities; fluctuations in manufacturing yields; delays in the introduction of new products; changes in the mix of sales of higher margin products and lower margin products; seasonal changes in demand during the year-end holiday season for devices that use our products; and the amount of legal and other expenses incurred in a particular quarter. For example, the level of legal expenses is not entirely within our control as we may need to respond to legal actions by opposing parties or scheduling decisions by the judges. It is difficult for us to forecast our legal expenses for any given quarter, which adversely affects our ability to forecast our expected results of operations in general.

In addition, the trading price of our ADSs may be affected by factors such as: significant price and volume fluctuations in our ADSs and financial markets in the U.S. and other countries, as well as relatively thin trading volume of our ADSs on the NASDAQ Global Select Market and the Cayman Islands Stock Exchange. Further, the trading markets for our ADSs are affected by the research reports that securities or industry analysts publish about us or our business. We do not have control over such coverage. If one or more analysts were to downgrade our ADSs, the price of our ADSs may decline. If one or more analysts cease coverage of our company or does not regularly publish reports on us, we may lose visibility in the financial markets, which could cause the price of our ADSs or trading volume to decline.

If orders for our products are cancelled or deferred, our net sales, operating margins and net income could be substantially reduced.

Orders for our products can be cancelled or deferred with little notice from and without significant penalty to our customers. A significant portion of our net sales in any financial reporting period depends on orders booked and shipped in that period. If a large amount of orders placed is cancelled or deferred, our net sales in that period could be substantially reduced. Since we do not have significant non-cancellable backlog, we typically plan our production and inventory expenses based on internal forecasts of customer demand, which are highly unpredictable and can fluctuate substantially. In particular, in response to anticipated lengthy lead times, which in the past have been as much as ten weeks or more, to obtain inventory and materials from our suppliers, we place orders with these suppliers in advance of anticipated customer demand, which can result in excess inventory if the expected orders fail to materialize. We also expect to increase our expenses for personnel and new product development. It is difficult for us to reduce our production, inventory, personnel and new product development expenses quickly in response to any shortfalls in net sales resulting from cancelled or deferred orders. As a result, any cancellation or deferral of orders would not only harm our net sales, it would also likely have a disproportionately adverse effect on our operating margins and net income.

If we do not develop and introduce new products in a timely manner, our net sales and gross margins could be harmed.

Our success depends upon our ability to develop and introduce new products selected for design into products for the consumer electronics, computer, industrial and communications markets. If we are unable to develop new products in a timely manner, our net sales will suffer. In addition, because our gross margins typically decline over the life cycle of our products as a result of competitive pressures and voluntary pricing arrangements, any failure to develop new

products in a timely manner will likely cause our gross margins to decline. The development of our new products is highly complex, and from time to time we have experienced delays in the introduction of new products of as much as eight-to-twelve weeks or more. Successful product development and introduction of new products depend on a number of factors, including accurate new product definition; timely completion of new product designs; achievement of manufacturing yields; timely and cost-effective production of new products; and timely delivery of new third-party supplied products used as key components in devices that incorporate our products. We often incur significant expenditures in the development of a new product without any assurance that it will be selected for design into our customers' products. If we incur such expenditures but fail to be selected, our results of operations will be adversely affected and may fluctuate significantly from period to period. Furthermore, even if our products were selected for design into our customers' products, we cannot be certain that these products will be commercially successful or that we will benefit from any associated sales.

If we fail to protect our intellectual property rights, competitors may be able to use our technology or trademarks, and this could weaken our competitive position, increase our costs, reduce our margins and reduce our net sales.

Our success is heavily dependent upon our proprietary technology. We rely primarily on a combination of patent, copyright and trademark laws, trade secrets, confidentiality procedures and contractual provisions to protect our proprietary technology and prevent competitors from using our technology in their products. These laws and procedures provide only limited protection. Our patents may not provide sufficiently broad protection or they may not prove to be enforceable in actions against alleged infringement.

Our ability to sell our products and prevent competitors from misappropriating our proprietary technology and trade names is dependent upon protecting our intellectual property. Despite the precautions we take, unauthorized third parties may copy aspects of our current or future products or obtain and use information that we regard as proprietary. Additionally, our competitors may independently develop similar or superior technology. Policing unauthorized use of software, circuit design or semiconductor design is difficult and some countries' laws do not protect our proprietary rights to the same extent as the laws of the United States, China and other developed countries. We have in the past and currently have initiated litigation to protect our intellectual property rights. Litigation may be necessary in the future to enforce our intellectual property rights, to protect our trade secrets or to determine the validity and scope of the proprietary rights of others. Litigation could result in substantial costs and diversion of resources, and could also result in a decision that our intellectual property is invalid or unenforceable and, could adversely affect our business, future results of operations and financial condition. See the section headed "Business Overview—Intellectual Property."

We depend on third parties to manufacture, assemble and test our products and, if they are unable to do so, our ability to ship products and our business and results of operations will be harmed.

We do not own or operate the integrated circuit fabrication facilities that manufacture the products we design. Three foundries, CR Micro, X-FAB, and SMIC, manufactured most of the integrated circuit products that we sold in 2009. These foundries manufacture integrated circuit products for us according to purchase orders. We do not have a guaranteed level of production capacity at any of these foundries, and any one or more could raise prices without notice. Although we provide the foundries with rolling forecasts of our production requirements, the ability of each foundry to provide wafers to us is limited by the foundry's available capacity. The term "wafers" refers to slices of silicon used to manufacture integrated circuits, and it is one of the principal raw materials in our products. These foundries could choose to prioritize capacity for other customers, particularly larger customers, reduce or eliminate deliveries to us on short notice or increase the prices they charge us. Accordingly, we cannot be certain that these foundries will allocate sufficient capacity, if any, to satisfy our requirements particularly during any industry-wide capacity shortages. In addition, if any of these foundries were unable to continue manufacturing our products in the required volumes at acceptable quality, yields and costs or in a timely manner, our business and results of operations would be seriously harmed.

There are other significant risks associated with our reliance on these foundries, including the disruption in our ability to ship products caused by the length of time, as much as 12-to-18 months, required for us to find alternative foundries for existing or new products; the reduction or elimination of deliveries to us by these outside foundries caused by a sudden increase in demand for semiconductor devices or a sudden reduction or elimination of manufacturing capacity by any existing manufacturers of semiconductor devices; the unavailability of, or delays in obtaining access to, key process technologies used by these foundries; and the susceptibility of our outside foundries to production interruptions resulting from natural disasters, such as the interruptions experienced in China and Taiwan in the past due to earthquake activity. Any of these events could cause these foundries to reduce or eliminate deliveries to us and cause disruption in our ability to ship products to our customers, which could negatively affect our business and results of operations.

We also rely on independent subcontractors to assemble and test most of our integrated circuit products. We do not have long-term agreements with any of these subcontractors but obtain services from them primarily on a purchase order basis. Our reliance on these subcontractors involves risks such as reduced control over delivery schedules, quality assurance and costs. These risks could result in product shortages or increase our costs of manufacturing, assembling or testing our products. If these subcontractors were unable or unwilling to continue to provide assembly and test services and deliver products at acceptable quality, yields and costs or in a timely manner, our business would be seriously harmed. We would also have to identify and qualify substitute subcontractors, which would be time consuming and costly and could result in unforeseen operational difficulties.

If we cannot compete effectively against new and existing competitors, our net sales and gross margins could be harmed.

Our ability to compete successfully in the market for integrated circuit products depends on factors both within and outside our control, including: our success in designing and subcontracting the manufacture of new products that implement new technologies and satisfy our customers' needs; the performance of our products across a variety of parameters such as reliability and cost efficiency; the price of our products and those of our competitors; our ability to control production costs; and the features of our competitors' products.

We believe our principal competitors include Intersil Corporation, Linear Technology Corporation, Maxim Integrated Products, Inc., Microsemi Corporation, Monolithic Power Systems, Inc., Ricoh Company, Ltd., Rohm Co., Ltd and Texas Instruments Incorporated. There is also competition from the internal integrated circuit design and manufacturing capabilities of some of our existing and potential customers, such as Toshiba and Fujitsu. In addition to these competitors, other integrated circuit companies may decide to enter the market with analog and mixed-signal integrated circuit products that compete with our products or incorporate functions similar to those provided by our products.

Some of our competitors, such as Texas Instruments, have greater name recognition, their own manufacturing capabilities, significantly greater financial and technical resources, and the sales, marketing and distribution strengths that are normally associated with large multinational companies. These competitors may also have pre-existing relationships with our

customers or potential customers. These competitors may be able to introduce new technologies more quickly, address customer requirements more rapidly and devote greater resources to the promotion and sale of their products than we do. Further, in the event of a manufacturing capacity shortage, these competitors may be able to manufacture products themselves or obtain third-party manufacturing capability when we are unable to do so.

We have substantial operations outside of the United States that expose us to risks specific to our international operations that could harm our net sales and net income.

As of December 31, 2009, a substantial portion of our operations, most of our employees, and most of the third parties we use to manufacture, assemble and test our products were located in China and Taiwan. In addition, sales outside the United States as a percentage of net sales accounted for almost all of our sales in the years ended December 31, 2005, 2006, 2007, 2008 and 2009. We expect our non-U.S. operations to grow and non-U.S. sales to continue to account for a substantial percentage of our net sales.

We are subject to risks specific to our international business operations, including: the risk of supply disruption, production disruption or other disruption arising from natural disasters such as the earthquake in China affecting our offices in Chengdu, the outbreak of any severe communicable disease or other widespread health problems; the risk of potential conflict and further instability in the relationship between Taiwan and China; risks related to international political instability; unpredictable consequences on the economic conditions in the U.S. and the rest of the world arising from terrorist attacks and other military or security operations, unexpected changes in regulatory requirements or legal uncertainties regarding tax regimes, that resulted in tariffs and other trade barriers, including current and future import and export restrictions; difficulties in staffing and managing international operations; adverse effects of changes in foreign currency exchange rates on our results of operations; limited ability to enforce agreements and other rights in foreign countries; changes in labor conditions; longer payment cycles and greater difficulty in collecting accounts receivables; burdens and costs of compliance with a variety of foreign laws; expropriation of private enterprises; and reversal of the current policies (including favorable tax and lending policies) encouraging foreign investment or foreign trade by our host countries. In addition, the geographical distances between Asia, the U.S., the Cayman Islands and Europe also create a number of logistical and communication challenges. Although we have not experienced any serious harm in connection with our international operations, we cannot assure you that such problems will not arise in the future.

In addition, our reporting currency is the U.S. dollar and our functional currency is the local currency of the respective entities. Therefore, a significant portion of our operating expenses is denominated in currencies other than the U.S. dollar, primarily the Chinese Renminbi and the New Taiwan dollar. As a result, appreciation or depreciation of other currencies in relation to the U.S. dollar could result in material transaction or translation gains or losses that could adversely affect, or cause fluctuations in, our results of operations. We do not currently engage in currency hedging activities.

If we cannot adapt our product offerings to respond to rapid technological changes, our net sales will be harmed.

The markets for consumer electronics, computer, industrial and communications products, and the components used in these products, are characterized by rapidly changing technology and very frequent new product introductions by our direct customers and our competitors. For example, the microprocessor, display and battery technologies with which our products inter-operate change very rapidly. Although our products integrate analog and mixed-signal circuits and therefore may have substantially longer life-cycles than digital integrated circuits, we must still update our products or introduce new ones on a regular basis. If we do not respond in a timely manner to technological changes and new product introductions by our direct customers and competitors, we will be unable to maintain and grow our product sales. In addition, the emergence of significantly more efficient or cost-effective microprocessor, display and battery technologies could lessen the need for the power management functionality of our products, which would harm our net sales.

We will need to recruit and retain qualified personnel to grow our business successfully.

Our future success will depend on our ability to attract and retain experienced sales, research and development, marketing, customer support and management personnel. If we do not attract and retain these personnel, our ability to grow our business, sell our products, enter new markets and increase our share of existing markets could be harmed. There can be no assurance that we will be successful in hiring for these positions in the near future. Our sales strategy requires that we hire additional direct sales persons and independent sales representatives in our major markets. Moreover, our independent sales representatives and direct sales personnel must market our products effectively and be qualified to provide timely and cost-effective customer support and service. If they are unable to do so or if we are unable to expand these organizations, this could harm our ability to increase our net sales and limit our ability to sell our products or expand our market share. Competition for qualified personnel in digital, analog and mixed-signal integrated circuit design is intense. In the past, we have experienced difficulty in recruiting qualified personnel, especially technical and sales personnel. As we intend to expand the scope of our international operations, this will require us to attract experienced management, research and development, marketing, sales and customer support personnel for our international offices. We expect competition for qualified personnel to remain intense, and we may not succeed in attracting or retaining such personnel. In addition, new employees generally require substantial training in our design methodology, design flow and technology, which in turn requires significant resources and management attention. There

is a risk that, even if we invest significant resources in attempting to attract, train and retain qualified personnel, we will not be successful in our efforts. In that event, our costs of doing business would increase without a corresponding increase in net sales.

Our success will depend to a significant extent on the continued service of our executive officers, including Sterling Du, our chief executive officer and chairman of our board, and other key employees, including key sales, consulting, technical, marketing and legal personnel. If we lose the services of one or more of our executives or key employees, our business and ability to implement our business objectives successfully could be harmed, particularly if one or more of our executives or key employees decide to join a competitor or otherwise compete directly or indirectly with us.

Defects in our products could result in significant costs and could impair our ability to sell our products.

Detection of any significant defects in our products may result in, among other things, loss of or delay in market acceptance and sales of our products, diversion of development resources, injury to our reputation and increased service and warranty costs. Because our products are complex, they may contain defects that can be present at any point in a product's life cycle. These defects could harm our reputation, which could result in significant costs to us and could impair our ability to sell our products. The costs we may incur in correcting any product defects may be substantial and could materially adversely affect our results of operations. While we continually test our products for defects and work with customers through our customer support services to identify and correct problems, defects in our products may be found in the future. Testing for defects is complicated in part because it is difficult to simulate the highly complex environments in which our customers may use our products. In the past, we have discovered defects in our products and have experienced delays in the shipment of our products. These delays have principally related to new product update releases. To date, none of these delays has materially affected our business; however, product defects or delays in the future could be material, and could adversely affect our reputation and our ability to sell our products.

A substantial portion of our net sales is generated by a small number of customers. If any of these customers delays or reduces its orders, our net sales and earnings may be harmed.

Historically, a relatively small number of customers has accounted for a significant portion of our net sales in any particular period. We have no long-term volume purchase commitments from any of our significant customers. We cannot be certain that our current customers will continue to place orders with us, that orders by existing customers will continue at the levels of previous periods or that we will be able to obtain orders from new customers. In addition, some of our customers, acting as intermediary manufacturers, supply products to end-market purchasers, and any of these end-market purchasers could choose to reduce or eliminate orders for our customers' products. This would in turn lower our customers' orders for our products.

In 2009, one customer accounted for 11.3% of our net sales and no other single customer accounted for more than 10% of our net sales. In 2008, two customers accounted for 23.8% of our net sales, and in 2007, one customer accounted for 11.1% of our net sales. The changes in sales to these customers as a percentage of our total net sales have been caused by a number of factors, such as the reduction, delay or cancellation of orders from one or more of our significant customers, some of which were outside our control. We anticipate that sales of our products to a relatively small number of customers will continue to account for a significant portion of our net sales.

Our ability to manage growth will affect our ability to achieve and maintain profitability.

Our ability to maintain profitability will depend in part on our ability to implement and expand operational, customer support and financial control systems and to train and manage our employees. We may not be able to augment or improve existing systems and controls or implement new systems and controls in response to future growth, if any. In

addition, we will need to expand our facilities to accommodate the growth in our personnel. Any failure to manage growth could divert management attention from executing our business plan and adversely affect our ability to expand our business successfully. Our historical growth has placed, and any further growth is likely to continue to place, a significant strain on our resources. In order to grow successfully, we will need to maintain close coordination among our executive, engineering, accounting, finance, marketing, sales, operations and customer support organizations, particularly in light of the internationally dispersed nature of our operations.

Third parties have asserted, and in the future could assert, that our products infringe their intellectual property rights. These claims could harm our ability to sell our products and expose us to litigation.

As is typical in the semiconductor industry, we have from time to time received communications from third parties asserting patents that cover certain of our technologies or products and alleging infringement of certain of their intellectual property rights. We may receive similar communications in the future. In the event any third party were to make a valid claim against us or our customers, we could be enjoined from selling selected products such as our inverter or power products or could be required to pay royalties to third parties. Third-party infringement claims, with or without merit, have been and could continue to be time consuming, result in substantial diversion of our resources and potentially significant litigation costs, including costs related to any fines and/or damages we may owe, cause product shipment delays, prevent us and/or our customers from selling some or all of our products, cause our customers or end-users not to use our products or require us to enter into license agreements. Such license agreements may not be available on acceptable terms, or at all. Any such event could seriously harm our business and our results of operations. We expect that semiconductor companies will increasingly be subject to infringement

claims as the number of products and competitors in the semiconductor industry grows. See the section headed "Business Overview—Intellectual Property."

From time to time, in the normal course of business, we agree to indemnify third parties with whom we enter into contractual relationships, including customers and parties to other transactions with us, with respect to certain matters. We have agreed, under certain conditions, to hold these third parties harmless against specified losses, such as those arising from a breach of representations or covenants, other third-party claims that our products when used for their intended purposes infringe the intellectual property rights of such other third parties or other claims made against certain parties. It is not possible to determine the maximum potential amount of liability under these indemnification obligations due to our limited history of prior indemnification claims and the unique facts and circumstances that are likely to be involved in each particular claim. To date, we have not made any payments under these obligations.

Until all outstanding litigation is resolved, we will continue to incur substantial legal expenses that vary with the level of activity in the legal proceedings. This level of activity is not entirely within our control as we may need to respond to legal actions. Consequently, we may find it difficult to predict the legal expenses for any given period, which will impair our ability to forecast our results of operations for that period.

Given the inherent uncertainties in litigation, there cannot be any assurance that we will prevail in any particular litigation matter, and we cannot predict the outcome of any such litigation. If any party were to prevail in its claims against us, our rights to certain patents and results of operations could be materially adversely affected. In any litigation arising from claims that we infringe on the intellectual property rights of others, an adverse result could involve an injunction to prevent the sales of a material portion of our products, and a reduction or the elimination of the value of related inventories, any of which could have a material adverse effect on our net sales, results of operations and financial condition. See the section headed "Business Overview—Intellectual Property."

We may be subject to lawsuits from third parties, which could harm our earnings and expose us to additional uncertainties.

We are a defendant or plaintiff in actions that arise in the normal course of business as well as actions that arose as counterclaims in response to our patent infringement actions, including actions for antitrust, unfair competition and interference. While we currently believe the amount of ultimate liability, if any, with respect to these actions will not materially affect our financial position, overall trends in results of operations, or liquidity, the ultimate outcome of any litigation or claim is uncertain, and the impact of an unfavorable outcome could be material to us.

If we fail to maintain an effective system of internal controls, we may not be able to report our financial results accurately. As a result, we may fail to meet our reporting obligations and current and potential holders of ADSs and/or ordinary shares could lose confidence in our financial reporting, which could adversely affect the trading price of our ADS.

Effective internal controls are necessary for us to provide reliable financial reports. If we cannot provide reliable financial reports or prevent fraud, our results of operations could be misstated, our reputation may be harmed and the trading price of our ADSs could be adversely affected. We cannot be certain that our controls over our financial processes and reporting will continue to be adequate in the future. Any failure of our internal controls over financial reporting could result in a material misstatement in financial statements.

In addition, under Section 404 of the Sarbanes-Oxley Act, beginning with our Annual Report on Form 20-F for the fiscal year ended December 31, 2006, we are required to furnish a report by our management on our internal control over financial reporting. This report contains, among other matters, an assessment of the effectiveness of our internal control over financial reporting as of the end of our fiscal year, including a statement as to whether or not our internal control over financial reporting is effective. This assessment must include disclosure of any material weaknesses in

our internal control over financial reporting identified by management. In addition, our independent registered public accountants must attest to and report on the operating effectiveness of our internal control over financial reporting as of the end of our fiscal year.

During this process, if our management or our independent auditors identifies one or more material weaknesses in our internal control over financial reporting, we may be unable to assert that such internal control is effective. If we were unable to assert that our internal control over financial reporting is effective or if our independent auditors were unable to express an opinion on the effectiveness of our internal controls, we could lose investor confidence in the accuracy and completeness of our financial reports, which could have an adverse effect on the trading price of our ADSs.

Our transfer pricing procedures may be challenged by tax or regulatory authorities or “taxing authorities”, which may subject us to higher taxes and adversely affect our earnings.

Transfer pricing refers to the prices that one member of a group of affiliated corporations charges to another member of the group for goods, services or the use of intellectual property. If two or more affiliated corporations are located in different countries, the laws or regulations of each country generally will require that transfer prices be the same as those charged by unrelated corporations dealing with each other at arm’s length. If one or more of the countries in which our affiliated corporations are located believe that transfer prices were manipulated by our affiliated corporations in a way that distorts the true taxable

income of the corporations, the laws of such countries could require us to redetermine transfer prices and thereby reallocate the income of our affiliate corporations in order to reflect such income clearly. Any reallocation of income from one of our corporations in a lower tax jurisdiction to an affiliated corporation in a higher tax jurisdiction would result in a higher overall tax liability to us. Moreover, if the country from which the income is being reallocated does not agree to the reallocation, the same income could be subject to taxation by both countries.

We have adopted transfer pricing agreements with our subsidiaries located in the United States, China, Taiwan, Japan and Singapore to regulate inter-company transfers. A transfer pricing agreement is a contract for the transfer of goods, services or intellectual property from one corporation to a related corporation that sets forth the prices that the related parties believe are those charged by unrelated corporations dealing with each other at arm's length. In such agreements, we have determined transfer prices that we believe are the same as the prices that would be charged by unrelated parties dealing with each other at arm's length. In this regard, we are subject to risks not faced by other companies with international operations that do not create inter-company transfers. If the taxing authorities of any jurisdiction, including Taiwan, China, and the United States, were to challenge these agreements successfully or require changes in our transfer pricing practices, we could become subject to higher taxes and our earnings would be adversely affected. There can be no assurance that we will continue to be found to be operating in compliance with transfer pricing laws, or that such laws will not be modified, which, as a result, may require changes to our transfer pricing practices or operating procedures. Any determination of income reallocation or modification of transfer pricing laws could result in an income tax assessment of the portion of income deemed to be derived from the taxing jurisdiction that so reallocates the income or modifies its transfer pricing laws.

Sales of our products could decline if our products fail to support evolving industry standards or environmental requirements.

Our net sales are mainly derived from sales of integrated circuit products that are components of electronic devices built to industry standards and widely accepted specifications. For example, the bus interconnect specifications of most notebook computers for attaching integrated peripherals are currently Peripheral Component Interconnect Express ("PCIe"), Universal Serial Bus ("USB") and Low Pin Count ("LPC") and the software used to control the power management functions of many notebook computers conforms to the industry's Advanced Configuration Power Interface specification. Our products must be designed to conform to these standards and specifications in order to achieve market acceptance. Technology standards and specifications continually evolve, and we may not be able to successfully design and manufacture new products that conform to these new standards or specifications in a timely manner. Additionally, new products we develop to conform to new specifications may not be accepted in the market.

In addition, a large percentage of our business is based on products that are used in systems that contain cold cathode fluorescent lamps ("CCFL"). CCFL tubes contain mercury, which is the subject of environmental concerns, particularly in Europe. Environmental issues may affect the use of our products being applied to CCFL applications and our business and results of operations could be adversely affected.

Climate change, other environmental concerns and green initiatives also presents other commercial challenges, economic risks and physical risks that could harm our results of operations or affect the manner in which we conduct our business.

Increasing climate change and environmental concerns could affect the results of our operations if any of our customers would request us to exceed any standard(s) set for environmentally compliant products and services. For example, we have been working with our suppliers, customers, and several industry consortia to develop and provide EU "RoHS" (European Union Restriction of Hazardous Substances) compliant products. If we are unable to offer such products or offer products that are compliant, but are not as reliable due to the lack of reasonably available alternative technologies or materials, we may lose market share to our competitors.

Provisions in our Memorandum and Articles of Association may discourage potential acquisition bids for us and prevent changes in our management that our shareholders may favor.

Provisions in our Memorandum and Articles of Association could discourage potential acquisition proposals and could delay or prevent a change in control transaction that our shareholders favor. These provisions could have the effect of discouraging others from making offers for our ordinary shares or ADSs. As a result, these provisions may prevent the trading price of our ADSs from reflecting the effects of actual or rumored takeover attempts and may prevent shareholders from reselling their ordinary shares or ADSs at or above the price at which they purchased their ordinary shares or ADSs. These provisions may also prevent changes in our management that our shareholders may favor. Our Memorandum and Articles do not permit shareholders to act by written consent, do not permit shareholders to call a general meeting and provide for a classified board of directors, which means shareholders can only elect a limited number of our directors in any given year. Furthermore, our board has the authority to issue up to 250,000,000 preference shares in one or more series. Our board can fix the price, rights, preferences, privileges and restrictions of such preference shares without any further vote or action by our shareholders but subject to any direction that may be given by the shareholders in a general meeting. The issuance of preference shares may delay or prevent a change in control transaction without further action by our shareholders or make removal of management more difficult.

As we are a Cayman Islands company, it could be difficult for investors to effect service of process on and recover against us or our directors and officers and our shareholders may face difficulties in protecting their interest.

We are a Cayman Islands company, and many of our officers and directors are residents of various jurisdictions outside the United States. A substantial portion of our assets and the assets of our officers and directors, at any one time, are and may be located in jurisdictions outside the United States. Although we have irrevocably agreed that we may be served with process in Santa Clara, California with respect to actions arising out of or in connection with United States federal securities laws relating to offers and sales of our ordinary shares and/or our ADSs, it could be difficult for investors to effect service of process within the United States on our directors and officers who reside outside the United States or to recover against us or our directors and officers on judgments of the United States courts predicated upon the civil liability provisions of the United States federal securities laws.

Our corporate affairs are governed by our charter documents, consisting of our Memorandum and Articles of Association, and by the companies law and common law of the Cayman Islands. The rights of our shareholders and the fiduciary responsibilities of our directors are governed by Cayman Islands law, which are not as clearly established as under statutes or judicial precedent in jurisdictions such as the United States. While there is some case law in the Cayman Islands on these matters, it is not as developed as, for example, in the United States. In addition, the laws of the Cayman Islands relating to the protection of the interests of minority shareholders differ in some respects from those established under statutes or judicial precedent in existence in the United States. Such differences may mean that our minority shareholders may have less protection than they would have under the laws of the United States. Due to the less protective nature of such laws in the Cayman Islands, our shareholders may have more difficulty in protecting their interests in the face of actions by our management or directors than would shareholders of a corporation incorporated in some other jurisdictions.

We may become a passive foreign investment company, which could result in adverse U.S. tax consequences to U.S. investors.

We may be classified as a passive foreign investment company by the U.S. Internal Revenue Service for U.S. federal income tax purposes. Such characterization could result in adverse U.S. tax consequences to you if you are a U.S. investor. For example, if we are a passive foreign investment company, our U.S. investors will become subject to increased tax liabilities under U.S. tax laws and regulations and will become subject to burdensome reporting requirements. The determination of whether or not we are a passive foreign investment company will be made on an annual basis and will depend on the composition of our income and assets, including goodwill, from time to time. Specifically, we will be classified as a passive foreign investment company for U.S. tax purposes if, after the application of look-through rules, either (a) 75% or more of our gross income in a taxable year is passive income, or (b) the average percentage of our assets (by value) in a taxable year that produce or are held for production of passive income is at least 50%. Our judgment is not binding on the Internal Revenue Service. In the future, the valuation of our intangible assets will be based in part on the then market value of our ADSs and ordinary shares which is subject to change. We cannot assure you that we will not be a passive foreign investment company for the current or any future taxable year. See “Taxation—United States Federal Income Taxation—Passive Foreign Investment Company.”

Holders of ADSs may not be able to exercise their right to vote.

Holders of our ADSs may instruct the depositary of our ADSs to vote the ordinary shares underlying their ADSs but only if we ask the depositary to ask for instructions. Otherwise, they will not be able to exercise their right to vote unless they withdraw the ordinary shares underlying the ADSs they hold. However, they may not know about the meeting sufficiently enough in advance to withdraw those ordinary shares. If we ask for instructions, the depositary will notify the holders of the upcoming vote and arrange to deliver our voting materials to them. We cannot assure you that holders will receive the voting materials in time to ensure that they can instruct the depositary to vote their ordinary shares. In addition, the depositary and its agents are not responsible for failing to carry out voting instructions

or for the manner of carrying out voting instructions. This means that holders may not be able to exercise their right to vote, and there is no guarantee that the ordinary shares underlying your ADSs would be voted as requested.

The depositary for our ADSs may give us a discretionary proxy to vote the ordinary shares underlying your ADSs if holders of ADSs do not vote at shareholders' meetings which could adversely affect their interests.

Under the deposit agreement for the ADSs, the depositary will give us a discretionary proxy to vote the ordinary shares on behalf of the underlying ADSs at shareholders' meetings if the holder of the ADSs did not vote, unless we notify the depositary that we do not wish to receive said discretionary proxy. Examples where we would not want to receive or exercise a discretionary proxy include, without limitation, instances where we think there is substantial shareholder opposition to the particular question, or we think the particular question would have a material adverse impact on our shareholders.

The effect of this discretionary proxy is that holders of ADSs cannot prevent the ordinary shares underlying their ADSs from being voted, absent the situation described above, and it may make it more difficult for shareholders to influence the management of our company. Holders of our ordinary shares are not subject to a discretionary proxy.

Holders of ADSs may not receive distributions on ordinary shares or any value for them if it is illegal or impractical to make them available.

The depositary of our ADSs has agreed to pay to ADS holders the cash dividends or other distributions it or the custodian for our ADSs receives on ordinary shares or other deposited securities after deducting its fees and expenses. Holders of our ADSs will receive these distributions in proportion to the number of ordinary shares the ADSs represent. However, the depositary is not responsible if it decides that it is unlawful or impractical to make a distribution available to any holders of ADSs. We have no obligation to take any other action to permit the distribution of our ADSs, ordinary shares, rights or anything else to holders of our ADSs. This means that ADS holders may not receive the distributions we make on ordinary shares or any value for them if it is illegal or impractical for us to make them available. These restrictions may have a material adverse effect on the value of the ADSs.

Holders of ADSs may be subject to limitations on transfer of ADSs.

ADSs represented by American Depositary Receipts, or ADRs, are transferable on the books of the depositary. However, the depositary may close its books at any time or from time to time when it deems expedient in connection with the performance of its duties. The depositary may refuse to deliver, transfer or register transfers of our ADSs generally when our books or the books of the depositary are closed, or at any time if we or the depositary thinks it is advisable to do so because of any requirement of law or any government or governmental body, or under any provision of the deposit agreement, or for any other reason.

ITEM 4. INFORMATION ON THE COMPANY

HISTORY AND DEVELOPMENT OF THE COMPANY

Our legal name is O2Micro International Limited. We are incorporated in the Cayman Islands. Our registered office is located at Maples Corporate Services Limited, Ugland House, P.O. Box 309, South Church Street, Grand Cayman KY1-1104, Cayman Islands. Our principal executive offices are located at Grand Pavilion Commercial Centre, West Bay Road, P.O. Box 32331 Grand Cayman KY1-1209, Cayman Islands. Our telephone number is (345) 945-1110. We have a subsidiary, O2Micro, Inc., which was incorporated as a California corporation in March 1995. In March 1997, O2Micro International Limited was incorporated as a Cayman Islands company. In March 1997, we exchanged our ordinary shares and preference shares for common stock and preferred stock of O2Micro, Inc. After the exchange, we held all of the outstanding capital stock of O2 Micro, Inc., our wholly owned subsidiary in the United States. Our shares were initially listed on the NASDAQ on August 23, 2000 and on the Cayman Islands stock Exchange on February 1, 2001. On November 25, 2005, we effected a 50-for-1 share split of our ordinary shares and created an ADS program for our ADSs to be quoted on the NASDAQ, with each ADS representing 50 ordinary shares. We delisted our ordinary shares from the NASDAQ on November 25, 2005 and listed our ADSs on the NASDAQ on November 28, 2005, the next trading day. We subsequently listed our ordinary shares on the SEHK on March 2, 2006 by way of introduction. On February 27, 2009, we submitted an application for the voluntary withdrawal of the listing of ordinary shares ("Shares") on the Main Board of the SEHK (collectively referred to as the "Proposed Withdrawal") for reasons of cost and utility. We have retained our existing primary listing of ADSs on the NASDAQ Global Select Market in the United States following the Proposed Withdrawal and for the foreseeable future. The Proposed Withdrawal was approved at the Extraordinary General Meeting of Shareholders held on May 30, 2009 and the listing of the Shares on SEHK was withdrawn on September 9, 2009.

Our agent for service of process in the U.S. for the purpose of our securities filings is our chief executive officer, Sterling Du, c/o O2Micro, Inc., 3118 Patrick Henry Drive, Santa Clara, CA 95054.

We have incorporated various wholly-owned subsidiaries, including (among others) O2Micro Electronics, Inc. ("O2Micro-Taiwan"), O2Micro International Japan Ltd. ("O2Micro-Japan"), O2Micro Pte Limited-Singapore ("O2Micro-Singapore"), O2Micro (China) Co., Ltd. ("O2Micro-China"), and O2Security Limited ("O2Security"). O2Micro-Taiwan is engaged in operations and sales support services. O2Micro-Japan is engaged in sales support services. O2Micro-Singapore, O2Micro-China, and other subsidiaries are mostly engaged in research

and development services. O2Security is primarily engaged in operations and sales of network security products. To assure its testing capacity and flexibility, we also established a subsidiary, OceanOne Semiconductor (Ningbo) Limited ("OceanOne") in Ningbo of the People's Republic of China ("China") in August 2005. OceanOne is engaged in semiconductor testing service and has commenced its operations in January 2007. In June, 2008, we entered into a share transfer agreement with Sigurd Microelectronics (Cayman) Co., Ltd. ("Sigurd Cayman") to dispose of 100% ownership of OceanOne for $6.7 million. The share transfer was subsequently completed on July 2, 2008.

Since January 1, 2007, our principal capital expenditures were investments in various private companies of approximately $5.7 million in the aggregate, and $12.2 million in the purchase of property and equipment.

BUSINESS OVERVIEW

We design, develop and market high performance integrated circuits for power management and security applications, as well as systems security solutions. We focus our product design efforts on integrated circuits for consumer electronics, computer, industrial and communications products, including LCD computer monitors, LCD televisions, notebook computers, Internet security devices, GPS, mobile phones and portable DVD players. Our integrated circuit products manage and provide power for LCD lighting, provide connections between notebook computers and external plug-in cards provide Internet security,

control and monitor battery charging and discharging, DC/DC conversion, and provide select and switch functionality between power sources.

We believe that our focus on these products provides us with an opportunity to participate in large and growing markets. Potential future growth in the LCD television market, especially units with larger-size panels, represents an attractive growth opportunity for us because larger LCD panels require more of our inverters for cold cathode fluorescent lamps, or CCFLs.

Our integrated circuit products use analog, digital or mixed-signal designs that combine analog and digital circuits on a single chip, reducing the number of components needed and allowing our customers to reduce the size, weight, power requirements or cost of their products. We offer a wide range of proprietary application specific standard products as well as customized products. We work closely with our customers to identify their product needs and establish engineering priorities for new product designs and development. We believe that our system-level expertise and extensive experience with power management systems allow us to develop proprietary solutions and foster long-term relationships with our customers.

We sell our products to OEMs, ODMs and module makers. Our integrated circuits have been incorporated into products sold by Acer, Apple Computer, Dell, Fujitsu, Hewlett-Packard, Lenovo, LG Electronics, NEC, Samsung Electronics, Sharp, Sony and Toshiba, among others. We sell our products through our direct sales force, independent sales representatives and distributors in China, Japan, Korea, Singapore, Taiwan and the United States. We also have design centers in many of our key markets to provide design and engineering support to our customers. We outsource the fabrication of our products to standard, high volume semiconductor foundries. This “fabless” approach allows us to focus on product development, minimize fixed costs and capital expenditures, and access diverse manufacturing technologies.

Industry Background

The markets for consumer electronics, mobile computing and communications products, such as LCD monitors, LCD televisions, notebook computers, mobile handsets and portable entertainment devices, are large and growing as functionality increases and prices decrease. One of the most significant challenges in these markets remains the efficient management of power. As the number of applications and features available for these products has increased, the number and variety of power loads, or individual subsystems requiring voltage or current regulation, has also grown. Each additional application or feature can require multiple functions and circuits that, in turn, require more individually-regulated and managed power sources. Increasingly, manufacturers are turning to innovative new semiconductor technologies to manage the available power source capacity more efficiently.

Power management integrated circuits deliver power and regulate voltage, controlling the flow of electrical energy among the various power loads and energy sources in a product or system. Power management requires a combination of two distinct technological disciplines: digital integrated circuit design and analog integrated circuit design. Digital circuits, such as microprocessor and memory semiconductors, provide most of the functionality of computer processing. However, digital circuits generally cannot handle significant amounts of current or multiple voltage levels. In contrast, analog circuits use and manipulate continuously varying voltage and current levels. Battery power systems, which have relatively high and continuously varying power levels, are inherently analog systems.

Digital integrated circuit technology can be used to manage power systems more intelligently and efficiently and help to prolong battery life in mobile applications. However, since battery power systems are analog by nature, mixed-signal integrated circuits, or circuits that incorporate both digital and analog technologies, are necessary in order to harness the intelligence provided by digital technology. Designing mixed-signal integrated circuits poses a number of difficulties: analog circuits are more sensitive than digital circuits to the physical layout and electrical characteristics of the circuit; analog circuit designers must have a very high level of circuit design experience; and

basic differences in the technologies used in digital and analog circuit design make combining the technologies problematic.

In addition, mixed-signal integrated circuits comprise both digital and analog components, and the trend toward more complex devices has increased the number of components substantially. Integrating the functions of those components on a single chip, known as a system-on-a-chip, can enable manufacturers to make products smaller, lighter and more reliable. Thus, as mobile computing and communications devices grow in complexity and functionality, there is an increasing need for higher levels of systems integration. In addition, variances in battery designs among manufacturers make it more difficult to design intelligent systems that are optimized for particular power systems.

Most consumer electronics, mobile computing and communications product manufacturers need mixed-signal and analog integrated circuits specifically designed to optimize the power system usage in their devices to enable them to offer new devices with richer functionality and longer battery lives. These semiconductors should also be highly integrated and standards-based to help manufacturers create products that are smaller, lighter, easier to use, more reliable and more cost-efficient to design and produce. In addition, in mobile device markets where product life cycles can be less than one year, these solutions typically need to be developed using advanced design methodologies to allow manufacturers to achieve rapid time-to-market with their new products.

Several different process technologies are available for designing and fabricating analog and digital integrated circuits. Of these, complementary metal oxide semiconductor, or CMOS, is the most widely used process technology, especially for purely digital

integrated circuits. CMOS processes are described in terms of feature size, or geometry, and are measured in microns. One micron equals one millionth of a meter. Currently, the most advanced process technologies achieve feature sizes of 0.09 micron, 0.065 micron, 0.04 micron and smaller. However, small feature size circuits can become damaged when exposed to high voltages and therefore power management integrated circuits are typically fabricated using larger feature sizes. For this reason, older manufacturing facilities, or fabs, having feature sizes of 0.18 micron and 0.5 micron or greater, have traditionally been used in fabricating power management integrated circuits, while the most advanced, and most expensive fabs are used for digital and non-power management analog integrated circuits.

Products

We market power management and cardbus controller components and system security for the Consumer, Computer, Industrial and Communications markets. Our power management and cardbus controller products include ICs to provide power for LCD and LED lighting, control and monitor battery charging and discharging, DC/DC conversion, provide connections between notebook computers and external plug-in cards, and provide select and switch functionality between power sources. Our system security solutions include VPNs and firewalls, which provide security functions for communications between computer systems and networks, including the transmission of data across the Internet. Our system security products are designed to provide high-speed and comprehensive security protection. In particular, our core technologies in the Application Specific Integrated Circuit ("ASIC") chips are exclusive to us and deliver enhanced performance and service to our customers. We sell our products into the following four end-markets:

- Consumer electronics market, including desktop monitors, LCD televisions, digital cameras and camcorders and portable media players;

- Computer market, including notebook computers, desktop computers and servers;

- Industrial market, including any product that is specified to operate over an extended temperature range, for instance, beyond the standard commercial operating temperature range of standard semiconductor products (zero degrees to 70 degrees centigrade). Products include industrial tools, automobile GPS systems, and other automobile systems; and

- Communications market, including portable GPS systems, mobile phone handsets, data communications security and networking systems, and Internet and Internet-related systems.

The majority of our revenue is derived from the sale of our products in the consumer and computer markets. Additionally, we have increased our efforts to expand our product portfolio addressing opportunities in the communications and industrial markets.

Marketing, Sales, and Customer Support

Our marketing strategy is focused on the sale of proprietary analog and mixed-signal integrated circuits to customers in the consumer electronics, computer, industrial and communications markets. These markets tend to be dominated by a small number of major brand name companies. As a result, we focus our resources on the major vendors in each market.

We primarily sell proprietary application specific products to our customers and work with them on new product development. We also design customized products for our customers. We work directly with our customers to create demand for our products by providing them with application specific product information for their system design, engineering and procurement groups. We actively participate in their design processes to introduce them to our products and the target applications our products address. We endeavor to design products that will meet increasingly complex and specific design requirements, but which will also support widespread demand for these future products.

We typically undertake a four-to-eight month development process with our customers. If successful, this process culminates in a customer deciding to use our product in its system, which we refer to as a design win. Volume production generally takes an additional three-to-six months after the initial design win confirmation. Once our products are accepted and designed into an application, the customer is likely to continue to use the same power architecture and derivative products in a number of its models, which tends to extend our product life cycles.

We sell our products to OEMs, ODMs and module makers. We market and sell these products through a combination of our direct sales force, independent sales representatives and distributors in Asia, Europe and North America. We sell most of our products through direct sales. We maintain direct sales offices in most of our major markets which include Texas, California, China, Taiwan, Korea and Japan. Additionally, we have sales representatives in China, Singapore, Taiwan and the United States, as well as distributors in China and Japan.

We pay our direct sales force on a salary and performance bonus basis only. Our independent sales representatives are paid on a commission basis, based on a percentage of the actual sales referred by them. For sales through sales representatives, we invoice and deliver our products directly to the customers. We have entered into distributorship arrangements with distributors on a non-exclusive basis for the sale of our products in Japan as a principal at the request of certain of our major end-

customers in Japan. For our other customers in Japan, sales are made through our direct sales offices in Japan. In Japan, it is customary practice for OEMs, ODMs and module makers to purchase products like ours through distributors because of the ancillary services provided by them such as inventory storage, payment terms and conditions and just-in-time delivery. We may provide a discount on the prices of the products we sell to our distributors (as compared to the prices we offer to end customers), depending on the terms and conditions of the individual purchases. We defer recognition of such sales until the product is sold by the distributors to its end customers. In addition, products held by the distributors are considered part of our inventory and included in our inventory balance. Sales to the distributors are recognized and inventory is adjusted upon shipment to its end-customers as title to inventories generally transfers upon shipment. We receive monthly inventory and sales reports from the distributors in China and Japan, which we use as part of our overall inventory control. We evaluate our inventory on a quarterly basis and full provision is made for inventory which is over six months old and for which there is no end customer demand based on forecasted product demand and market conditions.

Our marketing efforts include market analysis, participation in industry trade shows and technical conferences, sales training, publication of technical articles, maintenance of our web site and advertising. In addition, we maintain customer support staff in the United States, Taiwan, China, Japan and Korea for post order servicing and applications support.

Seasonality

The consumer electronics and computer markets are characterized by seasonal volume increases in the latter part of the year primarily driven by increased consumer spending during the holiday season. We normally experience the highest sales volume to our customers in these markets in the third and fourth quarter of each year, when such customers increase their inventories in anticipation of increased seasonal demand. Our customers in the industrial and communications markets are to a lesser extent subject to seasonal consumer demand. As a result, our sales volume to those customers has been largely consistent from quarter-to-quarter.

Customers

We focus on the major OEMs (or brand owners) in the consumer electronics, computer, industrial and communications markets. Many of these major OEMs use third-party providers, such as ODMs, module makers or other intermediaries, to produce their products or portions of their products containing our components. Hence, the majority of our direct sales are to these third-party providers.

We have no long-term volume sales contracts with any of our major customers. The majority of our sales to customers are conducted on the basis of purchase orders, which set out the specific terms for a particular sale. We price our products primarily with reference to the prevailing market conditions, taking into consideration the complexity, technology and features of the product, the order size and the relationship with the customer.

The table below sets forth, for the periods indicated, the dollar amount of our net sales derived from Asia, North America and other regions:

	Years Ended December 31 (In Thousands)		
Location of customers	2007	2008	2009
Asia	$165,391	$138,285	$127,099
North America	130	252	216
Other regions	19	288	183

	$165,540	$138,825	$127,498

The table below sets forth, for the periods indicated, the dollar amount of our net sales by category of activity.

	Years Ended December 31 (In Thousands)		
	2007	2008	2009
Integrated Circuit Group	$163,573	$135,438	$124,294
Network Security Group	1,967	3,387	3,204
	$165,540	$138,825	$127,498

We generally extend to our customers credit terms varying from 40 to 60 days. We may adjust our usual credit terms according to each customer's credit history as well as local market practice. Our customers generally pay us either by direct wire transfer or under letter of credit arrangement. To date, we have not experienced any material problems relating to customer

payments or material write-offs of accounts receivable due to uncollectability.

Manufacturing

We subcontract the manufacture of our products and most of the testing for our products to semiconductor foundries, assembly and testing service providers. This “fabless” approach allows us to focus on product development, reduce fixed costs and capital expenditures, and access diverse manufacturing technologies.

We use established mainstream processes for the manufacture of our products. This approach reduces our technical risks and minimizes the risks related to production capacity constraints.

Wafer Manufacturing

Wafer manufacturing is a capital intensive and complex operation which takes place at dedicated facilities of semiconductor foundries. After we have designed our integrated circuits, we place orders with a semiconductor foundry to fabricate wafers with our integrated circuits embedded in them. The semiconductor foundry purchases raw unprocessed wafers, or silicon substrates, and processes them according to mutually agreed manufacturing specifications to fabricate the wafers used in our products. Currently, the majority of our wafers are fabricated using 0.18 to 1.0 micron CMOS semiconductor processes. The wafer fabrication process generally takes six to 10 weeks. Fabricated wafers are then shipped by the semiconductor foundry, according to our instructions, to either an assembly service provider or to an electrical wafer sort service provider.

Our major semiconductor foundry providers are CR Micro, X-FAB, and SMIC. We do not enter into long-term contracts with our semiconductor foundry providers. They manufacture our products on a purchase-order basis in accordance with our specifications and requirements. In general, the cost charged to us for the foundry services depends on the manufacturing process technologies as well as order size and foundry capacity utilization.

Assembly and Testing

The fabricated wafers may or may not require electrical wafer sort prior to assembly. The completed wafers are either sent to an assembly service provider for assembly or held at our warehouse facilities, or an “inventory hub,” for assembly at a later date. An inventory hub is a provider of warehousing services. We often hold inventory of our semi-finished products in wafer form because it is at this manufacturing stage that most time has been invested, with much of the cost not yet incurred, and we then have the flexibility of choosing the type of packaging into which they are to be assembled. The wafer sort and assembly process generally takes three to six weeks.

Once our integrated circuits are assembled and packaged, they are ready for final electrical testing. We instruct the assembly service provider to send our packaged integrated circuits to a testing service provider for final testing or our warehouse facilities (or an inventory hub) for testing at a later date. The electrical testing process generally takes a few days. Once our products have been tested, they are ready for use by our customers.

Finished products may be sent to our customers or their designees such as third party service providers that manufacture their products or a portion of their products containing our integrated circuits. Our customers may request for our integrated circuits to be shipped in plastic tubes or trays, several to a tube or tray, or use a form of packaging called “tape and reel” that more readily provides for automated assembly of our integrated circuits into their products. If a customer orders “tape and reel” packaging, this is done either at a testing service provider or a “tape and reel” service provider prior to shipment of our products to the customer.

We utilize several assembly and testing service providers in Taiwan, China and other parts of Asia on a purchase order basis. They assemble and test our products based on our specifications and requirements. In general, the cost charged to us for these assembly and testing services depends on prevailing market rates for these services and our

relationship with the service provider. Typically analog and mixed-signal products have a greater portion of their product cost associated with product testing than digital products. We also operated a semiconductor testing facility to test a portion of our products prior to shipment. In June, 2008, we entered into a share transfer agreement with Sigurd Microelectronics (Cayman) Co., Ltd, a subsidiary of Sigurd Microelectronics Corporation, to dispose of 100% ownership of OceanOne for $6,700,000 to become their strategic partner. The share transfer was subsequently completed on July 2, 2008.

Our current credit terms with our foundry, assembly and testing service providers vary from 30 to 45 days, depending on our relationships with each of them. We generally pay our service providers by direct wire transfer.

We also have made investments in certain of our current suppliers and potential future suppliers, including software developers, foundries and testing service providers. These investments enable us to enhance our business relationships with these suppliers to ensure the adequacy of foundry capacity allocation and quality of services provided to us. We plan to continue to evaluate additional investment opportunities in our supply chain.

Competition

We compete in the market for analog and mixed-signal integrated circuits based on such factors as product performance, power efficiency, new technologies, functional innovation, reliability, price and availability. We believe our

principal competitors include Intersil Corporation, Linear Technology Corporation, Maxim Integrated Products, Inc., Microsemi Corporation, Monolithic Power Systems, Inc., Ricoh Company, Ltd., Rohm Co., Ltd and Texas Instruments Incorporated. There is also competition from internal integrated circuit design and manufacturing capabilities of some of our existing and potential customers, such as Toshiba and Fujitsu. In addition to these competitors, other integrated circuit companies may decide to enter the market with analog and mixed-signal integrated circuit products that compete with our products or incorporate functions similar to those provided by our products.

Intellectual Property

Our intellectual property is primarily developed in-house. We do, from time to time, acquire intellectual property from third parties which we believe is instrumental or complementary to our business. We also on occasion license our intellectual property to third parties in exchange for royalties or other consideration. From time to time, we may seek acquisitions to acquire businesses or technologies where synergies exist. Our success depends significantly upon our ability to protect our intellectual property. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or obtain and use information that we regard as proprietary. Competitors may recruit our employees who have access to our proprietary technologies, processes and operations.

We rely in part on patents to protect our intellectual property. As of December 31, 2009, we had approximately 206 patents issued in the United States and approximately 402 patents issued in other countries. In addition, we had approximately 227 patent applications pending in the United States Patent and Trademark Office, and approximately 552 patent applications pending in various countries other than the United States which may or may not be issued. Even if these patents are issued, taken together with our existing patents, they may not be sufficiently broad to protect all of our proprietary rights, or they may prove to be unenforceable. To protect our proprietary rights, we also rely on a combination of copyrights, trademarks, trade secret laws, contractual provisions, licenses and maskwork protection under the Federal Semiconductor Chip Protection Act of 1984, and similar laws in other jurisdictions. We also enter into confidentiality agreements with our employees, consultants and customers, and we seek to control access to, and distribution of, our proprietary information. We may from time to time grant rights to third parties for our patents and other intellectual property.

The laws of some foreign countries do not protect our proprietary rights to the same extent as do the laws of the United States, and many companies have encountered substantial infringement problems in these countries, including countries in which we have sold and continue to sell a significant portion of our products. There is a risk that our means of protecting our proprietary rights may not be adequate. For example, our competitors may independently develop similar technology, duplicate our products, or design around our patents and our other intellectual property rights. If we fail to protect our intellectual property adequately, it would make it easier for our competitors to sell competing products.

We are involved in a variety of litigation matters involving intellectual property. For example, we have initiated and are pursuing certain patent infringement actions in the United States and Taiwan. As of December 31, 2009, the Company deposited an amount of New Taiwan dollars equivalent to approximately $1.4 million with the Taiwan court for court bonds, which was accounted for as restricted assets, in connection with those actions and related preliminary injunction actions. The court bonds provide security for the enjoined party to claim damages against the Company incurred from the preliminary injunctions or the provision of a countersecurity in the event the Company does not ultimately succeed in the underlying infringement actions. We are currently in the process to retrieve the court bonds as related actions are closed.

We have several pending patent infringement actions in the United States. On April 3, 2008, the United States Court of Appeals for the Federal Circuit vacated a jury verdict, final judgment of infringement, and permanent injunction

against defendants Beyond Innovation Technology Company Limited, SPI Electronic Company Limited and FSP Group, and Lien Chang Electronic Enterprise Company Limited. The Federal Circuit further remanded the case to the Eastern District of Texas. The trial was concluded in July 2009, and the matter is still under submission by the District Court. O2Micro International Ltd. v. Beyond Innovation Technology Co. et al., Civil Action No. 2:04-CV-32 (TJW). On October 1, 2008, Monolithic Power Systems, Inc. filed a complaint for declaratory judgment that certain claims of O2Micro's patents are invalid and not infringed. O2Micro has filed counterclaims for patent infringement. Monolithic Power Systems, Inc. v. O2Micro International Limited, Case No. C 08-4567 CW. On December 15, 2008, O2Micro filed a complaint with the United States International Trade Commission in Washington, D.C. O2Micro alleges that MPS, Microsemi, AsusTek, LG and BenQ have engaged in unfair acts through the unlicensed importation of certain products with MPS or Microsemi inverter controllers covered by O2Micro's patents. O2Micro seeks an order preventing the importation of the products into the United States. See In the Matter of Certain Cold Cathode Fluorescent Lamp Inverter Circuits And Products Containing Same, Investigation No. 337-TA-666. On March 5, 2009, the United States Court of Appeals for the Federal Circuit affirmed the judgment of the District Court for the Northern District of California that certain claims of O2Micro's U.S. Patent Number 6,396,722 are invalid as obvious under 35 U.S.C. § 103. We filed an appeal on April 6, 2009. Monolithic Power Sys. v. O2 Micro Int'l Ltd., 2009 U.S. App. LEXIS 4528 (Fed. Cir. Mar. 5, 2009). In a companion case involving Taiwan Sumida Electronics, Inc., the Federal Circuit vacated a judgment of infringement from the District Court for the Eastern District of Texas because the Federal Circuit had held in the MPS case that the same claims of the '722 patent were invalid. We filed an appeal in the United States Court of Appeals, and in March 2009, the court upheld the Federal Circuit's ruling, and a judgment to that effect was entered by the Eastern District Court of Texas. O2Micro Int'l Ltd. v. Taiwan Sumida Elecs., Inc., 2009 U.S. App. LEXIS 4382 (Fed. Cir. Mar. 5, 2009). On August 7, 2009, Powertech

Association LLC, an entity formed by MPS and Microsemi, filed a complaint in the United States District Court in the Eastern District of New York, alleging certain products by Company infringe on three of their patents. To date, we have not been served by the Plaintiffs, so our defense obligations under the lawsuit have not begun. Powertech Association LLC v. O2Micro Internation