O2MICRO INTERNATIONAL LTD
Form 20-F
June 20, 2005

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, 2004

or

[ ] Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from _____ to _____.

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:

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 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.

39,188,062 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 [x] No [ ]

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

Item 17 [ ] Item 18 [x]

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Certain Definitions and Conventions

In this annual report on Form 20-F (the "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 ability to develop products in a timely manner to meet customer demands, our ability to take advantage of cost-efficiencies associated with the "fabless" semiconductor business model, our future gross profits, continued expansion of our engineering, research and development resources, our efforts to reduce costs and expenses, our expectations regarding outcome of litigation matters, our expectation that our existing facilities will be adequate to meet our needs, and our statements regarding the effect of adoption of certain accounting policies. 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, specific product manufacturing costs, increased competition, introduction of new 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, 2002, 2003 and 2004, and the selected consolidated financial data as of December 31, 2003 and 2004, 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 on Form 20-F. The selected consolidated financial data for the years ended December 31, 2000 and 2001 and the selected consolidated financial data as of December 31, 2000, 2001 and 2002, set forth below, are derived from our audited consolidated financial statements and related notes which do not appear in this annual report on Form 20-F. Our consolidated financial statements are prepared and presented in accordance with generally accepted accounting principles in the United States.

	Year Ended December 31,				
	2000	2001	2002	2003	2004
	(in thousands, except per share data)				
Consolidated Statement of Operations Data:					
Net sales	$ 40,356	$ 45,819	$ 70,187	$ 88,599	$ 92,
Cost of sales	15,687	16,465	28,143	38,314	37,
Gross profit	24,669	29,354	42,044	50,285	54,
Operating expenses:					
Research and development	9,682	14,320	18,935	19,219	20,
Selling, general and administrative	8,714	9,561	11,790	13,522	16,
Patent litigation	0	348	535	3,954	5,
Stock-based compensation	458	166	44	-	
Total operating expenses	18,854	24,395	31,304	36,695	41,
Income from operations	5,815	4,959	10,740	13,590	12,

Non-operating income - net	1,056	1,827	1,662	1,437	2,
Income before income tax	6,871	6,786	12,402	15,027	15,
Income tax expense	227	1,152	1,673	1,826	1,
Net income	6,644	5,634	10,729	13,201	14,
Earnings per share:					
Basic	0.34	0.17	0.28	0.34	0
Diluted	0.21	0.16	0.27	0.33	0
Shares used to compute basic earnings per share:	19,419	34,020	38,300	38,374	39,
Shares used to compute diluted earnings per share:	32,260	35,576	39,591	39,736	40,

	December 31,				
	2000	2001	2002	2003	2004
	(in thousands)				
Consolidated Balance Sheet Data:					
Cash and short term investments ...	$ 37,448	$ 118,950	$ 112,009	$ 120,412	$ 120,
Working capital	44,072	122,990	120,793	130,510	132,
Total assets	54,607	136,419	145,836	169,293	185,
Long-term debt, excluding current portion	13	7	-	-	
Net assets	47,928	128,424	135,148	154,727	170,
Ordinary shares and additional paid-in capital	55,104	130,235	126,232	137,115	139,

CAPITALIZATION AND INDEBTEDNESS

Not applicable.

REASONS FOR THE OFFER AND USE OF PROCEEDS

Not applicable.

RISK FACTORS

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

Our business focuses on designing, developing and marketing high performance integrated circuits for manufacturers of products for the computer, consumer electronics, industrial and communications markets. Because many of the leading suppliers 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. We also have targeted and are designing products for other

computer, consumer electronics, industrial and communications applications such as internet security, mobile phones, global positioning systems, portable DVD players, liquid crystal display (LCD) monitors and LCD television sets. We cannot be certain that the markets for these products will continue to grow as rapidly as they have in the past or that a significant slowdown in these markets will not occur. We believe that an important factor driving growth in these markets has been the growing popularity of mobile computing, the growing popularity of thinner displays, and the emergence and continued development of the Internet and wireless communications networks. If mobile computing does not continue to grow in popularity and the demand for notebook computers declines, or does not grow as quickly as we expect, our intermediaries or original equipment manufacturer customers will experience lower demand for notebook computers that use our products, and our net sales will suffer. If the growth in the use of the Internet and wireless communications networks declines, or does not grow as quickly as we anticipate, our customers may experience lower demand for the electronic devices that use our products, and our sales will suffer. If demand for products using LCDs declines, or does not grow as quickly as we anticipate, our customers may experience lower demand for those systems that use our products, which may cause our sales to suffer.

In addition, we have experienced, and may experience in the future, shortages of LCDs and semiconductors caused by industry market trends or by natural disasters, such as earthquakes, that are outside of our control. These shortages may increase the costs of components used in those products containing our products. This may cause an increase in the cost of such products, thus constraining their more widespread market acceptance.

Finally, the semiconductor industry has historically been highly cyclical and, at various times, has experienced significant downturns and wide fluctuations in supply and demand. This has caused significant variances in product demand, production capacity and rapid erosion of average selling prices. Industry-wide fluctuations in the future could result in pricing pressure on our products as well as lower demand for our products. If such fluctuations were to occur, it could materially adversely affect our operating margins and net sales.

Fluctuations in our quarterly operating results due to factors such as changes in the demand for electronic devices that can utilize our products could depress our stock price.

We believe that quarter-to-quarter comparisons of our financial results are not necessarily meaningful indicators of our future operating results, and they should not be relied upon as an indication of our future performance. If our quarterly operating results fail to meet the expectations of securities analysts, the trading price of our ordinary shares could be negatively 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 that are beyond our control. These factors include: changes in demand for devices that use our products; market conditions in the 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 introductions 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. In addition, the trading price of our ordinary shares may be

affected by factors such as: significant price and volume fluctuations in the stock and financial markets in the U.S. and other countries, as well as relatively thin trading volume of our stock on the Nasdaq National Market. In addition, the trading market for our stock is affected by the research and 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 stock, our stock price may decline. In addition, if one or more analysts cease coverage of the Company or does not regularly publish reports on us, we may lose visibility in the financial markets, which could cause our stock price or trading volume to decline.

If orders for our products are deferred or cancelled, our quarterly 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 quarter depends on orders booked and shipped in that quarter. If a large amount of orders placed is cancelled or deferred, our net sales in that quarter could be substantially reduced. Since we do not have significant non-cancelable 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 expenses 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 lower than expected, cancelled or deferred orders. As a result, any significant downturn in orders would not only harm our net sales, it would likely have a disproportionately adverse effect on our operating margins and net income.

A substantial portion of our net sales is generated by a small number of large customers. If any of these customers delays or reduces its orders, our net sales and earnings will 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 2004, one customer accounted for 10% or more of our net revenues (17.54%). In 2003, one customer accounted for 10% or more of our net revenues (13.5%). In 2002, two customers accounted for 10% or more of our net revenues (18.6% and 15.9%, respectively). The variations in sales to these customers as a percentage of our total revenue have been caused by a number of factors, 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. The reduction, delay or cancellation of orders from one or more of our significant customers would have a disproportionately negative impact on our results of operations.

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

Our ability to compete successfully in the market for semiconductor or 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 Linear Technology, Maxim Integrated Products Texas Instruments, Ricoh Company, Ltd. and Monolithic Power Systems. In addition to these competitors, other integrated circuit companies may decide to enter the market with mixed signal integrated products that compete with ours or incorporate functions similar to those provided by our products. We also face competition from in-house integrated circuit design and manufacturing groups at some of our existing and potential customers, such as Toshiba Corporation.

Many 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.

If we do not develop and introduce new products timely, our net sales and gross margins will be harmed.

Our success depends upon our ability to develop and introduce new products selected for design into products for the computer, consumer electronics, 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 the following: accurate new product definition; timely completion of new product designs; achievement of manufacturing yields; timely and cost-effective production of new products; and delays in the introduction 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-in to such products. If we incur such expenditures but fail to be selected, our operating results will be adversely affected, and may cause significant fluctuations from period to period. Furthermore, even if we were selected for design-in, we cannot be assured that these systems will be commercially successful or that we will benefit from any associated revenue.

It is difficult to evaluate our future prospects, and we cannot assure you that

we will not incur future losses.

Our past results cannot be relied upon to predict our future performance. We incurred net losses in each year prior to the year ended December 31, 1999. We experienced significant quarter to quarter sales growth in the years ended December 31, 2001, 2002 and 2003. However, in the first quarter ending March 31, 2004,

in the third quarter ending September 30, 2004 and in the first quarter ending March 31, 2005, we experienced a decrease in sales compared to the previous quarter. Our net sales are subject to fluctuation from quarter to quarter, our previous overall growth may not continue, and we may not be able to sustain or increase profitability in the future. We anticipate that our expenses will increase substantially in the foreseeable future as we continue to develop and protect our technology and expand our product offerings. These efforts may prove more expensive than we currently anticipate, and we may not succeed in increasing our net sales sufficiently to offset our increased expenses. If we fail to increase our net sales to keep pace with our increased expenses, we may again experience net losses in future periods, which would cause the value of our stock to decline.

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

The markets for computer, consumer electronics, 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 interoperate change very rapidly, and the product life cycles for products in the computer, consumer electronics, industrial and communications markets that use our power management and security technologies are often less than one year. If we do not respond in a timely manner to technological changes and new product introductions by our direct customers and competitors by developing new products and enhancing our existing products, we will be unable to maintain and grow our product sales. In addition, the emergence of significantly more efficient or cost-effective battery, display or microprocessor technologies could lessen the need for the power management functionality of our products, which would harm our net sales.

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 net sales and gross margins will be harmed.

We do not own or operate the integrated circuit fabrication facilities that manufacture the products we design. Three foundries, United Microelectronics Corporation, or UMC, Taiwan Semiconductor Manufacturer Company Limited, or TSMC, and X-FAB Semiconductor Foundries AG, or X-FAB, manufactured most of the semiconductor devices that we sold in 2004. These suppliers manufacture integrated circuit semiconductors for us according to purchase orders. We do not have a guaranteed level of production capacity at any of our suppliers, and any one or more could raise prices without notice. We provide the suppliers with rolling forecasts of our production requirements; however, the ability of each supplier to provide wafers to us is limited by the supplier's available capacity. Our suppliers 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 our suppliers will allocate sufficient capacity, if any, to satisfy

our requirements particularly during any industry-wide capacity shortages. In addition, if any of our suppliers were to become unable to continue manufacturing our products in the required volumes at acceptable quality, yields and costs or in a timely manner, our business and operating results would be seriously harmed.

There are other significant risks associated with our reliance on outside suppliers, including: the disruption in our ability to ship products caused by the length of time, as much as six to twelve months, required for us to qualify alternative suppliers for existing or new products; the reduction or elimination of deliveries to us by our foundries caused by a sudden demand for an increased amount of 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 suppliers; and the susceptibility of our third-party suppliers to production interruptions resulting from natural disasters, such as the interruptions experienced in Taiwan in the past due to earthquake activity. Any of these events could cause our foundries to either reduce or eliminate deliveries to us, and a disruption in our ability to ship products to our customers could negatively affect our business and results of operations.

We also rely on independent subcontractors to assemble and test substantially all of our semiconductor products. We do not have long-term agreements with any of these subcontractors and typically obtain services from them 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 are 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.

Sales of our products could decline if we fail to support evolving industry standards.

Our net sales are derived from sales of semiconductor products that are components of electronic devices built to industry standards and widely accepted specifications. For example, the hardware specification for the voltage of most notebook computers is currently either 3.3 or 5.0 volts and the software used to control the power management functions of many notebook computers conforms to the 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 in a timely manner that conforms to these new standards. Additionally, new products we develop to conform to new specifications may not be accepted in the market.

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 detected 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 decrease our profit margins. 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 ability to sell our products.

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, 2004, a substantial portion of our operations, approximately 68% of our employees, and most of the third parties we use to manufacture, assemble and test our products were located in Japan, Korea, the People's Republic of China, Singapore and Taiwan. In addition, sales outside the United States as a percentage of net sales were almost 100% in the years ended December 31, 2002, December 31, 2003 and December 31, 2004. 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 the outbreak of Severe Acute Respiratory Syndrome; the risk of potential conflict and further instability in the relationship between Taiwan and the People's Republic of China; risks related to international political instability and to the recent global economic turbulence and adverse economic circumstances in Asia, such as in Japan and Korea; unpredictable

consequences on the economic conditions in the U.S. and the rest of the world arising from terrorist attacks, such as the attacks of September 11, 2001 in the U.S. and other military or security operations, particularly with regard to the conflicts in the Middle East involving Iraq; unexpected changes in regulatory requirements or legal uncertainties regarding tax regimes, such as the change to the tax code of Taiwan in 2001 that resulted in a higher income tax rate on our retained earnings; tariffs and other trade barriers, including current and future import and export restrictions; difficulties in staffing and managing international operations, such as Singapore, the People's Republic of China and Taiwan; risks that changes in foreign currency exchange rates will make our products comparatively more expensive; 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; limitation on imports or exports and 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, America, 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.

Our reporting currency is the U.S. dollar. However, a significant portion of our operating expenses is denominated in currencies other than the U.S. dollar, primarily the New Taiwan dollar and the Chinese Renminbi. 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 reduce our operating results. We do not currently engage in currency hedging activities.

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 hurt 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.

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 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 rights 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 infringers.

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 precautions that we take, it may be possible for unauthorized third parties to copy aspects of our current or future products or to obtain and use information that we regard as proprietary. In particular, we may provide our customers with access to our proprietary information underlying our products. Additionally, our competitors may independently develop similar or superior technology. Policing unauthorized use of software, circuit design or semiconductor design is difficult and some foreign laws do not protect our proprietary rights to the same extent as United States laws. We have in the past and have currently 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 harm our business, future operating results and financial condition. See "Information on the Company--Business Overview--Intellectual Property".

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, this could harm our ability to grow our business, sell our products, enter new markets and increase our share of existing markets. 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 or independent sales representatives internationally and in the United States. 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 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 semiconductor design is intense. In the past, we have experienced difficulty in recruiting qualified personnel, especially technical and sales personnel. Moreover, we intend to expand the scope of our international operations, which 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 this case, our costs of doing business would increase without the expected 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 the board of directors, 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 decided to join a competitor or otherwise compete directly or indirectly with us.

Our transfer pricing procedures may be challenged, 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 related 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 believes that transfer prices were manipulated by our affiliate corporations in a way that distorts the true taxable income of the corporations, the laws of countries where our affiliated corporations are located could require us to redetermine transfer prices and thereby reallocate the income of our affiliate corporations in order to clearly reflect such income. 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, the People's Republic of China, Taiwan, Japan and

Singapore to regulate intercompany 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 at arm's length. We have entered into these types of agreements because a portion of our assets, such as intellectual property developed in our U.S. and foreign subsidiaries, is transferred among our affiliated corporations. 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 United States Internal Revenue Service or the taxing authorities of any other jurisdiction were to successfully challenge these agreements or require changes in our transfer pricing practices, we could become subject to higher taxes and our earnings would be adversely affected. We believe that we operate in compliance with all applicable transfer pricing laws in these jurisdictions. However, 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 can 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.

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 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 damages we may owe, cause product shipment delays or require us to enter into license agreements. Such license agreements may not be available on acceptable terms, or at all. Any one of such events could seriously harm our business and our operating results. 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 "Information on the Company--Business Overview--Intellectual Property".

From time to time, in the normal course of business, we 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. Historically, payments made by us under these obligations have not been material.

Until our litigations are 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 quarter, which will impair our ability to forecast our results of operations for that quarter. It is likely that these expenses will increase leading up to and during our trials scheduled for June 2005, for September 2005, and for December 2005.

Monolithic Power Systems, Inc. ("MPS") has alleged that our OZ960, OZ961, OZ969A and OZ970 products infringe on one of their patents and a continuation of that patent. On May 28, 2004, the U.S. District Court for the Northern District of California granted our motion for summary judgment that MPS lacked evidence of damages. As the case currently stands, MPS will not be able to recover damages at

trial but may only attempt to seek injunctive relief and attorneys' fees. However, 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 was to prevail in its claims against us, our operating results 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 revenues, net sales, result of operations and financial condition. This risk factor only summarizes the legal proceedings in which we are involved and related events. You are advised to read the descriptions of our litigation in "Business Overview - Intellectual Property."

We may be subject to lawsuits from third parties.

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 the 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. We believe that the ultimate disposition of these matters will not have a material adverse effect on our business, financial condition or results of operations.

Provisions in our charter documents may discourage potential acquisition bids for us and prevent changes in our management that our shareholders may favor.

Provisions in our charter documents 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 tender offers for our shares. As a result, these provisions may prevent the market price of our ordinary shares from reflecting the effects of actual or rumored takeover attempts and may prevent shareholders from reselling their shares at or above the price at which they purchased their

shares. These provisions may also prevent changes in our management that our shareholders may favor. Our charter documents 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, or remove, a limited number of our directors in any given year. Furthermore, our board of directors have the authority to issue up to 5,000,000 preference shares in one or more series. Our board of directors can fix the price, rights, preferences, privileges and restrictions of such preference shares without any further vote or action by our shareholders. 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.

We have and continue to incur significant costs with respect to corporate governance and financial reporting compliance.

To comply with the requirements of the Sarbanes-Oxley Act of 2002, as well as new rules subsequently implemented by the SEC and adopted by Nasdaq in response to Sarbanes-Oxley, we have made changes to our financial reporting, securities disclosure and corporate governance practices. We may incur increased legal and financial compliance costs due to these new or revised rules, regulations, and listing requirements and management time and resources may be re-directed to implement our compliance initiatives. These rules may make it more difficult for us to attract and retain qualified executive officers and members of our board of directors, as well as make it more costly to obtain liability coverage for our officers and directors.

If we fail to maintain an effective system of internal controls, we may not be able to accurately report our financial results. As a result, current and potential stockholders could lose confidence in our financial reporting, which would harm our business.

Effective internal controls are necessary for us to provide reliable financial reports. If we cannot provide reliable financial reports or prevent fraud, our operating results could be misstated, our reputation may be harmed and the trading price of our stock could be negatively affected. In connection with the audit of our financial statements for the three years ended December 31, 2004, in May 2005 our independent registered public accounting firm reported to our audit committee a matter that was a "reportable condition" in our internal controls as defined in standards established by the American Institute of Certified Public Accountants. In general, reportable conditions are significant deficiencies in our internal controls that, in our auditor's judgment, could adversely affect our ability to record, process and report financial data consistent with the assertions of management in the financial statements. In 2005, we devoted significant resources to remediate and improve our internal controls. We believe that these efforts have remediated the concerns that gave rise to the "reportable condition." However, 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 cause us to fail to meet our reporting obligations.

In addition, pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, beginning with our Annual Report on Form 20-F for the fiscal year ending December 31, 2006, we will be required to furnish a report by our management on our internal control over financial reporting. Such a report will contain, 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. Such report must also contain a statement that our auditors have issued an attestation report on management's assessment of such internal controls. We are still performing the system and process documentation and evaluation needed to comply with Section 404, which is both costly and challenging.

During this process, if our management identifies one or more material weaknesses in our internal control over financial reporting, we will be unable to assert such internal control is effective. If we are unable to assert that our internal control over financial reporting is effective (or if our auditors are unable to attest that our management's report is fairly stated or they are 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 would have an adverse effect on our stock price.

Changes in accounting standards for stock option plans may impact our operating results and our ability to use stock options to recruit, retain and motivate employees.

The Financial Accounting Standards Board has published revisions to Statement of Financial Accounting Standards No. 123 which requires all public entities to treat the value of stock options granted to employees as an expense. As a public entity as contemplated by SFAS 123R, we are required to record, as of the first annual reporting period beginning after June 15, 2005, a compensation expense equal to the value of each stock option granted. This expense would likely be recognized over the vesting period of the stock option. The requirement to expense stock option grants reduces the attractiveness of granting stock options because the additional expense associated with these grants may adversely affect our profitability. However, stock options remain an important employee recruitment and retention tool, and we may not be able to attract and retain key personnel if any future adverse effects on our profitability resulting from the application of SFAS 123R compel us to reduce the scope of our employee stock option program. Our employees are critical to our ability to develop and design systems that advance our productivity and technology goals, increase our sales goals and provide support to customers. Accordingly, as a result of the requirement to adopt SFAS 123R to expense

stock option grants beginning with the first fiscal year after June 15, 2005, our future profitability would be reduced, as would our ability to use stock options to recruit, retain and motivate key employees.

Because 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 interests.

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 violations of United States federal securities laws relating to offers and sales of ordinary shares, 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 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 of the Cayman Islands. The rights of our shareholders and fiduciary responsibilities of our directors are governed by Cayman Islands law and are not as clearly established as under statutes or judicial precedent in existence in jurisdictions in the United States. While there is some case law in the Cayman Islands on these matters, it is not as developed as, for example, English law and United States law. However, we believe that English case law, although not binding in the courts of the Cayman Islands, would be regarded as persuasive. Due to this relative vagueness of Cayman Islands law, our public shareholders may have more difficulty in protecting their interests in the face of actions by our management, directors or controlling shareholders than would shareholders of a corporation incorporated in a jurisdiction in the United States.

ITEM 4. INFORMATION ON THE COMPANY

HISTORY AND DEVELOPMENT OF THE COMPANY

Our legal name is O2Micro International Limited. We are incorporated in Cayman Islands. Our registered office is located at M&C Corporate Services Limited, P.O. Box 309, Ugland House, South Church Street, George Town, Grand Cayman, Cayman Islands. Our principal executive offices are located at Grand Pavilion Commercial Centre, West Bay Road, P.O. Box 32331 SMB, George Town, Grand Cayman, Cayman Islands. Our telephone number is (345) 945-1110. We have a subsidiary, O//2//Micro, Inc., which was incorporated as a California corporation in March 1995. In March 1997, O2 Micro 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 O//2// Micro, Inc. After the exchange, we held all of the outstanding capital stock of O//2// Micro, Inc., our wholly owned subsidiary in the United States.

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 O//2//Micro, Inc., 3118 Patrick Henry Drive, Santa Clara, CA 95054.

Since January 1, 2002, our principal capital expenditures were investments in and loans to various private companies of approximately $17.2 million in the aggregate, $21.6 million in the purchase of land, property and equipment, and $12.1 million deposited for Taiwan court bonds in connection with preliminary injunction actions in Taiwan.

BUSINESS OVERVIEW

We design, develop and market high performance integrated circuits for power management and security applications. We focus on integrated circuits that use mixed signal designs, which combine analog and digital circuits on a single chip, reducing the number of semiconductors needed and decreasing the size, weight, power requirements and cost of the end product. We focus our product design efforts on integrated circuits for the markets of computer, consumer electronics, industrial and communications products. Products in these markets include notebook computers, internet security devices, mobile phones, global positioning systems, portable DVD players, LCD monitors and LCD television sets. Our system-level expertise, proprietary design methodologies and extensive experience with power management systems allow us to develop products quickly so that our customers can achieve rapid time to market with new devices. Our products are used in electronic devices currently sold by large computer and consumer electronics companies.

Industry Background

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 fundamental computer technologies. 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 to help address the need for longer battery life in mobile applications. However, since power systems are analog by nature, mixed signal 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 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 expertise; and basic differences in the technologies used in digital and analog circuit design make combining the technologies problematic.

In addition, mixed signal circuits are comprised of 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, simpler to produce 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 designs among manufacturers make it more difficult to design intelligent systems that are optimized for particular power systems.

Most analog integrated circuit companies offer broad product lines of analog and, in some cases, mixed signal integrated circuit products. Their products are typically designed to function in a wide range of applications, and thus are not optimized for specific power system applications. Their products also usually must be combined with other discrete circuit components, creating larger and heavier products that are more difficult to manufacture and can be less reliable. In addition, many of these companies lack the digital circuit design and system-level expertise and focus necessary to design new products quickly to meet the rapidly changing needs of mobile computing and communications device manufacturers. Finally, many of these companies' existing integrated circuit products are not currently designed to take full advantage of recently developed standards-based battery design parameters, which can enable the use of simpler and more efficient power management systems.

Most mobile computing, communications and other consumer electronics product manufacturers need mixed signal and analog integrated circuit products specifically designed to optimize the power system usage in their devices so that they can offer new devices with richer functionality and longer battery lives. These integrated circuit products 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 need to be developed using advanced design methodologies to allow manufacturers to achieve rapid time to market with their new products.

Products

O2Micro designs, develops, and markets innovative power management and security components for manufacturers of products for the computer, consumer electronics, industrial and communications markets. The company's integrated circuit products are produced with digital, analog, and mixed signal integrated circuit manufacturing processes.

Our products control and monitor battery charging and discharging, select and switch between power sources, manage and provide power for lighting of liquid crystal displays, and link external notebook plug-in cards and provide internet security.

O2Micro's products include:

- Battery chargers and controllers for notebook computers and other applications. Our products control and monitor battery charging and discharging for various battery chemistry compositions and capacities. They incorporate a variety of built-in features such as temperature monitors, voltage monitors, current monitors, voltage limiting devices, current limiting devices, and the selection and switching between power sources.

- Intelligent Inverter for the control of backlight cold cathode fluorescent lamps (CCFL) in LCD displays in notebook computers, LCD monitors, LCD televisions, Global Positioning Systems (GPS), and other mobile applications.

- DC/DC Controllers for use in providing power to portable computing sub-systems and microprocessors.

- CardBus products, including SmartCardBus, 4-in-1 Memory CardBus, and Standard CardBus for PCMCIA interface reader for the direct detection and reading of smart card, four standard flash memory media cards, and standard modem cards.

Marketing, Sales, and Customer Support

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

We sell primarily standard products to our customers and work with them on new product development. We market these products through a combination of direct sales people, independent sales representatives and distributors in Asia, Europe and North America.

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 United States, Taiwan, China and Japan for post order servicing and applications support.

Customers

We focus on the major suppliers of products to the mobile computing, display, communications and other consumer electronics markets. Many of these major suppliers use third party providers, such as electronic manufacturing services (EMS) providers or other intermediaries, to produce their products or portions of their products containing our components. Hence, the majority of our sales occur with these third party service providers.

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

	Years Ended December 31		
	(In Thousands)		
Location of customers	2002	2003	2004
Asia	$ 70,149	$ 88,548	$ 92,105
United States	31	51	53
Other regions	7	-	38
	$ 70,187	$ 88,599	$ 92,196

Manufacturing

We subcontract the manufacture of our products to wafer foundries, assembly and test companies. This "fabless" approach allows us to focus on our product development strengths, minimize fixed costs and capital expenditures, and access diverse manufacturing technologies.

We use established mainstream processes for the manufacture of our products. The value added by our products is provided by differentiated functionality rather than leading edge processes. This approach reduces our technical risks and minimizes the risks related to production capacity constraints.

Currently, the majority of our products are manufactured using 0.25 to 0.80 micron CMOS semiconductor processes. Our major wafer foundry providers include UMC, TSMC and X-FAB. We maintain second source capacity on selected products. We utilize several assembly and test service providers in Taiwan and other parts of Asia on a monthly or quarterly purchase order basis.

Competition

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

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

Intellectual Property

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, 2004, we had approximately 51 patents issued in the United States and approximately 43 patents issued in other countries. In addition, we had approximately 117 patent applications pending in the United States Patent and Trademark Office. We also had approximately 230 patent applications pending in various countries other than the United States. These patents may never be issued. Even if these patents are issued, taken together with our existing patents, they may not be sufficiently broad to protect 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. We also enter into confidentiality agreements with our employees, consultants and customers and seek to control access to, and distribution of, our other proprietary information.

We may from time to time grant rights to third parties for our patents and other intellectual property. In March 2003, we granted a limited non-exclusive license to Ricoh Company, Ltd. for our patents entitled "Integrated PC Card Host Controller for the Detection and Operation of a Plurality of Expansion Cards" (U.S. Patent No. 6,470,284 and Taiwan Patent No. 155891) and their foreign counterparts.

The laws of some foreign countries do not protect our proprietary rights to as great an extent as do the laws of the United States, and many companies have encountered substantial infringement problems in these countries, some of which are 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 or our other intellectual property rights. If we fail to adequately protect our intellectual property, it would be easier for our competitors to sell competing products.

We have initiated and are pursuing certain patent infringement actions in Taiwan. In January 2003, the Shihlin District Court in Taiwan issued a preliminary injunction prohibiting Monolithic Power Systems, Inc. or MPS from designing, manufacturing, selling, importing or displaying its MP1011A and MP1015 products. In March 2003, the Taipei District Court in Taiwan issued a preliminary injunction prohibiting Beyond Innovation Technology Co., Ltd. ("Bitek") from making, selling, using, or importing for the purposes of making, selling and using, their BIT3105, BIT3105-P & BIT3106 "high efficiency ZVS CCFL controller" related products, irrespective of their various types of package. In August 2003, the Taipei District Court issued a preliminary injunction prohibiting Bitek from designing, making, selling, displaying and importing and all other disposing acts related to its parts, which infringe on our Taiwan Patent Number 152318, including without limitation BIT3107. As of December 31, 2004, we have deposited $13.9 million with the Taiwan courts for court bonds in connection with those preliminary injunction actions and related provisional attachment actions as well as other preliminary injunction actions and

provisional attachment actions. The court bonds provide security for the enjoined party to claim damages against in the event we do not ultimately prevail in the underlying infringement action associated with the particular preliminary injunction action or provisional attachment action.

We have also been in litigation against MPS in the U.S. MPS has alleged that our OZ960, OZ961, OZ969A and OZ970 products infringe on one of their patents and a continuation of that patent. Litigation on such claim is pending in the United States District Court in the Northern District of California. We have answered MPS' claims, denying all of their substantive allegations. In addition, given the results of the claims constructions adopted by the Court on November 26, 2001 and December 27, 2002, we believe that we have meritorious defenses against MPS' allegations. On May 28, 2004, the Court granted our motion for summary judgment that MPS lacked evidence of damages. As the case currently stands, MPS will not be able to recover damages at trial but may only attempt to seek injunctive relief and attorneys' fees. Trial on these claims is currently scheduled for June 2005.

Given the inherent uncertainties in litigation, there cannot be any assurance that we will prevail in any of the pending litigations, and we cannot predict the outcome of any such litigation. If any party was to prevail in its claims against us, our operating results 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, a reduction or the elimination of the value of related inventories, and the assessment of a substantial monetary award for damages related to past sales, any of which could have a material adverse effect on our result of operations and financial condition.

ORGANIZATIONAL STRUCTURE

We are incorporated under the laws of the Cayman Islands and we are a holding company for the various subsidiaries that conduct our business on a worldwide basis. Our significant subsidiaries, all of which are wholly-owned, are:

Significant Subsidiary	Country of Incorporation	Date of Incorporation
O//2//Micro, Inc.	U.S.A.	March 1995
O//2//Micro Electronics, Inc.	Taiwan	March 1999
O//2//Micro International Japan Limited	Japan	August 1999
O//2//Micro PTE Limited-Singapore	Singapore	September 1999
O//2//Micro (Wuhan) Co., Ltd.	People's Republic of China	January 2001

O//2//Micro (Beijing) Co., Ltd.	People's Republic of China	February 2001
O//2//Micro (Shanghai) Co., Ltd.	People's Republic of China	April 2001
O//2//Micro (Chengdu) Co., Ltd.	People's Republic of China	July 2004

PROPERTY, PLANT AND EQUIPMENT

The table below describes our headquarters and the facilities where the above subsidiaries are located as of December 31, 2004:

Location	Approx. Available Square Feet	Lease Expiration
California, USA.....	37,180	not applicable
Taipei, Taiwan.....	20,779	2006
Hsin-Chu, Taiwan.....	25,450	2006
Singapore.....	7,078	2005
Shanghai, China.....	12,276	2005
Beijing, China.....	17,608	2007
Wuhan, China.....	10,884	2006
Chengdu, China.....	10,291	2005
Grand Cayman, Cayman Islands.....	1,000	2006
Tokyo, Japan.....	1,301	2006

We use our Cayman Islands facility for performing invoicing and receiving amounts payable. Research and development, marketing, applications and administrative staff are located in California. We also have sales offices in Pfluggerville, Texas and Houston, Texas. Marketing, sales, applications, worldwide production support, final inspection and shipping, and general and administrative staff are located in Hsin-Chu and Taipei, Taiwan. We have an office in Tokyo, Japan housing marketing, sales and applications staff, and offices in Singapore, Beijing, Shanghai, Wuhan and Chengdu primarily for research and development activities. We believe our current leased 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.

In May 2004, we purchased a 37,180 square foot building in Santa Clara, California housing our California operations. The purchase price was approximately $4.6 million. In March 2005, we purchased a 10,350 square foot facility in Shanghai, China for approximately $2.3 million. In May 2005, we purchased an additional 20,559 square feet of space for the Shanghai, China facility for approximately $4.9 million.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Overview

We design, develop and market high performance integrated circuits for power management and computer security applications. Our net sales have been derived primarily from the sale of mixed signal integrated circuit products to customers in the computer, consumer electronics, industrial and communications products markets.

Our net sales have grown from $70.2 million in 2002 to $88.6 in 2003 and $92.2 million in 2004. This increase in net sales was due primarily to introduction of our new products, higher unit shipments of our existing products and expansion of our customer base and the number of intermediaries we supply to. We continued to diversify our customer base and market focus entering additional market segments in the consumer electronics, industrial and communications markets. Our overall gross margin has fluctuated in the past and is likely to fluctuate in the future due to 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. New products typically have higher gross margins than products that are more mature. Gross margins on specific products we sell will typically decline over the life of these products due to competitive pressures and volume pricing agreements.

Operating expenses grew from $31.3 million in 2002 to $36.7 million in 2003 and $41.9 million in 2004. Our operating expenses increased as we continued our new product development efforts, expanded our operations and hired additional personnel. Our net income was $10.7 million in 2002, $13.2 million in 2003 and $14.1 million in 2004. We have been profitable in each quarter since the quarter ended September 30, 1999. We believe this profitability was the result of our strategy to make investments to develop new products and grow net sales, while maintaining a high level of fiscal control, product quality and customer satisfaction. Our profitability resulted in retained earnings of $31.3 million at December 31, 2004.

We utilize a fabless semiconductor business model, which means we focus on designing, developing and marketing products, while having these products manufactured by large independent semiconductor foundries. Because we are a fabless semiconductor company, we do not need to invest significant capital to manufacture semiconductor devices, and can take advantage of some of the cost-efficiencies of third-party foundries. We place purchase orders for specific quantities of packaged semiconductor devices or wafers at set prices. We also use third parties to test and assemble our products, which reduces the capital we need to invest in these activities.

We sell our products through a combination of direct sales offices, sales representatives and distributors. We have sales representatives in China, Singapore, Taiwan, and the United Kingdom, as well as one distributor in Japan. In the year ended December 31, 2004, we continued to experience increased sales activities in China.

Revenue from product sales to customers, other than distributors, is recognized at the time of shipment, including revenue that has been realized and earned. Sales through distributors are recognized when the distributors make a sale. Under certain conditions, customers may return defective products. Allowances for sales returns are provided on the basis of past experience; these provisions are deducted from sales.

Critical Accounting Policies--

Revenue Recognition and Accounts Receivable Allowances

We recognize revenue to direct customers in accordance with SEC Staff Accounting Bulletin No. 104, Revenue Recognition in Financial Statements (SAB 104). SAB 104 requires that four basic criteria must be met before revenue can be recognized: (1) persuasive evidence of an agreement exists, (2) delivery has occurred or services have been rendered, (3) the fee is fixed and determinable,

and (4) collectibility is reasonably assured. Determination of criteria (4) is based on the management's judgments regarding the collectibility of those fees.

In certain limited instances, we sell products through distributors. We have limited control over these distributors' selling of products to third parties. Accordingly we recognize revenues on sales to distributors when the distributors sell the products to third parties. We defer recognition of such sales until the product is sold by the distributors to their end customers. Products held by distributors are included in our inventory balance. Accounts receivable from distributors are recognized and inventory is relieved upon shipment as title to inventories generally transfers upon shipment at which point we have a legally enforceable right to collection under normal terms.

We make estimates of potential future product returns and sales allowances related to current period revenue. We analyze historical returns, changes in current demand, and acceptance of products when evaluating the adequacy of sales returns and allowances. Estimates may differ from actual product returns and allowances. These differences may materially impact our reported revenue and amounts ultimately collected on accounts receivable. In addition, we monitor collectability of accounts receivable primarily through review of the accounts receivable aging. When facts and circumstances indicate the collection of specific amounts or from specific customers is at risk, we access the impact on amounts recorded for bad debts and, if necessary, will record a charge in the period such determination is made. To date, we have not experienced material write-offs of accounts receivable due to uncollectability.

As of December 31, 2002, 2003 and 2004, the allowance we set aside for product returns and sales allowances was $314,000, $315,000 and $317,000, respectively, representing 0.4%, 0.4% and 0.3% of our revenue as of those dates. For the years ended December 31, 2002 and 2003, we did not have to record any additional provisions subsequent to the year ended because actual returns and sales allowances were lower than the estimated amounts. For the year ended December 31, 2004, we also did not have to record any additional provisions as of May 7, 2005.

Inventories

Our 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. Because of the cyclicality of the market, inventory levels, obsolescence of technology and the product life cycles, we write down inventories to net realizable value based on backlog, forecasted product demand and historical sales levels. Backlog is subject to revisions, cancellations and rescheduling. Actual demand and market

conditions may be lower than those projected by us. This difference could have a material adverse effect on our gross margin should inventory write downs beyond those initially recorded become necessary.

As of December 31, 2002, 2003 and 2004, we recorded inventory allowances in an aggregate amount of $1.1 million, $1.3 million and $791,000, respectively. Our inventory valuation allowances were primarily for estimated scraps and defects. For the years ended December 31, 2002 and 2003, we did not have to record any additional allowances subsequent to the year ended because actual write-offs were lower than the estimated amounts. For the year ended December 31, 2004, we also did not record any additional allowances as of May 7, 2005.

Long-Lived Assets

We evaluate the recoverability of property, plant and equipment in accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets." We perform periodic reviews to determine whether facts and circumstances exist that would indicate that the carrying amounts of property, plant and equipment might not be fully recoverable. If facts and circumstances indicate that the carrying amount of property, plant and equipment might not be fully recoverable, we compare projected undiscounted net cash flows associated with the related assets over their estimated remaining useful life against their respective carrying amounts. In the event that the projected undiscounted cash flows are not sufficient to recover the carrying value of the assets, the assets are written down to their estimated fair values based on the expected discounted future cash flows attributable to the assets. Evaluation of impairment of property, plant and equipment requires estimates in the forecast of future operating results that are used in the preparation of the expected future undiscounted cash flows. Actual future operating results and remaining economic lives of the property, plant and equipment could differ from the estimates used in assessing the recoverability of these assets. These differences could result in additional impairment charges, which could have a material adverse impact on the results of operations.

Income Taxes

Our income taxes are accounted 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 primarily the tax effects of the operating loss carryforwards and temporary differences. On a periodic basis we evaluate the deferred tax assets balance for realizability. To the extent we believe it is more likely than not that some portion of deferred tax assets will not be recognized, we will increase the valuation allowance against the deferred tax assets. Realization of the deferred tax assets is dependent primarily upon future taxable income, changes in tax laws and other factors. These changes, if any, may require possible material adjustment to the deferred tax assets, resulting in a reduction in net income in the period when such determinations are made.

Legal Contingencies

We are currently involved in various claims and legal proceedings. We periodically assess each matter in order to determine if a contingent liability in accordance with Statement of Financial Accounting Standards No. 5 (SFAS 5), "Accounting for Contingencies," should be recorded. In making the determination, we, depending on the nature of the matter, consult with external counsel and technical experts. Based on the information obtained combined with our judgment regarding all the facts and circumstances of each matter, we determine whether it is probable that a contingent loss may be incurred and whether the amount of such loss can be estimated. Should a loss be probable and estimable, we record a contingent loss in accordance with SFAS 5. In determining the amount of a contingent loss, we take into consideration advice received from experts in the specific matter, current status of legal proceedings, prior case history and other factors. Should the judgments and estimates be incorrect, we may need to record additional contingent losses that could materially adversely impact our results of operations.

Operating Results

The following table summarizes historical results of operations as a percentage of net sales for the periods shown.

	Year Ended December 31,		
	2002	2003	2004
Consolidated Statement of Operations Data:			
Net sales	100.0%	100.0%	100.0%
Cost of sales	40.1	43.2	40.6
Gross margin	59.9	56.8	59.4
Operating expenses:			
Research and development	27.0	21.7	22.0
Selling, general and administrative	16.8	15.3	17.7
Patent litigation	0.8	4.5	5.8
Stock-based compensation	0.1	-	-
Total operating expenses	44.6	41.4	45.5
Income from operations	15.3	15.4	13.9
Non-operating income-net	2.4	1.6	2.9
Income tax expenses	2.4	2.1	1.6
Net income	15.3%	14.9%	15.2%

Years Ended December 31, 2004 and 2003

Net Sales. Net sales consisted of product revenues generated principally by sales of our integrated circuit products. Net sales for the year ended December 31, 2004 were $92.2 million, an increase of $3.6 million or 4.1% from $88.6 million for the year ended December 31, 2003. This increase in net sales resulted from increased unit shipments of our existing products as well as shipments of new products and expansion of our customer base and the number of intermediaries we supply to. In 2004, we introduced new Cardbus and CCFL inverter controller products. We also enhanced the features of certain products in every existing product group in 2004 (except for Audio DJ products).

Gross Profit. Gross profit represents net sales less cost of sales. Cost of sales primarily consists of the cost of purchasing packaged integrated circuit products manufactured and assembled for us by independent foundries and packaging vendors and other costs associated with the procurement, storage and shipment of these products. Gross profit for the year ended December 31, 2004 was $54.8 million, an increase of $4.5 million or 9.0% from $50.3 million for the year ended December 31, 2003. This increase in absolute dollars was due to increased sales. Gross profit as a percentage of net sales for the year ended December 31, 2004 increased to 59.4% from 56.8% for the year ended December 31, 2003 due to increased sales of higher margin products. 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.

Research and Development Expenses. Research and development expenses consist primarily of salaries and related costs of employees engaged in research, design and development activities and, to a lesser extent, expenses for outside engineering consultants. Research and development expenses for the year ended December 31, 2004 were $20.3 million, an increase of $1.0 million or 5.4% from $19.2 million for the year ended December 31, 2003. This increase primarily reflected the addition of research and development personnel. As a

percentage of net sales, research and development expenses were 22.0% for the year ended December 31, 2004, an increase from 21.7% for the year ended December 31, 2003. Research and development expenses as a percentage of net sales will fluctuate from quarter to quarter depending on the

amount of net sales and the success of new product development efforts, which we view as critical to our future growth. At any point in time, we have many research and development projects underway, and we believe that none of these projects is material on an individual basis. We expect to continue the development of innovative technologies and processes for new products and we believe that a continued commitment to research and development is essential in order to maintain product leadership with our existing products and to provide innovative new product offerings. Therefore, we expect to continue to invest significant resources into research and development in the future.

Selling, General and Administrative Expenses. Selling, general and administrative expenses consist primarily of employee-related expenses, sales commissions to agents, professional fees, legal fees, travel and other promotional expenses. Selling, general and administrative expenses for the year ended December 31, 2004 were $16.3 million, an increase of $2.8 million or 20.9% from $13.5 million for the year ended December 31, 2003. This increase in absolute dollars was primarily due to additional personnel, additional traveling and increased sales and marketing expenses. As a percentage of net sales, selling, general and administrative expenses were 17.7% for the year ended December 31, 2004, an increase from 15.3% for the year ended December 31, 2003. We expect that selling, general and administrative expenses will continue to increase in absolute dollars for the foreseeable future.

Patent Litigation Expenses. Patent litigation expenses consist primarily of fees paid to outside counsel and consultants engaged by outside counsel. Patent litigation expenses for the year ended December 31, 2004 were $5.3 million, an increase of $1.4 million or 34.9% from $4.0 million for the year ended December 31, 2003. This increase in absolute dollars was primarily due to increased litigation activity in existing cases and filing of additional litigation by us. As a percentage of net sales, patent litigation expenses were 5.8% for the year ended December 31, 2004, an increase from 4.5% for the year ended December 31, 2003. We expect that patent litigation expenses will continue to fluctuate for the foreseeable future. (Please see also, "Business Overview - Intellectual Property.")

Non-operating Income-net. Non-operating income-net reflects interest earned on average cash balances, less interest on borrowings, foreign exchange transaction gains and losses, gain on sales of long-term investments and impairment loss on investment in shares of stock. Non-operating income-net was $2.7 million for the year ended December 31, 2004 increasing from $1.4 million for the year ended December 31, 2003, reflecting additional foreign exchange transaction gains and gains on sales of long-term investments.

Income Taxes. Income tax expenses were $1.5 million for the year ended December 31, 2004, compared to income tax expenses of $1.8 million for the year ended December 31, 2003. This decrease in the amount of our income tax expenses was primarily due to a change in the global sales mix and the reversal of additional income tax payable for the 2000 tax year as a result of an examination and approval of our 2000 income tax return by the local Taiwan tax office authority. The effective tax rate was 9.5% for the year ended December 31, 2004, compared to 12.2% for the year ended December 31, 2003.

Years Ended December 31, 2003 and 2002

Net Sales. Net sales consisted of product revenues generated principally by sales of our integrated circuit products. Net sales for the year ended December 31, 2003 were $88.6 million, an increase of $18.4 million or 26.2% from $70.2 million for the year ended December 31, 2002. This increase in net sales resulted from increased unit shipments of our existing products as well as shipments of new products and expansion of our customer base and the number of intermediaries we supply to. In 2003, we introduced Cardbus Power Switch (OZ2216) and Cardbus Security (OZH31B) products. We also enhanced the features of certain products in every existing product group in 2003.

Gross Profit. Gross profit represents net sales less cost of sales. Cost of sales primarily consists of the cost of purchasing packaged integrated circuit products manufactured and assembled for us by independent foundries and packaging vendors and other costs associated with the procurement, storage and shipment of

these products. Gross profit for the year ended December 31, 2003 was $50.3 million, an increase of $8.2 million or 19.6% from $42.0 million for the year ended December 31, 2002. This increase in absolute dollars was due to increased sales. Gross profit as a percentage of net sales for the year ended December 31, 2003 decreased to 56.8% from 59.9% for the year ended December 31, 2002 due to increased sales of lower margin products. 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.

Research and Development Expenses. Research and development expenses consist primarily of salaries and related costs of employees engaged in research, design and development activities and, to a lesser extent of, expenses for outside engineering consultants. Research and development expenses for the year ended December 31, 2003 were $19.2 million, an increase of $284,000 or 1.5% from $18.9 million for the year ended December 31, 2002. This increase primarily reflected the addition of research and development personnel. As a percentage of net sales, research and development expenses were 21.7% for the year ended December 31, 2003, a decrease from 27.0% for the year ended December 31, 2002. Research and development expenses as a percentage of net sales will fluctuate from quarter to quarter depending on the amount of net sales and the success of new product development efforts, which we view as critical to our future growth. At any point in time, we have many research and development projects underway, and we believe that none of these projects is material on an individual basis. We expect to continue the development of innovative technologies and processes for new products and we believe that a continued commitment to research and development is essential in order to maintain product leadership with our existing products and to provide innovative new product offerings. Therefore, we expect to continue to make significant research and development investments in the future.

Selling, General and Administrative Expenses. Selling, general and administrative expenses consist primarily of employee-related expenses, sales commissions to agents, professional fees, legal fees, travel and other promotional expenses. Selling, general and administrative expenses for the year ended December 31, 2003 were $13.5 million, an increase of $1.7 million or 14.7% from $11.8 million for the year ended December 31, 2002. This increase in absolute dollars was primarily due to additional personnel, additional traveling and increased sales commissions relating to higher sales. As a percentage of net sales, selling, general and administrative expenses were 15.3% for the year

ended December 31, 2003, a decrease from 16.8% for the year ended December 31, 2002. We expect that selling, general and administrative expenses will continue to increase in absolute dollars for the foreseeable future.

Patent Litigation Expenses. Patent litigation expenses consist primarily of fees paid to outside counsel and consultants engaged by outside counsel. Patent litigation expenses for the year ended December 31, 2003 were $4.0 million, an increase of $3.4 million or 639.1% from $535,000 for the year ended December 31, 2002. This increase in absolute dollars was primarily due to increased litigation activity in existing cases and filing of additional litigation by us. As a percentage of patent litigation expenses were 4.5% for the year ended December 31, 2003, an increase from 0.8% for the year ended December 31, 2002. We expect that patent litigation expenses will continue to fluctuate for the foreseeable future. (Please see also, "Business Overview - Intellectual Property.")

Stock-based Compensation. For accounting purposes, we recognize deferred stock-based compensation whenever we grant options or warrants to purchase our ordinary shares to employees with exercise prices that are less than the deemed fair market value of the underlying shares at the grant date and whenever we grant options or warrants to consultants. Amortization of deferred stock-based compensation recorded in the year ended December 31, 2003 was $0, a decrease of $44,000 or 100.0% from $44,000 for the year ended December 31, 2002.

Non-operating Income-net. Non-operating income-net reflects interest earned on average cash balances, less interest on borrowings, impairment loss on investment in shares of stock and foreign exchange transaction gains and losses. Non-operating income-net was $1.4 million for the year ended December 31, 2003

decreasing from $1.7 million for the year ended December 31, 2002, reflecting less interest earned in our cash and short-term investment.

Income Taxes. Income tax expenses were $1.8 million for the year ended December 31, 2003, compared to income tax expenses of $1.7 million for the year ended December 31, 2002. This increase in the amount of our income tax expenses was primarily due to increase in our net income. The effective tax rate was 12.2% for the year ended December 31, 2003, compared to 13.5% for the year ended December 31, 2002.

Liquidity and Capital Resources

Since our inception, we have financed our operations primarily through private sales of securities and through our initial public offering in August 2000 and our public offering in November 2001 as well as cash provided by operating activities in recent years. Cash and short-term investments were $120.1 million at December 31, 2004 as compared to $120.4 million at December 31, 2003. Our operating activities provided cash in the amount of $14.1 million in the year ended December 31, 2004, $14.8 million in the year ended December 31, 2003 and $9.5 million in the year ended December 31, 2002.

Non-cash charges consist of depreciation of fixed assets, impairment of investment in shares of stock, changes of deferred income tax assets and amortization of stock-based compensation from stock options and warrants. The working capital components that have a significant impact on our cash flows are accounts receivable, inventory, notes, accounts payable, prepaid expenses and other current assets, income tax payable and accrued liabilities.

These net cash inflows for operations resulted from net income offset by

increases in inventory and accounts receivable due to increased sales and also resulted from increases in notes and accounts payable, income tax payable and accrued liabilities.

Our investing activities used cash of $25.2 million in the year ended December 31, 2004, $23.5 million in the year ended December 31, 2003 and $34.7 million in the year ended December 31, 2002. Investing activities in the year ended December 31, 2004 primarily represented increase in short-term investments, acquisition of land, property and equipment and additional long-term investments. Investing activities in the year ended December 31, 2003 primarily represented the increases of short-term investments and the increase of restricted assets. Investing activities in the year ended December 31, 2002 primarily represented short-term investments, investment in shares of stock and purchases of capital equipment. In the year ended December 31, 2004, there were net purchases of $11.0 million in short-term investments and $1.9 million increase of restricted assets. In the year ended December 31, 2003, there were net purchases of $11.0 million in short-term investments and $10.0 million increase of restricted assets. In the year ended December 31, 2002, there were net purchases of $22.3 million on short-term investments, $7.0 million investment in shares of stocks and $4.3 million purchase of capital equipment. In the year ended December 31, 2004, we sold 1,000,000 shares of stock in 360 Degree Web for $1.0 million, purchased $313,000 of stock in Etrend Hightech and purchased $4.5 million of common stock in CSMC Technologies Corporation.

Net cash provided by financing activities was $946,000 in the year ended December 31, 2004, primarily due to exercise of stock options and issuance of shares under our Employee Stock Purchase Plan and offset by repurchases of our stock under a share repurchase program. Net cash provided by financing activities was $5.9 million in the year ended December 31, 2003, primarily due to exercises of stock options and issuance of shares under our Employee Stock Purchase Plan, offset by repurchases of our stock from shareholders under share repurchases program. Net cash used in financing activities was $4.4 million in the year ended December 31, 2002, primarily due to repurchases of our stock under the Company's existing share repurchase program offset by proceeds from the exercise of stock options, exercise of warrants and issuance of shares under Employee Stock Purchase Plan.

We believe our cash balances will be sufficient to meet our capital requirements for at least the next 12 months. Our future capital requirements will depend on many factors, including the inventory levels we maintain, the level of investments we make in new technology and improvements to existing technology, the levels of promotion and advertising required to launch new products and attain competitive position in the marketplace, and the market acceptance of our products. Thereafter, we may need to raise additional funds through public or private financing. No assurance can be given that additional funds will be available or that we can obtain additional funds on terms favorable to us.

Research and Development, Patents and Licenses, etc.

We believe that the continued introduction of new products in our target markets is essential to our growth. As of December 31, 2004, we had approximately 257 full-time employees world-wide engaged in research and development efforts. Our total expenditures for research and development were $20.3 million for the year ended December 31, 2004, $19.2 million for the year ended December 31, 2003, and $18.9 million for the year ended December 31, 2002. We believe that our research and development staffing will increase in the next 12 months primarily due to the expansion of our existing design centers and the

opening of additional design centers in China.

We employ designers who have the necessary engineering and systems qualifications and are experienced in system architecture, analog, digital, mixed signal and software design and development. We also utilize independent contractors from time to time for specific research and development projects. Our internal research and development personnel thoroughly review the external development processes and the design of these products as part of our quality assurance process. All development is carried out using ISO 9001 certified design processes, and our design tools are continuously enhanced to improve design, fabrication and verification of our products.

We work with our customers to monitor the performance of our product designs and to provide support at each stage of customer product development. Due to the complexity of our products, we maintain a significant direct applications support staff for customer technical support in our key markets - Japan, Taiwan, China, Korea and the United States. These direct applications engineering personnel assist with capturing business and supporting existing products at key customers. Additionally, we work closely with our customers to develop highly efficient power management products for specific mobile applications.

Trend Information

See "Risk Factors" and "Operating and Financial Review and Prospects" above.

Off-Balance Sheet Arrangements

There are no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

Tabular Disclosure of Contractual Obligations

The table below describes our contractual obligations as of December 31, 2004:

	Payments due by period				
Contractual Obligations	Total	Less than 1 year	1-3 years	3-5 years	M
	(in thousands)				
Operating Lease Obligations.....	$ 1,340	$ 998	$ 342	$	$
Licenses, Maintenance and Support.....	547	304	243	-	
Total.....	1,887	1,302	585	-	

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

Directors and Senior Management

Our executive officers and directors and their ages as of December 31,

2004, were as follows:

Name	Age	Position
Sterling Du.....	45	Chief Executive Officer, Class I Director and Chairman of Board
Chuan Chiung "Perry" Kuo.....	45	Chief Financial Officer, Class I Director and Secretary
Ivan Chang	42	Vice-President, Finance
Johnny Chiang	47	Vice-President, Logistics and Backend
James Keim.....	60	Class II Director and Head of Marketing and Sales
Michael Austin.....	69	Class III Director
Geok Ling Goh.....	63	Class I Director and member of Audit Committee
Lawrence Lin.....	54	Class II Director and member of Audit Committee
Keisuke Yawata.....	70	Class III Director and member of Audit Committee

Sterling Du has served as our chief executive officer and chairman of our board of directors since March 1997 and as a Class I Director since June 2001. He also served as our chief financial officer from March 1997 to March 1999. From May 1995 to March 1997, Mr. Du was president and chief executive officer of O//2//Micro, Inc., our predecessor entity. From October 1993 to April 1995, Mr. Du was vice president of engineering at GreenLogic, Inc., a semiconductor design company, which he co-founded. Mr. Du received a B.S. in chemical engineering from National Taiwan University and an M.S. in electrical engineering from the University of California, Santa Barbara.

Chuan Chiung "Perry" Kuo has served as our general manager of Taiwan operations since January 1997, as chief financial officer and a director since March 1999, as secretary since October 1999 and as a Class I director since June 2001. From February 1992 to December 1996, he was executive vice president of Pac Net Group, a holding company with investments in chemicals, electronics and real estate. From July 1983 to February 1992, he held various positions at Formosan Rubber Group, a rubber manufacturer, including product design engineer, plant manager, research and development director, and vice president. Mr. Kuo received a B.S. in chemical engineering from National Taiwan University and an M.B.A. from the Rotterdam School of Management, Erasmus University in The Netherlands.

Ivan Chang has served as our Vice-President, Finance since February 2003. He also served as our Controller from July 1999 until February 2003. From August 1996 to July 1999, he was Finance Manager at Siemens Limited in Taiwan. Mr. Chang received a B.S. in Accounting from Soochow University and an M.S. in Accounting Information from University of Maryland, College Park.

Johnny Chiang has served as our Vice-President, Logistics and Backend since February 2003. He also served as our Director of Operations from March 1999 to February 2003 and our Operations Manager from November 1997 to March 1999. Mr. Chiang received a B.S. in Industrial Engineering from Chung Yung University.

James Keim has served as a director since March 1999 and as Head of Marketing and Sales since December 2001 and a Class II director since June 2001. He also served as our chief operating officer from June 1998 to June 2001. From March 1995 to June 1998, Mr. Keim was a principal in Global Marketing Associates, an international consulting firm. Prior to March 1995, he had been

vice president of sales at Alliance Semiconductor Corporation, vice president of marketing at Performance Semiconductor Corporation and worldwide linear marketing manager at Fairchild Semiconductor Corporation. Mr. Keim received a B.S. in engineering from Iowa State University, an M.S. in electrical engineering and an M.B.A. from the University of Illinois.

Michael Austin has served as a director since October 1997 and as a Class III director since June 2001. Mr. Austin is a resident of the Cayman Islands and is a Chartered Accountant. Mr. Austin was admitted as an Associate of the Institute of Chartered Accountants in England and Wales in 1964 and as a Fellow in 1969. Mr. Austin is also an Associate Member of The Chartered Institute of Taxation, a Member of the Society of Trust and Estate Practitioners, and a Notary Public of the Cayman Islands. Mr. Austin served as the managing partner of the Cayman Islands office of KPMG Peat Marwick, an international accounting firm, for 23 years. Since retiring in July 1992, Mr. Austin has been a consultant and currently serves as a non-executive director on several company boards, including those of a number of mutual funds, trust and insurance companies. He serves as a director of Scottish Re, a public company. Mr. Austin served as a director of the Cayman Islands Monetary Authority from January 1997, and was appointed Chairman of the Board in January 2003, a position he held until his retirement on July 31, 2004. He has also served on a variety of other government committees and government related boards, including the Cayman Islands Agricultural and Industrial Development Board, as Chairman; the Stock Exchange Committee; and the Government/Private Sector Consultative Committee. In 1990 Mr. Austin was awarded an M.B.E. by Her Majesty the Queen in recognition of services to the public and business community.

Geok Ling Goh has served as a director since January 2000, as a member of the Audit Committee since August 2000 and as a Class I director since June 2001. From October 1998 to October 1999, he was the managing director of Micron Semiconductor Asia Pte Ltd. From June 1970 to October 1998, he held various positions at Texas Instruments Singapore Pte Ltd, including Vice-President of Marketing and in 1993, the first local managing director of Texas Instruments Singapore Pte Ltd. He serves as the Chairman of Tuas Power and as a director on the boards of Sembcorp Industries Ltd., Plato Capital Ltd. (formerly PKTech International Ltd), Venture Corporation Ltd., DBS Group Holdings Ltd. and DBS Bank Ltd. He also serves as a council member of Nanyang Technology University. He received a bachelor of engineering degree from Sydney University.

Lawrence Lin has served as a Class II director and member of the Audit Committee since June 2003. He is a Certified Public Accountant in Taiwan. Mr. Lin co-founded L&C Company, Certified Public Accountants, a member firm of Urbach Hacker Young International, in 1990. Mr. Lin has been a partner of L&C Company since 1990 and a Director of Urbach Hacker Young International from October 1994 to October 1998. Prior to L&C Company, he had been a partner at T N Soong & Co. Mr. Lin serves as Corporate Supervisor for a number of Taiwan companies including Cellink Company Limited and Tex Year Industries Inc. He received a bachelor of science degree from Taipei Vocational Commerc