SIMULATIONS PLUS INC
Form 10-Q
January 14, 2015

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

[X] Quarterly Report Pursuant to Section 13 or 15(d) of the Security Exchange Act of 1934 for the quarterly period ended **November 30, 2014**

OR

[_] Transmission Report Pursuant to Section 13 or 15(d) of the Security Exchange Act of 1937 for the transition period from ______ to ______

Commission file number: **001-32046**

Simulations Plus, Inc.

(Name of registrant as specified in its charter)

California	**95-4595609**
(State or other jurisdiction of Incorporation or Organization)	(I.R.S. Employer identification No.)

42505 10th Street West

Lancaster, CA 93534-7059

(Address of principal executive offices including zip code)

(661) 723-7723

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) 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 filings requirements for the past 90 days. Yes [X] No [_]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [X] No [_]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer,” and “smaller reporting company” in Rule 12b-2 of the Exchange Act (Check one):

[_] Large accelerated filer	[_] Accelerated filer
[_] Non-accelerated filer (Do not check if a smaller reporting company)	[X] Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes [_] No [X]

The number of shares outstanding of the registrant’s common stock, par value $0.001 per share, as of January 14, 2015 was 16,852,117 and no shares of preferred stock were outstanding.

Simulations Plus, Inc.

FORM 10-Q

For the Quarterly Period Ended November 30, 2014

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PART II. OTHER INFORMATION

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SIMULATIONS PLUS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

As of

	(Unaudited) November 30,	(Audited) August 31,
ASSETS	2014	2014
Current assets		
Cash and cash equivalents	$5,791,177	$8,614,929
Accounts receivable, net of allowance for doubtful accounts of $0	2,995,959	1,708,158
Revenues in excess of billings	734,503	158,914
Prepaid income taxes	626,128	748,359
Prepaid expenses and other current assets	264,093	188,160
Deferred income taxes	274,548	114,846
Total current assets	10,686,408	11,533,366
Long-term assets		
Capitalized computer software development costs, net of accumulated amortization of $6,822,573 and $6,609,282	3,736,980	3,452,541
Property and equipment, net (note 3)	518,378	95,242
Intellectual property, net of accumulated amortization of $345,625 and $193,750	5,729,375	5,881,250
Other intangible assets net of accumulated amortization of $36,875	1,613,125	–
Goodwill	4,789,248	–
Other assets	34,083	18,445
Total assets	$27,107,597	$20,980,844
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$153,211	$130,547
Accrued payroll and other expenses	672,734	340,709
Accrued bonuses to officer	24,000	120,000
Other current liabilities	19,859	19,859
Current portion - Contracts payable (note 4)	750,000	750,000
Billings in excess of revenues	129,725	–
Deferred revenue	34,879	30,370
Total current liabilities	1,784,408	1,391,485
Long-term liabilities		
Deferred income taxes	3,230,446	2,375,874
Payments due under Contracts payable (note 4)	3,604,405	1,750,000

Other long-term liabilities	23,169	28,134
Total liabilities	8,642,428	5,545,493
Commitments and contingencies (note 5)		
Shareholders' equity (note 6)		
Preferred stock, $0.001 par value 10,000,000 shares authorized no shares issued and outstanding	–	–
Common stock, $0.001 par value 50,000,000 shares authorized 16,841,114 and 16,349,956 shares issued and outstanding	5,312	4,821
Additional paid-in capital	9,427,906	6,085,427
Retained earnings	9,031,951	9,345,103
Total shareholders' equity	18,465,169	15,435,351
Total liabilities and shareholders' equity	$27,107,597	$20,980,844

The accompanying notes are an integral part of these financial statements.

SIMULATIONS PLUS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

For the three months ended

	(Unaudited) November 30, 2014	2013
Net revenues	$4,086,192	$2,641,000
Cost of sales	997,734	448,420
Gross profit	3,088,458	2,192,580
Operating expenses		
Selling, general, and administrative	2,079,169	1,071,091
Research and development	259,912	162,116
Total operating expenses	2,339,081	1,233,207
Income from operations	749,377	959,373
Other income (expense)		
Interest income	4,592	9,026
Miscellaneous income	–	–
Loss on currency exchange	(7,790)	23,709
	–	–
Total other income (expense)	(3,198)	32,735
Income from continuing operations before provision for income taxes	746,179	992,108
Provision for income taxes	(217,275)	(306,953)
Net Income	$528,904	$685,155
Earnings per share		
Basic	$0.03	$0.04
Diluted	$0.03	$0.04
Weighted-average common shares outstanding		
Basic	16,830,319	16,049,707
Diluted	17,097,858	16,366,720

The accompanying notes are an integral part of these financial statements.

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SIMULATIONS PLUS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the three months ended

	(Unaudited) November 30, 2014	2013
Cash flows from operating activities		
Net income	$528,904	$685,155
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization of property and equipment	93,036	11,903
Amortization of capitalized computer software development costs	213,290	191,829
Amortization of Intellectual property	151,875	1,875
Stock-based compensation	65,799	15,360
Deferred income taxes	32,370	70,178
(Increase) decrease in		
Accounts receivable	(353,283)	(40,957)
Revenues in excess of billings	(177,880)	–
Prepaid income taxes	122,231	236,775
Prepaid expenses and other assets	12,788	19,098
Increase (decrease) in		
Accounts payable	(36,753)	89,408
Accrued payroll and other expenses	(112,413)	26,394
Accrued bonus	(96,000)	(30,000)
Billings in excess of revenues	(216,715)	–
Other liabilities	(4,965)	(4,965)
Deferred revenue	4,509	79,014
Net cash provided by operating activities	226,793	1,351,067
Cash flows from investing activities		
Purchases of property and equipment	(20,944)	(9,843)
Cash used to purchase Cognigen	(2,080,000)	–
Cash received in acquisition	190,184	–
Capitalized computer software development costs	(297,729)	(373,204)
Net cash provided by (used in) investing activities	(2,208,489)	(383,047)
Cash flows from financing activities		
Payment of Dividends	(842,056)	(642,956)
Proceeds from the exercise of stock options	–	50,345
Net cash (used in) financing activities of continuing operations	(842,056)	(592,611)
Net increase (decrease) in cash and cash equivalents	(2,823,752)	375,409

Cash and cash equivalents, beginning of year	8,614,929	10,179,298
Cash and cash equivalents, end of period	$5,791,177	$10,554,707
Supplemental disclosures of cash flow information		
Interest paid	$–	$–
Income taxes paid	$3,232	$–
Non-Cash Investing and Financing Activities		
Stock issued for acquisition of Cognigen Corporation	$3,277,171	$–
Creation of contract liability for acquisition of Cognigen Corporation	$1,854,405	$–

The accompanying notes are an integral part of these financial statements.

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Simulations Plus, Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

November 30, 2014 and 2013

(Unaudited)

Note 1: GENERAL

This report on Form 10-Q for the quarter ended November 30, 2014, should be read in conjunction with the Company's annual report on Form 10-K for the year ended August 31, 2014, filed with the Securities and Exchange Commission ("SEC") on November 28, 2014. As contemplated by the SEC under Article 8 of Regulation S-X, the accompanying consolidated financial statements and footnotes have been condensed and therefore do not contain all disclosures required by generally accepted accounting principles. The interim financial data are unaudited; however, in the opinion of Simulations Plus, Inc. and Subsidiary ("we", "our", "us"), the interim data includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the results for the interim periods. Results for interim periods are not necessarily indicative of those to be expected for the full year.

<u>Organization</u>

Simulations Plus, Inc. was incorporated on July 17, 1996. On September 2, 2014 Simulations Plus, Inc. acquired all outstanding equity interests of Cognigen Corporation ("Cognigen") pursuant to the terms of the Merger Agreement and Cognigen became a wholly owned subsidiary of Simulations Plus, Inc. (collectively, the "Company").

Note 2: SIGNIFICANT ACCOUNTING POLICIES

<u>Principles of Consolidation</u>

The consolidated financial statements include the accounts of Simulations Plus, Inc. and, as of September 2, 2014, its wholly owned subsidiary, Cognigen Corporation. All significant intercompany accounts and transactions are eliminated in consolidation.

<u>Estimates</u>

Our condensed consolidated financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America. Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. These estimates and assumptions are affected by management’s application of accounting policies. Actual results could differ from those estimates. Significant accounting policies for us include revenue recognition, accounting for capitalized computer software development costs, valuation of stock options, and accounting for income taxes.

Revenue Recognition

We recognize revenues related to software licenses and software maintenance in accordance with Financial Accounting Standard Board (“FASB”) Accounting Standard Codification (“ASC”) 985-605, “*Software - Revenue Recognition”*. Software product revenue is recorded when the following conditions are met: 1) evidence of arrangement exists, 2) delivery has been made, 3) the amount is fixed, and 4) collectability is probable. Post-contract customer support ("PCS") obligations are insignificant; therefore, revenue for PCS is recognized at the same time as the licensing fee, and the costs of providing such support services are accrued and amortized over the obligation period.

As a byproduct of ongoing improvements and upgrades for the new programs and new modules of software, some modifications are provided to customers who have already purchased software at no additional charge. Other software modifications result in new, additional cost modules that expand the functionality of the software. These are licensed separately. We consider the modifications that are provided without charge to be minimal, as they do not significantly change the basic functionality or utility of the software, but rather add convenience, such as being able to plot some additional variable on a graph in addition to the numerous variables that had been available before, or adding some additional calculations to supplement the information provided from running the software. Such software modifications for any single product have typically occurred once or twice per year, sometimes more, sometimes less. Thus, they are infrequent. The Company provides, for a fee, additional training and service calls to its customers and recognizes revenue at the time the training or service call is provided.

Generally, we enter into one-year license agreements with customers for the use of our pharmaceutical software products. We recognize revenue on these contracts when all the criteria are met.

Most license agreements have a term of one year; however, from time to time, we enter into multi-year license agreements. We generally unlock and invoice software one year at a time for multi-year licenses. Therefore, revenue is recognized one year at a time.

We recognize revenue from collaboration research and revenue from grants equally over their terms. For contract revenues based on actual hours incurred we recognize revenues when the work is performed. For fixed price contracts, we recognize contract study and other contract revenues using the percentage-of-completion method, depending upon how the contract studies are engaged, in accordance with ASC 605-35, "*Revenue Recognition – Construction-Type and Production-Type Contracts*". To recognize revenue using the percentage-of-completion method, we must determine whether we meet the following criteria: 1) there is a long-term, legally enforceable contract, 2) it is possible to reasonably estimate the total project costs, and 3) it is possible to reasonably estimate the extent of progress toward completion.

Cash and Cash Equivalents

For purposes of the statements of cash flows, we consider all highly liquid investments purchased with original maturities of three months or less to be cash equivalents.

Accounts Receivable

We analyze the age of customer balances, historical bad debt experience, customer creditworthiness, and changes in customer payment terms when making estimates of the collectability of the Company's trade accounts receivable balances. If we determine that the financial conditions of any of its customers deteriorated, whether due to customer-specific or general economic issues, an increase in the allowance may be made. Accounts receivable are written off when all collection attempts have failed.

Capitalized Computer Software Development Costs

Software development costs are capitalized in accordance with ASC 985-20, *"Costs of Software to Be Sold, Leased, or Marketed"*. Capitalization of software development costs begins upon the establishment of technological feasibility and is discontinued when the product is available for sale.

The establishment of technological feasibility and the ongoing assessment for recoverability of capitalized software development costs require considerable judgment by management with respect to certain external factors including, but not limited to, technological feasibility, anticipated future gross revenues, estimated economic life, and changes in software and hardware technologies. Capitalized software development costs are comprised primarily of salaries and direct payroll-related costs and the purchase of existing software to be used in our software products.

Amortization of capitalized software development costs is calculated on a product-by-product basis on the straight-line method over the estimated economic life of the products (not to exceed five years, although all of our current software products have already been on the market for 7-15 years except for our newest MedChem Designer™ program, and we do not foresee an end-of-life for any of them at this point). Amortization of software development costs amounted to $213,290 and $191,829 the three months ended November 30, 2014 and 2013, respectively. We expect future amortization expense to vary due to increases in capitalized computer software development costs.

We test capitalized computer software development costs for recoverability whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

Property and Equipment

Property and equipment are recorded at cost, which equals fair market value for property and equipment acquired in business combinations, less accumulated depreciation and amortization. Depreciation and amortization are provided using the straight-line method over the estimated useful lives as follows:

Equipment	5 years
Computer equipment	3 to 7 years
Furniture and fixtures	5 to 7 years
Leasehold improvements	Shorter of life of asset or lease

Maintenance and minor replacements are charged to expense as incurred. Gains and losses on disposals are included in the results of operations.

Intangible Assets and Goodwill

The Company performs valuations of assets acquired and liabilities assumed on each acquisition accounted for as a business combination and recognizes the assets acquired and liabilities assumed at their acquisition date fair value. Acquired intangible assets include customer relationships, software, trade name, and non-compete agreements. The Company determines the appropriate useful life by performing an analysis of expected cash flows based on historical experience of the acquired businesses. Intangible assets are amortized over their estimated useful lives using the straight-line method, which approximates the pattern in which the majority of the economic benefits are expected to be consumed.

Goodwill represents the excess of the cost of an acquired entity over the fair value of the acquired net assets. Goodwill is not amortized, instead it is tested for impairment annually or when events or circumstances change that would indicate that goodwill might be impaired. Events or circumstances that could trigger an impairment review include, but are not limited to, a significant adverse change in legal factors or in the business climate, an adverse action or assessment by a regulator, unanticipated competition, a loss of key personnel, significant changes in the manner of the Company's use of the acquired assets or the strategy for the Company's overall business, significant negative industry or economic trends or significant under-performance relative to expected historical or projected future results of operations.

Goodwill is tested for impairment at the reporting unit level, which is one level below or the same as an operating segment. As of November 30, 2014, the Company determined that it has two reporting units, Simulations Plus and Cognigen Corporation. When testing goodwill for impairment, the Company first performs a qualitative assessment to determine whether it is necessary to perform step one of a two-step annual goodwill impairment test for each reporting unit. The Company is required to perform step one only if it concludes that it is more likely than not that a reporting unit's fair value is less than its carrying value. Should this be the case, the first step of the two-step process is to identify whether a potential impairment exists by comparing the estimated fair values of the Company's reporting units with their respective book values, including goodwill. If the estimated fair value of the reporting unit exceeds book value, goodwill is considered not to be impaired, and no additional steps are necessary. If, however, the fair value of the reporting unit is less than book value, then the second step is performed to determine if goodwill is impaired and to measure the amount of impairment loss, if any. The amount of the impairment loss is the excess of the carrying amount of the goodwill over its implied fair value. The estimate of implied fair value of goodwill is primarily based on an estimate of the discounted cash flows expected to result from that reporting unit, but may require valuations of certain internally generated and unrecognized intangible assets such as the Company's software, technology, patents and trademarks. If the carrying amount of goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to the excess.

As of November 30, 2014, the entire balance of goodwill was attributed to the Company's Cognigen Corporation reporting unit. Intangible assets subject to amortization are reviewed for impairment whenever events or circumstances indicate that the carrying amount of these assets may not be recoverable. The Company has not recognized any impairment charges during the periods ended November 30, 2014 and 2013.

Reconciliation of Goodwill for the period ended November 30, 2014:

Balance, August 31, 2014	$–
Addition	4,789,248
Impairments	–
Balance, November 30, 2014	$4,789,248

Other Intangible Assets

The following table summarizes other intangible assets as of November 30, 2014:

	Amortization Period	Acquisition Value	Accumulated Amortization	Net book value
Customer relationships	Straight line 8 years	$1,100,000	$ 34,375	$1,065,625
Trade Name-Cognigen	None	500,000	0	500,000
Covenants not to compete	Straight line 5 years	50,000	2,500	47,500
		$1,650,000	$ 36,875	$1,613,125

Amortization expense for the three months ended November 30, 2014 was $36,875.

Business Acquisitions

The Company accounted for the acquisition of Cognigen using the purchase method of accounting where the assets acquired and liabilities assumed are recognized based on their respective estimated fair values. The excess of the purchase price over the estimated fair values of the net assets acquired is recorded as goodwill. Determining the fair value of certain acquired assets and liabilities is subjective in nature and often involves the use of significant estimates and assumptions, including, but not limited to, the selection of appropriate valuation methodology, projected revenue, expenses and cash flows, weighted average cost of capital, discount rates, estimates of advertiser and publisher turnover rates and estimates of terminal values. Business acquisitions are included in the Company's consolidated financial statements as of the date of the acquisition.

Fair Value of Financial Instruments

Assets and liabilities recorded at fair value in the Condensed Consolidated Balance Sheets are categorized based upon the level of judgment associated with the inputs used to measure their fair value. The categories, as defined by the standard are as follows:

Level Input:	**Input Definition:**
Level I	Inputs are unadjusted, quoted prices for identical assets or liabilities in active markets at the measurement date.
Level II	Inputs, other than quoted prices included in Level I, that are observable for the asset or liability through corroboration with market data at the measurement date.
Level III	Unobservable inputs that reflect management’s best estimate of what market participants would use in pricing the asset or liability at the measurement date.

The following table summarizes fair value measurements by level at November 30, 2014 for assets and liabilities measured at fair value on a recurring basis: