

SIMULATIONS PLUS INC  
Form 10-Q  
April 14, 2015

SECURITIES AND EXCHANGE COMMISSION

**Washington, DC 20549**

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Security Exchange Act of 1934 for the quarterly period ended **February 28, 2015**

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 (I.R.S. Employer  
Incorporation or Organization) identification No.)

42505 10<sup>th</sup> 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 April 14, 2015 was 16,852,117; no shares of preferred stock were outstanding.

**Simulations Plus, Inc.**

**FORM 10-Q**

**For the Quarterly Period Ended February 28, 2015**

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**PART I. FINANCIAL INFORMATION**Item 1. Condensed Financial Statements**SIMULATIONS PLUS, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****As of**

	(Unaudited) February 28, 2015	(Audited) August 31, 2014
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$6,103,042	\$8,614,929
Accounts receivable, net of allowance for doubtful accounts of \$0	3,179,288	1,708,158
Revenues in excess of billings	648,933	158,914
Prepaid income taxes	326,234	748,359
Prepaid expenses and other current assets	268,787	188,160
Deferred income taxes	205,593	114,846
Total current assets	\$10,731,877	\$11,533,366
Long-term assets		
Capitalized computer software development costs, net of accumulated amortization of \$7,099,333 and \$6,609,283	\$3,893,345	\$3,452,541
Property and equipment, net (note 3)	460,313	95,242
Intellectual property, net of accumulated amortization of \$497,500 and \$193,750	5,577,500	5,881,250
Other intangible assets net of accumulated amortization of \$73,750	1,576,250	-
Goodwill	4,789,248	-
Other assets	34,082	18,445
Total assets	\$27,062,615	\$20,980,844
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities		
Accounts payable	\$120,657	\$130,547
Accrued payroll and other expenses	388,057	340,709
Accrued bonuses to officer	48,000	120,000
Other current liabilities	19,859	19,859
Current portion - Contracts payable (note 4)	750,000	750,000
Billings in excess of revenues	96,803	-
Deferred revenue	44,948	30,370
Total current liabilities	\$1,468,324	\$1,391,485

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Long-term liabilities		
Deferred income taxes	\$3,289,089	\$2,375,874
Payments due under Contracts payable (note 4)	3,604,404	1,750,000
Other long-term liabilities	18,204	28,134
Total liabilities	\$8,380,021	\$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 16,852,117 and 16,349,955 shares issued and outstanding	\$5,323	\$4,821
Additional paid-in capital	9,517,692	6,085,427
Retained earnings	9,159,579	9,345,103
Total shareholders' equity	\$18,682,594	\$15,435,351
Total liabilities and shareholders' equity	\$27,062,615	\$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 and six months ended February 28,****(Unaudited)**

	Three months ended		Six months ended	
	2015	2014	2015	2014
Net sales	\$4,574,191	\$3,081,492	\$8,660,382	\$5,722,492
Cost of sales	1,125,660	492,199	2,123,394	940,619
Gross profit	3,448,531	2,589,293	6,536,988	4,781,873
Operating expenses				
Selling, general, and administrative	1,612,742	1,103,547	3,679,182	2,174,638
Research and development	360,708	354,007	633,348	516,123
Total operating expenses	1,973,450	1,457,554	4,312,530	2,690,761
Income from operations	1,475,081	1,131,739	2,224,458	2,091,112
Other income (expense)				
Interest income	4,412	7,957	9,004	16,983
Gain (loss) on currency exchange	(34,684 )	4,428	(42,475 )	28,137
Total other income (expense)	(30,272 )	12,385	(33,471 )	45,120
Income from operations before provision for income taxes	1,444,809	1,144,124	2,190,987	2,136,232
Provision for income taxes	(474,576 )	(334,260 )	(691,851 )	(641,213 )
Net Income	\$970,233	\$809,864	\$1,499,136	\$1,495,019
Earnings per share				
Basic	\$0.06	\$0.05	\$0.09	\$0.09
Diluted	\$0.06	\$0.05	\$0.09	\$0.09
<b>Weighted-average common shares outstanding</b>				
Basic	16,848,983	16,107,327	16,839,599	16,078,173
Diluted	17,105,412	16,356,544	17,096,357	16,319,902

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

## SIMULATIONS PLUS, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the six months ended February 28,

(Unaudited)

	2015	2014
Cash flows from operating activities		
Net income	\$1,499,136	\$1,495,019
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization of property and equipment	112,441	23,873
Amortization of capitalized computer software development costs	490,051	383,652
Amortization of Intellectual property	377,500	3,750
Stock-based compensation	150,624	71,087
Deferred income taxes	159,968	101,086
(Increase) decrease in		
Accounts receivable	(536,612 )	(711,477 )
Revenues in excess of billings	(92,310 )	–
Prepaid income taxes	422,125	(38,739 )
Prepaid expenses and other assets	8,095	14,629
Increase (decrease) in		
Accounts payable	(69,307 )	160,712
Accrued payroll and other expenses	(397,090 )	3,086
Accrued bonus	(72,000 )	–
Billings in excess of revenues	(249,637 )	–
Other liabilities	(9,930 )	(9,929 )
Deferred revenue	14,576	154,161
Net cash provided by operating activities	1,807,630	1,650,910
Cash flows from investing activities		
Purchases of property and equipment	(19,159 )	(18,353 )
Cash used to purchase Cognigen	(2,080,000)	–
Cash received in acquisition	190,184	–
Capitalized computer software development costs	(730,855 )	(733,454 )
Net cash provided by (used in) investing activities	(2,639,830)	(751,807 )
Cash flows from financing activities		
Payment of Dividends	(1,684,660)	(1,450,429 )
Proceeds from the exercise of stock options	4,973	73,445
Net cash (used in) financing activities of continuing operations	(1,679,687)	(1,376,984 )
Net increase (decrease) in cash and cash equivalents	(2,511,887)	(477,881 )
Cash and cash equivalents, beginning of year	8,614,929	10,179,298
Cash and cash equivalents, end of period	\$6,103,042	\$9,701,417



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Supplemental disclosures of cash flow information

Interest paid	\$-	\$-
Income taxes paid	\$76,519	\$572,192

Non-Cash Investing and Financing Activities

Stock issued for acquisition of Cognigen Corporation	\$3,277,170	\$-
Creation of contract liability for acquisition of Cognigen Corporation	\$1,854,404	\$-

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

**Simulations Plus, Inc.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

February 28, 2015 and 2014

(Unaudited)

Note 1: GENERAL

This report on Form 10-Q for the quarter ended February 28, 2015, 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 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. ("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.

Organization

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

Principles of Consolidation

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.

Estimates

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 programs MedChem Designer™ and MembranePlus™, and we do not foresee an end-of-life for any of them at this point). Amortization of software development costs amounted to \$490,051 and \$383,652 for the six months ended February 28, 2015 and 2014, respectively, and amortization of software development costs was \$276,761 and \$191,823 for the three months ended February 28, 2015 and 2014, 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, 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 February 28, 2015, 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 February 28, 2015, 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 February 28, 2015 and 2014.

Reconciliation of Goodwill for the period ended February 28, 2015:

Balance, August 31, 2014	\$—
Addition	4,789,248
Impairments	—
<b>Balance, February 28, 2015</b>	<b>\$4,789,248</b>

#### Other Intangible Assets

The following table summarizes other intangible assets as of February 28, 2015:

	Amortization Period	Acquisition Value	Accumulated Amortization	Net book value
Customer relationships	Straight line 8 years	\$1,100,000	\$ 68,750	\$1,031,250
Trade Name-Cognigen	None	500,000	0	500,000
Covenants not to compete	Straight line 5 years	50,000	5,000	45,000
		<b>\$1,650,000</b>	<b>\$ 73,750</b>	<b>\$1,576,250</b>



Amortization expense for the three and six months ended February 28, 2015 was \$36,875 and 73,750, respectively.

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 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 February 28, 2015 for assets and liabilities measured at fair value on a recurring basis:

	Level I	Level II	Level III	Total
Cash and cash equivalents	\$6,103,042	\$ -	\$ -	\$6,103,042
Total	\$6,103,042	\$ -	\$ -	\$6,103,042

For certain of our financial instruments, including accounts receivable, accounts payable, accrued payroll and other expenses, accrued bonus to officer, and accrued warranty and service costs, the amounts approximate fair value due to their short maturities.

Research and Development Costs

Research and development costs are charged to expense as incurred until technological feasibility has been established. These costs consist primarily of salaries and direct payroll-related costs. It also includes purchased software and databases which were developed by other companies and incorporated into, or used in the development of, our final products.

Income Taxes

We utilize FASB ASC 740-10, "*Income Taxes*" which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns.

Under this method, deferred income taxes are recognized for the tax consequences in future years of differences between the tax bases of assets and liabilities and their financial reporting amounts at each year-end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized. The provision for income taxes represents the tax payable for the period and the change during the period in deferred tax assets and liabilities.

Intellectual property

On February 28, 2012, we bought out the royalty agreement with Enslein Research of Rochester, New York. The cost of \$75,000 is being amortized over 10 years under the straight-line method. Amortization expense for each of the six months periods ended February 28, 2015 and 2014 was \$3,750 and was \$1,875 for each three-month period ended February 28, 2015 and 2014. Accumulated amortization as of February 28, 2015 was \$22,500.

On May 15, 2014, we entered into a termination and non-assertion agreement with TSRL, Inc., pursuant to which the parties agreed to terminate an exclusive software licensing agreement entered into between the parties in 1997. As a result, the company obtained a perpetual right to use certain source code and data, and TSRL relinquished any rights and claims to any GastroPlus products and to any claims to royalties or other payments under that 1997 agreement. We agreed to pay TSRL total consideration of \$6,000,000, which is being amortized over 10 years under the straight-line method. Amortization expense for the three and six months ended February 28, 2015 was \$150,000 and \$300,000, respectively. Accumulated amortization as of February 28, 2015 was \$475,000. (See Note 4).

Total amortization expense for intellectual property agreements for the three and six months ended February 28, 2015 and 2014 was \$151,875 and \$1,875, and \$303,750 and \$3,750, respectively. Accumulated amortization as of February 28, 2015 was \$497,500.

Earnings per Share

We report earnings per share in accordance with FASB ASC 260-10. Basic earnings per share is computed by dividing income available to common shareholders by the weighted-average number of common shares available. Diluted earnings per share is computed similar to basic earnings per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential common shares had been issued and if the additional common shares were dilutive. The components of basic and diluted earnings per share for the three and six months ended February 28, 2015 and 2014 were as follows:

	<u>Three month ended</u>		<u>Six month ended</u>	
	02/28/2015	02/28/2014	02/28/2015	02/28/2014
Numerator:				
Net income attributable to common shareholders	\$970,233	\$809,864	\$1,499,136	\$1,495,019
Denominator:				
Weighted-average number of common shares outstanding during the period	16,848,983	16,107,327	16,839,599	16,078,173
Dilutive effect of stock options	256,429	249,217	256,758	241,729
Common stock and common stock equivalents used for diluted earnings per share	17,105,412	16,356,544	17,096,357	16,319,902



Stock-Based Compensation

Compensation costs related to stock options are determined in accordance with FASB ASC 718-10, “*Compensation-Stock Compensation*”, using the modified prospective method. Under this method, compensation cost is calculated based on the grant-date fair value estimated in accordance FASB ASC 718-10, amortized on a straight-line basis over the options’ vesting period. Stock-based compensation was \$150,624 and \$71,087 for the six months ended February 28, 2015 and 2014, respectively, and was \$84,825 and \$55,727 for the three months ended February 28, 2015 and 2014, respectively. This expense is included in the condensed consolidated statements of operations as Selling, General and Administration (SG&A), and Research and Development expense.

Recently Issued Accounting Pronouncements

In July 2013, the FASB issued ASU 2013-11, *Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*, which eliminates diversity in practice for the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss or a tax credit carryforward is available to reduce the taxable income or tax payable that would result from disallowance of a tax position. ASU 2013-11 affects only the presentation of such amounts in an entity’s balance sheet and is effective for fiscal years beginning after December 15, 2013 and interim periods within those years. Early adoption is permitted. We adopted this standard during fiscal 2015 and believe that it did not have a significant effect on our financial position or results of operation.

In May 2014, FASB issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers*. The standard will eliminate the transaction- and industry-specific revenue recognition guidance under current U.S. GAAP and replace it with a principles-based approach for determining revenue recognition. ASU 2014-09 is effective for annual and interim periods beginning after December 15, 2016. Early adoption is not permitted. The revenue recognition standard is required to be applied retrospectively, including any combination of practical expedients as allowed in the standard. We are evaluating the impact, if any, of the adoption of ASU 2014-09 to our financial statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting.

## Note 3: Property and Equipment

Property and equipment as of February 28, 2015 consisted of the following:

Equipment	\$416,798
Computer equipment	123,234
Furniture and fixtures	182,073
Leasehold improvements	103,599

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Sub total	825,704
Less: Accumulated depreciation and amortization	(365,391)
Net Book Value	\$460,313

## NOTE 4: CONTRACTS PAYABLE

TSRL

Pursuant to the termination and non-assertion agreement with TSRL (See note 2), the Company will pay TSRL \$2,500,000 over a three-year period. The payment schedule, by year, is below.

Cognigen

On September 2, 2014, the Company acquired Cognigen Corporation (See note 11). As part of the consideration the Company agreed that within three business days following the two year anniversary of July 23, 2014 (the date of the Merger Agreement) and subject to any offsets, the Company will pay the former shareholders of Cognigen a total of \$1,800,000, comprised of \$720,000 of cash and the issuance of 170,014 shares of stock.

Future payments under the Agreements, which are non-interest-bearing, are due as follows:

<b>Twelve month Period ending February 28</b>	<b>TSRL</b>	<b>Cognigen</b>	<b>Total</b>
2015	\$750,000	\$—	\$750,000
2016	750,000	1,854,404	2,604,404
2017	1,000,000	0	1,000,000
Total	\$2,500,000	\$1,854,404	\$4,104,404
Less Current portion	(750,000 )	—	(750,000 )
Contract payable, net of current portion	\$1,750,000	\$1,854,404	\$3,604,404

## Note 5: COMMITMENTS AND CONTINGENCIES

Employment Agreement

On August 22, 2013, the Company entered into an employment agreement with its President/Chief Executive Officer that expired in August 2014. The employment agreement provided for an annual base salary of \$300,000 per year, and a performance bonus in an amount equal to 5% of the Company's net income before taxes of the previous fiscal year, not to exceed \$60,000. The agreement also provided Employee stock options, exercisable for five years, to purchase ten (10) shares of Common Stock for each one thousand dollars (\$1,000) of net income before taxes at the end of each fiscal year up to a maximum of 20,000 options over the term of the agreement. The Company may terminate the agreement upon 30 days written notice if termination is without cause. The Company's only obligation would be to pay its President the greater of a) 12 months' salary or b) the remainder of the term of the employment agreement from the date of notice of termination. A copy of the agreement is attached to the Company's 2013 Form 10-K filed with the



SEC on November 18, 2013 as Exhibit 10.9.

For fiscal year 2013, the Compensation Committee awarded a \$30,000 performance bonus to Walter Woltosz, our President/Chief Executive Officer, which was paid in September 2013.

Effective September 1, 2014, the Company entered into a new Employment Agreement with Walter S. Woltosz to serve as Chief Executive Officer of the Company (the “Woltosz Employment Agreement”). The Woltosz Employment Agreement has a one-year term. Under the terms of the Woltosz Employment Agreement, Mr. Woltosz is required to devote a minimum of 60% of his productive time to the position of Chief Executive Officer of the Company. He will receive annual compensation of \$180,000, be eligible to receive up to 12,000 Company stock options under the 2007 Simulations Plus, Inc. Stock Option Plan, as determined by the Company’s Board of Directors, and shall be paid an annual performance bonus of up to 5% of the Company’s net income before taxes, not to exceed \$36,000. A copy of the Woltosz Employment Agreement was filed as an attachment to the 8-K filed with the Securities and Exchange Commission on September 4, 2014.

On September 2, 2014, Thaddeus H. Grasela, Jr., Ph.D., was appointed President of the Company and its wholly-owned subsidiary Cognigen, and the Company and Cognigen have entered into an Employment Agreement with Dr. Grasela (the “Grasela Employment Agreement”) which has a three-year term. Pursuant to the Grasela Employment Agreement, Dr. Grasela will receive an annual base salary of \$250,000, will be eligible to receive Company stock options under the 2007 Simulations Plus, Inc. Stock Option Plan, as determined by the Company’s Board of Directors, and will be eligible to receive an annual performance bonus in an amount not to exceed 10% of salary to be determined by the Compensation Committee of the Company’s Board of Directors.

#### License Agreement

We have a royalty agreement with Accelrys, Inc. (the original agreement was entered into with Symyx Technologies in March 2010; Symyx Technologies later merged with Accelrys, Inc.) for access to their Metabolite Database for developing our Metabolite Module within ADMET Predictor™. The module was renamed the Metabolism Module when we released ADMET Predictor version 6 on April 19, 2012. Under this agreement, we pay 25% of revenue derived from the sale of Metabolism/Metabolite module to Accelrys. In 2014, Dassault Systemes of France acquired Accelrys and the company now operates under the name Biovia.

For the six months ended February 28, 2015 and 2014 we incurred royalty expense of \$34,989 and \$364,369, respectively and for the three months ended February 28, 2015 and 2014, we incurred royalty expense of approximately \$24,824 and \$198,837, respectively.

#### Litigation

Except as described below, we are not a party to any legal proceedings and are not aware of pending legal proceedings of any kind.

In June 2014, the Company was served with a complaint in a civil action entitled Sherri Winslow v. Incredible Adventures, Inc., et al. (Los Angeles Superior Court Case No. BC545789) alleging wrongful death and seeking unspecified damages arising out of a May 18, 2012 plane crash in the State of Nevada. The Company's Chief Executive Officer owns the subject aircraft and is also a named defendant. The complaint alleged that the Company was the owner of the subject aircraft. The Company denies all material allegations against it, including that it owns or has ever owned any interest in the subject aircraft. On November 25, 2014, the plaintiff and the Company signed a stipulation of dismissal pursuant to which the plaintiff agreed to dismiss the Company without prejudice. If the plaintiff does not discover evidence during a nine month period to and including August 31, 2015 that justifies bringing the Company back into the litigation, the Company will prepare a dismissal with prejudice to be signed on behalf of the plaintiff.

## Note 6: SHAREHOLDERS' EQUITY

Dividend

The Board of Directors declared cash dividends during fiscal year 2014. The details of dividends paid are in the following table:

Record Date	Distribution Date	Number of Shares Outstanding on Record Date	Dividend per Share	Total Amount
11/08/2013	11/15/2013	16,073,894	\$ 0.04	\$ 642,956
2/17/2014	2/24/2014	16,149,460	\$ 0.05	807,473
5/09/2014	5/16/2014	16,165,171	\$ 0.05	808,259
8/04/2014	8/11/2014	16,337,955	\$ 0.05	816,897
Total				\$ 3,075,585

The Board of Directors has also declared cash dividends during fiscal year 2015. The details of dividends paid are in the following table:

Record Date	Distribution Date	Number of Shares Outstanding on Record Date	Dividend per Share	Total Amount
11/07/2014	11/14/2014	16,841,114	\$ 0.05	\$ 842,056
1/26/2015	2/2/2015	16,852,117	\$ 0.05	\$ 842,604
Total				\$ 1,684,660

Stock Option Plan

In September 1996, the Board of Directors adopted, and the shareholders approved, the 1996 Stock Option Plan (the "Option Plan") under which a total of 1,000,000 shares of common stock had been reserved for issuance. In March 1999, the shareholders approved an increase in the number of shares that may be granted under the Option Plan to 2,000,000. In February 2000, the shareholders approved an increase in the number of shares that may be granted under the Option Plan to 4,000,000. In December 2000, the shareholders approved an increase in the number of shares that may be granted under the Option Plan to 5,000,000. Furthermore, in February 2005, the shareholders approved an additional 1,000,000 shares, resulting in the total number of shares that may be granted under the Option Plan to 6,000,000. The 1996 Stock Option Plan terminated in September 2006 by its term.

On February 23, 2007, the Board of Directors adopted and the shareholders approved the 2007 Stock Option Plan under which a total of 1,000,000 shares of common stock had been reserved for issuance. On February 25, 2014 the shareholders approved an additional 1,000,000 shares increasing the total number of shares that may be granted under the Option Plan to 2,000,000.

Qualified Incentive Stock Options (Qualified ISO)

As of February 28, 2015, employees hold Qualified ISO to purchase 802,200 shares of common stock at exercise prices ranging from \$1.00 to \$6.85, which were granted prior to February 28, 2015.

Transactions in FY15	Number of Options	Weighted-Average Exercise Price		Weighted-Average Remaining Contractual Life
			Per Share	
Outstanding, August 31, 2014	798,500	\$	4.59	6.265
Granted	17,000	\$	6.85	
Exercised	(4,500 )	\$	1.11	
Cancelled/Forfeited	(8,800 )	\$	6.85	
Outstanding, February 28, 2015	802,200	\$	4.64	5.840
Exercisable, February 28, 2015	370,500	\$	2.40	2.737

The fair value of the options, including both ISO and NQSO options, granted during the six months ended February 28, 2015 is estimated at \$130,781. The fair value of these options was estimated at the date of grant using the Black-Scholes option-pricing model with the following assumptions for Fiscal quarter ended February 28, 2015: dividend yield of 2.92%, pre-vest forfeiture rate of 6.23%, expected volatility of 49.55%, risk-free interest rate of 2.23%, and expected life of 6.90 years.

#### Non-Qualified Stock Options (Non-Qualified ISO)

As of February 28, 2015, the outside members of the Board of Directors hold options to purchase 35,600 shares of common stock at exercise prices ranging from \$1.67 to \$6.85, which were granted prior to February 28, 2015.

Transactions in FY15	Number of <u>Options</u>	Weighted-Average Exercise Price		Weighted-Average Remaining Contractual Life
			<u>Per Share</u>	
Outstanding, August 31, 2014	56,600	\$	4.82	7.96
Granted	0	\$	0.00	
Exercised	(6,503 )	\$	3.28	
Cancelled/Forfeited	(14,497 )	\$	4.97	
Outstanding, February 28, 2015	35,600	\$	5.05	7.38
Exercisable, February 28, 2015	19,000	\$	4.29	7.32

The weighted-average remaining contractual life of options outstanding issued under the Plan, both Qualified ISO and Non-Qualified SO, was 5.90 years at February 28, 2015. The exercise prices for the options outstanding at February 28, 2015 ranged from \$1.00 to \$6.85, and the information relating to these options is as follows:

Exercise Price		Awards Outstanding			Awards Exercisable			
Low	High	Quantity	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Quantity	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	
\$1.00	\$1.50	193,000	3.02 years	\$1.04	193,000	3.02 years	\$1.04	
\$1.51	\$3.00	13,600	5.15 years	\$2.41	3,600	5.19 years	\$2.19	
\$3.01	\$4.50	133,500	2.36 years	\$3.25	131,700	2.29 years	\$3.23	
\$4.51	\$6.00	128,000	3.85 years	\$5.47	57,200	3.71 years	\$5.42	
\$6.01	\$6.85	369,700	9.42 years	\$6.84	4,000	2.50 years	\$6.67	
<b>TOTAL</b>		<b>837,800</b>	<b>5.90 years</b>	<b>\$4.65</b>	<b>389,500</b>	<b>2.89 years</b>	<b>\$2.49</b>	

#### NOTE 7: RELATED PARTY TRANSACTIONS

As of February 28, 2015, included in bonus expenses to officers was \$48,000, of which \$30,000 was accrued bonus representing an estimated quarterly amount of bonus payable to the Corporate Secretary, Virginia Woltoz, as part of the terms of the sale of Words+ to Simulations Plus in 1996, and \$18,000 accrued bonus representing an estimated quarterly amount of bonus payable to our President/Chief Executive Officer, Walter Woltoz as part of his current employment agreement.

#### NOTE 8: CONCENTRATIONS AND UNCERTAINTIES

Revenue concentration shows that International sales accounted for 39.8% and 53% of net sales for the six months ended February 28, 2015 and 2014, respectively. Two customers accounted for 10% (a dealer account in Japan representing various customers) and 8% of sales for the six months ended February 28, 2015 compared to one customer (a dealer account in Japan representing various customers) accounting for 10% of sales for the six months ended February 28, 2014.

Accounts receivable concentration shows that one customer (a dealer account in Japan representing various customers) comprised 13% of accounts receivable at February 28, 2015, compared to two customers comprising 13% (a dealer account in Japan representing various customers) and 11% of accounts receivable at February 28, 2014.

We operate in the computer software industry, which is highly competitive and changes rapidly. Our operating results could be significantly affected by our ability to develop new products and find new distribution channels for new and existing products.

The majority of our customers are in the pharmaceutical industry. Consolidation and downsizing in the pharmaceutical industry could have an impact on our revenues and earnings going forward.



## NOTE 9: SEGMENT AND Geographic Reporting

We account for segments and geographic revenues in accordance with guidance issued by the FASB. Our reportable segments are strategic business units that offer different products and services.

Results for each segment and consolidated results are as follows for the three and six months ended February 28, 2015 (in thousands):

## Three months ended February 28, 2015

	Simulations Plus, Inc	Cognigen Corporation*	Eliminations	Total
Net Revenues	\$ 3,302	\$ 1,271		\$4,574
Income (loss) from operations	\$ 1,288	\$ 187		\$1,475
Total assets	\$ 25,974	\$ 8,327	\$ (7,238 )	\$27,063
Capital expenditures	\$ 0	\$ 0		\$0
Capitalized software costs	\$ 393	\$ 39		\$432
Depreciation and Amortization	\$ 431	\$ 91		\$458

## Six months ended February 28, 2015

	Simulations Plus, Inc	Cognigen Corporation*	Eliminations	Total
Net Revenues	\$ 6,254	\$ 2,406		\$8,660
Income (loss) from operations	1,975	249		\$2,224
Total assets	\$ 25,974	\$ 8,327	\$ (7,238 )	\$27,063
Capital expenditures	\$ 17	\$ 3		\$20
Capitalized software costs	\$ 667	\$ 64		\$730
Depreciation and Amortization	\$ 798	\$ 182		\$980

\*Cognigen Corporation was acquired on September 2, 2014.

In addition, the Company allocates revenues to geographic areas based on the locations of its customers. Geographical revenues for the three months and six months ended February 28, 2015 and 2014 were as follows (in thousands):

## Three months ended February 28, 2015

Europe	Asia	Total
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	North America		South America		
Simulations Plus, Inc.	\$ 1,459	\$1,265	\$578	\$ 1	\$3,303
Cognigen Corporation *	\$ 1,271	\$0	\$0	\$ 0	\$1,271
Total	\$ 2,730	\$1,265	\$578	\$ 1	\$4,574

Six months ended February 28, 2015

	North America	Europe	Asia	South America	Total
Simulations Plus, Inc.	\$ 2,805	\$1,905	\$1,543	\$ 1	\$6,254
Cognigen Corporation *	\$ 2,406	–	–	–	\$2,406
Total	\$ 5,211	\$1,905	\$1,543	\$ 1	\$8,660

\*Cognigen Corporation was acquired on September 2, 2014

Three and six months ended February 28, 2014\*\*

	North America	Europe	Asia	South America	Total
Three Months	\$ 968	\$1,432	\$673	\$ 8	\$3,081
Six Months	\$ 2,228	\$1,968	\$1,515	\$ 11	\$5,722

\*\* Does not include Cognigen Corporation acquired on September 2, 2014

Note 10: EMPLOYEE BENEFIT PLAN

We maintain a 401(K) Plan for all eligible employees, and we make matching contributions equal to 100% of the employee's elective deferral, not to exceed 4% of total employee compensation. We can also elect to make a profit-sharing contribution. Our contributions to this Plan amounted to \$122,846 and \$61,756 for the six months ended February 28, 2015 and 2014, respectively, and \$65,519 and \$35,629 for the three months ended February 28, 2015 and 2014, respectively.

Note 11: ACQUISITION/MERGER WITH COGNIGEN CORPORATION

On July 23, 2014, the Company entered into an Agreement and Plan of Merger (the "Merger Agreement") with Cognigen Corporation ("Cognigen"). On September 2, 2014, the Company consummated the acquisition of all outstanding equity interests of Cognigen pursuant to the terms of the Merger Agreement, with Cognigen merging with and into a newly formed, wholly owned subsidiary of the Company. We believe the combination of Simulations Plus and Cognigen provides substantial future potential based on the complementary strengths of each of the companies.

Under the terms of the Merger Agreement, as described below, the Company will pay the former shareholders of Cognigen total consideration of \$7,000,000, consisting of \$2,800,000 of cash and \$4,200,000 worth of newly issued, unregistered shares of the Company's common stock.

On September 2, 2014, the Company paid the former shareholders of Cognigen a total of \$5,200,000, comprised of cash in the amount of \$2,080,000 and the issuance of 491,159 shares of the Company's common stock valued at \$3,120,000 (under the terms of the Merger Agreement a price of approximately \$6.35 dollars per share was used based upon the volume-weighted average closing price of the Company's shares of common stock for the 30-consecutive-trading-day period ending two trading days prior to September 2, 2014). The actual stock price at September 2, 2014 was \$6.67, so the total value of the stock issued was approximately \$3,277,000. The Merger Agreement provides for a two-year market standoff period in which the newly issued shares may not be sold by the recipients thereof.

Within three business days following the two-year anniversary of July 23, 2014 (the date of the Merger Agreement) and subject to any offsets, the Company will pay the former shareholders of Cognigen a total of \$1,800,000, comprised of \$720,000 of cash and the issuance of 170,014 shares of stock valued at \$1,080,000 under the formula described above.

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The Merger Agreement provided for a targeted working capital adjustment to be made 120 days after the closing date.

Under the acquisition method of accounting, the total estimated purchase price is allocated to Cognigen's tangible and intangible assets and liabilities based on their estimated fair values at the date of the completion of the acquisition (September 2, 2014). The following table summarizes the preliminary allocation of the purchase price for Cognigen:

Assets acquired, including accounts receivable of \$934,000 and estimated Contracts receivable of \$530,000	\$1,524,389
Fixed assets acquired	458,351
Estimated value of software acquired	200,000
Estimated value of Intangibles acquired (Customer Lists, trade name etc.)	1,600,000
Working Capital Adjustment	(26,707 )
Current Liabilities assumed	(644,499 )
Goodwill	4,789,248
Estimated Deferred income taxes	(662,500 )
Total Consideration	\$7,238,282

Goodwill has been provided in the transaction based on estimates of future earnings of this subsidiary including anticipated synergies associated with the positioning of the combined company as a leader in model-based drug development. Based on the structure of the transaction, the Company does not anticipate benefiting from any tax deductions in future periods for recognized goodwill.

The accounting for this acquisition has not been completed, as further valuations and analyses are required to establish beginning fair market values and the implication on deferred taxes. The amounts shown are provisional, and do not include any adjustments for charges that will result from integration activities related to the acquisition. Additional assets or liabilities may be recorded that could affect the amounts. During the measurement period, any such adjustments to provisional amounts would increase or decrease goodwill. Adjustments that occur after the end of the measurement period will be recognized in the post-combination current period operations.

#### Consolidated supplemental Pro Forma information

The following consolidated supplemental pro forma information assumes that the acquisition of Cognigen took place on September 1, 2013 for the income statements for the three- and six-month periods ended February 28, 2014. These amounts have been calculated after applying the Company's accounting policies and adjusting the results of Cognigen to reflect the same expenses in the period ended February 28, 2014 that were incurred in the current three months ended February 28, 2015. The adjustments include costs of acquisition of \$410,000, the amortization of intangibles acquired during the merger, and depreciation changes to reflect the value of the fixed assets acquired that would have occurred assuming the fair value adjustments to fixed assets had been applied on September 1, 2013, together with consequential tax effects.

	<b>For the three months ended February 28</b>		<b>For the six months ended February 28</b>	
	<b>( in 1000's)</b>		<b>( in 1000's)</b>	
	2015	2014	2015	2014
Net Sales	\$4,574	\$4,208	\$8,660	\$8,043
Net Income	\$970	\$598	\$1,499	\$1,109

Item 2. Management's Discussion and Analysis or Plan of Operations

**Forward-Looking Statements**

This document and the documents incorporated in this document by reference contain forward-looking statements that are subject to risks and uncertainties. All statements other than statements of historical fact contained in this document and the materials accompanying this document are forward-looking statements.

The forward-looking statements are based on the beliefs of our management, as well as assumptions made by and information currently available to our management. Frequently, but not always, forward-looking statements are identified by the use of the future tense and by words such as “believes,” “expects,” “anticipates,” “intends,” “will,” “may,” “could,” “would,” “projects,” “continues,” “estimates” or similar expressions. Forward-looking statements are not guarantees of future performance and actual results could differ materially from those indicated by the forward-looking statements. Forward-looking statements involve known and unknown risks, uncertainties, and other factors that may cause our or our industry’s actual results, levels of activity, performance, or achievements to be materially different from any future results, levels of activity, performance, or achievements expressed or implied by the forward-looking statements.

The forward-looking statements contained or incorporated by reference in this document are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (“Securities Act”) and Section 21E of the Securities Exchange Act of 1934, as amended (“Exchange Act”) and are subject to the safe harbor created by the Private Securities Litigation Reform Act of 1995. These statements include declarations regarding our plans, intentions, beliefs, or current expectations.

Among the important factors that could cause actual results to differ materially from those indicated by forward-looking statements are the risks and uncertainties described under “Risk Factors” in our Annual Report and elsewhere in this document and in our other filings with the SEC.

Forward-looking statements are expressly qualified in their entirety by this cautionary statement. The forward-looking statements included in this document are made as of the date of this document and we do not undertake any obligation to update forward-looking statements to reflect new information, subsequent events or otherwise.

**General**

## **BUSINESS**

As used in this report, each of the terms “we,” “us,” “our,” the “Company” and “Simulations Plus” refers to Simulations Plus, Inc. and Cognigen Corporation, unless otherwise stated or the context otherwise requires.

## **OVERVIEW**

Simulations Plus, Inc., incorporated in 1996, is a premier developer of groundbreaking drug discovery and development software for mechanistic modeling and simulation. Our software is licensed to major pharmaceutical, biotechnology, agrochemical, and food industry companies and to regulatory agencies worldwide for use in the conduct of industry-based research. We also provide consulting services to these industries. Recently, we have been exploring the application of some of our machine-learning technologies for problems in aerospace and healthcare outside of our traditional markets. Simulations Plus is headquartered in Southern California and its common stock trades on the NASDAQ Capital Market under the symbol “SLP.”

In September 2014, Simulations Plus acquired Cognigen Corporation (Cognigen) as a wholly owned subsidiary. The acquisition is expected to add approximately \$5 million to our revenues for the fiscal year ended August 31, 2015.

Cognigen, incorporated in 1992, is a leading provider of population modeling and simulation contract research services for the pharmaceutical and biotechnology industries. Cognigen's clinical-pharmacology-based consulting services include pharmacokinetic and pharmacodynamic modeling, clinical trial simulations, data programming, and technical writing services in support of regulatory submissions. Cognigen develops software for harnessing cloud-based computing in support of modeling and simulation activities and provides consulting services to improve interdisciplinary collaborations and R&D productivity.

We are a global leader focused on improving the ways scientists use knowledge and data to predict the properties and outcomes of pharmaceutical and biotechnology agents, and one of only two global companies who provide a wide range of preclinical and clinical consulting services and software. Our innovations in integrating new and existing science in medicinal chemistry, computational chemistry, pharmaceutical science, biology, and physiology into our software have made us the leading software provider for physiologically based pharmacokinetics (PBPK) modeling and simulation.

We generate revenue by delivering relevant, cost-effective software and creative and insightful consulting services. Pharmaceutical and biotechnology companies use our software programs and scientific knowledge to guide discovery and preclinical development programs. They also use it to enhance their understanding of the properties of potential new medicines and to use emerging data to improve formulations, select and justify dosing regimens, support the generics industry, optimize clinical trial design, and simulate outcomes in special populations, such as the elderly and pediatric patients.

## **PRODUCTS**

### **General**

Simulations Plus develops and produces software for use in pharmaceutical research and in the education of pharmacy and medical students, and we provide contract consulting services to the pharmaceutical and chemical industries. Our wholly owned subsidiary, Cognigen, conducts high-quality analysis and regulatory report generation for data gathered during clinical trials of new and existing pharmaceutical products. Cognigen also has developed a proprietary software product called KIWI™ which is used internally and by some of its customers to access data and analysis results on Cognigen's internal computer cloud. Each business division is discussed separately below, followed by a discussion of the expected synergies from the combination of Simulations Plus and Cognigen.



## **Simulations Plus**

We currently offer six software products for pharmaceutical research: three simulation programs that provide time-dependent results based on solving large sets of differential equations: GastroPlus™, DDDPlus™, and MembranePlus™; and three programs that are based on predicting and analyzing static (not time-dependent) properties of chemicals: ADMET Predictor™, MedChem Designer™, and MedChem Studio™. We call the combination of ADMET Predictor, MedChem Designer and MedChem Studio our ADMET Design Suite™. After years in development, our newest software product, MembranePlus, was released in October 2014.

### GastroPlus

Our flagship product and largest source of revenues is GastroPlus. GastroPlus simulates the absorption, pharmacokinetics, and pharmacodynamics of drugs administered to humans and animals, and is currently the most widely used software of its type in pharmaceutical companies, the U.S. Food and Drug Administration (FDA), the U.S. National Institutes of Health (NIH), and other government agencies in the U.S. and other countries. Because of the widespread use of GastroPlus, we were the only non-European company invited to join the European Innovative Medicines Initiative (IMI) program for Oral Bioavailability Tools (OrBiTo). OrBiTo is an international collaboration among 27 industry, academic, and government organizations working in the area of oral absorption of pharmaceutical products. Because we are outside of Europe, our participation in this project is at our own expense, while other members are compensated for their work; however, we are a full member with access to all of the data and discussions of all other members. We believe participation in this initiative enables us to benefit from and to contribute to advancing the prediction of human oral bioavailability from preclinical data, and ensures that we are in front of the audience of member pharmaceutical companies and regulatory agencies.

After the end of our 2014 fiscal year, in September 2014, we entered into a research collaboration agreement (RCA) with the FDA to enhance the Ocular Compartmental Absorption and Transit (OCAT™) model within the Additional Dosing Routes Module of GastroPlus to provide a tool for generic companies and the FDA to assess the likely bioequivalence of generic drug formulations dosed to the eye. Under this RCA, we receive \$200,000 per year. This RCA may be renewed for up to a total of three years based on the progress achieved during the project.

Because we did not want our customers to have to wait for the next major release, an interim release of GastroPlus, version 8.6, was released in August 2014, adding two important requested capabilities: (1) the addition of minipig physiology – a species becoming common in preclinical research; and (2) the expansion of the Drug-Drug Interaction (DDI) Module to include population simulations.

The next major release, version 9.0, is already in development. This version will add the ability to simulate dosing of biologics (such as antibodies), and will add dermal (through the skin) drug absorption from creams and ointments. The dermal dosing capability was developed through a funded collaboration with a top-5 pharmaceutical company, and has been in use at the customer's sites for over a year. A number of other improvements will be included in version 9.0 that will be announced with the release of the product, and which we believe will expand the market for GastroPlus in pharmaceutical research and development. We currently expect release of version 9.0 in early 2015.

### DDDPlus

DDDPlus simulates *in vitro* laboratory experiments that measure the rate of dissolution of a drug and, if desired, the additives (excipients) in a particular dosage form (e.g., tablet or capsule) under a variety of experimental conditions. This software program is used by formulation scientists in industry and the FDA to (1) understand the physical mechanisms affecting the dissolution rate for various formulations, (2) reduce the number of cut-and-try attempts to design new drug formulations, and (3) design *in vitro* dissolution experiments to better mimic *in vivo* conditions.



MembranePlus™

MembranePlus is a new product that has been under development for a number of years, but was put on hold for several years due to other priorities. The development effort was revived in the past year and the program was released in October 2014. Similar to DDDPlus, MembranePlus simulates laboratory experiments, but in this case, the experiments are for measuring permeability of drug-like molecules through various membranes, including several different cell cultures (Caco-2, MDCK) as well as artificially formulated membranes (PAMPA). The value of such a simulation derives from the fact that when the permeabilities of the same molecules are measured in different laboratories, results are often significantly different. These differences are caused by a complex interplay of factors in how the experiment was set up and run. MembranePlus simulates these experiments with their specific experimental details, and this enables the scientist to better interpret how results from specific experimental protocols can be used to predict permeability in human and animals, which is the ultimate goal. We believe MembranePlus is unique and a number of customers have expressed interest in the new capability.

ADMET Predictor™

ADMET (Absorption, Distribution, Metabolism, Excretion, and Toxicity) Predictor is a chemistry-based computer program that takes molecular structures as inputs and predicts approximately 145 different properties for them at an average rate of over 100,000 compounds per hour. This capability allows chemists to generate estimates for a large number of important molecular properties without the need to synthesize and test the molecules, or to generate estimates of unknown properties for molecules that have been synthesized but for which only a limited number of experimental properties have been measured. Thus, a chemist can assess the likely success of a large number of existing molecules in a company's chemical library, as well as molecules that have never been made, by providing their molecular structures, either by drawing them using a tool such as our MedChem Designer software, or by automatically generating large numbers of molecules using various computer algorithms, including those embedded in our MedChem Studio software.

ADMET Predictor has been top-ranked for predictive accuracy in peer-reviewed, independent comparison studies, while generating its results at a high throughput rate. Although the state-of-the-art of this type of software does not enable identifying the best molecule in a series, it does allow early screening of molecules that are highly likely to fail as potential drug candidates (i.e., the worst molecules, which is usually the majority of a chemical library) before synthesizing and testing them. Thus, millions of compounds can be created and screened in a day, compared to potentially months or years of work to actually synthesize and test a much smaller number of actual compounds.

During fiscal year 2014, we released version 7.1 of ADMET Predictor. This new version incorporates a powerful new model for predicting ionization constants (pKa's), developed in a collaboration with Bayer AG that enabled us to more than double the size of our data set from about 16,000 pKa values to more than 35,000, and to expand the chemical space it covers to include a larger number of molecules more like those of interest to the pharmaceutical industry today. We believe the resulting improvement in pKa prediction will further differentiate our best-in-class model from any competitor. Predicting ionization is critical to predicting most other properties, so all other models (approximately 144) were retrained based on this new capability for version 7.1.

The ADMET Modeler™ subprogram that is integrated into ADMET Predictor enables scientists to use their own experimental data to quickly create proprietary high-quality predictive models using the same powerful machine learning methods we use to build our top-ranked property predictions. Pharmaceutical companies expend substantial time and money conducting a wide variety of experiments on new molecules each year, resulting in large databases of experimental data. Using this proprietary data to build predictive models can provide a second return on their investment; however, model building has traditionally been a difficult and tedious activity performed by specialists. The automation in ADMET Modeler makes it easy for a scientist to create very powerful models with a minimum of training.

We are currently examining three different applications of this machine learning engine: (1) building predictive models for missile aerodynamic force and moment coefficients as a function of missile geometry, Mach number, and angle of attack, (2) classifying/identifying missiles from radar tracking data, and (3) classifying patients as healthy or experiencing some disease state or genetic disorder evidenced by magnetic resonance imaging (MRI) of the brain. Other potential applications for this modeling engine have also been identified; however, our focus to date has been in these three areas.

The aerodynamic coefficient prediction problem was identified by the aerospace engineering department at Auburn University. Working with them, we have done some preliminary testing of the ADMET Modeler modeling engine for this type of problem. Results have been encouraging, and we believe there are government agencies and industrial aerospace companies that will find such a capability to be useful. To this end, we are developing a prototype AEROModeler™ program to test this concept and to use as a demonstrator for proposal efforts directed to potential funding agencies. A joint Simulations Plus/Auburn University scientific poster was accepted for presentation at the National Space and Missile Material Symposium/Commercial and Government Responsive Access to Space Technology Exchange (NSMMS/CRASTE) Conference in Huntsville, Alabama, in June 2014, and received attention and positive feedback from both government agencies and aerospace contractors, not only for aerodynamic coefficient predictions, but also for application to several other potential problems of interest to the industry. We have also successfully applied the same technology to identify/classify missiles from radar tracking data in a proof-of-concept study. Identification of missile characteristics from radar tracking data can be a valuable tool for example, in rapidly determining whether defensive countermeasures are needed for an observed launch, and if so, what type(s) of countermeasures are most appropriate. We are planning to present at two aerospace conferences in the first half of 2015 to further show what our technology can do for these new applications.

The analysis of magnetic resonance imaging (MRI) data to classify patients as healthy or likely to experience a form of autism (in our first proof-of-concept case) has been developed in cooperation with the MRI facility at Auburn University. This state-of-the-art facility has two MRIs – a 3-Tesla machine and a 7-Tesla machine. The amount of data from MRI imaging is massive, requiring us to modify our code to handle much larger data arrays than our previous applications have required. Our current goal is to demonstrate the potential of our modeling technology to provide useful classification of a patient into one of four groups based only on MRI data, so that we can approach various agencies (such as the NIH) to obtain funding to develop a commercial product. We presented a scientific poster at the Fourth Biennial Conference on Resting State/Brain Connectivity held at the Massachusetts Institute of Technology in September 2014 that received interest from a number of researchers working in this area.

We believe our machine learning modeling engine has a wide variety of applications and we intend to pursue funding to develop customized tools based on the engine for a number of potential applications.

MedChem Designer™

MedChem Designer was launched in 2011. It was initially a molecule-drawing program, or “sketcher”, but now has capabilities exceeding those of other molecule-drawing programs because of its integration with both MedChem Studio and ADMET Predictor. We provide MedChem Designer for free to our customers because we believe that in the long run it will help to increase demand for ADMET Predictor and MedChem Studio, and because most other existing molecule-drawing programs are also provided for free. Our free version includes a small set of ADMET Predictor’s best-in-class property predictions, allowing the chemist to modify molecular structures and then see a few key properties very quickly. With a paid ADMET Predictor license the chemist would see the entire 145 predictions that are available. As of March 31, 2015, over 14,000 copies of MedChem Designer have been downloaded by scientists around the world.

When used with a license for ADMET Predictor, MedChem Designer becomes a *de novo* molecule design tool. With it, a researcher can draw one or more molecular structures, then click on the ADMET Predictor icon and have over 145 properties for each structure calculated in seconds, including our proprietary ADMET Risk™ index. Researchers can also click on an icon to generate the likely metabolites of a molecule and then predict all of the properties of those metabolites from ADMET Predictor, including each of their ADMET Risk scores. This is important because a metabolite of a molecule can be therapeutically beneficial (or harmful) even though the parent molecule is not.

Our proprietary ADMET Risk score provides a single number that tells the chemist how many default threshold values for various predicted properties were crossed (or violated) by each structure. The default rules can be modified and new rules can be added by the user to include any desired rule set based on any combination of calculated descriptors, predicted properties, and user inputs. Thus, in a single number, the chemist can instantly compare the effects of different structural changes in many dimensions. The ideal score is zero; however, a low score greater than zero might be acceptable, depending on what property(s) caused the points to be assigned. If the number is too high (greater than 5-6), the molecule is not likely to be successful as a drug. As chemists attempt to modify structures to improve one property, they often cause others to become unacceptable. Without ADMET Risk, the chemist would have to individually examine many key properties for each new molecule (and its metabolites) to determine whether any of them became unacceptable as a result of changing the structure.

During fiscal year 2014, we released version 3.0 of MedChem Designer, which added the ability to capture the image of a molecular structure from a variety of publication files with a new snapshot tool, and then have the program automatically convert the graphic image into any of several computer-based chemical structure files. Converting from lines and letters on the screen to an exact chemical representation of the molecule (Optical Structure Recognition, or OSR) is a complex task. Although a few OSR programs are in existence, we are not aware of any that can accurately convert as many varieties of images to chemical representation as the OSR tool within MedChem Designer. Such a capability allows chemists to quickly capture molecular structures from the scientific literature to use for various purposes, including for use in our simulation and modeling software programs.

MedChem Studio™

MedChem Studio is a tool that is used both for data mining and for *de novo* design of new molecules. In its data-mining role, MedChem Studio facilitates searching of large chemical libraries to find molecules that contain identified substructures, and it enables rapid generation of clusters (classes) of molecules that share common substructures from high-throughput screening (HTS) data. MedChem Studio version 4.0 was released during fiscal year 2014.



While MedChem Designer can be used to refine a small number of molecules, MedChem Studio can be used to create and screen (with ADMET Predictor) a very large number of molecules down to a few promising lead candidates. MedChem Studio has features that enable it to generate new molecular structures using a variety of *de novo* design methods. When MedChem Studio is used with ADMET Predictor and MedChem Designer (which we refer to as our ADMET Design Suite), we believe the programs provide an unmatched capability for chemists to search through large libraries of compounds that have undergone high-throughput screening experiments to find the most promising classes (groups of molecules with a large common part of their structures) and molecules that are active against a particular target. In addition, MedChem Studio can take an interesting (but not acceptable) molecule and, using a variety of design algorithms, quickly generate many thousands to millions of high quality analogs (similar new molecules). These molecules can then be screened using ADMET Predictor to find molecules that are both active against the target as well as acceptable in a variety of ADMET properties.

#### NCE Projects

During late 2012, we initiated a new molecule (NCE, or New Chemical Entity) design project in which we used our own products to design novel molecules and have them synthesized and tested. Our goal was to demonstrate the ability of our ADMET Design Suite to generate new lead molecules in a fraction of the time and cost normally required in the pharmaceutical industry. We have conducted two NCE design projects. In the first, we designed molecules to test against the malaria parasite and in the other we designed molecules to test against the cyclo-oxygenase-2 (COX-2) enzyme that is the target for Celebrex®, while also inhibiting to a lesser extent the COX-1 enzyme that is the target for aspirin. Both projects were successful in that when the molecules that we designed were tested against the malaria parasite and the COX-2/COX-1 enzymes, every molecule successfully inhibited the malaria parasite or the COX-2/COX-1 enzymes. We believe these projects demonstrate that our ADMET Design Suite can save considerable time and money in developing new lead compounds for particular targets. We have generated revenue from new software sales that resulted from presenting our NCE project results.

#### KIWI™

Drug development programs rely increasingly on modeling and simulation analyses to support decision making and submissions to regulatory agencies. To ensure high-quality analyses, organizations must not only apply high-quality science, but must also be able to support the science by being able to validate the results. KIWI is a cloud-based web application that was developed to efficiently organize, process, maintain, and communicate the volume of data and results generated by pharmacologists and scientists over the duration of a drug development program. The validated workflow and tools within KIWI promote traceability and reproducibility of results.

KIWI Version 1.2 was released in September 2014. This new release includes output of new statistical criteria, new graphic and tabular outputs, and improvements in the KIWI interface to more easily access functionality throughout the application.

#### Contract Research and Consulting Services

Our employees have expertise in oral absorption and pharmacokinetics. They have been speakers or presenters at over 150 scientific meetings worldwide in the past four years. We frequently conduct contracted studies for large customers (including the largest five pharmaceutical companies) who have particularly difficult problems and who recognize our expertise in solving them, as well as for smaller customers who prefer to have studies run by our scientists rather than to license our software and train someone to use it. The demand for our consulting services has been steadily increasing, and we have expanded our Simulations Studies team to meet the increased workload. Our acquisition of Cognigen is expected to result in increased demand for the consulting services of both companies.

We currently are working with the FDA on three different Research Collaboration Agreements (RCAs): the one for the ocular model in GastroPlus described above under "--GastroPlus," and two more described below.

During fiscal year 2014, we continued to perform under our RCA with the FDA's Center for Food Safety and Applied Nutrition (CFSAN). This RCA has a five-year renewable term that commenced in January 2011. FDA scientists and our scientists are using ADMET Predictor/Modeler to build predictive models for likely toxicities of food additives and contaminants. Both FDA scientists and our scientists are building a series of models to classify new compounds as toxic or nontoxic from FDA datasets. Included early on in this effort was a special modification to ADMET Predictor requested by FDA scientists to allow the user to set a minimum value for specificity or sensitivity when building a model, and this is now a standard part of the program available to all users. Sensitivity refers to how well a model identifies toxic (or any other property) compounds. A model that determined all compounds are toxic would have 100% sensitivity, because all toxic compounds would be labeled as such; however, all nontoxic compounds would also be labeled toxic. Specificity refers to how well a model distinguishes between toxic and nontoxic compounds. Increasing one usually results in decreasing the other. Depending on the purpose of the model, some scientists will prefer to train models that emphasize one statistic over the other.

During fiscal year 2014 we entered into an RCA with the FDA's Office of Generic Drugs (OGD). The objective of this RCA, which also has a five-year term, is directed toward the FDA's evaluation of mechanistic IVIVCs (*in vitro-in vivo* correlations), an approach to determine whether mechanistic absorption modeling (MAM) correlates laboratory (*in vitro*) dissolution experiments with the *in vivo* behavior of dosage forms better than traditional empirical methods.

## **Cognigen**

We acquired Cognigen on September 2, 2014. Cognigen has a reputation for high-quality analyses and regulatory reporting of data collected during preclinical experiments and clinical trials of new and existing pharmaceutical products, typically working on 30-40 drug projects per year. The modeling analysis of clinical trial data that Cognigen performs is different from the modeling analysis offered by Simulations Plus; the former relies more on statistical and semi-mechanistic models, whereas the latter relies more on mechanistic models. Statistical models rely on direct observation and the mathematical equations are used to fit data collected across multiple studies along with describing the variability within and between patients taking a medicine when the mechanistic understanding of a medicine may not be fully understood. Mechanistic models are based on the detailed understanding of the human body and the chemistry of the drug and involve mathematical and scientific representation of the phenomena involved in drug dissolution/precipitation, absorption, distribution, metabolism, and elimination. Collectively, the models guide drug formulation design and dose selection.

At recent meetings held by the FDA and other regulatory agencies, such agencies emphasized an interest in bringing physiologically based pharmacokinetics (PBPK – a core strength of Simulations Plus) into clinical pharmacology (a core strength of Cognigen). We believe the combined strengths of Cognigen and Simulation Plus will uniquely

position us at the forefront of model-based drug development going forward.

## **STRATEGY**

Our business strategy is to do the things we need to do to promote growth both organically (by expanding our current products and services through in-house efforts) and by acquisition. We believe in the “Built to Last” approach - that the fundamental science and technologies that underlie our business units are the keys both to improving our existing products and to expanding the product line with new products that meet our various customers’ needs. We believe the continued growth of our pharmaceutical software and services business segment is the result of steadily increasing adoption of simulation and modeling software tools across the pharmaceutical industry, as well as the expertise we offer as consultants to assist companies involved in the research and development of new medicines. We have received a continuing series of study contracts with pharmaceutical companies ranging from several of the largest in the world to a number of medium-sized and smaller companies in the U.S. and Europe.

On July 23, 2014, we signed a merger agreement with Cognigen. The merger closed on September 2, 2014, and Cognigen became our wholly owned subsidiary. We believe the combination of Simulations Plus and Cognigen provides substantial future potential based on the complementary strengths of each of the companies. It is our intent to continue to search for acquisition opportunities that are compatible with our current businesses and that are accretive, i.e., adding to both revenues and earnings.

The Company's financial performance has enabled the Company to maintain significant cash reserves while seeking merger candidates and continuing to invest in our marketing and sales activities in order to reach a wider customer base, as well as to distribute significant cash dividends to our shareholders, buy out the former royalty agreement with TSRL related to GastroPlus, and still have sufficient reserves to close the acquisition of Cognigen Corporation in September 2014.

In the fiscal year ended August 31, 2014 we distributed \$0.19 per share in dividends to our shareholders. We anticipate future dividends to be \$0.05 per share per quarter; however, there can be no assurances that such dividends will be distributed, or if so, whether the amounts will be more, less, or the same as expected. The Board of Directors must approve each dividend distribution and may decide to increase, decrease, or eliminate dividend distributions at any time.

## Results of Operations

### *Comparison of Three Months Ended February 28, 2015 and 2014.*

The following table sets forth our condensed statements of operations (in thousands) and the percentages that such items bear to net sales (because of rounding, numbers may not foot):

	Three Months Ended			
	2/28/15		2/28/14	
Net sales	\$4,574	100.0%	\$3,081	100.0%
Cost of sales	1,126	24.6	492	16.0
Gross profit	3,448	75.4	2,589	84.0
Selling, general and administrative	1,612	35.2	1,104	35.8
Research and development	361	7.9	354	11.5
Total operating expenses	1,973	43.1	1,458	47.3
Income from operations	1,475	32.3	1,131	36.7
Other income	(30 )	0.7	12	0.4
Income from operations before taxes	1,445	31.6	1,144	37.1

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(Provision for) income taxes	(475 )	(10.4 )	(334 )	(10.8 )
Net income	\$970	21.2 %	\$810	26.3 %

Net Revenues

Consolidated net revenues increased by 48.4% or \$1.493 million to \$4.574 million in the second fiscal quarter of Fiscal Year 2015 (“2QFY15”) from \$3.081 million in the second fiscal quarter of Fiscal Year 2014 (“2QFY14”). \$1.271 million of this increase was from revenues generated by our newly acquired subsidiary, Cognigen Corporation. Net revenues of Simulations Plus increased \$221,000 or 7.2%, to \$3.302 million in 2QFY15 from \$3.081 million in 2QFY14. Software sales were down slightly by 0.2%, this was mainly due to a delayed renewal order for approximately \$250,000 that renewed in the first week of the third quarter. Training revenues increased \$54,000, while analytical study revenues increased by \$171,000.

Cost of Revenues

Consolidated cost of revenues increased by \$634,000 in 2QFY15 to \$1,126,000 from \$492,000 in 2QFY14. The majority of this increase was due to salary expenses of \$520,000 added as a result of the Cognigen Acquisition. Cost of revenues for Simulations Plus increased \$112,000 in 2QFY15 compared to 2QFY14, \$48,000 of this increase was due to salaries related to increased analytical study activities and a \$75,000 increase in software amortization expense. Simulations Plus saw a decrease in royalty costs of \$174,000, which was offset by increased amortization cost of \$150,000 related to the TSRL agreement (see note 4). The royalty payment for 2QFY15 that would have been due under the previous TSRL agreement would have been approximately \$179,000.

Cost of revenues as a percentage of revenue increased from 16.0% in 2QFY14 to 24.6% in 2QFY15. This percentage change is a result of the blending of lower margins on Cognigen’s consulting services with Simulations Plus’s higher margins that are based primarily on software sales.

A significant portion of cost of revenues for pharmaceutical software products is the systematic amortization of capitalized software development costs, which is an independent fixed cost rather than a variable cost related to revenues. This amortization cost increased approximately \$85,000 or 11.2%, in 2QFY15 compared with 2QFY14. The increase is related to our latest releases of GastroPlus and ADMETPredictor.

Gross Margin

Consolidated gross margin increased \$860,000 or 33.2%, to \$3,448,000 in 2QFY15 from \$2,589,000 in 2QFY14. \$534,000 of this increase in gross margin is from Cognigen, which showed a 58% gross margin on \$1,271,000 in revenues. The remainder of the increase came mainly from the Simulations Plus margin on software sales, training and analytical study revenues.

Selling, General and Administrative Expenses

Selling, general, and administrative (SG&A) expenses increased \$509,000 or 46.1%, to \$1.612 million in 2QFY15 from \$1.104 million in 2QFY14.

The major increases in SG&A expense were:

Cognigen Corporation SG&A Expenses, which were \$539,000 for 2QFY15. Significant expenses for Cognigen for 2QFY15 were as follows:

- o Selling expenses: \$11,000
- o Amortization of customer lists and other intangibles: \$37,000.
- o Depreciation Expense: \$44,000.
- o Employee benefits: \$94,000.
- o Software licensing: \$42,000.

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o Payroll and payroll taxes: \$200,000.  
o Rent: \$47,000.

· Simulation Plus SG&A expenses were down \$30,000 in 2QFY15 compared to 2QFY14

o Increases:

Professional fees-Accounting: Fees increased by \$27,000 over 2QFY14 as the Company's tax return was prepared a quarter earlier in 2QFY15. In addition, the Company incurred additional accounting and tax-related costs associated with the Cognigen acquisition.

§ Salaries: Increased \$22,000 in 2QFY15, mainly due to annual salary adjustments and related payroll taxes.



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Decreases:

§ Selling expenses-travel costs: Decreased by \$44,000 in 2QFY15, the result of less foreign travel compared to 2QFY14.

§ Consulting Fees: decreased by \$42,000. During 2QFY14 we were paying a business consultant related to our acquisition activities.

§ Legal Fees: decreased by \$38,000. During 2QFY14 we incurred legal fees associated with the amendment of the Company's 2007 Stock Option Plan. There were no such fees in 2QFY15.

### Research and Development

We incurred approximately \$717,000 of research and development costs during 2QFY15. Of this amount, \$394,000 was capitalized software development costs and \$361,000 was expensed. In 2QFY14, we incurred \$714,000 of research and development costs, of which \$360,000 was capitalized software development costs and \$354,000 was expensed.

### Other income (expense)

Net other income (expense) in 2QFY15 decreased by \$42,000 to a net expense of \$30,000 from \$12,000 of income in 2QFY14. This is due mainly to currency exchange losses in 2QFY15 caused by a strengthening US dollar.

### Provision for Income Taxes

The provision for income taxes was \$475,000 for 2QFY15 compared to \$334,000 for 2QFY14. Our effective tax rate increased to 32.9% in 2QFY15 from 29.2% in 2QFY14, due to increased income and the attendant lower percentage of permanent tax deductions in 2QFY15 for R&D and other credits.

### Net Income

Net income increased by \$160,000, or 19.8%, in 2QFY15 to \$970,000 from \$810,000 in 2QFY14. We attribute the majority of this increase to the added earnings from our Cognigen subsidiary of \$124,000 and the effect of approximately \$34,000 in increased earnings from the parent company.

### ***Comparison of Six Months Ended February 28, 2015 and 2014.***

The following table sets forth our condensed statements of operations (in thousands) and the percentages that such items bear to net sales (because of rounding, numbers may not foot):

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	Six Months Ended			
	02/28/15		02/28/14	
Net sales	\$8,660	100.0%	\$5,722	100.0%
Cost of sales	2,123	24.5	941	16.4
Gross profit	6,537	75.5	4,782	83.6
Selling, general and administrative	3,679	42.5	2,175	38.0
Research and development	633	7.3	516	9.0
Total operating expenses	4,312	49.8	2,691	47.0
Income from operations	2,225	25.7	2,091	36.6
Other income	(34 )	0.4	45	0.7
Income from operations before taxes	2,191	25.3	2,136	37.3
(Provision for) income taxes	(692 )	(8.0 )	(641 )	(11.2 )
Net income	\$1,499	17.3 %	\$1,495	26.1 %

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Net Revenues

Consolidated net revenues increased by 51.3% or \$2,938 million to \$8.660 million in the first six months of Fiscal Year 2015 (“6moFY15”) from \$5.722 million in the first six months of Fiscal Year 2014 (“6moFY14”). \$2.406 million of this increase was from revenues generated by our newly acquired subsidiary, Cognigen Corporation. Net revenues of the Simulations Plus division increased \$532,000 or 9.3%, to \$6.254 million in 6moFY15 from \$5.722 million in 6moFY14. Six-month software revenues were negatively impacted by a delayed renewal order for approximately \$250,000 that was renewed the week after the quarter ended, and so had to be booked as third- quarter revenues. Nonetheless, 6moFY15 software sales increased \$281,000 and training revenues increased \$87,000 while analytical study revenues were up by \$156,000 compared to 6moFY14.

Cost of Revenues

Consolidated cost of revenues increased by \$1.182 Million to \$2.123 Million in 6moFY15 from \$941,000 in 6moFY14. The majority of this increase was salary expenses of \$1.041 million added as a result of the Cognigen acquisition. Cost of revenues for Simulations Plus increased by \$114,000 in 6moFY15 compared to 6moFY14. Of that amount, \$86,000 was due to increased software amortization costs, and \$31,000 was due to increased labor costs associated with increased study activities, plus another \$19,000 of increased technical support costs. Simulations Plus saw a decrease in royalty costs of \$330,000 for the first six months, which was offset by increased amortization cost of \$300,000 related to the TSRL agreement (see note 4).

Cost of revenues as a percentage of revenue increased from 12.1% in 6moFY14 to 24.5% in 6moFY15. This percentage change is a result of the blending of lower margins on Cognigen’s consulting services with Simulations Plus’s higher margins that are based primarily on software sales.

A significant portion of cost of revenues for pharmaceutical software products is the systematic amortization of capitalized software development costs, which is an independent fixed cost rather than a variable cost related to revenues. This amortization cost increased approximately \$86,000 or 22.5% in 6moFY15 compared with 6moFY14. The increase is related to our latest releases of GastroPlus and ADMETPredictor.

Gross Margin

Consolidated gross margin increased \$1.755 million or 36.7%, to \$6.537 million in 6moFY15 from \$4.782 in 6moFY14. \$1.338 million of this increase in gross margin is from Cognigen, which showed a 55.6% gross margin on \$2.406 million in revenues for 6moFY15. The remainder of the increase came mainly from margin on software sales and analytical studies.

Selling, General and Administrative Expenses

Selling, general, and administrative (SG&A) expenses increased \$1.504 million, or 69.2% to \$3.679 million in 6moFY15 from \$2.175 million in 6moFY14.

The major increases in SG&A expense were:

Cognigen Corporation SG&A Expenses, which were \$1.065 million for 6moFY15. Significant expenses for Cognigen for 6moFY15 were as follows:

- o Selling expenses: \$36,000.
- o Amortization of customer lists and other intangibles: \$74,000.
- o Depreciation Expense: \$88,000.
- o Employee benefits: \$182,000.
- o Software licensing: \$84,000.
- o Payroll and payroll taxes: \$405,000. Rent - \$94,000.

Simulation Plus-Overall SG&A costs were up \$440,000 in 6moFY15 compared to 6moFY14

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Increases:

Consulting Fees: Fees were up \$351,000 for 6moFY15 compare to 6moFY14. We paid \$398,000 in one-time fees and expenses to our financial advisor/business broker related to the Cognigen acquisition. That one-time expense represented 4.6% of revenues and 10.8% of the SG&A costs for the period ended 6moFY15.

Commission expense: We incurred commissions to our Japanese and Chinese dealers as they increased their sales. Commissions were up by \$49,000.

Employee benefits: increased by \$29,000 due to increased medical insurance costs and higher 401K cost on increased salaries.

Payroll and payroll taxes: increased \$46,000 due to annual salary increases and an increase in administrative time associated with the Cognigen integration.

Profession fees-Accounting: increased by \$28,000 over 6moFY14 as the Company's tax return was prepared a quarter earlier in 6moFY15. In addition, the Company incurred additional accounting and tax-related costs associated with the Cognigen acquisition.

o

Decreases:

Legal fees: We paid \$13,000 in one-time legal fees during 6moFY15 to complete the activities related to the Cognigen acquisition; however, overall legal fees for 6moFY15 vs 6moFY14 decreased by \$34,000. In 2014, we incurred legal fees associated with the buyout of the TSRL agreement (See Note 4), the review of proxy issues, and legal issues associated with the amendment of the Company's 2007 Stock Option Plan. There were no such fees in 6moFY15.

Bonus Expense was \$42,000 less in 6moFY15 compared to 6moFY14 due to a change in executive officer agreements and the timing of the 2014 bonus.

### Research and Development

We incurred approximately \$1.364 million of research and development costs during 6moFY15. Of this amount, \$731,000 was capitalized software development costs and \$633,000 was expensed. In 6moFY14 we incurred \$1.250 million of research and development costs, of which \$734,000 was capitalized software development costs and \$516,000 was expensed.

### Other income (expense)

Net other income (expense) in 6moFY15 decreased by \$79,000 to a net expense of \$33,000 from income of \$45,000 in 6moFY14. This is due mainly to currency exchange losses in 6moFY15 due to currency fluctuations caused by a strengthening US dollar.

### Provision for Income Taxes

The provision for income taxes was \$692,000 for 6moFY15 compared to \$642,000 for 6moFY14. Our effective tax rate increased to 31.6% in 6moFY15 from 30% in 6moFY14, due to increased income and the attendant lower percentage of permanent tax deductions in 6moFY15 for R&D and other credits.

Net Income

Net income increased by \$4,000, or 0.3%, to \$1.499 million in 6moFY15 from \$1.495 million in 6moFY14. As discussed above, we incurred one-time consulting costs associated with the Cognigen acquisition of \$400,000. Without those one-time costs, net income would have increased by approximately \$280,000 to \$1,780,000 net of tax, an increase of 18.7% over 6moFY14. In addition, a major software renewal of approximately \$250,000 was delayed into the first week of our third quarter.

## **Liquidity and Capital Resources**

Our principal sources of capital have been cash flows from our operations. We have achieved continuous positive operating cash flow over the last eight fiscal years. We believe that our existing capital and anticipated funds from operations will be sufficient to meet our anticipated cash needs for working capital and capital expenditures for the foreseeable future. Thereafter, if cash generated from operations is insufficient to satisfy our capital requirements, we may open a revolving line of credit with a bank, or we may have to sell additional equity or debt securities or obtain expanded credit facilities. In the event such financing is needed in the future, there can be no assurance that such financing will be available to us, or, if available, that it will be in amounts and on terms acceptable to us. If cash flows from operations became insufficient to continue operations at the current level, and if no additional financing was obtained, then management would restructure the Company in a way to preserve its pharmaceutical business while maintaining expenses within operating cash flows.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

Our risk from exposure to financial markets is limited to foreign exchange variances and fluctuations in interest rates. We may be subject to some foreign exchange risks. Most of our business transactions are in U.S. dollars, although we generate significant revenues from customers overseas. The exception is that we have been compensated in Japanese yen by Japanese customers and PRC Yuan by Chinese customers. In the future, if foreign currency transactions increase significantly, then we may mitigate this effect through price adjustments and/or foreign currency forward contracts whose market-to-market gains or losses are recorded in "Other Income or expense" at the time of the transaction. To date, exchange rate exposure has not resulted in a material impact.

### **Item 4. Controls and Procedures**

We are responsible for maintaining disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Disclosure controls and procedures are controls and other procedures designed to ensure that the information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure. In designing and evaluating disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Based on management's evaluation (with the participation of our chief executive officer and chief financial officer) of our disclosure controls and procedures as required by Rule 13a-15 under the Exchange Act, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures were effective.

Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal controls over financial reporting, as defined in Exchange Act Rule 13a-15(f). Our internal controls over financial reporting are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of condensed financial statements for external purposes in accordance with generally accepted accounting principles.



No changes were made in our internal controls over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) during our most recent fiscal quarter that have materially affected or are reasonably likely to materially affect, our internal controls over financial reporting.

Our management, including our CEO, president, and CFO, does not expect that our disclosure controls or internal controls over financial reporting will prevent all errors or all instances of fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within our company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple errors or mistakes. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and any design may not succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitation of a cost-effective control system, misstatements due to error or fraud may occur and not be detected.



## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

Except as described below, we are not a party to any legal proceedings and are not aware of pending legal proceedings of any kind.

In June 2014, the Company was served with a complaint in a civil action entitled Sherri Winslow v. Incredible Adventures, Inc., et al. (Los Angeles Superior Court Case No. BC545789) alleging wrongful death and seeking unspecified damages arising out of a May 18, 2012 plane crash in the State of Nevada. The Company's Chief Executive Officer owns the subject aircraft and is also a named defendant. The complaint alleged that the Company was the owner of the subject aircraft. The Company denies all material allegations against it, including that it owns or has ever owned any interest in the subject aircraft. On November 25, 2014, the plaintiff and the Company signed a stipulation of dismissal pursuant to which the plaintiff agreed to dismiss the Company without prejudice. If the plaintiff does not discover evidence during a nine month period to and including August 31, 2015 that justifies bringing the Company back into the litigation, the Company will prepare a dismissal with prejudice to be signed on behalf of the plaintiff.

### Item 1A. Risk Factors

Not applicable.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

### Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

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Item 6. Exhibits

EXHIBIT NUMBER	DESCRIPTION
2.1	Agreement and Plan of Merger, dated July 23, 2014, by and among the Company, Cognigen Corporation and the other parties thereto. (13)^
3.1	Articles of Incorporation of the Company. (5)
3.2	Amended and Restated Bylaws of the Company. (5)
4.1	Articles of Incorporation of the Company. (incorporated by reference to Exhibit 3.1 hereof)
4.2	Amended and Restated Bylaws of the Company. (incorporated by reference to Exhibit 3.2 hereof)
4.3	Form of Common Stock Certificate (1)
4.4	Share Exchange Agreement (1)
10.1	The Company's 1996 Stock Option Plan and forms of agreements relating thereto (1) (†)
10.2(a)	Exclusive License Software Agreement by and between the Company and Therapeutic Systems Research Laboratories dated June 30, 1997. (2)
10.2(b)	Termination and Non-Assertion Agreement entered into on May 15, 2014 by and between the Company and TSRL, Inc. (11)
10.3(a)	The Company's 2007 Stock Option Plan. (3) (†)
10.3(b)	The Company's 2007 Stock Option Plan as amended as of December 6, 2013. (10) (†)
10.4(a)	Lease dated May 12, 2005 by and between Freeway Ventures, LLC and the Company. (6)
10.4(b)	Notice of Election to Extend Term of Lease by and between the Company and Crest Development LLC (formerly Freeway Ventures LLC) dated July 29, 2010.(4)
10.4(c)	One Amendment to Lease by and between the Company and Crest Development LLC entered into as May 23, 2013. (8)
10.5	Stock Purchase Agreement by and among the Company, Words+, Inc., and Prentke Romich Company dated November 15, 2011. (7)
10.6	Employment Agreement by and between the Company and Walter S. Woltosz, dated as of July 22, 2011. (5) (†)
10.7	Employment Agreement by and between the Company and Walter S. Woltosz, dated as of August 22, 2013. (9) (†)
10.8	Employment Agreement by and between the Company and Walter S. Woltosz, dated as of August 28, 2014. (12) (†)
10.9	Employment Agreement by and between the Company and Thaddeus H Grasela Jr. dated as of September 2, 2014. (12) (†)
31.1	Section 302 – Certification of the Principal Executive Officer*
31.2	Section 302 – Certification of the Principal Financial Officer*
32.1	Section 906 – Certification of the Chief Executive Office and Chief Financial Officer**
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.

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^ Schedules and exhibits omitted pursuant to Item 601(b)(2) of Registration S-K. The registrant agrees to furnish supplementally a copy of any omitted schedule to the SEC upon request.

\* Filed herewith

\*\* Furnished herewith

(1) Incorporated by reference to the Company's Registration Statement on Form SB-2 (Registration No. 333-6680) filed on March 25, 1997.

(2) Incorporated by reference to the Company's Form 10-KSB for the fiscal year ended August 31, 1997.

(3) Incorporated by reference to the Company's Form 10-K for the fiscal year ended August 31, 2009.

(4) Incorporated by reference to the Company's Form 10-K for the fiscal year ended August 31, 2010.

(5) Incorporated by reference to the Company's Form 10-K for the fiscal year ended August 31, 2011.

(6) Incorporated by reference to the Company's Form 10-KSB for the fiscal year ended August 31, 2006.

(7) Incorporated by reference to the Company's Form 8-K filed November 16, 2011.

(8) Incorporated by reference to the Company's Form 10-Q filed July 10, 2013.

(9) Incorporated by reference to the Company's Form 10-K filed November 18, 2013.

(10) Incorporated by reference to the Company's Form 10-Q filed April 9, 2014.

(11) Incorporated by reference to the Company's Form 8-K filed May 19, 2014.

(12) Incorporated by reference to the Company's Form 8-K filed September 4, 2014.

(13) Incorporated by reference to the Company's Form 8-K/A filed November 18, 2014.

**SIGNATURE**

In accordance with Section 13 or 15 (d) of the Securities Exchange Act of 1934, the Registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Lancaster, State of California, on April 14, 2015.

Simulations Plus, Inc.

Date: April 14, 2015 By: */s/ John R. Kneisel*  
John R. Kneisel  
Chief Financial Officer