SIMULATIONS PLUS INC
Form 10-Q
April 14, 2010

SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

[X] Quarterly Report Pursuant to Section 13 or 15(d) of the Security Exchange Act of 1934 for the quarterly period ended February 28, 2010

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
(State or other jurisdiction of
Incorporation or Organization)

95-4595609
(I.R.S. Employer
identification No.)

42505 10th Street West
Lancaster, CA 93534-7059
(Address of principal executive offices including zip code)

(661) 723-7723
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filings requirements for the past 90 days. Yes [X] No [_]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [_] 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, 2010 was 16,066,245 and no shares of preferred stock were outstanding.

Simulations Plus, Inc.
FORM 10-Q Quarterly Report
For the Quarterly Period Ended February 28, 2010

Table of Contents

PART I. FINANCIAL INFORMATION



PART II. OTHER INFORMATION

SIMULATIONS PLUS, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED BALANCE SHEETS
February 28, 2010 (Unaudited) and August 31, 2009 (Audited)

| ASSETS | February 28, 2010 | August 31, 2009 |
|---|---|---|
| Current assets | | |
| Cash and cash equivalents | $8,641,289 | $7,473,485 |
| Accounts receivable, net of allowance for doubtful accounts and estimated contractual discounts of $369,897 and $447,073 | 1,646,851 | 1,888,904 |
| Contracts receivable | 383,111 | 79,565 |
| Inventory | 336,177 | 325,926 |
| Prepaid expenses and other current assets | 110,743 | 158,738 |
| Deferred income taxes | 329,573 | 338,516 |
| Total current assets | 11,447,744 | 10,265,134 |
| | | |
| Capitalized computer software development costs, net of accumulated amortization of $4,160,046 and $3,843,743 | 2,082,671 | 1,942,893 |
| Property and equipment, net (note 3) | 48,191 | 53,220 |
| Customer relationships, net of accumulated amortization of $112,332 and $104,728 | 15,709 | 23,314 |
| Other assets | 18,445 | 18,445 |
| | | |
| Total assets | $13,612,760 | $12,303,006 |
| | | |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities | | |
| Accounts payable | $301,637 | $199,218 |
| Accrued payroll and other expenses | 613,921 | 552,431 |
| Accrued bonuses to officers | 60,000 | 60,000 |
| Accrued warranty and service costs | 30,670 | 43,236 |
| Accrued income taxes | 168,438 | - |
| Deferred revenue | 119,751 | 82,190 |
| Total current liabilities | 1,294,417 | 937,075 |
| | | |
| Long-Term liabilities | | |
| Deferred income taxes | 857,104 | 795,140 |
| | | |
| Total liabilities | 2,151,521 | 1,732,215 |
| | | |
| Commitments and contingencies (note 4) | | |
| | | |
| Shareholders' equity (note 5) | | |

| | | |
|---|---|---|
| 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 16,054,176 and 15,700,382 shares issued and outstanding on February 28, 2010 and August 31, 2009, respectively. | 4,526 | 4,172 |
| Additional paid-in capital | 5,391,840 | 5,572,411 |
| Retained earnings | 6,064,873 | 4,994,208 |
| | | |
| Total shareholders' equity | 11,461,239 | 10,570,791 |
| | | |
| Total liabilities and shareholders' equity | $13,612,760 | $12,303,006 |

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

SIMULATIONS PLUS, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
For the Three and Six Months Ended February 28,
(Unaudited)

| | Three months ended 2010 | Three months ended 2009 | Six months ended 2010 | Six months ended 2009 |
|---|---|---|---|---|
| Net sales | $2,949,719 | $2,456,762 | $5,386,771 | $4,590,012 |
| Cost of sales | 700,475 | 627,124 | 1,307,364 | 1,187,096 |
| Gross profit | 2,249,244 | 1,829,638 | 4,079,407 | 3,402,916 |
| Operating expenses | | | | |
| Selling, general, and administrative | 1,088,819 | 1,036,724 | 2,093,092 | 1,940,414 |
| Research and development | 252,098 | 286,115 | 513,423 | 553,954 |
| Total operating expenses | 1,340,917 | 1,322,839 | 2,606,515 | 2,494,368 |
| Income from operations | 908,327 | 506,799 | 1,472,892 | 908,548 |
| Other income (expense) | | | | |
| Interest income | 23,560 | 19,606 | 46,046 | 52,993 |
| Interest expense | (1) | - | (303) | - |
| Miscellaneous income | - | - | 231 | 43 |
| Gain on sales of property and equipment | - | - | 1,024 | - |
| Gain on currency exchange | 41,962 | 32,340 | 115,194 | 50,216 |
| Total other income (expense) | 65,521 | 51,946 | 162,192 | 103,252 |
| Income before provision for income taxes | 973,848 | 558,745 | 1,635,084 | 1,011,800 |
| Provision for income taxes | (332,985) | (190,673) | (564,418) | (332,006) |
| Net income | $640,863 | $368,072 | $1,070,666 | $679,794 |
| Basic earnings per share | $0.04 | $0.02 | $0.07 | $0.04 |
| Diluted earnings per share | $0.04 | $0.02 | $0.06 | $0.04 |
| Weighted-average common shares outstanding | | | | |
| Basic | 15,826,030 | 16,268,583 | 15,735,400 | 16,309,683 |
| Diluted | 16,558,423 | 17,108,322 | 16,479,033 | 17,312,242 |

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

SIMULATIONS PLUS, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Six Months Ended February 28,
(Unaudited)

| | 2010 | 2009 |
|---|---|---|
| Cash flows from operating activities | | |
| Net income | $1,070,666 | $679,794 |
| Adjustments to reconcile net income to net cash provided by operating activities | | |
| Depreciation and amortization of property and equipment | 13,246 | 10,719 |
| Amortization of customer relationships | 7,605 | 10,597 |
| Amortization of capitalized computer software development costs | 316,304 | 252,043 |
| Bad debts | 70,283 | 129,881 |
| Stock-based compensation | 32,285 | 80,968 |
| Gain on sales of property and equipment | (1,024) | - |
| Deferred income taxes | 70,907 | (62,400) |
| | | |
| (Increase) decrease in | | |
| Accounts receivable | (107,200) | (209,815) |
| Inventory | (10,251) | 22,453 |
| Other assets | 47,995 | 91,695 |
| Increase (decrease) in | | |
| Accounts payable | 102,418 | (6,757) |
| Accrued payroll and other expenses | 61,491 | 58,909 |
| Accrued bonuses to officers | - | (6,747) |
| Accrued income taxes | 168,438 | 301,564 |
| Accrued warranty and service costs | (12,566) | 17,759 |
| Deferred revenue | 37,561 | 122,500 |
| | | |
| Net cash provided by operating activities | 1,868,158 | 1,493,163 |
| | | |
| Cash flows from investing activities | | |
| Purchases of property and equipment | (31,769) | (34,777) |
| Proceeds from sale of investments | - | 750,000 |
| Capitalized computer software development costs | (456,082) | (352,869) |
| | | |
| Net cash provided by (used in) investing activities | (487,851) | 362,354 |
| | | |
| Cash flows from financing activities | | |
| Repurchase of common stock | (288,698) | (271,713) |
| Proceeds from the exercise of stock options | 76,195 | 48,806 |
| | | |
| Net cash used in financing activities | (212,503) | (222,907) |
| | | |
| Net increase in cash and cash equivalents | $1,167,804 | $1,632,610 |
| | | |
| Cash and cash equivalents, beginning of year | 7,473,485 | 5,889,601 |

| | | |
|---|---|---|
| Cash and cash equivalents, end of period | $8,641,289 | $7,522,211 |
| | | |
| Supplemental disclosures of cash flow information | | |
| | | |
| Interest paid | $302 | $- |
| | | |
| Income taxes paid | $260,464 | $- |

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

Simulations Plus, Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1: GENERAL

This report on Form 10-Q for the quarter ended February 28, 2010, should be read in conjunction with the Company's annual report on Form 10-K for the year ended August 31, 2009, filed with the SEC on November 30, 2009 and its amendment filed on March 1, 2010. As contemplated by the Securities and Exchange Commission 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.

Note 2: SIGNIFICANT ACCOUNTING POLICIES

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.

Principles of Consolidation
The condensed consolidated financial statements include the accounts of Simulations Plus, Inc. and its wholly owned subsidiary, Words+, Inc. All significant intercompany accounts and transactions are eliminated in consolidation.

Revenue Recognition
We recognize revenues related to software licenses and software maintenance in accordance with Financial Accounting Standards Boards (“FASB”) Accounting Standards Codification (“ASC”) 985-605. Software products 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. For Words+ products, the revenue is recorded at the time of shipment, net of estimated allowances and returns.

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. We provide, for a fee, additional training and service calls to our customers and recognize 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 contract study revenue either equally over the term of the contract or using the percentage of completion method, depending upon how the contract studies are engaged, in accordance with FASB ASC 605-35. 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.

Reclassifications
Certain numbers in the prior year have been reclassified to conform to the current year's presentation.

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 maintain an allowance for doubtful accounts for estimated losses that may arise if any of its customers are unable to make required payments. Management specifically analyzes the age of customer balances, historical bad debt experience, customer credit-worthiness, and changes in customer payment terms when making estimates of the collectability of the Company's trade accounts receivable balances. If management determines 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. We also estimate the contractual discount obligation for third-party funding such as Medicare, Medicaid, and private insurance companies. Those estimated discounts are reflected in the allowance for doubtful accounts and contractual discounts.

Inventory
Inventory is stated at the lower of cost (first-in, first-out basis) or market and consists primarily of computers and peripheral computer equipment.

Capitalized Computer Software Development Costs
Software development costs are capitalized in accordance with FASB ASC 985-20. 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 provided on a product-by-product basis on the straight-line method over the estimated economic life of the products (not to exceed five years). Amortization of software development costs amounted to $316,304 and $252,043 for the six months ended February 28, 2010 and 2009, respectively. We expect future amortization expense to vary due to increases in capitalized computer software development costs.

We test capitalized computer software 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.

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

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

measurement date.

The following table summarizes fair value measurements by level at February 28, 2010 for assets and liabilities measured at fair value on a recurring basis:

| | Level I | Level II | Level III | Total |
|---|---|---|---|---|
| Cash and cash equivalents | $ 8,641,289 | $ - | $ - | $ 8,641,289 |
| Total assets | $ 8,641,289 | $ - | $ - | $ 8,641,289 |

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

Shipping and Handling
Shipping and handling costs, recorded as cost of sales, amounted to $54,715 and $47,666 for the six months ended February 28, 2010 and 2009, respectively.

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 which was developed by other companies and incorporated into, or used in the development of, our final products.

Income Taxes
We utilize FASB ASC 740-10 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.

The difference between income tax expense attributable to continuing operations and the amount of income tax expenses that would result from applying domestic federal statutory rates to pre-tax income is mainly related to state income taxes, offset by the utilization of research and development credits for federal and state purposes. Our policy is to include interest and penalties related to unrecognized tax benefits in income tax expense. Interest and penalties amounted to $731 and $315 for the six months ended February 28, 2010 and 2009, respectively.

Customer relationships
We purchased customer relationships as a part of the acquisition of certain assets of Bioreason, Inc. in November 2005. Customer relationships was recorded at a cost of $128,042, and is being amortized over 78 months under the sum-of-the-years'-digits method. Amortization expense for the six months ended February 28, 2010 and 2009 amounted to $7,605 and $10,597, respectively. Accumulated amortization as of February 28, 2010 and 2009 was $112,333 and $95,626, respectively.