

DIRECTORS' REPORT

Directors

The Directors of our Company as at the date of this annual report are as follows:

Executive Directors

Sterling Du
Chuan Chiung "Perry" Kuo
James Elvin Keim

Independent non-executive Directors

Michael Austin
Geok Ling Goh
Lawrence Lai-Fu Lin
Keisuke Yawata
Xiaolang Yan

Details of each member of the Board are set out in the "Directors and Senior Management" section on pages 19 to 20 of this annual report.

Our Company has received annual confirmation from each of the independent non-executive Directors of his independence pursuant to Rule 13.13 of the Listing Rules and our Company is satisfied of their independence.

Directors' Service Contracts

None of the Directors has a service contract with our Company which is not determinable by our Company within one year without payment of compensation, other than statutory compensation.

Directors' interests in contracts of significance

No contracts of significance subsisted during or at the end of the financial year in which a Director is or was materially interested.

Directors' Interests in Shares and Underlying Shares

As at December 31, 2005, there was no interest or short position of any of our Directors or chief executive officer in any of our, or our associated corporation's, (within the meaning of Part XV of the Securities and Futures Ordinance, Chapter 571 of the laws of Hong Kong (the "SFO")) shares, underlying shares or debentures required to be recorded in the register maintained by us under Section 352 of the SFO, or notified to us and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO as we were not listed on the Stock Exchange on that date.

We became a listed company in Hong Kong on March 2, 2006. As at the date of this annual report, the interests or short positions of our Directors and chief executive officer in any of our, or our associated corporation's, (within the meaning of Part XV of the SFO) shares, underlying shares or debentures which were required to be recorded in the register maintained by us under Section 352 of the SFO, or notified to us and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO are as follows:

Name of Director	Name of Corporation	Nature of interest	Total number of Shares	Approximate percentage interest in the Company ⁽⁹⁾
Sterling Du	O2Micro International Limited	Personal Interest ⁽¹⁾	116,085,000	5.94%
		Interest of Child under 18	29,907,500	1.53%
Chuan Chiung "Perry" Kuo...	O2Micro International Limited	Personal Interest ⁽²⁾	18,687,500	0.96%
James Elvin Keim	O2Micro International Limited	Personal Interest ⁽³⁾	15,844,400	0.81%
		Corporate Interest ⁽³⁾	10,420,000	0.53%

Michael Austin	O2Micro International Limited	Personal Interest ⁽⁴⁾	4,450,000	0.23%
Geok Ling Goh	O2Micro International Limited	Personal Interest ⁽⁵⁾	3,400,000	0.17%
Keisuke Yawata	O2Micro International Limited	Personal Interest ⁽⁶⁾	3,375,000	0.17%
Lawrence Lai-Fu Lin	O2Micro International Limited	Personal Interest ⁽⁷⁾	3,000,000	0.15%
Xiaolang Yan	O2Micro International Limited	Personal Interest ⁽⁸⁾	3,000,000	0.15%

Notes:

- Mr. Du beneficially owns 107,992,500 Shares. In addition, Mr. Du holds options to purchase an aggregate of 38,000,000 Shares, if fully exercised. As at the date of this document, none of these options has been exercised.*
- Mr. Kuo beneficially owns 5,937,500 Shares. In addition, Mr. Kuo holds options to purchase an aggregate of 12,750,000 Shares, if fully exercised. As at the date of this document, none of these options has been exercised.*
- Mr. Keim and his spouse jointly and beneficially own 94,400 Shares. Mr. Keim holds options to purchase an aggregate of 15,750,000 Shares, if fully exercised. As at the date of this document, none of these options has been exercised. In addition, Mr. Keim has a controlling interest in two private companies which hold an aggregate of 10,420,000 Shares.*
- Mr. Austin has been granted options to purchase an aggregate of 4,450,000 Shares, if fully exercised. As at the date of this document, none of these options has been exercised.*
- Mr. Goh has been granted options to purchase an aggregate of 3,400,000 Shares, if fully exercised. As at the date of this document, none of these options has been exercised.*
- Mr. Yawata beneficially owns 653,500 Shares. In addition, Mr. Yawata holds options to purchase an additional 2,721,500 Shares, if fully exercised. As at the date of this document, none of these options has been exercised.*
- Mr. Lin has been granted options to purchase an aggregate of 3,000,000 Shares, if fully exercised. As at the date of this document, none of these options has been exercised.*
- Mr. Yan has been granted options to purchase an aggregate of 3,000,000 Shares, if fully exercised. As at the date of this document, none of these options has been exercised.*
- The above percentage figures are calculated based on our issued and outstanding share capital as at the date of this report without taking into account any Shares which may be issued under our Existing Equity Incentive Plans, the 2005 Share Option Plan and 2005 Share Incentive Plan.*

Substantial Shareholders' Interests in Shares and Underlying Shares

As at December 31, 2005, there was no interest or short position of persons, other than our Directors and chief executive officer, in our shares and underlying shares required to be notified to us pursuant to the provisions of Divisions 2 and 3 of Part XV of the SFO, or who were directly or indirectly interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at the general meetings of any other member of the Group as we were not listed on the Stock Exchange on that date.

As at the date of this report, based on the most recent filings with the U.S. Securities and Exchange Commission, the interests or short positions of persons, other than our Directors and chief executive officer, in our shares and underlying shares as required to be notified to us pursuant to the provisions of Divisions 2 and 3 of Part XV of the SFO, or who were directly or indirectly interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at the general meetings of any other member of the Group are as follows:

Name of Substantial Shareholder	Nature of interest	Total number of Shares	Approximate percentage Interest in our Company
Wasatch Advisors, Inc.	Beneficial owner	333,911,750	17.09
Fidelity Management & Research Company	Beneficial owner	286,780,450	14.68
Capital Research and Management Company	Beneficial owner	194,750,000	9.97

Pre-emptive rights

There are no pre-emptive or similar rights under Cayman Islands law or our Memorandum and Articles of Association which would oblige us to offer new shares on a pro-rata basis to its existing shareholders.

Major customers and suppliers

For the year ended December 31, 2005, sales to our largest customer accounted for 8.3% of our net sales and the aggregate sales to our top five customers represented 30.4% of our net sales.

For the year ended December 31, 2005, our five largest suppliers accounted for approximately 76.2% of our total purchases, while our largest supplier accounted for approximately and 31.1% of our total purchases.

None of the Directors or their respective associates or, as far as the Directors are aware, any other shareholders owning more than 5% of our share capital were interested in any of our five largest suppliers and customers.

Sufficiency of public float

We have maintained a sufficient public float since the date of our listing on the Stock Exchange.

Re-purchase of listed securities

During the year ended December 31, 2005, we repurchased an aggregate of 20,420,000 Shares on the following dates and at the following purchase prices:

Date of Purchase	Total Number of Shares	Purchase Price per Share
March 18, 2005.....	1,250,000	US\$0.1950
March 21, 2005.....	750,000	US\$0.1963
March 22, 2005.....	1,500,000	US\$0.2001
April 11, 2005.....	370,000	US\$0.1931
April 13, 2005.....	750,000	US\$0.1954
April 18, 2005.....	770,000	US\$0.1891
November 30, 2005	500,000	US\$0.2341
December 1, 2005	750,000	US\$0.2384
December 2, 2005	900,000	US\$0.2366
December 5, 2005	1,250,000	US\$0.2354
December 6, 2005	500,000	US\$0.24
December 8, 2005	1,250,000	US\$0.2307
December 9, 2005	1,500,000	US\$0.2288
December 12, 2005	1,000,000	US\$0.2237
December 13, 2005	1,500,000	US\$0.22
December 16, 2005	1,500,000	US\$0.1988
December 19, 2005	80,000	US\$0.178
December 20, 2005	1,200,000	US\$0.20
December 21, 2005	100,000	US\$0.2006
December 23, 2005	1,000,000	US\$0.2045
December 27, 2005	500,000	US\$0.20
December 28, 2005	750,000	US\$0.1995
December 30, 2005	750,000	US\$0.203
Total Number of Shares Repurchased in 2005.....	20,420,000	

Pension schemes

We have a savings plan that qualifies under Section 401(k) of the United States Internal Revenue Code of 1986 (the "U.S. Internal Revenue Code") and is a defined contribution plan. Each year, participating employees may contribute to the savings plan up to the U.S. Internal Revenue Service annual statutory limit amount of pretax salary.

There is no matching by our Company of employee contributions to the savings plan and our Company has not made any contributions to the savings plan since its inception. There is no pension cost charged to our Company's income statement with respect to the savings plan in 2005. An employee who terminates employment with our Company (1) is entitled to a complete return of all amounts contributed by such employee to the savings plan or (2) may "roll-over" such contributions to another qualified plan. There are no vesting or other requirements which an employee must fulfill in order to be entitled to return or "roll-over" of amounts contributed to the savings plan upon termination of employment.

Our Company does not maintain any defined benefit plan.

Equity Based Plans

1999 Employee Stock Purchase

The following is a summary of the principal terms of the 1999 Employee Stock Purchase Plan (the "ESPP") which was adopted by our Board and Shareholders in October 1999 and amended in October 2005.

(a) *Purpose of the ESPP*

The purpose of the ESPP is to attract and retain the best available personnel, to provide additional incentives to employees and to promote the success of our business.

(b) *Who may join*

All employees who are regularly employed for more than five months in any calendar year and work more than 20 hours per week are eligible to participate in the ESPP, subject to a 10-day waiting period after hiring. Non-employee directors, consultants and employees subject to the rules or laws of a non-U.S. jurisdiction that prohibit or make impracticable their participation in the ESPP will not be eligible to participate.

(c) *Number of securities available for issue under the ESPP*

As at the date of this annual report, an aggregate of 21,523,150 shares are available for issuance under the ESPP, representing approximately 1.1% of our issued share capital.

(d) *Individual Limit*

Unless otherwise permitted under the Listing Rules, the total number of Shares subject to options and purchase rights granted by us under the ESPP (or any other of our share incentive plans) to an employee (including both exercised and outstanding options) in any 12-month period may not exceed 1% of the Shares outstanding at the date of such grant. If such grant would cause the total number of Shares subject to options and purchase rights to exceed 1% of the Shares outstanding on the date of grant, such grant must be approved by our Shareholders at a general meeting.

The maximum number of Shares that any employee may purchase under the ESPP during a purchase period is 100,000 Shares. The U.S. Internal Revenue Code imposes additional limitations on the amount of common stock that may be purchased during any calendar year.

(e) *Purchase Rights*

The ESPP is intended to qualify as an "Employee Stock Purchase Plan" under Section 423 of the Internal Revenue Code in order to provide our employees with an opportunity to purchase common stock through payroll deductions.

The ESPP will designate offer periods, purchase periods and exercise dates. Offer periods (and purchase periods) are 3 months in duration and commence on each February 1, May 1, August 1 and November 1. Exercise dates are the last day of each purchase period.

On the first day of each offer period, a participating employee will be granted a purchase right. A purchase right will automatically be exercised at the end of the purchase period during which authorized deductions are to be made from the pay of participants and credited to their accounts under the ESPP. When the purchase right is exercised, the participant's withheld salary is used to purchase Shares. Payroll deductions may range from 1% to 10% in whole percentage increments of a participant's regular base pay and shall commence on the first day of each offer period.

Upon termination of a participant's employment relationship, the payroll deductions credited to such participant's account during the offer period but not yet used to exercise the option will be returned to such participant or, in the case of his/her death, to the person or persons entitled and such participant's option will be automatically terminated.

(f) *Administration of the ESPP*

The Board or a committee designated by the Board (the "Administrator") administers the ESPP. The Administrator has full and exclusive discretionary authority to construe, interpret and apply the terms of the ESPP, to determine eligibility and to adjudicate all disputed claims filed under the ESPP. Unless otherwise specified by the Administrator, there is no performance target that needs to be achieved by the participant before a purchase right can be exercised nor any minimum period for which a purchase right must be held before a purchase right can be exercised.

(g) *Purchase Price*

The price per Share at which Shares are purchased under the ESPP will be expressed as a percentage not less than the lower of (i) 90% of the fair market value of the Shares on the date of grant of the purchase right (which is the commencement of the offer period) or (ii) 90% of the fair market value of the Shares on the date the purchase right is exercised. We have obtained from the Stock Exchange a waiver from strict compliance with Listing Rule 17.03(9) relating to the discounted exercise price of option grants under the ESPP. We requested the waiver on the basis of the following reasons: the ESPP satisfies all other requirements of Chapter 17 of the Listing Rules except that the exercise price for the purchase of Shares will be at a discount to the market price of the underlying Shares on the date of grant; the ESPP is a plan designed to provide tax benefits to our U.S. employees; the price per Share at which Shares are to be purchased under the ESPP will be not less than the lower of (i) 90% of the fair market value of the Shares on the date of grant of the purchase right, or (ii) 90% of the fair market value of the Shares on the date that the purchase right is exercised; the ESPP operates as a savings-related share purchase plan which enables employees to purchase Shares through payroll deduction; all of our employees who meet certain minimum work and hour requirements are eligible to participate in the ESPP; notwithstanding the fact that the plan is designed for U.S. tax benefit purposes, all employees are eligible to participate in the ESPP; and that we propose to maintain the listing of our Shares on the Nasdaq and the ESPP satisfies the requirements of the tax regulations in the U.S.

(h) *Period of the ESPP*

Unless terminated sooner, the ESPP will terminate ten years after its initial adoption.

2005 Share Option Plan

The following is a summary of the principal terms of the 2005 Share Option Plan (the "SOP") adopted by us on March 2, 2006.

(a) *Purpose of the SOP*

The purpose of the SOP is to attract and retain the best available personnel, to provide additional incentives to employees, Directors and consultants and to promote the success of our business.

(b) *Who may join*

The Board or any committee composed of members of the Board appointed by the Board to administer the SOP (the "Administrator") may, at its discretion, select the employees, Directors and consultants to whom the options under the SOP (the "Options") may be granted.

(c) *Number of securities available for issue under the SOP*

As at the date of this annual report, an aggregate of 98,590,500 shares are available for issuance under the SOP, representing approximately 5.1% of our issued share capital.

(d) *Share options*

Each option shall be designated as an Incentive Share Option or a Non-Qualified Share Option. Subject to the terms of the SOP, the Administrator shall determine the provisions, terms and conditions of each Option. Such terms and conditions shall be specified in written agreements evidencing the grant of the Option (an "Option Agreement").

An Incentive Option is an Option intended to qualify as an incentive stock option within the meaning of section 422 of the Internal Revenue Code. A Non-Qualified Share Option is an option which is not intended to qualify as an Incentive Share Option. Non-Qualified Share Options may be granted to employees, Directors and consultants. The terms of Incentive Share Options must comply with specific requirements set forth under Section 422 of the U.S. Internal Revenue Code. For example, Incentive Share Options are subject to restrictions with respect to the exercise price of the option, the transferability of the option and holding periods applicable to the shares acquired upon exercise of an Incentive Share Option. Also, Incentive Share Options may be granted only to our employees or the employees of our parent or subsidiary. As a result of satisfying such requirements, Incentive Share Options are eligible for preferential treatment under United States income tax rules.

(e) *Individual Limit*

Unless otherwise permitted under the Listing Rules, the total number of Shares subject to Options granted by us under the SOP (or any other of our share incentive plans) to an employee, Director or consultant who receives an Option (a "Grantee") (including both exercised and outstanding options) in any 12 month period, may not exceed 1% (or 0.1% in the case of an "independent non-executive director" as the term is used in the Listing Rules) of the Shares outstanding at the date of such grant. If such grant would cause the total number of Shares subject to options to exceed 1% (or 0.1% in the case of an "independent non-executive director") of the Shares outstanding on the date of grant, such grant must be approved by our Shareholders at a general meeting.

(f) *Exercise of Option*

An Option shall be exercisable at such times and under such conditions as determined by the Administrator under the terms of the SOP and specified in the Option Agreement. An Option shall be deemed to be exercised when written notice of such exercise has been given to us in accordance with the terms of the Option Agreement by the person entitled to exercise the Option and full payment for the Shares with respect to which the Option is exercised has been made.

(g) *Administration of the SOP*

The Administrator shall be responsible for the administration of the SOP. Unless otherwise specified by the Administrator, there is no amount payable upon receipt of an Option, performance target that needs to be achieved by the participant before an Option can be exercised nor any minimum period for which an Option must be held before an Option can be exercised (subject to any applicable vesting schedule for the Option).

(h) *Exercise Price*

The exercise price for an Incentive Share Option granted to an employee who, at the time of the grant of such Incentive Share Option, owns shares representing more than 10% of the voting power of all classes of shares of our Company or any parent or subsidiary of our Company shall not be less than 110% of the greater of (1) the fair market value (as defined in the SOP) per Share on the date of grant (which must be a trading day)

and (2) the average fair market value per Share for the five trading days immediately preceding the date of grant. No amounts are payable upon receipt or acceptance of an Incentive Share Option by an employee.

The exercise price for an Incentive Share Option granted to an employee other than an employee described above shall not be less than 100% of the greater of (1) the fair market value per Share on the date of grant (which must be a trading day) and (2) the average fair market value per Share for the five trading days immediately preceding the date of grant.

The exercise price for a Non-Qualified Share Option shall not be less than 100% of the greater of (1) the fair market value per Share on the date of grant (which must be a trading day) and (2) the average fair market value per Share for the five trading days immediately preceding the date of grant.

(i) *Period of the SOP*

The SOP shall continue for a term of 10 years from the date of our listing on the Stock Exchange unless terminated earlier.

The term of each Option shall be as stated in the Option Agreement, provided however, that the term of an Option shall be no more than 10 years from the date of grant of that Option. However, in the case of an Incentive Share Option granted to a Grantee who, at the time the Option is granted, owns Shares representing more than 10% of the voting power of all our classes of shares or the shares of our parent or subsidiary, the term of the Incentive Stock Option shall be five years from the date of grant of that Option or such shorter term as may be provided in the Option Agreement. The specified term of any Option shall not include any period for which the Grantee has elected to defer the receipt of the Shares or cash issuable pursuant to the Option.

2005 Share Incentive Plan

The following is a summary of the principal terms of the 2005 Share Incentive Plan (the "SIP") adopted by us on March 2, 2006.

(a) *Purpose of the SIP*

The purpose of the SIP is to attract and retain the best available personnel, to provide additional incentives to employees, Directors and consultants and to promote the success of our business.

(b) *Who may join*

The Board or any committee composed of members of the Board appointed by the Board to administer the SIP (the "Administrator") may, at its discretion, select the employees, Directors and consultants to whom the awards under the SIP (the "Awards") may be granted (the "Grantee").

(c) *Number of securities available for issue under the SIP*

As at the date of this annual report, an aggregate of 75,000,000 shares have are available for issuance under the SIP, representing approximately 3.8% of our issued share capital.

(d) *Awards*

The Administrator may award any type of arrangement to a Grantee that is not inconsistent with the provisions of the SIP and that by its terms involves or might involve the issuance of restricted Shares, cash, dividend equivalent rights, restricted Share units or stock appreciation right ("SAR") or similar right with a fixed or variable price related to the fair market value of the Shares and with an exercise or conversion privilege related to the passage of time, the occurrence of one or more event, or the satisfaction of performance criteria or other conditions. Each Award shall be designated in a written agreement evidencing the grant of an Award (the "Award Agreement").

An SAR entitles the Grantee to receive an amount in cash (or Shares) equal to the excess, if any, of the fair market value of a Share at the time of exercise of the SAR over the base appreciation amount. A dividend equivalent right entitles the Grantee to receive cash compensation measured by the dividends paid with respect to a Share. Restricted Shares are transferred to the Grantee either at a specified price or for no consideration, but

the Shares are nontransferable and subject to the restriction that the Shares must be returned to the employer (or sold back at the original price) if the Grantee terminates service prior to a specified time. Typically, a portion of the total restricted Shares becomes vested, i.e., freed of restrictions, annually over a period of years. In connection with the issuance of restricted Share units, units are granted (for no consideration) that do not represent any actual ownership interest in the company. The units granted correspond in number and value to a specified number of Shares. No actual Shares are issued. The units may be subject to forfeiture provisions to replicate the treatment of restricted Shares. The units can ultimately be paid in cash or Shares.

(e) *Limit of the SIP*

Subject to the terms of the SIP, the maximum aggregate number of Shares which may be issued pursuant to all Awards is 75,000,000. In addition, a right entitling a Grantee to compensation measured by dividends paid with respect to ordinary shares (a "Dividend Equivalent Right") shall be payable solely in cash and shall not be deemed to reduce the maximum aggregate number of Shares which may be issued under the SIP.

(f) *Purchase Price*

The purchase price, if any, for an Award shall be as follows:

- (1) in the case of SARs, the base appreciation amount shall not be less than 100% of the fair market value per Share on the date of grant; and
- (2) in the case of restricted Shares, the Shares may be transferred to the Grantee either at a specified price or for no consideration;
- (3) in the case of restricted Share units, the units are transferred to the Grantee for no consideration; and
- (4) in the case of dividend equivalent rights, the rights are transferred to the Grantee for no consideration.

(g) *Administration of the SIP*

The Administrator shall be responsible for the administration of the SIP. An Award shall be exercisable at such times and under such conditions as determined by the Administrator under the terms of the SIP and specified in the Award Agreement. An Award shall be deemed to be exercised when written notice of such exercise has been given to us in accordance with the terms of the Award by the person entitled to exercise the Award and full payment for the Shares with respect to which the Award is exercised has been made.

(h) *Period of the SIP*

The SIP shall continue for a term of 10 years from the date of our listing on the Stock Exchange unless terminated earlier.

The term of each Award shall be as stated in the Award Agreement, provided however that the term of an Award shall be no more than 10 years from the date of grant of the Award.

Existing Equity Incentive Plans

The Existing Equity Incentive Plans were terminated as of our listing on the Stock Exchange. All awards granted under those plans prior to such date remain in effect in accordance with their terms under the applicable plan, but no new awards will be granted from and after such listing date under such plans.

Particulars of Outstanding Options

As at December 31, 2005, particulars of outstanding options granted to our Directors, consultants and employees under our Existing Equity Incentive Plans are as follows:

As at February 15, 2006, particulars of outstanding Existing Options granted to our (1) Directors, (2) senior management, (3) consultants and (4) employees are as follows:

Category	Total number of grantees in category	Number of Shares under outstanding Existing Options	% of total issued share capital	Exercise Period	Exercise Price (per Share)
Directors of our Company⁽¹⁾	8				
Sterling Du		38,000,000	1.94	10/31/2001-12/30/2015	US\$0.2036–US\$0.2878
Chuan Chiung “Perry” Kuo		12,750,000	0.65	04/30/2001-12/30/2015	US\$0.1808–US\$0.3494
James Elvin Keim		15,750,000	0.81	04/30/2001-12/30/2015	US\$0.162–US\$0.3494
Michael Austin		4,450,000	0.23	10/16/1997-10/31/2011	US\$0.0017–US\$0.2878
Geok Ling Goh		3,400,000	0.17	01/21/2000-10/31/2011	US\$0.13–US\$0.2878
Keisuke Yawata		2,721,500	0.14	10/31/2001-10/31/2011	US\$0.2878
Lawrence Lai-Fu Lin		3,000,000	0.15	06/30/2003-06/30/2013	US\$0.3226
Xiaolang Yan		3,000,000	0.15	12/30/2005-12/30/2015	US\$0.2036
Senior Management of our Company	2				
Ivan Chang		2,470,400	0.13	10/28/1999-12/30/2015	US\$0.1175–US\$0.4836
Johnny Chiang		4,800,000	0.25	03/11/1999-12/30/2015	US\$0.01–US\$0.4836
Consultants of our Company⁽¹⁾	21	7,481,650	0.38	10/28/1999-10/31/2013	US\$0.1300–US\$0.4262
Employees of our Company⁽²⁾	642	216,629,600	11.09	04/30/1997-01/31/2016	US\$0.0006–US\$0.4836
Total number of Shares under outstanding Existing Options		314,453,150			

Notes:

1. None of these consultants is a connected person of the Company.
2. Includes grantees who are no longer employees of the Company.

No consideration was paid or is payable for the grant of any of the existing options.

Disclosure under Rules 13.11 to 13.19 of the Listing Rules

The Directors have confirmed that they are not aware of any circumstances which would give rise to disclosures under Rules 13.11 to 13.19 of the Listing Rules.