SIMULATIONS PLUS INC
Form 10-Q
April 11, 2013

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, 2013**

OR

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

Commission file number: **001-32046**

Simulations Plus, Inc.

(Name of registrant as specified in its charter)

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

42505 10th Street West

Lancaster, CA 93534-7059

(Address of principal executive offices including zip code)

(661) 723-7723

(Registrant's telephone number, including area code)

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

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

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

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

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

The number of shares outstanding of the registrant’s common stock, par value $0.001 per share, as of April 8, 2013 was 16,021,309 and no shares of preferred stock were outstanding.

Simulations Plus, Inc.

FORM 10-Q

For the Quarterly Period Ended February 28, 2013

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PART I. FINANCIAL INFORMATION

SIMULATIONS PLUS, INC. CONDENSED BALANCE SHEETS

at February 28, 2013 (Unaudited) and August 31, 2012 (Audited)

ASSETS

	February 28, 2013	August 31, 2012
Current assets		
Cash and cash equivalents	$9,754,861	$12,701,075
Income tax refund receivable	2,650	153,896
Accounts receivable, net of allowance for doubtful accounts of $0	2,535,816	1,451,864
Contracts receivable	86,995	18,893
Prepaid expenses and other current assets	168,351	150,856
Deferred income taxes	210,456	193,712
Total current assets	12,759,129	14,670,296
Long-term assets		
Capitalized computer software development costs,net of accumulated amortization of $5,443,703 and $5,084,691	2,702,535	2,479,468
Property and equipment, net (note 3)	94,091	107,410
Intellectual property, net of accumulated amortization of $7,500 and $3,750	67,500	71,250
Other assets	18,445	18,445
Total assets	$15,641,700	$17,346,869

LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$254,737	$177,509
Accrued payroll and other expenses	308,592	312,912
Accrued bonuses to officer	30,000	60,000
Accrued income taxes	27,859	733,233
Deferred revenue	222,735	131,782
Total current liabilities	843,923	1,415,436
Long-term liabilities		
Deferred income taxes	876,968	788,857
Total liabilities	1,720,891	2,204,293
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 16,021,309 and 15,923,019 shares issued and outstanding	4,493	4,399
Additional paid-in capital	4,797,317	4,628,366
Retained earnings	9,118,999	10,509,811
Total shareholders' equity	13,920,809	15,142,576
Total liabilities and shareholders' equity	$15,641,700	$17,346,869

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

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SIMULATIONS PLUS, INC.

CONDENSED STATEMENTS OF OPERATIONS

For the three and six months ended February 28 and 29,
(Unaudited)

	Three months ended		Six months ended	
	2013	2012	2013	2012
Net sales	$3,118,121	$2,789,226	$5,408,215	$5,037,182
Cost of sales	498,778	396,566	885,648	748,936
Gross profit	2,619,343	2,392,660	4,522,567	4,288,246
Operating expenses				
Selling, general, and administrative	854,983	956,325	1,786,043	1,656,438
Research and development	247,522	264,581	427,857	516,516
Total operating expenses	1,102,505	1,220,906	2,213,900	2,172,954
Income from operations	1,516,838	1,171,754	2,308,667	2,115,292
Other income (expense)				
Interest income	17,074	25,083	30,802	46,956
Interest expense	–	–	–	(3)
Miscellaneous income	15,390	22,656	30,794	22,656
Gain on currency exchange	22,988	40,502	97,642	138,888
Gain (loss) from sale of assets	–	(433)	–	(433)
Total other income (expense)	55,452	87,808	159,238	208,064
Income from continuing operations before provision for income taxes	1,572,290	1,259,562	2,467,905	2,323,356
Provision for income taxes	(510,715)	(420,985)	(819,344)	(729,680)
Income from continuing operations	1,061,575	838,577	1,648,561	1,593,676
Discontinued operations:				
Gain (loss) from discontinued operations, net of tax	–	–	–	(249,898)
Gain on sale of Words+, net of tax	–	–	–	465,820
Results of discontinued operations	–	–	–	215,922
Net Income	$1,061,575	$838,577	$1,648,561	$1,809,598
Basic earnings per share:				
Continuing operations	$0.07	$0.05	$0.10	$0.10
Discontinued operations	–	–	–	0.01
Net basic earning per share	$0.07	$0.05	$0.10	$0.11
Diluted earnings per share				

Continuing operations	$0.06	$0.05	$0.10	$0.10
Discontinued operations	–	–	–	0.01
Net basic earning per share	$0.06	$0.05	$0.10	$0.11
Weighted-average common shares outstanding				
Basic	16,004,397	15,635,898	15,965,890	15,604,420
Diluted	16,336,353	15,995,226	16,305,235	15,957,657

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

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SIMULATIONS PLUS, INC.

CONDENSED STATEMENTS OF CASH FLOWS

For the three and six months ended February 28 and 29,
(Unaudited)

	2013	2012
Cash flows from operating activities		
Net income	$1,648,561	$1,809,598
Adjustments to reconcile net income to net cash provided by operating activities		
(Income)/Loss from Discontinued Operations	–	(215,922)
Depreciation and amortization of property and equipment	20,999	19,637
Amortization of customer relationships	–	1,622
Amortization of intellectual property	3,750	–
Amortization of capitalized computer software development costs	359,013	303,336
Excess tax benefits from share-based arrangements	(70,806)	–
Stock-based compensation	70,253	59,405
(Gain)/Loss from sale of assets	–	433
Deferred income taxes	71,367	140,053
(Increase) decrease in		
Accounts receivable and Contracts receivable	(1,152,054)	(949,906)
Income tax receivable	151,246	–
Prepaid expenses and other assets	(17,495)	(16,479)
Increase (decrease) in		
Accounts payable	77,228	211,711
Accrued payroll and other expenses	(4,320)	9,957
Accrued Bonus	(30,000)	60,000
Accrued income taxes	(634,568)	690,937
Deferred revenue	90,953	39,741
Net cash provided by operating activities of continuing operations	584,127	2,164,123
Net cash (used in) operating activities of discontinued operations	–	(688,862)
Net cash provided by operating activities	584,127	1,475,261
Cash flows from investing activities		
Proceeds from sale of Words+, Inc.	–	1,973,096
Proceeds from sale of assets	–	200
Purchases of property and equipment	(7,680)	(90,350)
Purchase of royalty	–	(75,000)
Capitalized computer software development costs	(582,080)	(486,499)
Net cash provided by (used in) investing activities of continuing operations	(589,760)	1,321,447
Net cash provided by investing activities of discontinued operations	–	6,532
Net cash provided by (used in) investing activities	(589,760)	1,327,979

Cash flows from financing activities		
Excess tax benefits from share-based arrangements	70,806	–
Proceeds from the exercise of stock options	27,986	256,641
Declaration of dividends	(3,039,373)	–
Net cash (used in) financing activities of continuing operations	(2,940,581)	256,641
Net increase (decrease) in cash and cash equivalents from continuing operations	(2,946,214)	3,742,211
Net (decrease) in cash and cash equivalents from discontinued operations	–	(682,330)
Net increase (decrease) in cash and cash equivalents	(2,946,214)	3,059,881
Cash and cash equivalents, beginning of year	12,701,075	10,181,049
Cash and cash equivalents, end of period	$9,754,861	$13,240,930
Supplemental disclosures of cash flow information		
Interest paid	$–	$3
Income taxes paid	$1,382,545	$170,000

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

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Simulations Plus, Inc.

NOTES TO CONDENSED FINANCIAL STATEMENTS

February 28, 2013 and 29, 2012

(Unaudited)

Note 1: GENERAL

This report on Form 10-Q for the quarter ended February 28, 2013, should be read in conjunction with the Company's annual report on Form 10-K for the year ended August 31, 2012, filed with the Securities and Exchange Commission (“SEC”) on November 15, 2012. 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.

As further discussed in note 10 below, we sold all of the common stock of our 100% owned subsidiary, Words+, Inc. (“Words+”), on November 30, 2011.

Note 2: SIGNIFICANT ACCOUNTING POLICIES

Estimates

Our condensed 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. However, we recognize contract study revenue 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. Prior to the sale of our former Words+ subsidiary, the Company also estimated the contractual discount obligation for third-party funding, such as Medicaid and private insurance companies. Those estimated discounts were reflected in the allowance for doubtful accounts and contractual discounts and included in discontinued operations. Although we experienced significant collection problems with our former Words+ subsidiary, we have never had a customer fail to pay on the pharmaceutical software and services side of the business, which now constitutes our entire business.

Capitalized Computer Software Development Costs

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

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

Amortization of capitalized software development costs is calculated on a product-by-product basis on the straight-line method over the estimated economic life of the products (not to exceed five years, although all of our current software products have already been on the market for 7-15 years except for our newest MedChem Designer™ program, and we do not foresee an end-of-life for any of them at this point). Amortization of software development costs amounted to $359,013 and $303,336 for the six months ended February 28, 2013 and 29, 2012, 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.

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, 2013 for assets and liabilities measured at fair value on a recurring basis:

	Level I	Level II	Level III	Total
Cash and cash equivalents	$ 9,754,861	$ -	$ -	$ 9,754,861
Total	$ 9,754,861	$ -	$ -	$ 9,754,861

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.

The California Franchise Tax Board ("FTB") audited us for the fiscal years ended ("FYE") August 31, 2007 and 2008. We received refunds as we claimed; however they have now continued their audit to include FYE 2009 and 2010, and are reviewing 2007 and 2008 R&D credits since those credits were carried forward to FYE 2009 and 2010. In March 2012, we also received a notice from the Internal Revenue Service (IRS) that our fiscal year ended August 31, 2008 is subject to their examination. In October 2012, the IRS completed their examination of our 2007 tax filing. The outcome of this examination was a decrease of $36,868 in the amount refundable. We received a refund of $151,246 in December 2012.

Customer relationships

The Company 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, 2013 and 29, 2012 amounted to $0 and $1,622 respectively. Accumulated amortization as of February 28, 2013 and 29, 2012 was $128,042 and $127,793, respectively.

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 six months ended February 28, 2013 and 29, 2012 were as follows:

	02/28/2013	02/29/2012
Numerator Net income attributable to common shareholders	$1,648,561	$1,809,598
Denominator		
Weighted-average number of common shares outstanding during the 6 months of FY13 and FY12	15,965,890	15,604,420
Dilutive effect of stock options	339,345	353,238
Common stock and common stock equivalents used for diluted earnings per share	16,305,235	15,957,657

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 includes: (1) compensation cost for all share-based payments granted prior to, but not yet vested as of September 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123 amortized over the options' vesting period, and (2) compensation cost for all share-based payments granted subsequent to September 1, 2006, 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 $70,253 and $59,405 for the six months ended February 28, 2013 and 29, 2012, respectively, and is included in the condensed statements of operations as Selling, General and Administration (SG&A), and Research and Development expense. As of November 30, 2011, the unvested options for employees who terminated due to the sale of Words+, Inc. became fully vested. As a result, the unamortized portion of such stock-based compensation for those employees was expensed in full during the first fiscal quarter ended November 30, 2011. There was no incremental cost associated with the accelerated vesting of these options.

Recently Issued Accounting Pronouncements

In July 2012, the FASB issued ASU 2012-02, "*Testing Indefinite-Lived Intangible Assets for Impairment",* which amended the guidance in ASU 2011-08 to simplify the testing of indefinite-lived intangible assets other than goodwill for impairment. ASU 2012-02 becomes effective for annual and interim impairment tests performed for fiscal years beginning on or after September 15, 2012 and earlier adoption is permitted. We adopted this standard in the first quarter of fiscal year 2013. We believe adoption did not have a material effect on our financial statements.

Note 3: Property and Equipment

Property and equipment as of February 28, 2013 consisted of the following:

Equipment	$123,062
Computer equipment	280,242
Furniture and fixtures	48,813
Leasehold improvements	53,898
Sub total	506,015
Less: Accumulated depreciation and amortization	(411,924)
Net Book Value	94,091

Note 4: COMMITMENTS AND CONTINGENCIES

Sublease with Words+, Inc., a wholly owned subsidiary of Prentke Romich Company (PRC)

After the sale of Words+, we entered into a sublease agreement under which Words+ paid 20 percent of the monthly rent we pay to our landlord, plus 20% of facility-related operating expenses. The term of this sublease is from month to month commencing on January 1, 2012.

On February 4, 2013, we received a 30-day notice from PRC stating their cancellation of the sublease due to the closure of Words+.

Employment Agreement

On July 22, 2012, the Company entered into an employment agreement with its President/Chief Executive Officer that expires in August 2013. The employment agreement provides for an annual base salary of $300,000 per year, and a performance bonus in an amount not to exceed 10% of Employee’s salary, or $30,000 per year, at the end of each fiscal year. The specific amount of the bonus to be awarded will be determined by the Compensation Committee of the Board of Directors, based on the financial performance and achievements of the Company for the previous fiscal year. The agreement also provides Employee stock options, exercisable for five years, to purchase fifty (50) 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 120,000 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.

For fiscal year 2012, the Compensation Committee awarded a $30,000 performance bonus to Walter Woltosz, our President/Chief Executive Officer, which was paid in September 2012.

Litigation

We are not a party to any litigation at this time and we are not aware of any pending litigation of any kind.

Note 5: SHAREHOLDERS’ EQUITY

Dividend

The Board of Directors declared cash dividends during fiscal year 2012. 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
02/21/2012	03/01/2012	15,813,844	$0.05	$790,692
04/27/2012	05/08/2012	15,923.019	$0.05	$796,151
08/07/2012	08/10/2012	15,923.019	$0.05	$796,151
Total				**$2,382,994**

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The Board of Directors also declared the following cash dividend during the first six months of fiscal year 2013.

Record Date	Distribution Date	Number of Shares Outstanding on Record Date	Dividend per Share	Total Amount
11/08/2012	11/13/2012	15,927,806	$0.05	$796,390
12/24/2012	12/28/2012	16,021,309	$0.14*	$2,242,983
Total				**$3,039,373**

*As a tax benefit to our shareholders considering the increase in federal income tax for capital gains in 2013, the Board of Directors declared an accelerated cash dividend, $0.14 per share, on December 14, 2012, consisting of all of the planned February 2013 distribution of $0.05 per share, plus $0.03 per share of the planned $0.05 per share per quarter for the remaining three fiscal quarters ending in calendar year 2013.

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.

Qualified Incentive Stock Options (Qualified ISO)

As of February 28, 2013, employees hold Qualified ISO to purchase 556,800 shares of common stock at exercise prices ranging from $1.00 to $5.06 which were granted prior to February 28, 2013.

Transactions in FY13	Number of Options	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Life

Outstanding, August 31, 2012	689,800	$	1.74	
Granted	20,000	$	5.06	
Exercised	(153,000)	$	1.84	
Outstanding, February 28, 2013	556,800	$	1.84	4.57
Exercisable, February 28, 2013	370,000	$	1.52	4.22

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

As of February 28, 2013, the outside members of the Board of Directors hold options to purchase 36,600 shares of common stock at exercise prices ranging from $1.67 to $6.68, which were granted prior to February 28, 2013.

Transactions in FY13	Number of Options	Weighted-Average Exercise Price Per Share		Weighted-Average Remaining Contractual Life
Outstanding, August 31, 2012	36,600	$	3.47	
Outstanding, February 28, 2013	36,600	$	3.47	7.64
Exercisable, February 28, 2013	19,400	$	3.14	6.49

The weighted-average remaining contractual life of options outstanding issued under the Plan, both Qualified ISO and Non-Qualified ISO, was 4.8 years at February 28, 2013. The exercise prices for the options outstanding at February 28, 2013 ranged from $1.00 to $6.68, 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	357,700	4.5 years	$1.07	286,900	4.1 years	$1.08
$1.51	$3.00	54,600	7.0 years	$2.37	22,200	6.8 years	$2.20
$3.01	$4.50	157,100	4.7 years	$3.26	76,300	4.6 years	$3.10
$4.51	$6.68	24,000	4.5 years	$5.33	4,000	4.5 years	$6.68
		593,400	**4.8 years**	**$1.94**	**389,400**	**4.3 years**	**$1.60**

NOTE 6: RELATED PARTY TRANSACTIONS

As of February 28, 2013, included in bonus expenses to officers was $60,000, of which $30,000 was accrued bonus representing an estimated quarterly amount of bonus payable to the Corporate Secretary, Virginia Woltosz, as part of the terms of the sale of Words+ to Simulations Plus in 1996. The other $30,000, paid in September 2012, was FY2012 performance bonus to Walter Woltosz, our President/Chief Executive Officer, which was approved by the compensation committee in FY2013.

NOTE 7: CONCENTRATIONS AND UNCERTAINTIES

Revenue concentration shows that International sales accounted for 53% and 50% of net sales for the six months ended February 28, 2013 and 29, 2012, respectively. Two customers accounted for 11% (a dealer account in Japan representing various customers) and 10% of net sales during the six months ended February 28, 2013, compared with three customers accounting for 11%, 8% (a dealer account in Japan representing various customers), and 6% of net sales during the six months ended February 29, 2012.

Accounts receivable concentration shows that three customers comprised 12%, 10% (a dealer account in Japan representing various customers), and 10% of accounts receivable at February 28, 2013, and two customers comprised 14% and 13% (a dealer account in Japan representing various customers) of accounts receivable at February 29, 2012.

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. During the current economic downturn, we have seen consolidations in the pharmaceutical industry, especially in this first fiscal quarter of 2013. Although we have not seen any significant reduction in total revenues to date, our growth rate has been affected. Continued consolidation and downsizing in the pharmaceutical industry could have an impact on our revenues and earnings going forward.

NOTE 8: Segment and Geographic Reporting

We allocate revenues to geographic areas based on the locations of our customers. Geographical revenues for the six months ended February 28, 2013 and 29, 2012 were as follows (in thousands):

	North America	Europe	Asia	South America	Total
February 28, 2013	$ 2,605	$ 1,775	$ 1,028	$ -	$ 5,408
February 29, 2012	$ 2,515	$ 1,626	$ 886	$ 10	$ 5,037

Prior to the sale of Words+ on November 30, 2011, the Company operated in two business segments, which consisted of the pharmaceutical software and services business and the augmentative communication device business. Upon the sale of Words+ on November 30, 2011, the Company ceased operations in the augmentative communication device business. The results of this former business segment are presented as discontinued operations in the accompanying financial statements. The pharmaceutical software and services segment, which represents the Company's ongoing business, is presented as continuing operations.

Note 9: 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 $50,545 and $45,616 for the six months ended February 28, 2013 and 29, 2012, respectively.

NOTE 10: DISCONTINUED OPERATIONS

On November 30, 2011, we sold our interest in Words+, Inc. for $1,973,096 in cash. Words+ operations are now presented as discontinued operations in accordance with accounting rules related to the disposal of long-lived assets.

We recognized a gain of $465,820, net of tax, from this sale, which is included in income from discontinued operations in our condensed statement of operations for the fiscal quarter ended November 30, 2011. The revenue and expenses of discontinued operations for the first fiscal quarter of 2011 and the fiscal year ended August 31, 2011 are as follows:

(in thousand)	Period from 09/01/11 to 11/30/11	For the fiscal year ended 08/31/11
Net sales	$479	$2,981
Cost of sales	265	1,381
Gross profit	214	1,600
Selling, general and administrative	563	1,466
Research and development	55	64
Total operating expenses	618	1,530
Income (Loss) from discontinued operations	(404)	70
Other income	–	2
Income (Loss) from discontinued operations before income taxes	(404)	72
(Provision for) income taxes	154	–
Results from discontinued operations, net of tax	$(250)	$72

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The carrying amount of the assets and liabilities of discontinued operations at August 31, 2011 and just prior to the date of the sale on November 30, 2011 were as follows:

(in thousands)	11/30/11	08/31/11
Cash and cash equivalents	$6	$143
Receivables, net	357	603
Inventory	392	392
Prepaid and other current assets	33	57
Capitalized software development costs, net	212	220
Property and equipment, net	91	120
Total Assets	1,091	1,535
Accounts payable	72	116
Accrued payroll and other expenses	109	219
Accrued warranty and service costs	37	44
Total Liabilities	218	379
Net liabilities of discontinued operations	$873	$1,153

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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,” “co “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

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Simulations Plus, Inc., incorporated in 1996, develops and produces software for use in pharmaceutical research and for education, as well as provides consulting and contract research services to the pharmaceutical industry. Simulations Plus also took over responsibility for producing a personal productivity software program called Abbreviate! originally spun out of products for the disabled by its former subsidiary, Words+ for the retail market. Words+, founded in 1981, produced computer software and specialized hardware for use by persons with disabilities. The Words+ subsidiary was sold effective November 30, 2011, and is treated as “discontinued operations” in the financial statements. The new owners of Words+ ceased its operations in March 2013. This discussion will therefore focus on the ongoing operations for pharmaceutical software and services and the Abbreviate! utility software.

We currently offer five software products for pharmaceutical research: ADMET Predictor™, MedChem Designer™, MedChem Studio™, DDDPlus™, and GastroPlus™.

ADMET (Absorption, Distribution, Metabolism, Excretion and Toxicity) Predictor is a computer program that takes molecular structures as inputs and predicts over 140 different properties for them at the rate of about 200,000 compounds per hour on a laptop computer. ADMET Predictor has been consistently top-ranked in peer-reviewed, independent comparison studies for predictive accuracy, while generating its results at this very high throughput rate. This capability lets a pharmaceutical scientist rapidly screen large numbers of new molecules for acceptable properties. The current state-of-the-art of this type of software does not enable finding the best molecule in a series, but it does allow identifying molecules that are highly likely to fail as potential drug candidates before synthesizing and testing them. Thus, millions of "virtual" compounds can be created and screened in a day, compared to potentially months of work to actually synthesize and test a much smaller number of actual compounds.

The ADMET Modeler™ subprogram that is integrated into ADMET Predictor enables scientists to use their own experimental data to quickly create high-quality, proprietary predictive models using the same powerful modeling methods we use to build our best-in-class property predictions. Pharmaceutical companies spend enormous amounts of 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 tedious activity performed by specialists.

We released Version 6.0 of ADMET Predictor in May 2012. This version incorporated a new feature to enable users to generate likely metabolites for any molecule using an embedded version of our MedChem Designer program. It also increased the number of predictive models for metabolism and toxicity, and refined many of our earlier predictions. We are now very close to releasing Version 6.2, which will extend our metabolism prediction capabilities based on a much larger experimental data set. These improvements will also be available via MedChem Designer and MedChem Studio for customers who license ADMET Predictor.

MedChem Designer

MedChem Designer was launched in February 2011. It was initially a molecule drawing program, or "sketcher", but now has capabilities far exceeding those of other molecule drawing programs because of its integration with both MedChem Studio and ADMET Predictor. We provide MedChem Designer for free because we believe that in the long run it will help to increase demand for ADMET Predictor and MedChem Studio. Most other existing molecule drawing programs are also free. Our free version includes a small set of ADMET Predictor property predictions, allowing the chemist to modify molecular structures and then see a few key properties very quickly. The chemist also sees that with a paid ADMET Predictor license, a total of over 140 predictions would be available.

When coupled with a license for ADMET Predictor, MedChem Designer becomes a *de novo* design tool for medicinal chemists. With it, they can draw one or more molecular structures, then click on the ADMET Predictor icon and have over 140 properties for each structure calculated in seconds, including our proprietary ADMET Risk™ index. They can also click on an icon to generate likely metabolites and predict their properties and ADMET Risks as well. ADMET Risk provides a single number that tells the chemist how many default threshold values for 24 predicted properties were crossed (or violated) by each structure. The rules can be modified and new rules 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. 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 separately examine many key properties for each new molecule to check whether any became unacceptable as a result of changing the structure.

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We released MedChem Designer 2.0 in May 2012 with its new capabilities, including showing the most likely metabolites that would be produced from a parent molecule by the most common CYP enzymes. With this capability, the chemist can not only see predicted likely metabolites, but can also use ADMET Predictor to assess whether any of the predicted metabolites would be likely to result in unacceptable adverse effects. When a molecule that could have been a good medicine is converted into a toxic metabolite, it can be rendered dangerous or useless. The ability to predict likely metabolites and their properties is another way to reduce the number of molecules that are taken forward into development only to fail at a later stage after considerable time and money have been expended. The upcoming release of ADMET Predictor combined with MedChem Designer will show the predicted atom locations for metabolism by each of the enzymes predicted to act upon a molecule.

MedChem Studio

Over the past several years, MedChem Studio updates have resulted in a very powerful tool for medicinal and computational chemists for both data mining and for designing new drug-like molecules.