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O2MICRO INTERNATIONAL LTD
Form 20-F/A
May 27, 2005

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

(Mark One)

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

or

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

For the fiscal year ended December 31, 2003

or

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

Commission file number: 0-30910

O2 MICRO 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 SMB, George Town
Grand Cayman, Cayman Islands
(Address of Principal Executive Offices)

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

None
(Title of Class)

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

Title of Each Class -----	Name of Each Exchange On Which Registered -----
Ordinary Shares, par value \$0.001 per share	Nasdaq National Market Cayman Islands Stock Exchange

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

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report.

39,032,616 Ordinary Shares

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 No

Indicate by check mark which financial statement item the registrant has elected to follow:

Item 17 Item 18

EXPLANATORY NOTE

This Form 20-F/A amends and restates Items 8, 18, and 19 of the annual report on Form 20-F for the year ended December 31, 2003 filed by O2 Micro International Limited (the "Company") on June 14, 2004 (the "2003 Form 20-F") to make certain corrections to disclosures set forth in Notes 2 and 12 to the Company's Consolidated Financial Statements included in those items in the 2003 Form 20-F.

This Form 20-F/A consists of a cover page, this explanatory note, the disclosures as required by Items 8, 18, and 19 of the 2003 Form 20-F, the signature page and the required certifications of the principal executive officer and the principal financial officer of O2 Micro International Limited. While the disclosures required by Items 8, 18, and 19 of the Form 20-F have been restated in full in this Form 20-F/A as required by Rule 12b-15 under the Securities Exchange Act of 1934, no changes have been made to the disclosures except to the Notes as described above.

Other than as set forth above, this Form 20-F/A does not, and does not purport to, amend, update or restate the information in any other Item of the 2003 Form 20-F nor reflect any events that have occurred after the 2003 Form 20-F was filed on June 14, 2004.

ITEM 8. FINANCIAL INFORMATION

CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION

Consolidated Financial Statements

Our financial statements set forth in the accompanying index to Consolidated Financial Statements included in this Annual Report on Form 20-F/A following Part IV beginning on page F-1 are hereby incorporated in this Annual Report on Form 20-F/A. Our Consolidated Financial Statements are filed as part of this Annual Report.

DIVIDEND POLICY

We have never declared or paid any cash dividends on our ordinary shares or other securities and do not anticipate paying cash dividends in the foreseeable future.

ITEM 18. FINANCIAL STATEMENTS

The Company's financial statements set forth in the accompanying Index to

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Consolidated Financial Statements included in this annual report on Form 20-F/A following Part IV beginning on page F-1 are hereby incorporated herein by this reference. Such consolidated financial statements are filed as part of this annual report on Form 20-F/A.

ITEM 19. EXHIBITS

- 12.3 Certification of Chief Executive Officer of the Company, pursuant to Section 302 of the Sarbanes-Oxley Act, for this Form 20-F/A.
- 12.4 Certification of Chief Financial Officer of the Company, pursuant to Section 302 of the Sarbanes-Oxley Act, for this Form 20-F/A.
- 13.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act, for this Form 20-F/A
- 14.3 Consent of Deloitte & Touche, independent registered public accounting firm
- 14.4 Consent of Deloitte & Touche, independent registered public accounting firm

SIGNATURES

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this Form 20-F/A amendment to the annual report on Form 20-F for the year ended December 31, 2003 on its behalf.

O2 MICRO INTERNATIONAL LIMITED

Date: May 26, 2005

By: /s/ STERLING DU

Name: Sterling Du
Title: Chief Executive Officer

O2 MICRO INTERNATIONAL LIMITED

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

	Page

Independent Auditors' Report	F-2
Consolidated Balance Sheets	F-4
Consolidated Statements of Operations and Comprehensive Income	F-5
Consolidated Statements of Shareholders' Equity	F-7
Consolidated Statements of Cash Flows	F-8
Notes to Consolidated Financial Statements	F-10

O//2//Micro International Limited and Subsidiaries

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Consolidated Financial Statements as of
December 31, 2002 and 2003 and
Report of Independent Registered Public Accounting Firm

[LETTERHEAD OF DELOITTE&TOUCHE CAYMAN ISLANDS]

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and the Shareholders
O//2//Micro International Limited

We have audited the accompanying consolidated balance sheets of O//2//Micro International Limited and subsidiaries as of December 31, 2002 and 2003 and the related consolidated statements of operations and comprehensive income, shareholders' equity, and cash flows for each of the years ended December 31, 2002 and 2003 (expressed in United States dollars). These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. The financial statements of the Company for the year ended December 31, 2001 were audited by other auditors whose report expressed an unqualified opinion on those statements.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of O//2//Micro International Limited and subsidiaries as of December 31, 2002 and 2003 and the results of their operations and their cash flows for each of the years ended December 31, 2002 and 2003, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 "Stock-based Compensation" and Note 12, the 2002 and 2003 pro forma net income and pro forma earnings per share disclosures have been restated.

/s/ Deloitte & Touche
January 30, 2004 (May 10, 2005 as to Note 2 "Stock-based Compensation" and Note 12)

F-2

[LETTERHEAD OF DELOITTE&TOUCHE TAIPEI, TAIWAN]

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and the Shareholders
O2Micro International Limited

We have audited the accompanying consolidated balance sheet of O//2//Micro International Limited and subsidiaries as of December 31, 2001 and the related consolidated statements of operations and comprehensive income, shareholders'

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equity, and cash flows for the year ended December 31, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States).. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of O//2//Micro International Limited and its subsidiaries as of December 31, 2001 and the results of their operations and their cash flows for the year ended December 31, 2001 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 "Stock-based Compensation" and Note 12, the 2001 pro forma net income and pro forma earnings per share disclosures have been restated.

/s/Deloitte & Touche

January 24, 2002 (May 10, 2005 as to Note 2 "Stock-based Compensation" and Note 12)

F-3

O//2//MICRO INTERNATIONAL LIMITED AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In Thousand U.S. Dollars, Except Per Share Amounts)

	December
	----- 2002 -----
ASSETS	
CURRENT ASSETS	
Cash and cash equivalents	\$ 69,334
Restricted cash	2,019
Short-term investments	42,675
Accounts receivable--net	7,595
Inventories	6,967
Prepaid expenses and other current assets	2,891

Total current assets	131,481

LONG-TERM INVESTMENTS	7,735

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FIXED ASSETS--Net	5,611	
OTHER ASSETS		
Restricted assets--net	--	
Others	1,009	
TOTAL ASSETS	\$ 145,836	\$
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Notes and accounts payable	\$ 5,202	\$
Income tax payable	1,957	
Accrued expenses and other current liabilities	3,529	
Total current liabilities	10,688	
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS' EQUITY		
Preference shares at \$0.001 par value per share		
Authorized--5,000,000 shares		--
Ordinary shares at \$0.001 par value per share		
Authorized--95,000,000 shares		
Issued--38,857,094 shares including 720,700 shares of treasury stocks as		
of December 31, 2002 and 39,032,616 shares as of December 31, 2003		39
Treasury stock		(6,823)
Additional paid-in capital		133,016
Accumulated other comprehensive loss		(692)
Retained earnings		9,608
Total shareholders' equity	135,148	
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 145,836	\$

The accompanying notes are an integral part of the consolidated financial statements.

F-4

O//2//MICRO INTERNATIONAL LIMITED AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
(In Thousand U.S. Dollars, Except Per Share Amounts)

	Years Ended Dec	
	2001	2002
NET SALES	\$ 45,819	\$ 70,187

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COST OF SALES	16,465	28,143
	-----	-----
GROSS PROFIT	29,354	42,044
	-----	-----
OPERATING EXPENSES		
Research and development (exclusive of amortization of deferred stock compensation of \$91, \$30 and \$0 in 2001, 2002 and 2003, respectively)	14,320	18,935
Selling, general and administrative (exclusive of amortization of deferred stock compensation of \$75, \$14 and \$0 in 2001, 2002 and 2003, respectively)	9,909	12,325
Stock-based compensation	166	44
	-----	-----
Total operating expenses	24,395	31,304
	-----	-----
INCOME FROM OPERATIONS	4,959	10,740
	-----	-----
NON-OPERATING INCOME (EXPENSES)		
Interest income	1,814	1,802
Impairment loss on long-term investments	--	(483)
Interest expenses	(11)	(4)
Foreign exchange gain--net	59	4
Other--net	(35)	343
	-----	-----
Total non-operating income	1,827	1,662
	-----	-----
INCOME BEFORE INCOME TAX	6,786	12,402
	-----	-----
INCOME TAX EXPENSE	1,152	1,673
	-----	-----
NET INCOME	5,634	10,729
	-----	-----
OTHER COMPREHENSIVE INCOME (LOSS)		
Translation adjustments on subsidiaries	(489)	132
Unrealized gain (loss) on available-for-sale securities	15	(127)
	-----	-----
Total other comprehensive income (loss)	(474)	5
	-----	-----
COMPREHENSIVE INCOME	\$ 5,160	\$ 10,734
	=====	=====

(Continued)

F-5

	Years Ended Dec	
	2001	2002
	-----	-----
EARNINGS PER SHARE:		
Basic	\$ 0.17	\$ 0.28

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Diluted	=====	=====
	\$ 0.16	\$ 0.27
	=====	=====
SHARES USED IN EARNINGS PER SHARE CALCULATION:		
Basic (in thousands)	34,020	38,300
	=====	=====
Diluted (in thousands)	35,576	39,591
	=====	=====

The accompanying notes are an integral part of the consolidated financial statements.

(Concluded)

F-6

O//2//MICRO INTERNATIONAL LIMITED AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(In Thousand U.S. Dollars, Except Per Share Amounts)

	Ordinary Shares		Additional Paid-in Cap		
	Shares	Amount	Ordinary shares	Stock options	T
BALANCE, JANUARY 1, 2001	32,788,238	\$ 33	\$ 53,148	\$ 1,923	\$
Issuance of:					
Shares issued for exercise of stock options	656,215	1	1,780	(796)	
Shares issued for 1999 ESPP Plan	90,058	--	690	--	
Shares, net of \$601 in offering costs	4,600,000	4	73,450	--	
Cancellation of stock options	--	--	--	(39)	
Options granted to nonemployees	--	--	--	41	
Amortization of deferred stock compensation	--	--	--	--	
Net income for 2001	--	--	--	--	
Translation adjustments on subsidiaries	--	--	--	--	
Unrealized gain on available-for-sale securities	--	--	--	--	
BALANCE, DECEMBER 31, 2001	38,134,511	38	129,068	1,129	1
Issuance of:					
Shares issued for exercise of stock options	325,279	1	1,187	(275)	
Shares issued for 1999 ESPP Plan	97,304	--	737	--	
Shares issued for exercise of warrants	300,000	--	801	--	
Acquisition of treasury stocks--720,700 shares	--	--	--	--	
Cancellation of stock options	--	--	--	(2)	
Options granted to nonemployees	--	--	--	371	
Amortization of deferred stock compensation	--	--	--	--	
Net income for 2002	--	--	--	--	
Translation adjustments on subsidiaries	--	--	--	--	
Unrealized loss on available-for-sale securities	--	--	--	--	

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BALANCE, DECEMBER 31, 2002	38,857,094	39	131,793	1,223	1
Issuance of:					
Shares issued for exercise of stock options	863,987	1	6,135	(503)	
Shares issued for 1999 ESPP Plan	109,735	--	942	--	
Cancellation of stock options	--	--	--	(23)	
Acquisition of treasury stock--77,500 shares	--	--	--	--	
Retirement of treasury stock	(798,200)	(1)	(2,793)	--	
Options granted to nonemployees	--	--	--	302	
Net income for 2003	--	--	--	--	
Translation adjustments on subsidiaries	--	--	--	--	
Unrealized loss on available-for-sale securities	--	--	--	--	
	-----	-----	-----	-----	-----
BALANCE, DECEMBER 31, 2003	39,032,616	\$ 39	\$136,077	\$ 999	\$ 1
	=====	=====	=====	=====	=====

		Accumulated Other Comprehensive Income (Loss)			
	Deferred Compensation	Unrealized investment gain/loss	Cumulative translation adjustment	To	
	-----	-----	-----	-----	-----
BALANCE, JANUARY 1, 2001	(\$ 249)	\$ --	(\$ 223)	(\$	
Issuance of:					
Shares issued for exercise of stock options	--	--	--	--	
Shares issued for 1999 ESPP Plan	--	--	--	--	
Shares, net of \$601 in offering costs	--	--	--	--	
Cancellation of stock options	6	--	--	--	
Options granted to nonemployees	--	--	--	--	
Amortization of deferred stock compensation	199	--	--	--	
Net income for 2001	--	--	--	--	
Translation adjustments on subsidiaries	--	--	(489)	(
Unrealized gain on available-for-sale securities	--	15	--	--	
	-----	-----	-----	-----	-----
BALANCE, DECEMBER 31, 2001	(44)	15	(712)	(
Issuance of:					
Shares issued for exercise of stock options	--	--	--	--	
Shares issued for 1999 ESPP Plan	--	--	--	--	
Shares issued for exercise of warrants	--	--	--	--	
Acquisition of treasury stocks--720,700 shares	--	--	--	--	
Cancellation of stock options	--	--	--	--	
Options granted to nonemployees	--	--	--	--	
Amortization of deferred stock compensation	44	--	--	--	
Net income for 2002	--	--	--	--	
Translation adjustments on subsidiaries	--	--	132		
Unrealized loss on available-for-sale securities	--	(127)	--	(
	-----	-----	-----	-----	-----
BALANCE, DECEMBER 31, 2002	--	(112)	(580)	(
Issuance of:					
Shares issued for exercise of stock options	--	--	--	--	
Shares issued for 1999 ESPP Plan	--	--	--	--	
Cancellation of stock options	--	--	--	--	
Acquisition of treasury stock--77,500 shares	--	--	--	--	
Retirement of treasury stock	--	--	--	--	
Options granted to nonemployees	--	--	--	--	

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Net income for 2003	--	--	--
Translation adjustments on subsidiaries	--	--	(90)
Unrealized loss on available-for-sale securities	--	261	-
	-----	-----	-----
BALANCE, DECEMBER 31, 2003	\$ --	\$ 149	(\$ 670)
	=====	=====	=====

The accompanying notes are an integral part of the consolidated financial statements.

F-7

O//2//MICRO INTERNATIONAL LIMITED AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousand U.S. Dollars)

	Years Ended December 31		
	2001	2002	2003
	-----	-----	-----
OPERATING ACTIVITIES			
Net income	\$ 5,634	\$ 10,729	\$ 11,100
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	1,180	1,937	2,100
Amortization of deferred stock compensation	166	44	100
Amortization of stock options granted for services	19	74	100
Loss (gain) on sale of short-term investments	2	(385)	100
Deferred income tax assets	(153)	198	100
Impairment of long-term investments	--	483	100
Loss on sale of fixed assets	--	7	100
Changes in operating assets and liabilities:			
Accounts receivable--net	1,720	(3,895)	(1,000)
Inventories	111	(1,606)	(1,000)
Prepaid expenses and other current assets	(571)	(765)	(1,000)
Notes and accounts payable	(197)	1,632	1,000
Income taxes payable	770	737	1,000
Accrued expenses and other current liabilities	831	333	1,000
	-----	-----	-----
Net cash provided by operating activities	9,512	9,523	11,100
	-----	-----	-----
INVESTING ACTIVITIES			
Receivables from employee cash advance	(185)	(262)	(1,000)
Acquisition of:			
Fixed assets	(2,295)	(4,275)	(1,000)
Patents	(122)	--	(1,000)
Long-term investments	--	(6,968)	(1,000)
Short-term investments	(21,636)	(188,231)	(1,000)
(Increase) decrease in:			
Restricted assets	--	--	(1,000)
Restricted cash	40	(860)	(1,000)
Other assets	(68)	(46)	(1,000)
Proceeds from:			

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Sale of short-term investments	1,513	165,970	10
Sale of fixed assets	--	3	
	-----	-----	-----
Net cash used in investing activities	(22,753)	(34,669)	(2)
	-----	-----	-----

(Continued)

F-8

	Years Ended December 31		
	2001	2002	2003
	-----	-----	-----
FINANCING ACTIVITIES			
Acquisitions of treasury stock	\$ --	\$ (6,823)	\$ (647)
Proceeds from:			
Exercise of stock options	985	913	5,633
Issuance of ordinary shares	73,454	--	--
Issuance of shares for warrants exercised	--	750	--
Issuance of ordinary shares under ESPP Plan	690	737	942
Payments of principal of capital leases	(42)	(10)	(6)
Decrease in guarantee deposits	(51)	--	--
	-----	-----	-----
Net cash provided by (used in) financing activities	75,036	(4,433)	5,922
	-----	-----	-----
EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATE	(429)	99	(3)
	-----	-----	-----
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	61,366	(29,480)	(2,845)
	-----	-----	-----
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	37,448	98,814	69,334
	-----	-----	-----
CASH AND CASH EQUIVALENTS AT END OF YEAR	\$ 98,814	\$ 69,334	\$ 66,489
	=====	=====	=====
SUPPLEMENTAL DISCLOSURES OF CASH FLOWS			
Cash paid for interest	\$ 11	\$ 4	\$ 1
Cash paid for tax	474	744	600
NON-CASH INVESTING AND FINANCING ACTIVITIES			
Property and equipment acquired under capital leases	5	--	--
Convertible loans converted to long-term investments	--	--	1,750
Unrealized gain (loss) on short-term investments	15	(127)	261

The accompanying notes are an integral part of the consolidated financial statements.

(Concluded)

F-9

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O//2//MICRO INTERNATIONAL LIMITED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in United States Dollars Unless Otherwise Noted)

1. GENERAL

Business

O//2//Micro, Inc. was incorporated in the state of California in the United States of America on March 29, 1995 to design, develop, and deliver semiconductor components primarily for mobile applications. In March 1997, O//2//Micro, Inc. reincorporated in the Cayman Islands under the name O//2//Micro International Limited (the "Company"). In connection with the reincorporation, all authorized and outstanding common stock, preferred stock and stock options of O//2//Micro, Inc. were exchanged for the Company's ordinary shares, preference shares and stock options with identical rights and preferences. O//2//Micro, Inc. became the Company's subsidiary after the shares exchange.

The Company had incorporated various wholly-owned subsidiaries, namely, O//2//Micro Electronics, Inc. (O//2//Micro--Taiwan), O//2//Micro International Japan Limited (O//2//Micro--Japan), O//2//Micro PTE Limited--Singapore (O//2//Micro--Singapore), and other subsidiaries. O//2//Micro-Taiwan and O//2//Micro--Japan are engaged in trading while O//2//Micro--Singapore and other subsidiaries are engaged in research and development. The Company also established a Taiwanese branch office, O//2//Micro International Limited--Taiwan Branch (O//2//Micro--Taiwan Branch) to engage in marketing and customer support related services. Due to the duplicate function of O//2//Micro--Taiwan Branch and O//2//Micro--Taiwan, the Board of Directors determined to dissolve O//2//Micro--Taiwan Branch on October 31, 2002. The dissolution process of O//2//Micro--Taiwan Branch was not completed as of December 31, 2003.

2. ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated on consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to a concentration of credit risk consist of cash, cash equivalents and accounts receivable. Cash is deposited with high credit quality financial institutions. For accounts receivable, the Company performs ongoing credit evaluations of its

customers' financial condition and the Company maintains an allowance for doubtful accounts receivable based upon review of the expected collectibility of individual accounts.

Fair Value of Financial Instruments

The Company's financial instruments, including cash and cash equivalents, restricted cash, accounts receivable, notes and accounts payable, and capital lease obligations are carried at cost, which approximates the fair value due to the short-term maturity of those instruments. Fair values of short-term investments and long-term investments represent quoted market prices, if available. If no quoted market prices are available, fair values are estimated based on other factors.

Cash and Cash Equivalents

The Company considers all highly liquid investments with maturities of not more than three months when purchased to be cash equivalents.

Restricted Assets

The Company classifies deposits made for customs, collateral for obtaining foundry capacity, lines of credit, office leases and Taiwan court cases as restricted assets. The deposits are classified as current asset if refundable within a twelve-month period.

Short-term Investments

The Company maintains its excess cash in U.S. treasury bills and notes, government and corporate bonds issued by financial institutions with strong ratings. The specific identification method is used to determine the cost of securities sold, with realized gains and losses reflected in non-operating income and expenses. As of December 31, 2003, all of the Company's investments were classified as available-for-sale securities and are recorded at market value. Unrealized gains and losses on these investments are included with accumulated other comprehensive income, as a separate component of shareholders' equity, net of any related tax effect, unless unrealized losses are deemed other than temporary. Unrealized losses are recorded as a charge to income when deemed other than temporary.

Inventories

The Company outsources the wafer fabrication, assembly, and testing of its products. Inventories are stated at the lower of standard cost or market value. Cost is determined on a currently adjusted standard basis, which approximates actual cost on a first-in first-out basis.

Long-term Investments

Long-term investments over which the Company does not exercise significant influence are accounted for under the cost method of accounting. Management evaluates related information in addition to quoted market prices, if any, in determining the fair value of these investments and whether an other than temporary decline in value exists. Factors indicative of an other than temporary decline include recurring operating losses, credit defaults and subsequent rounds of financings at an amount below the cost basis of the investment. The list is not all inclusive and management periodically weighs all quantitative and qualitative factors in determining if any

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impairment loss exists.

F-11

Fixed Assets

Fixed assets are stated at cost less accumulated depreciation. Major additions, renewals and betterments are capitalized, while maintenance and repairs are expensed as incurred.

Depreciation is provided on the straight-line method over estimated service lives that range as follows: equipment--3 to 10 years, furniture and fixtures--3 to 15 years, equipment under capital lease--2 to 5 years, leasehold improvements--2 to 6 years and transportation equipment--5 years. Depreciation expense recognized during the years ended December 31, 2001, 2002 and 2003 was approximately \$1,129,000, \$1,884,000 and \$2,325,000, respectively.

Equipment covered by agreements qualifying as capital leases is stated at the lower of fair market value or the present value of the minimum lease payments at the inception of the lease, less depreciation.

Asset Impairment

The Company evaluates the recoverability of long-lived assets whenever events or changes in circumstances indicate the carrying value may not be recoverable. The carrying value of a long-lived asset is considered impaired when the anticipated undiscounted cash flows from such asset is separately identifiable and is less than the carrying value. If impairment occurs, a loss based on the excess of carrying value over the fair market value of the long-lived asset is recognized. Fair market value is determined by reference to quoted market prices, if available, or discounted cash flows, as appropriate.

Other Assets--Others

Other assets--others consist of refundable deposits, employee cash advances, deferred charges and patents. Costs incurred in connection with securing patents, including attorneys' fees, are capitalized and amortized over the estimated life of the related technology which is estimated to be five years.

Treasury Stock

In 2003, the Company determined it will retire ordinary shares repurchased under a share repurchase plan. Accordingly, the excess of the purchase price over par value was allocated between additional paid-in capital and retained earnings based on the average issuance price of the shares repurchased. Any future repurchases will be immediately retired.

Revenue Recognition

Revenue from product sales to customers, other than distributors, is recognized at the time of shipment and when title and right of ownership transfers to customers. The four criteria for revenue being realized and earned are the existence of evidence of sale, actual shipment, fixed or determinable selling price, and reasonable assurance of collectibility.

Allowances for sales returns and discounts are provided at the time of the recognition of the related revenues on the basis of experience and these

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provisions are deducted from sales.

In certain limited instances, the Company sells its products through distributors. The Company has limited control over these distributors' selling of products to third parties. Accordingly, the Company

F-12

recognizes revenue on sales to distributors when the distributors sell the Company's products to third parties. Thus, products held by distributors are included in the Company's inventory balance.

The Company provides its distributors with limited product rotation and price protection rights for products held in distributors' inventory. To date, the Company has given no price adjustments to or rotated products for its distributors.

Research and Development

Research and development costs consist of expenditures incurred during the course of planned research and investigation aimed at the discovery of new knowledge that will be useful in developing new products or processes, or at significantly enhancing existing products or production processes as well as expenditures incurred for the design and testing of product alternatives or construction of prototypes. All expenditures related to research and development activities of the Company are charged to operating expenses when incurred.

Advertising Expenses

The Company expenses all advertising and promotional costs as incurred. These costs were \$1,464,000, \$1,577,000 and \$795,000 in the years ended December 31, 2001, 2002 and 2003, respectively. A portion of these costs were for advertising, which amounted to \$138,000 in 2001, \$138,000 in 2002 and \$153,000 in 2003.

Income Taxes

The Company is not subject to income or other taxes in the Cayman Islands. However, subsidiaries are subject to taxes of the jurisdiction where they are located.

Under current Republic of China ("ROC") tax regulations, the current year's earnings, on a tax basis, that are not distributed in the following year are subject to a 10% additional income tax. This 10% additional income tax is recognized in the period during which the related income is generated.

Income taxes are accounted for in accordance with Statement of Financial Accounting Standards ("SFAS") No. 109 "Accounting for Income Taxes". The provision for income tax represents income tax paid and payable for the current year plus the changes in the deferred income tax assets and liabilities during the years. Deferred income tax assets are recognized for operating loss carryforwards, research and development credits, and temporary differences. The Company believes that uncertainty exists regarding the realizability of certain deferred income tax assets and, accordingly, has established a valuation allowance for those net deferred income tax assets to the extent the realizability is not deemed more likely than not.

Stock-based Compensation

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The Company has elected to follow Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees" and complies with the disclosure provisions of SFAS No. 123, "Accounting for Stock-Based Compensation" for its employee stock options. Under APB No. 25, compensation expense is measured based on the difference, if any, on the date of the grant, between the fair value of the Company's stock and the exercise price.

Had the compensation expense for the Company's stock-based compensation plans been determined on the basis of the fair values under SFAS No. 123, the Company's fiscal 2001, 2002 and 2003 net income and net income per share would be the following.

F-13

	Years Ended December 31		
	2001	2002	2003
Net income as reported (in thousands)	\$ 5,634	\$ 10,729	\$ 13,500
Add: Stock-based compensation expense included in net income, including tax expense of \$0 for 2001, 2002 and 2003, respectively	166	44	
Deduct: Stock-based compensation expense determined under SFAS No. 123 including tax expense of \$0 for 2001, 2002 and 2003, respectively	(3,929)	(8,643)	(8,643)
Pro forma net income	\$ 1,871	\$ 2,130	\$ 5,214
Pro forma shares used in calculation--basic (in thousands)	34,020	38,300	38,300
Pro forma earnings per share--basic	\$ 0.05	\$ 0.06	\$ 0.14
Earnings per share--basic as reported	\$ 0.17	\$ 0.28	\$ 0.34
Pro forma shares used in calculation--diluted (in thousands)	35,576	39,591	39,591
Pro forma earnings per share--diluted	\$ 0.05	\$ 0.05	\$ 0.14
Earnings per share--diluted as reported	\$ 0.16	\$ 0.27	\$ 0.33

The Company determined that certain volatility assumptions used to compute the fair value of employee stock compensation for 2001, 2002 and 2003 were inappropriate. Accordingly, such pro forma amounts presented above have been restated. The pro forma net income previously reported was \$3,503,000, \$5,652,000 and \$8,676,000 for 2001, 2002 and 2003, respectively. The pro forma basic earnings per share and pro forma diluted earnings per share previously reported for 2001, 2002 and 2003 was \$0.10 and \$0.10, \$0.15 and \$0.14, and \$0.23 and \$0.22, respectively. This change did not impact the Company's consolidated financial position, results of operations, or cash flows for any periods presented.

Foreign Currency Transactions

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The functional currency is the local currency of the respective entities. Foreign currency transactions are recorded at the rate of exchange in effect when the transaction occurs. Gains or losses, resulting from the application of different foreign exchange rates when cash in foreign currency is converted into the entities' functional currency, or when foreign currency receivables and payables are settled, are credited or charged to income in the period of conversion or settlement. At year-end, the balances of foreign currency monetary assets and liabilities are restated based on prevailing exchange rates and any resulting gains or losses are credited or charged to income.

Translation of Foreign Currency Financial Statements

The reporting currency of the Company is the U.S. dollar. Accordingly, the financial statements of the foreign subsidiaries are translated into U.S. dollars at the following exchange rates: Assets and liabilities--current rate on balance sheet date; shareholders' equity--historical rate; income and expenses--weighted average rate during the year. The resulting translation adjustment is recorded as a separate component of shareholders' equity.

F-14

Comprehensive Income (Loss)

Comprehensive income represents net income plus the results of certain changes in shareholders' equity during a period from non-owner sources that are not reflected in the consolidated statement of operations.

Legal Contingencies

The Company is currently involved in various claims and legal proceedings. Periodically, the Company reviews the status of each significant matter and assesses the potential financial exposure. If the potential loss from any claim or legal proceeding is considered probable and the amount can be estimated, the Company accrues a liability for the estimated loss. Because of uncertainties related to these matters, accruals are based only on the best information available at the time. As additional information becomes available, the Company reassesses the potential liability related to the pending claims and litigation and revises these estimates as appropriate. Such revisions in the estimates of the potential liabilities could have a material impact on the results of operations and financial position.

Recent Accounting Pronouncements Not Yet Adopted

In January 2003, the Financial Accounting Standards Board ("FASB") released Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46") which requires that all primary beneficiaries of Variable Interest Entities ("VIE") consolidate that entity. FIN 46 is effective immediately for VIEs created after January 31, 2003 and to VIEs in which an enterprise obtains an interest after that date. It applies in the first fiscal year or interim period beginning after June 15, 2003 to VIEs in which an enterprise holds a variable interest it acquired before February 1, 2003. In December 2003, the FASB published a revision to FIN 46 ("FIN 46R") to clarify some of the provisions of the interpretation and to defer the effective date of implementation for certain entities. Under the guidance of FIN 46R, entities that do not have interests in structures that are commonly

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referred to as special purpose entities (SPE's) are required to apply the provisions of the interpretation in financial statements for periods ending after March 14, 2004. The Company does not have interests in special purpose entities and will apply the provisions of FIN 46R with its first quarter 2004 financial statements.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity". The statement establishes standards for how an issuer classifies and measures certain financial instruments. This statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The statement requires that certain financial instruments that, under previous guidance, could be accounted for as equity, be classified as liabilities, or assets in some circumstances. This statement does not apply to features embedded in a financial instrument that is not a derivative in its entirety. The statement also requires disclosures about alternative ways of settling the instruments and the capital structure of entities whose shares are mandatorily redeemable. The adoption of SFAS No. 150 did not impact the Company's consolidated financial statements.

Reclassifications

Certain amounts reported in previous years have been reclassified to conform to the 2003 presentation.

F-15

3. CASH AND CASH EQUIVALENTS

	December 31	
	2002	2003
	(In Thousands)	
Time deposits	\$ 31,191	\$ 34,951
US treasury bills and corporate bonds	25,997	17,122
Savings and checking accounts	12,140	14,409
Petty cash	6	7
	-----	-----
	\$ 69,334	\$ 66,489
	=====	=====

4. SHORT-TERM INVESTMENTS

The following is a summary of available-for-sale securities:

	December 31	
	2002	2003
	(In Thousands)	
US treasury bills	\$ 26,914	\$ 33,958
Time deposits	10,263	10,611
Corporate bonds	2,247	8,185
Foreign government bonds	3,227	1,144

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Others	24	25
	-----	-----
	\$ 42,675	\$ 53,923
	=====	=====

Available-for-sale securities by contractual maturity are as follows:

	December 31	

	2002	2003
	-----	-----
	(In Thousands)	
Due within one year	\$ 40,606	\$ 52,752
Due after one year through two years	2,069	--
Due after two years	--	1,171
	-----	-----
	\$ 42,675	\$ 53,923
	=====	=====

The Company's gross realized gains and losses on the sale of investments for the year ended December 31, 2002 were \$606,000 and \$221,000, respectively, and for the year ended December 31, 2003 were \$0 and \$5,000, respectively. Gross unrealized gains and losses at December 31, 2002 were \$64,000 and \$176,000, respectively, and at December 31, 2003 were \$196,000 and \$47,000, respectively. The Company did not provide the disclosure of fair value and unrealized losses by category of investment as required by EITF No 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" as the amount of the unrealized losses for 2003 are deemed insignificant.

F-16

5. ACCOUNTS RECEIVABLE--NET

	December 31	

	2002	2003
	-----	-----
	(In Thousands)	
Accounts receivable	\$ 7,973	\$ 10,195
Allowances for		
Doubtful receivables	(64)	(86)
Sales returns and discounts	(314)	(315)
	-----	-----
	\$ 7,595	\$ 9,794
	=====	=====

The changes in the allowances are summarized as follows:

	2001	2002	2003
	-----	-----	-----
	(In Thousands)		
Allowances for doubtful receivables			
Balance, beginning of year	\$ 38	\$ 55	\$ 64

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Additions	17	9	22
	-----	-----	-----
Balance, end of year	\$ 55	\$ 64	\$ 86
	=====	=====	=====
Allowances for sales returns and discounts			
Balance, beginning of the year	\$ 252	\$ 314	\$ 314
Additions	62	--	1
	-----	-----	-----
Balance, end of the year	\$ 314	\$ 314	\$ 315
	=====	=====	=====

6. INVENTORIES

	December 31	
	-----	-----
	2002	2003
	-----	-----
	(In Thousands)	
Finished goods	\$ 2,344	\$ 2,042
Work-in-process	2,846	3,608
Raw materials	1,777	3,963
	-----	-----
	\$ 6,967	\$ 9,613
	=====	=====

7. LONG-TERM INVESTMENTS

	December 31	
	-----	-----
	2002	2003
	-----	-----
	(In Thousands)	
Cost method		
X-FAB Semiconductor Foundries AG (X-FAB)	\$ 4,968	\$ 4,968
360 Degree Web Ltd. (360 Degree Web)	--	1,750
GEM Services, Inc. (GEM)	500	500
Etrend Hightech Corporation (Etrend)	500	647
Silicon Genesis Corporation (SiGen)	17	--
	-----	-----
	5,985	7,865
Convertible loans to 360 Degree Web	1,750	--
	-----	-----
	\$ 7,735	\$ 7,865
	=====	=====

F-17

The Company invested in X-FAB's ordinary shares in July 2002. X-FAB is a European-American foundry group that specializes in mixed signal applications. As of December 31, 2003, the Company acquired 530,000 shares for \$4,968,000 (4,982,000 EURO), which represents a 2.03% ownership of X-FAB.

The Company invested in GEM's preferred shares in August 2002. GEM is a

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multinational semiconductor assembly and test company. As of December 31, 2003, the Company acquired 333,334 shares for \$500,000, which represents a 1.26% ownership of GEM.

The Company invested in Etrend's ordinary shares in December 2002 and July 2003. Etrend is a wafer probing, packing and testing company. As of December 31, 2003, the Company acquired 2,189,288 shares for \$647,000, which represents approximately 12.5% ownership of Etrend.

The Company invested in SiGen preferred shares in December 2000. SiGen is an advanced nanotechnology company that develops silicon-on-insulator "SOI", strained-silicon products and other engineered multi-layer structures to the microelectronics and photonics industries for advanced electronic and opto-electronic device applications. As of December 31, 2003, the Company acquired 71,840 shares for \$500,000, which represents a 0.25% ownership of SiGen. In 2002 and 2003, the Company reviewed qualitative factors of this investment and determined that the decline in value of SiGen was other-than-temporary and recognized an impairment loss of \$483,000 and \$17,000, respectively.

On January 3, 2003, the Company exercised its option to convert its convertible loans of \$1,750,000 in 360 Degree Web to 2,083,333 Series B preference shares of capital stock at \$0.36 per share and 1,000,000 Series B2 preference shares of capital stock at \$1.00 per share. 360 Degree Web designs, develops and markets intelligent security software solutions that provide secure computing environment for personal computer mobile devices and the internet. After the conversion, the Company had a 35.18% ownership in 360 Degree Web. The Company did not participate in 360 Degree Web's financing during 2003 and the ownership was diluted to 29.33% as of December 31, 2003. At December 31, 2003, one of the Company's directors serves as a director of 360 Degree Web. In addition, the Company does not actively participate in the decision-making process at 360 Degree Web. Management of 360 Degree Web owns more than 50% of the outstanding voting shares and 100% of the Series A voting preferred shares which has more characteristics of common stock than the other preferred shares. Therefore, the Company accounts for the investment under the cost method of accounting.

8. FIXED ASSETS--NET

	December 31	
	2002	2003
	(In Thousands)	
Cost		
Equipment	\$ 8,928	\$ 10,457
Furniture and fixtures	242	336
Equipment under capital lease	165	165
Leasehold improvements	654	727
Transportation equipment	56	56
Prepayment for leasehold	239	43
	10,284	11,784
Accumulated depreciation		
Equipment	3,985	6,096
Furniture and fixtures	117	131
Equipment under capital lease	155	162
Leasehold improvements	398	486
Transportation equipment	18	29

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4,673	6,904
-----	-----
\$ 5,611	\$ 4,880
=====	=====

F-18

9. OTHER ASSETS

	December 31	
	2002	2003

	(In Thousands)	
Restricted assets	\$ --	\$ 10,044
	-----	-----
Long-term note receivables from employees	447	551
Deferred charges	39	473
Refundable deposits	373	404
Patent costs--net of accumulated amortization of \$169 in 2002 and \$319 in 2003	150	--
	-----	-----
	1,009	1,428
	-----	-----
	\$ 1,009	\$ 11,472
	=====	=====

As of December 31, 2003, restricted assets consisted of deposits made for Taiwan court cases in the form of Taiwan Government bonds, negotiated certificates of deposit and cash, amounting to \$10,044,000.

In 2001, James Keim, one of the Company's directors, accepted the assignment of Head of Marketing and Sales in the Cayman Islands, and moved to the Cayman Islands in December 2001. In connection with the move and to assist Mr. Keim to purchase a residence in the Cayman Islands, the Company entered into a term loan agreement with Mr. Keim in February 2002, under which the Company made an interest free, unsecured loan in the amount of \$400,000 to Mr. Keim. The loan is repayable on February 2007. As of December 31, 2003, \$18,000 had been repaid.

10. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

	December 31	
	2002	2003

	(In Thousands)	
Legal and audit fees	\$ 314	\$ 1,180
Salaries and bonus	995	1,155
Deferred income tax liabilities	--	444
Accrued vacation	350	371
ESPP payable	172	301
Commissions	331	239
Others accrued expenses	1,367	1,690

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-----	-----
\$ 3,529	\$ 5,380
=====	=====

F-19

11. INCOME TAXES

Income before income taxes consisted of:

	Years Ended December 31		
	2001	2002	2003
	-----	-----	-----
	(In Thousands)		
Cayman	\$ 2,635	\$ 10,735	\$ 12,159
Other subsidiaries	4,151	1,667	2,868
	-----	-----	-----
	\$ 6,786	\$ 12,402	\$ 15,027
	=====	=====	=====

Income tax expense consisted of:

	Years Ended December 31		
	2001	2002	2003
	-----	-----	-----
	(In Thousands)		
Current	\$ 1,305	\$ 1,475	\$ 1,440
Deferred	(153)	198	386
	-----	-----	-----
Income tax expense	\$ 1,152	\$ 1,673	\$ 1,826
	=====	=====	=====

The Company and its subsidiaries file separate income tax returns. Reconciliation of the significant differences between the statutory income tax rate and the effective income tax rate on pretax income is as follows:

	Years Ended December 31		
	2001	2002	2003
	-----	-----	-----
Cayman statutory rate	0%	0%	0%
Foreign in excess of statutory rate	22.40%	12.40%	10.72%
Research and development credits	(14.10%)	(5.90%)	(4.39%)
Adjustments to prior years' taxes	(6.40%)	0.40%	0.09%
Valuation allowance	10.40%	5.70%	2.55%
Others	4.70%	0.90%	3.18%
	-----	-----	-----
Effective tax rate	17.00%	13.50%	12.15%
	=====	=====	=====

The deferred income tax assets and liabilities as of December 31, 2002 and 2003 consisted of the following:

	December 31	
	2002	2003
	-----	-----
	(In Thousands)	

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Deferred income tax assets		
Net operating loss carryforwards	\$ 567	\$ 390
Research and development credits	2,835	3,409
Depreciation and amortization	93	104
Accrued vacation	122	118
Others	43	165
	-----	-----
	3,660	4,186
Valuation allowance	(3,440)	(3,909)
	-----	-----
Total net deferred income tax assets	220	277
	-----	-----
Deferred income tax liabilities		
Withholding tax liabilities	--	359
Unrealized capital allowance	--	76
Unrealized foreign exchange	1	9
	-----	-----
Total deferred income tax liabilities	1	444
	-----	-----
Net deferred income tax assets (liabilities)	\$ 219	(\$ 167)
	=====	=====
Balance sheet caption reported in:		
Prepaid expenses and other current assets	\$ 219	\$ 277
Accrued expenses and other current liabilities	--	444
	-----	-----
	\$ 219	(\$ 167)
	=====	=====

F-20

As of December 31, 2003, O//2//Micro, Inc. had U.S. federal and state net operating loss carryforwards of approximately \$290,000 and \$4,994,000, and federal and state research and development credit carryforwards of approximately \$2,123,000 and \$1,949,000, respectively. The U.S. federal net operating loss carryforwards will expire from 2011 through 2012 if not utilized. The state net operating loss carryforwards will expire in 2004 and 2005 if not utilized. The U.S. federal research and development credit will expire from 2012 through 2023 if not utilized, while the state research and development credit will never expire. Utilization of the net operating loss carryforwards may be subject to significant annual limitation due to the ownership change limitations provided by the U.S. Internal Revenue Code of 1986 and similar provisions in the State of California's tax regulations. The annual limitation may result in the expiration of net operating losses before utilization.

12. EMPLOYEE BENEFIT PLANS

Savings plan

The Company has a savings plan that qualifies under Section 401(k) of the U.S. Internal Revenue Code. Participating employees may defer up to 15% of pretax salary, but not more than statutory limits. The Company may make voluntary contributions to the savings plan but has made no contributions since the inception of the savings plan.

1999 employee stock purchase plan ("1999 purchase plan")

In 1999, the Company's Board of Directors adopted the 1999 Purchase Plan, which was approved by the shareholders in October 1999. A total of 1,000,000 ordinary shares have been reserved for issuance under the 1999

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Purchase Plan, plus annual increases on January 1 of each year, commencing in 2001, up to 800,000 shares as approved by the Board of Directors. The 1999 Purchase Plan is subject to adjustment in the event of a stock split, stock dividend or other similar changes in ordinary shares or capital structure.

The 1999 Purchase Plan permits eligible employees to purchase ordinary shares through payroll deductions, which may range from 1% to 10% of an employee's regular base pay at a price equal to the lesser of 85% of the fair market value of the Company's ordinary shares on the date of grant of

F-21

the option to purchase or 85% of the fair market value of the Company's ordinary shares on the applicable exercise date. Employees may elect to discontinue their participation in the purchase plan at any time during the enrollment period. Participation ends automatically on termination of employment with the Company. If not terminated earlier, the 1999 Purchase Plan will have a term of 10 years. During 2002 and 2003, 97,304 and 109,735 ordinary shares, respectively, had been purchased under the 1999 Purchase Plan. As of December 31, 2003, 702,903 shares were available for issuance.

Stock option plans

In 1997, the Company's Board of Directors adopted the 1997 Stock Plan, and in 1999, adopted the 1999 Stock Incentive Plan (collectively, the "Plans"). The Plans provide for the granting of stock options to employees, directors and consultants of the Company. Options granted under the Plans may be either incentive stock options ("ISO") within the meaning of Section 422 of the United States Internal Revenue Code, or nonstatutory stock options ("NSO"). ISOs may be granted only to Company employees and directors. NSOs may be granted to Company employees and consultants.

Options under the Plans may be granted for periods of up to ten years and at prices no less than 85% of the estimated fair value of the shares (in the case of NSOs) on the date of grant as determined by the Board of Directors, provided, however, that (i) the exercise price of an ISO may not be less than 100% of the estimated fair value of the shares on the date of grant, and (ii) the exercise price of an ISO granted to a 10% shareholder may not be less than 110% of the estimated fair value of the shares on the date of grant. Options may be exercised following the termination of a grantee's continuous service only to the extent provided in the award agreement. Options generally expire no later than ten years after grant, or five years in the case of an ISO granted to a 10% shareholder. The options generally vest over a period of four years from the vesting commencement date. Options may be granted with different vesting terms from time to time.

Under the 1997 Stock Plan, the Board of Directors reserved 3,700,000 ordinary shares for issuance. After the completion of an initial public offering, no further options were granted under the 1997 Stock Plan. Under the 1999 Stock Incentive Plan, the maximum aggregate number of shares available for grant shall be 3,000,000 ordinary shares plus an annual increase on January 1 of each year, commencing in 2001, equal to the least of 1,500,000 shares (in the case of ISOs) or 4% of the outstanding ordinary shares on the last day of the preceding fiscal year or a smaller number determined by the administrator. As of December 31, 2003, the number of options outstanding and exercisable were 570,207 and 522,554 under the 1997 Stock Plan, respectively, and 3,349,653 and 878,038 under the 1999 Stock Incentive Plan, respectively.

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A summary of the Company's stock option activity and related information is as follows:

	Available for Grant	Number of Outstanding Options	Weighted Average Exercise Price
Balance, January 1, 2001	3,034,006	2,323,365	
Granted	(1,615,000)	1,615,000	\$ 12.04
Exercised	--	(656,215)	\$ 1.50
Canceled	168,373	(168,373)	\$ 6.45
Balance, December 31, 2001	1,587,379	3,113,777	
Additional shares authorized	1,500,000	--	
Granted	(1,310,400)	1,310,400	\$ 12.30
Exercised	--	(325,113)	\$ 2.96
Canceled	54,894	(54,894)	\$ 10.83
Balance, December 31, 2002	1,831,873	4,044,170	
Additional shares authorized	1,500,000	--	
Granted	(913,300)	913,300	\$ 13.88
Exercised	--	(863,987)	\$ 6.52
Canceled	173,623	(173,623)	\$ 13.05
Balance, December 31, 2003	2,592,196	3,919,860	

F-22

The following table summarizes information about the stock options outstanding as of December 31, 2003:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable and Vested	Weighted Average Exercise Price
\$0.03--\$0.09	69,292	3.46	\$ 0.045	69,292	\$ 0.05
\$0.18--\$0.25	2,396	4.80	\$ 0.245	2,396	\$ 0.25
\$0.50	50,333	5.19	\$ 0.500	50,333	\$ 0.50
\$3.95--\$5.88	277,560	6.23	\$ 4.777	234,749	\$ 4.58
\$6.50--\$9.60	1,115,723	7.87	\$ 8.460	522,204	\$ 8.37
\$10.06--\$14.97	1,550,677	8.36	\$12.900	316,156	\$12.92
\$15.38--\$24.18	853,879	8.68	\$18.168	205,462	\$17.81
	3,919,860	8.01	\$ 11.81	1,400,592	\$ 9.44

For purposes of measuring compensation expense under APB No. 25, the fair value of the shares on the date of grant was determined by the Board of

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Directors for grants prior to August 23, 2000. The fair value of subsequent option grants were based on the market price of ordinary shares on the day of grant.

The Company calculated the fair value of each option grant on the date of grant using the Black-Scholes option pricing model as prescribed by SFAS No. 123. The Black-Scholes option valuation model was developed for estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation model requires the input of highly subjective assumptions, including the expected stock price volatility. The Company used the following weighted-average assumptions in calculating the fair value of the options granted: For purposes of measuring compensation expense under APB No. 25, the fair value of the shares on the date of grant was determined by the Board of Directors for grants prior to August 23, 2000. The fair value of subsequent option grants were based on the market price of ordinary shares on the day of grant.

F-23

	Stock Options			Employee
	Years Ended December 31			
	2001	2002	2003	2001
Risk-free interest rate	4.40%	2.76%	3.34%	2.21 %- 4.32%
Expected life	5 - 9 years	5 - 9 years	5 - 9 years	0.51-1.53 years
Volatility	80%	75%	70%	85%
Dividend	--	--	--	--

Expected life of stock options is estimated to be one year after vesting.

The weighted average fair values under SFAS No. 123 for options granted during the years ended December 31, 2001, 2002 and 2003 was \$7.54, \$9.83 and \$7.64, respectively. The weighted average fair values under SFAS No. 123 for purchase rights granted pursuant to the Employee Stock Purchase Plan during the years ended December 31, 2001, 2002, and 2003 was \$4.40, 5.13 and \$5.40, respectively.

As explained in Note 2, the Company determined that certain volatility assumptions used to compute the fair value of employee stock compensation for 2001, 2002 and 2003 were inappropriate. Accordingly, such volatility percentages presented above have been restated. The volatility previously used in the computation for stock options was 41%, 45% and 31% for 2001, 2002 and 2003, respectively.

Deferred compensation

In connection with stock option grants since the Company's inception, the Company recognized accumulated deferred compensation totaling \$3,056,000 which was fully amortized as of December 31, 2002. Amortization expense recognized during the years ended December 31, 2001, 2002 and 2003 was approximately \$166,000, \$44,000 and \$0, respectively.

Shares reserved

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Ordinary shares reserved for future issuance was as follows at December 31, 2003:

	Shares
Outstanding stock options	3,919,860
Shares reserved for future stock option grants	2,592,196
Shares reserved for employee stock purchase plan	702,903
	7,214,959
	=====

F-24

13. EARNINGS PER SHARE

Basic earnings per share is calculated by dividing net income by the weighted average number of ordinary shares outstanding during the period. Diluted earnings per share is calculated by dividing net income by the weighted average number of ordinary and dilutive ordinary equivalent shares outstanding during the period, using either the "as if converted" method for convertible preference shares or the treasury stock method for options and warrants.

A reconciliation of the numerator and denominator of basic and diluted earnings per share calculations is provided as follows:

	Years Ended December 31		
	2001	2002	2003
Net income (in thousands)	\$ 5,634	\$ 10,729	\$ 13,201
	=====	=====	=====
Weighted average thousand shares outstanding--basic	34,020	38,300	38,374
Effect of dilutive securities:			
Options	1,317	1,194	1,362
Warrants	239	97	--
	35,576	39,591	39,736
	=====	=====	=====
Earnings per share--basic	\$ 0.17	\$ 0.28	\$ 0.34
	=====	=====	=====
Earnings per share--diluted	\$ 0.16	\$ 0.27	\$ 0.33
	=====	=====	=====

Certain antidilutive outstanding options and warrants were excluded from the computation of diluted EPS since their exercise prices exceeded the average market price of the ordinary shares during the period. The antidilutive stock options excluded and their associated exercise prices per share were 1,023,100 shares and \$12.54 to \$24.05 as of December 31, 2001, 1,141,900 shares and \$14.10 to \$24.18 as of December 31, 2002 and 916,646 shares and \$15.38 to \$24.18 as of December 31, 2003.

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14. LEASE COMMITMENTS

The Company leases office space and certain equipment under non-cancelable operating lease agreements that expire at various dates through January 2006. The Company's office lease provides for periodic rent increases based on the general rate of inflation. The Company also leases certain equipment under a capital lease that expires in May 2004. There are provisions in the lease that provide for a bargain purchase option upon the expiration of the lease.

As of December 31, 2003, minimum lease payments under all noncancelable leases were as follows:

Year	Capital Leases	Operating Leases
----	-----	-----
(In Thousands)		
2004	\$ 2	\$ 1,359
2005	--	213
2006	--	3
2007	--	--
2008	--	--
	-----	-----
Total minimum lease payments	2	\$ 1,575
		=====
Less--amount representing interest	1	

Present value of minimum lease payments	1	
Less--current portion	1	

Long-term obligations under capital lease	\$ --	
	=====	

F-25

Capital lease obligations are secured by the related equipment and the total costs of the equipment under capital lease was \$165,000, \$165,000 and \$165,000 for December 31, 2001, 2002 and 2003, respectively. Accumulated depreciation was \$122,000, \$155,000 and \$162,000 at December 31, 2001, 2002 and 2003, respectively.

15. CONTINGENCIES

Monolithic Power Systems, Inc. ("MPS"), a privately held company in Los Gatos, California, USA has alleged in a counterclaim that certain products of the Company infringe on two of MPS' patents. Litigation on such claim is pending in the United States District Court in the Northern District of California. Trial is currently scheduled for August 2004.

While the Company cannot make any assurance regarding the eventual resolution of this matter, the Company does not believe the final outcome will have a material adverse effect on its consolidated results of operations or financial condition.

The Company, as a normal course of business, is a party to various litigation matters, legal proceedings and claims. These actions may be in various jurisdictions, and may involve patent protection and/or patent

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infringement. While the results of such litigations and claims cannot be predicted with certainty, the final outcome of such matters is not expected to have a material adverse effect on its consolidated financial position or results of operations. No assurance can be given, however, that these matters will be resolved without the Company becoming obligated to make payments or to pay other costs to the opposing parties, with the potential for having an adverse effect on the Company's financial position or its results of operations.

16. FINANCIAL INSTRUMENTS

Information on the Company's financial instruments are as follows:

	December 31			
	2002		2003	
	Carrying Value	Fair Value	Carrying Value	Fair Value
	(In Thousands)			
Assets				
Cash and cash equivalents	\$ 69,334	\$ 69,334	\$ 66,489	\$ 66,489
Restricted cash	2,019	2,019	1,892	1,892
Short-term investments	42,675	42,675	53,923	53,923
Accounts receivable--net	7,595	7,595	9,794	9,794
Restricted assets--net	--	--	10,044	10,796
Liabilities				
Notes and accounts payable	5,202	5,202	6,334	6,334

F-26

Fair values of restricted assets made in the form of Taiwan Government bonds are based on market value; otherwise are carried at amounts which approximate fair value.

Long-term investments are in privately-held companies where there is no readily determinable market value. The Company periodically evaluates these investments for impairment. If it is determined that an other than temporary decline has occurred in the carrying value, an impairment charge is recorded in the period of decline in value.

17. SEGMENT INFORMATION

The Company designs, develops and markets innovative power management and security components for mobile communication, computer, information appliance and LCD products. The Company's integrated circuit products are produced with digital, analog, and mixed signal integrated circuit manufacturing processes. The Company's Chief Operating Decision Maker ("CODM"), the Chief Executive Officer, reviews information on an enterprise-wide basis to assess performance and allocate resources so the Company has one reporting segment.

Net revenues from unaffiliated customers by geographic region are based on the customer's bill-to location and were as follows:

Years Ended December 31		
2001	2002	2003
-----	-----	-----

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(In Thousands)

Asia	\$ 45,780	\$ 70,149	\$ 88,548
United States	39	31	51
Europe	--	7	--
	-----	-----	-----
	\$ 45,819	\$ 70,187	\$ 88,599
	=====	=====	=====

Long-lived assets consist of fixed assets and are based on the physical location of the assets at the end of each year.

Years Ended December 31

	-----	-----	-----
	2001	2002	2003
	-----	-----	-----
	(In Thousands)		
Taiwan	\$ 1,272	\$ 2,759	\$ 2,354
U.S.A.	1,190	1,422	1,251
Singapore	227	764	633
People's Republic of China	204	388	415
Others	320	278	227
	-----	-----	-----
	\$ 3,213	\$ 5,611	\$ 4,880
	=====	=====	=====

During the year ended December 31, 2003, one customer accounted for 13.5% of net revenues. During the year ended December 31, 2002, two customers accounted for 18.6% and 15.9% of net revenues. During the year ended December 31, 2001, two customers accounted for 20.9% and 11.0% of net revenues.