SIMULATIONS PLUS INC
Form 10-Q
April 13, 2016

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 29, 2016**

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   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)   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

The number of shares outstanding of the registrant's common stock, par value $0.001 per share, as of April 13, 2016 was 17,029,501; no shares of preferred stock were outstanding.

Simulations Plus, Inc.

FORM 10-Q

For the Quarterly Period Ended February 29, 2016

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PART I. FINANCIAL INFORMATION

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SIMULATIONS PLUS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

As of

	(Unaudited) February 29, 2016	(Audited) August 31, 2015
ASSETS		
Current assets		
Cash and cash equivalents	$7,062,993	$8,551,275
Accounts receivable, net of allowance for doubtful accounts of $0	3,808,081	1,593,707
Revenues in excess of billings	856,558	795,125
Prepaid income taxes	240,116	–
Prepaid expenses and other current assets	309,152	381,718
Deferred income taxes	237,557	210,972
Total current assets	12,514,457	11,532,797
Long-term assets		
Capitalized computer software development costs, net of accumulated amortization of $8,126,958 and $7,632,421	3,849,025	3,798,339
Property and equipment, net (note 3)	317,019	413,510
Intellectual property, net of accumulated amortization of $1,105,000 and $801,250	4,970,000	5,273,750
Other intangible assets net of accumulated amortization of $221,250 and $147,500	1,428,750	1,502,500
Goodwill	4,789,248	4,789,248
Other assets	34,082	34,082
Total assets	$27,902,581	$27,344,226
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$126,078	$209,407
Accrued payroll and other expenses	441,088	429,580
Accrued bonuses to officer	60,500	121,000
Income taxes payable	–	43,602
Other current liabilities	18,204	19,859
Current portion - Contracts payable (note 4)	2,604,404	2,604,404
Billings in excess of revenues	172,297	106,534
Deferred revenue	114,631	78,945
Total current liabilities	3,537,202	3,613,331
Long-term liabilities		
Deferred income taxes	3,054,076	3,190,419
Payments due under Contracts payable (note 4)	1,000,000	1,000,000
Other long-term liabilities	–	8,274
Total liabilities	$7,591,278	$7,812,024

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 17,018,001 and 16,943,001 shares issued and outstanding	5,489	5,414
Additional paid-in capital	9,942,194	9,714,290
Retained earnings	10,363,620	9,812,498
Total shareholders' equity	$20,311,303	$19,532,202
Total liabilities and shareholders' equity	$27,902,581	$27,344,226

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

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SIMULATIONS PLUS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

For the three and six months ended February 29 and 28,

| | Three months ended (Unaudited) | | Six months ended (Unaudited) | |
	2016	2015	2016	2015
Net Revenues	$5,163,726	$4,574,191	$10,002,346	$8,660,382
Cost of revenues	1,263,741	1,130,907	2,347,088	2,175,582
Gross profit	3,899,985	3,443,284	7,655,258	6,484,800
Operating expenses				
Selling, general, and administrative	1,722,844	1,607,495	3,399,278	3,626,994
Research and development	461,389	360,708	812,696	633,348
Total operating expenses	2,184,233	1,968,203	4,211,974	4,260,342
Income from operations	1,715,752	1,475,081	3,443,284	2,224,458
Other income (expense)				
Interest income	4,486	4,412	8,953	9,004
Gain(loss) on currency exchange	(28,330)	(34,684)	(43,224)	(42,475)
Total other income (expense)	(23,844)	(30,272)	(34,271)	(33,471)
Income from operations before provision for income taxes	1,691,908	1,444,809	3,409,013	2,190,987
Provision for income taxes	(546,559)	(474,576)	(1,157,191)	(691,851)
Net Income	$1,145,349	$970,233	$2,251,822	$1,499,136
Earnings per share				
Basic	$0.07	$0.06	$0.13	$0.09
Diluted	$0.07	$0.06	$0.13	$0.09
Weighted-average common shares outstanding				
Basic	17,005,649	16,848,983	16,985,869	16,839,599
Diluted	17,268,144	17,105,412	17,230,099	17,096,357

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

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SIMULATIONS PLUS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the six months ended February 29 and 28,

	(Unaudited) 2016	2015
Cash flows from operating activities		
Net income	$2,251,822	$1,499,136
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization of property and equipment	98,992	112,441
Amortization of capitalized computer software development costs	494,537	490,051
Amortization of Intellectual Property	377,500	377,500
Stock-based compensation	120,249	150,624
Deferred income taxes	(162,928)	159,968
(Increase) decrease in		
Accounts receivable	(2,214,374)	(536,612)
Revenues in excess of billings	(61,433)	(92,310)
Prepaid income taxes	(240,116)	422,125
Prepaid expenses and other assets	72,566	8,095
Increase (decrease) in		
Accounts payable	(83,329)	(69,307)
Accrued payroll and other expenses	11,508	(397,090)
Accrued bonus	(60,500)	(72,000)
Billings in excess of revenues	65,763	(249,637)
Accrued income taxes	(43,602)	–
Other liabilities	(9,929)	(9,930)
Deferred revenue	35,686	14,576
Net cash provided by (use in) operating activities	652,412	1,807,630
Cash flows from investing activities		
Purchases of property and equipment	(2,501)	(19,159)
Cash used to purchase Cognigen	–	(2,080,000)
Cash received in acquisition	–	190,184
Capitalized computer software development costs	(545,223)	(730,855)
Net cash provided by (used in) investing activities	(547,724)	(2,639,830)
Cash flows from financing activities		
Payment of Dividends	(1,700,700)	(1,684,660)
Proceeds from the exercise of stock options	107,730	4,973
Net cash (used in) financing activities of continuing operations	(1,592,970)	(1,679,687)
Net increase (decrease) in cash and cash equivalents	(1,488,282)	(2,511,887)
Cash and cash equivalents, beginning of year	8,551,275	8,614,929

Cash and cash equivalents, end of period	$7,062,993	$6,103,042
Supplemental disclosures of cash flow information		
Interest paid	$–	$–
Income taxes paid	$1,596,000	$76,519
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.

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Simulations Plus, Inc.

NOTES TO CONDENSED FINANCIAL STATEMENTS

February 29, 2016 and February 28, 2015

(Unaudited)

Note 1: GENERAL

This report on Form 10-Q for the quarter ended February 29, 2016, should be read in conjunction with the Company's annual report on Form 10-K for the year ended August 31, 2015, filed with the Securities and Exchange Commission ("SEC") on November 20, 2015. As contemplated by the SEC under Article 8 of Regulation S-X, the accompanying consolidated financial statements and footnotes have been condensed and therefore do not contain all disclosures required by generally accepted accounting principles. The interim financial data are unaudited; however, in the opinion of Simulations Plus, Inc. ("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. ("Simulations Plus", "Lancaster") was incorporated on July 17, 1996. On September 2, 2014, Simulations Plus, Inc. acquired all of the outstanding equity interests of Cognigen Corporation ("Cognigen", "Buffalo") and Cognigen became a wholly owned subsidiary of Simulations Plus, Inc. (collectively, "Company", "we", "us", "our"), pursuant to the terms of that certain Agreement and Plan of Merger, dated as of July 23, 2014, by and between Simulations Plus and Cognigen (the "Merger Agreement").

Lines of Business

The Company designs and develops pharmaceutical simulation software to promote cost-effective solutions to a number of problems in pharmaceutical research and in the education of pharmacy and medical students, and it provides consulting services to the pharmaceutical and chemical industries. Recently, the Company has begun to explore developing software applications for defense and for health care outside of the pharmaceutical industry.

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.

Reclassifications

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

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.

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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.

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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 $494,537 and $490,051 for the six months ended February 29, 2016 and February 28, 2015, respectively, and amortization of software development costs was $247,269 and $276,761 for the three months ended February 29, 2016 and February 28, 2015, 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.

Goodwill and indefinite-lived assets

Goodwill and indefinite-lived assets are not amortized, but are evaluated for impairment annually or when indicators of a potential impairment are present. Our impairment testing of goodwill is performed separately from our impairment testing of indefinite-lived intangibles. The annual evaluation for impairment of goodwill and indefinite-lived intangibles is based on valuation models that incorporate assumptions and internal projections of expected future cash flows and operating plans.

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 29, 2016 for assets and liabilities measured at fair value on a recurring basis:

	Level I	Level II	Level III	Total
Cash and cash equivalents	$7,062,993	$ –	$ –	$7,062,993
Total	$7,062,993	$ –	$ –	$7,062,993

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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 29, 2016 and February 28, 2015 was $3,750 and was $1,875 for each three-month period ended February 29, 2016 and February 28, 2015. Accumulated amortization as of February 29, 2016 was $30,000.

On May 15, 2014, we bought out a royalty agreement with TSRL, Inc. of Ann Arbor, Michigan. The cost of $6,000,000 is being amortized over 10 years under the straight-line method. Amortization expense for each of the six months periods ended February 29, 2016 and February 28, 2015 was $300,000 and was $150,000 for each three-month period ended February 29, 2016 and February 28, 2015. Accumulated amortization as of February 29, 2016 and August 31, 2015 was $1,075,000 and $775,000, respectively. (See Note 4.)

Total amortization expense for intellectual property agreements for the three months ended February 29, 2016 and February 28, 2015 was $151,875. Accumulated amortization as of February 29, 2016 and August 31, 2015 was $1,105,000 and $801,250, respectively.

Intangible assets

The Company acquired certain intangible assets as part of the acquisition of Cognigen Corporation on September 2, 2014. The following table summarizes those intangible assets as of February 29, 2016:

	Amortization Period	Acquisition Value	Accumulated Amortization	Net book value
Customer relationships	Straight line 8 years	$1,100,000	$ 206,250	$893,750
Trade Name-Cognigen	None	500,000	0	500,000
Covenants not to compete	Straight line 5 years	50,000	15,000	35,000
		$1,650,000	$ 221,250	$1,428,750

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Amortization expense for each of the six months periods ended February 29, 2016 and February 28, 2015 was $73,750 and was $36,875 for each three-month periods ended February 29, 2016 and February 28, 2015. According to policy in addition to normal amortization, these assets are tested for impairment as needed.

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 29, 2016 and February 28, 2015 were as follows:

| | Three months ended | | Six months ended | |
	02/29/2016	02/28/2015	02/29/2016	02/28/2015
Numerator:				
Net income attributable to common shareholders	$1,145,349	$970,233	$2,251,822	$1,499,136
Denominator:				
Weighted-average number of common shares outstanding during the period	17,005,649	16,848,983	16,985,869	16,839,599
Dilutive effect of stock options	262,495	256,429	244,230	256,758
Common stock and common stock equivalents used for diluted earnings per share	17,268,144	17,105,412	17,230,099	17,096,357

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 with FASB ASC 718-10, amortized on a straight-line basis over the options' vesting period. Stock-based compensation was $120,249 and $150,624 for the six months ended February 29, 2016 and February 28, 2015, respectively, and was $56,287 and $84,825 for the three months ended February 29, 2016 and February 28, 2015, 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 are evaluating the impact, if any, of the adoption of ASU 2013-11 on our balance sheet.

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In May 2014, FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers* ("ASU No. 2014-09"). 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, 2017. Early adoption is permitted for years beginning after December 15, 2016. 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 29, 2016 consisted of the following:

Equipment	$192,958
Computer equipment	460,626
Furniture and fixtures	123,235
Leasehold improvements	103,599
Sub total	880,418
Less: Accumulated depreciation and amortization	(563,399)
Net Book Value	$317,019

NOTE 4: CONTRACTS PAYABLE

TSRL

Pursuant to the termination and non-assertion agreement with TSRL, the Company agreed to pay TSRL total consideration of $6.0 million. The Company paid $3.5 million on May 20, 2014, comprised of cash in the amount of $2.5 million and the issuance of $1 million worth of the Company's common stock - 164,745 shares of the Company's common stock based upon the April 25, 2014 closing price per share of $6.07 (See note 2). According to the contract, the Company paid $750,000 to TSRL in April 2015 and will pay TSRL an additional $1,750,000 within the next two-year period. The remaining payments scheduled, by year, are below.

Cognigen Acquisition Liability-Related Party

On September 2, 2014, the Company acquired Cognigen Corporation. As part of the above-discussed consideration payable to the former shareholders of Cognigen, 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 $1,854,404, comprised of $720,000 of cash and the issuance of 170,014 shares of the Company's stock. The former shareholders of Cognigen are currently employed by the consolidated Company, one of whom serves as the President.

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

As of the period ending February 28,	TSRL	Cognigen Acquisition Liability	Total
2016	$750,000	$1,854,404	$2,604,404
2017	1,000,000	0	1,000,000
Total	$1,750,000	$1,854,404	$3,604,404
Less current portion	(750,000)	(1,854,404)	(2,604,404)
contracts payable, net of current portion	$1,000,000	$0	$1,000,000

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Note 5: COMMITMENTS AND CONTINGENCIES

Employment Agreement

Effective September 1, 2014, the Company entered into an Employment Agreement with Walter S. Woltosz to serve as Chief Executive Officer of the Company (the "Woltosz Employment Agreement"). The Woltosz Employment Agreement had a one-year term. Under the terms of the Woltosz Employment Agreement, Mr. Woltosz was required to devote a minimum of 60% of his productive time to the position of Chief Executive Officer of the Company. He received annual compensation of $180,000, was eligible to receive stock options to purchase up to 12,000 shares of the Company's common stock under the 2007 Simulations Plus, Inc. Stock Option Plan, as determined by the Company's Board of Directors, and was to 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 July 9, 2015, the Company renewed this employment agreement for another year on the same terms as the September 2014 agreement. A copy of the agreement was filed as an attachment to the 8-K filed with the Securities and Exchange Commission on July 15, 2015. Mr. Woltosz' bonuses under these agreements were paid in September following each agreement's term.

On September 2, 2014, Thaddeus H. Grasela, Jr., Ph.D., was appointed President of the Company, and the Company has 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 receives an annual base salary of $250,000, is eligible to receive stock options to purchase shares of the Company's common stock under the 2007 Simulations Plus, Inc. Stock Option Plan, as determined by the Company's Board of Directors, and is eligible to receive an annual performance bonus in an amount not to exceed 10% of base salary, to be determined by the Compensation Committee of the Company's Board of Directors. On September 1, 2015 the Compensation Committee awarded a $25,000 performance bonus to Dr. Grasela. This expense was accrued as an expense as of August 31, 2015. This bonus was paid in September 2015.

License Agreement

The Company executed a royalty agreement with Accelrys, Inc. ("Accelrys") (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 a royalty of 25% of revenue derived from the sale of the 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 29, 2016 and February 28, 2015, we incurred royalty expense of $50,838 and $34,989, respectively, and for the three months ended February 29, 2016 and February 28, 2015, we incurred royalty expense of approximately $35,288 and $24,824, respectively.

Income taxes

We follow guidance issued by the FASB with regard to our accounting for uncertainty in income taxes recognized in the financial statements. Such guidance prescribes a recognition threshold of more likely than not and a measurement process for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. In making this assessment, a company must determine whether it is more likely than not that a tax position will be sustained upon examination, based solely on the technical merits of the position and must assume that the tax position will be examined by taxing authorities. Our policy is to include interest and penalties related to unrecognized tax benefits in income tax expense. We file income tax returns with the IRS and various state jurisdictions and India. Our federal income tax returns for fiscal year 2012 thru 2015 are open for audit, and our state tax returns for fiscal year 2011 through 2015 remain open for audit. In addition, our California tax returns for fiscal years 2008 and 2009 remain open with regard to research and development tax credits as a result of a previous audit for which we received a letter from the California Franchise Tax Board stating that an audit will not be conducted for those years at this time; however it may be subject to future audit. In 2015 the Company was informed that the IRS will be auditing the Company's tax return for 2014. The audit was started in October 2015 and has not been completed. The Company does not believe that this examination by the IRS will result in a significant change to our financial position or results of operations.

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Litigation

Except as described below, we are not a party to any legal proceedings and are not aware of any 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 denied 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. The Company planned to prepare a dismissal with prejudice to be signed on behalf of the plaintiff in the event the plaintiff did not discover evidence during a nine-month period to and including August 31, 2015, that justified bringing the Company back into the litigation. The Company did not receive notification of any such discovery and is in the process of preparing documents for the plaintiff's final dismissal with prejudice.

Note 6: SHAREHOLDERS' EQUITY

Dividend

The Company's Board of Directors declared cash dividends during fiscal years 2016 and 2015. The details of the dividends paid are in the following tables:

FY2015

Record Date	Distribution Date	Number of Shares Outstanding on Record Date	Dividend per Share	Total Amount
11/7/2014	11/14/2014	16,841,114	$ 0.05	$ 842,056
1/26/2015	2/2/2015	16,852,117	$ 0.05	$ 842,606
5/11/2015	5/18/2015	16,875,117	$ 0.05	$ 843,754
7/23/2015	7/30/2015	16,943,001	$ 0.05	$ 847,150
Total				$ 3,375,566

FY2016

Record Date	Distribution Date	Number of Shares Outstanding on Record Date	Dividend per Share	Total Amount
11/09/2015	11/16/2015	16,996,001	$ 0.05	$ 849,800
1/29/2016	02/05/2016	17,018,001	$ 0.05	$ 850,900
Total				$ 1,700,700

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.

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Qualified Incentive Stock Options (Qualified ISO)

As of February 29, 2016, employees hold Qualified ISO to purchase 950,900 shares of common stock at exercise prices ranging from $1.00 to $9.71, which were granted prior to February 29, 2016.

Transactions in FY16	Number of Options	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Life
Outstanding, August 31, 2015	621,000	$ 5.01	6.10
Granted	412,100	$ 9.71	
Exercised	(75,000)	$ 1.44	
Cancelled/Forfeited	(7,200)	$ 6.85	
Outstanding, February 29, 2016	950,900	$ 7.32	7.97
Exercisable, February 29, 2016	230,160	$ 3.80	4.34

Non-Qualified Stock Options (Non-Qualified ISO)

As of February 29, 2016, the outside members of the Board of Directors hold options to purchase 49,350 shares of common stock at exercise prices ranging from $1.67 to $6.75, which were granted prior to February 29, 2016.

Transactions in FY16	Number of Options	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Life
Outstanding, August 31, 2015	49,350	$ 5.52	7.78
Granted	0	$ 0.00	
Exercised	0	$ 0.00	
Outstanding, February 29, 2016	49,350	$ 5.52	7.25
Exercisable, February 29, 2016	27,200	$ 4.70	5.81

The weighted-average remaining contractual life of options outstanding issued under the Plan, both Qualified ISO and Non-Qualified SO, was 7.93 years at February 29, 2016. The exercise prices for the options outstanding at February 29, 2016 ranged from $1.00 to $9.82, 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	100,500	2.34 years	$ 1.04	100,500	2.34 years	$ 1.04
$1.51	$3.00	3,600	4.19 years	$ 2.20	3,600	4.19 years	$ 2.20
$3.01	$4.50	29,000	3.35 years	$ 3.33	29,000	3.35 years	$ 3.35
$4.51	$6.00	74,000	3.16 years	$ 5.48	41,600	3.21 years	$ 5.42
$6.01	$7.50	381,050	8.48 years	$ 6.85	82,660	8.19 years	$ 6.86
$7.50	$9.82	412,100	10.00 years	$ 9.71	0	–	–
		1,000,250	**7.93 years**	$ 7.23	257,360	**4.49 years**	$ 3.89

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NOTE 7: RELATED PARTY TRANSACTIONS

As of February 28, 2016, included in bonus expenses to officers was $60,500, 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, and $18,000 accrued bonus representing an estimated amount of bonus payable to our Chief Executive Officer, Walter Woltosz as part of his current employment agreement, and $12,500 accrued bonus representing as estimated amount of bonus payable to our President, Thaddeus Grasela as part of his current employment agreement.

NOTE 8: CONCENTRATIONS AND UNCERTAINTIES

Revenue concentration shows that international sales accounted for 42.6% and 39.8% of net sales for the six months ended February 29, 2016 and February 28, 2015, respectively. Three customers accounted for 10% (a dealer account in Japan representing various customers), 6%, and 6% of sales for the six months ended February 26, 2016. 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.

Accounts receivable concentrations shows that two customers comprised 12% (a dealer account in Japan representing various customers) and 11% of accounts receivable at February 29, 2016 compared to one customer (a dealer account in Japan representing various customers) that comprised 13% of accounts receivable at February 28, 2015.

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 29, 2016 and February 28, 2015 (in thousands):

Three months ended February 29, 2016

	Lancaster	Buffalo	Eliminations	Total
Net revenues	$ 3,648	1,516		$5,164
Income (loss) from operations	1,470	246		1,716
Identifiable assets	25,854	9,267	$ (7,238)	27,903
Capital expenditures	0	1		1
Capitalized software costs	233	45		278
Depreciation and amortization	394	90		484

Three months ended February 28, 2015

	Lancaster	Buffalo	Eliminations	Total
Net Revenues	$ 3,303	$ 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

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Six months ended February 29, 2016

	Lancaster	Buffalo	Eliminations	Total
Net Revenues	$7,058	$2,944		$10,002
Income (loss) from operations	$2,894	$549		$3,443
Total assets	$25,854	$9,267	$ (7,238)	$27,903
Capital expenditures	$1	$1		$2
Capitalized software costs	$455	$90		$545
Depreciation and Amortization	$789	$182		$971

Six months ended February 28, 2015

	Lancaster	Buffalo	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

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 29, 2016 and February 28, 2015 were as follows (in thousands):

Three months ended February 29, 2016

	North America	Europe	Asia	South America	Total
Lancaster	$1,331	$1,490	$827	$ 0	$3,648
Buffalo	$1,516	$0	$0	$ 0	$1,516
Total	$2,847	$1,490	$827	$ 0	$5,164

Three months ended February 28, 2015

	North America	Europe	Asia	South America	Total
Lancaster	$1,459	$1,265	$578	$ 1	$3,303
Buffalo	$1,271	$0	$0	$ 0	$1,271
Total	$2,730	$1,265	$578	$ 1	$4,574

Six months ended February 29, 2016

	North America	Europe	Asia	South America	Total
Lancaster	$ 2,793	$2,404	$1,860	$ 1	$7,058
Buffalo	$ 2,944	–	–	–	$2,944
Total	$ 5,737	$2,404	$1,860	$ 1	$10,002

Six months ended February 28, 2015

	North America	Europe	Asia	South America	Total
Lancaster	$ 2,805	$1,905	$1,543	$ 1	$6,254
Buffalo	$ 2,406	–	–	–	$2,406
Total	$ 5,211	$1,905	$1,543	$ 1	$8,660

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 $107,075 and $122,846 for the six months ended February 29, 2016 and February 28, 2015, respectively, and $51,737 and $65,519 for the three months ended February 29, 2016 and February 28, 2015, respectively.

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Item 2. <u>Management's Discussion and Analysis or Plan of Operations</u>

<u>Forward-Looking Statements</u>

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

BUSINESS

OVERVIEW

The Company is a premier developer of groundbreaking drug discovery and development simulation and modeling software. Our software is licensed to major pharmaceutical, biotechnology, agrochemical, and food industry companies and to regulatory agencies worldwide for use in the conduct of model-based drug development and the study of environmental toxicants. We also provide consulting services ranging from early drug discovery through preclinical and clinical development and regulatory submissions. Recently, we have been exploring the application of some of our advanced machine-learning technologies for problems in aerospace and healthcare outside of our traditional markets. The Company is headquartered in Southern California, with offices in Buffalo, New York. Our common stock trades on the NASDAQ Capital Market under the symbol "SLP."

We are also a leading provider of population modeling and simulation contract research services for the pharmaceutical and biotechnology industries. Our clinical-pharmacology-based consulting services include pharmacokinetic and pharmacodynamic modeling, clinical trial simulations, data programming, and technical writing services in support of regulatory submissions. We have also developed software for harnessing cloud-based computing in support of modeling and simulation activities and secure data archiving, and we provide consulting services to improve interdisciplinary collaborations and R&D productivity.

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We are a global leader focused on improving the ways scientists use knowledge and data to predict the properties of new molecules and the outcomes of clinical trials with pharmaceutical and biotechnology agents. We are one of only two global companies who provide a wide range of early discovery, preclinical, and clinical consulting services and software. Our innovations in integrating new and existing science in medicinal chemistry, computational chemistry, computer science, pharmaceutical science, biology, and physiology into our software have made us the leading software provider for physiologically based pharmacokinetics (PBPK) modeling and simulation. Our powerful machine-learning technology that has resulted in best-in-class predictions in pharmaceutical chemistry is now being successfully tested for solving several complex problems in the aerospace and healthcare industries.

We generate revenue by delivering relevant, cost-effective software, as well as creative and insightful consulting services. Pharmaceutical and biotechnology companies use our software programs and scientific knowledge to guide discovery, preclinical, and clinical 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, develop generic dosage forms, optimize clinical trial designs, and simulate outcomes in special populations, such as the elderly and pediatric patients.

PRODUCTS

General

We currently offer seven software products for pharmaceutical research and development: three simulation programs that provide time-dependent results based on solving large sets of differential equations: GastroPlus™, DDDPlus™, and MembranePlus™; three programs that are based on predicting and analyzing static (not time-dependent) properties of chemicals: ADMET Predictor™, MedChem Designer™, and MedChem Studio™ (the combination of ADMET Predictor, MedChem Designer, and MedChem Studio is called our ADMET Design Suite™); and one program called KIWI™ that supports data analysis and reporting through our proprietary secure cloud. During the first fiscal quarter of FY2016, we announced the upcoming release of a new software product called PKPlus™ for noncompartmental and compartmental pharmacokinetic analysis and reporting, which is further described below.

GastroPlus

Our flagship product and currently our largest source of revenue 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. The U.S. FDA recently added 50 additional GastroPlus licenses to the 20 it already had, bringing the total to 70.

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, begun in 2012, 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 our investment to participate 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 well-known to member pharmaceutical companies and regulatory agencies.

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. The objective of this agreement is 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 up to $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. After a highly successful first year, the RCA was renewed for its second year in September 2015.

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We were awarded another RCA by the FDA in September 2015, this time to expand the capabilities of GastroPlus to simulate the dosing of long-acting injectable microspheres. This type of dosage form is usually injected via subcutaneous or intramuscular routes, but can also be used for ocular dosing. Once again, this RCA provides up to $200,000 per year for up to three years. Under this agreement, we are developing simulation models to deal with the slow dissolution/decomposition of the microsphere carrier material that gradually releases the active drug over periods as long as weeks or months.

In addition to the two funded efforts with the FDA described above, we also have an unfunded RCA with the FDA's Office of Generic Drugs (OGD) that began in 2014. The objective of this RCA, which has a five-year term, is directed toward the FDA's evaluation of mechanistic IVIVCs (*in vitro-in vivo* correlations) to determine whether mechanistic absorption modeling (MAM) can relate laboratory (*in vitro*) dissolution experiment results to the behavior of dosage forms in humans and animals (*in vivo*) better than traditional empirical methods.

In April 2015, we released Version 9.0 of GastroPlus. This was the largest single upgrade we've made to the program to date, and the added level of science and technology enabled valuable new functionalities that we believe provide the most advanced decision-making tool for preclinical and early clinical trial simulation and modeling analysis available today. Several of the significant enhancements include:

· ability to simulate the absorption and distribution of biologics (antibodies and proteins)
· ability to simulate dosing to the skin, including patches, creams, ointments, and subcutaneous injections
·tighter integration with our ADMET Predictor™ software to increase the utility of the program in early drug discovery.

Our goal with GastroPlus is to integrate the most advanced science into user-friendly software to enable pharmaceutical researchers and regulators to perform sophisticated analyses of complex drug behaviors in humans and laboratory animals. Already the most widely used program in the world for physiologically based pharmacokinetics (PBPK), the addition of these new capabilities is expected to expand the user base in the early pharmaceutical research & development process, while also helping us further penetrate the biopharmaceuticals, food, cosmetics, and general toxicology markets.

We are now developing version 9.5 of GastroPlus, which will add a number of new capabilities and will refine and enhance some of the existing capabilities in the program, including intramuscular dosing, simulation of antibody-drug conjugates, additional animal physiologies, enhanced report generation, and enhancements to the PBPK tissue models. We expect to release version 9.5 before the end of FY2016.

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., powder, tablet, or capsule) under a variety of experimental conditions. This unique 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. Version 5.0 DDDPlus, which adds a number of significant enhancements to the capabilities of DDDPlus, is in final stages of development and is expected to be released in the third fiscal quarter of FY2016. This version will add new formulation types (controlled release bilayer tablet, delayed release coated tablet, and immediate release coated beads), expanded formulation specification options, biorelevant solubilities and surfactant effects on dissolution, tablet compression and disintegration models, links with GastroPlus, and update licensing.

MembranePlus™

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 standard 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 using (supposedly) the same experimental conditions, the 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 scientists to better interpret how results from specific experimental protocols can be used to predict permeability in human and animals, which is the ultimate goal. A few initial sales of MembranePlus have been made. Like DDDPlus was ten years ago, this program is a very new concept that requires educating scientists on how and why to use it, and our marketing and sales program has been tasked with providing that training.

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PKPlus™

On October 15, 2015 we announced the upcoming release of a new standalone software product called PKPlus, based on the internal PKPlus Module in GastroPlus that has been available since 2000. The PKPlus Module in GastroPlus provides quick and easy fitting of compartmental pharmacokinetic models and noncompartmental analysis (NCA) for oral and intravenous doses. The original module was not designed to meet all of the requirements for performing these analyses and producing report-quality output for regulatory submissions. The new standalone PKPlus program is being developed to provide the full level of functionality needed by pharmaceutical industry scientists to perform the analyses and generate the outputs needed to fully satisfy regulatory agency requirements for both NCA and compartmental PK modeling. The program has been in development for about 20 months, and is nearing completion. We believe the potential number of users for PKPlus is large and that it has the potential to become one of our leading revenue producers.

ADMET Predictor™

ADMET (Absorption, Distribution, Metabolism, Excretion, and Toxicity) Predictor is a chemistry-based computer program that takes molecular structures (i.e., drawings of molecules represented in various forms) as inputs and predicts approximately 150 different properties for them at an average rate of over 100,000 compounds per hour on a modern laptop computer. 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 multiple 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 virtual 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.

The most recent release of ADMET Predictor (version 7.2, released in May, 2015) contains updated cytochrome P450 enzyme kinetics models that are seamlessly integrated into the recently released GastroPlus Version 9.0, enhancing the synergy between predicted properties and PBPK simulations and enabling discovery chemists – a new group of potential users – to use PBPK simulations. It also contains two new models related to human liver microsomal (HLM) stability, an experiment that is routinely run on newly synthesized compounds in the pharmaceutical industry. The updated models illustrate our commitment to providing the best predictive models in the industry.

We are now in final development and testing of ADMET Predictor 8.0, which features a completely redesigned and modernized interface as well as a number of new capabilities to enhance the performance and user-friendliness of the program. We expect to release version 8.0 during the third fiscal quarter of FY2016.

The optional ADMET Modeler™ Module in 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, generating 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 minimal training.

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We are currently investigating three applications of this machine-learning engine outside of our normal pharmaceutical markets, including: (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 and other objects 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.

We believe our machine-learning software engine has a wide variety of potential applications and we intend to pursue funding to develop customized tools to further monetize our investment in this technology by expanding our markets beyond the life sciences and chemistry.

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 ~150 predictions that are available. Over 15,000 copies of MedChem Designer have been downloaded by scientists around the world to date.

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 ~150 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. 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. 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. 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.

MedChem Studio™

MedChem Studio is a powerful software 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. We have now merged MedChem Studio with the refactoring of ADMET Predictor 8.0, so that either program can be entered through the same interface, and the communication between the two programs is enhanced through the seamless integration of both technologies. We believe this will enhance the attractiveness of both ADMET Predictor and MedChem Studio to medicinal and computational chemists.

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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) very large numbers 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. We demonstrated the power of the ADMET Design Suite during two NCE (new chemical entity) projects wherein we designed lead molecules to inhibit the growth of the plasmodium falciparum malaria parasite in one study and lead molecules that were combined COX-1 and COX-2 inhibitors. Every molecule we designed and had synthesized hit their targets. We are not aware of any other software company that has demonstrated the ability of their software in this way.

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.

The pharmaceutical industry has been rapidly adopting cloud technology as a solution to ever-expanding computer processing needs. Leveraging our 20-plus years of experience in providing an architecture supporting modeling and simulation efforts, we have developed KIWI as a secure, validated, enterprise-scale environment, enabling global teams to collaborate on model-based decision making. KIWI has proven to be a valuable platform for encouraging interdisciplinary discussions about the model development process and interpretation of results. We continue to receive positive feedback about the functionality implemented in KIWI and the value of the approach we have taken to harness cloud technology. We continue to improve functionality and collaboration within the KIWI platform, and we expect the licensing fee will be a source of recurring revenue for further development and growth. KIWI Version 1.3 was released in May 2015. This version of KIWI provides our user community with access to new features that accelerate completion of modeling projects by decreasing run times and facilitating the comparison and exporting of results across models. These features include dynamic comparisons of model parameter estimates and diagnostic plots, export of model run records for regulatory submissions, and accelerated infrastructure with the upgrade to the latest versions of NONMEM® and Perl-speaks-NONMEM running in a 64-bit Linux environment.

KIWI Version 1.5 was released in March 2016. This new version introduced major enhancements in the functionality of visualization tools offered by the platform. These enhancements include simplifying the creation of plots and comparing them across multiple models, thus accelerating the model refinement process. In addition, analysts can now

conveniently copy visualization preferences across projects, improving consistency and facilitating collaboration and communication with clients and colleagues.

Contract Research and Consulting Services

Our scientists and engineers have world-class expertise in drug absorption via various dosing routes (oral, intravenous, ocular, nasal/pulmonary, and dermal), pharmacokinetics, and pharmacodynamics. 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 five largest 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 consulting teams to meet the increased workload.

We currently are working with the FDA on three different Research Collaboration Agreements (RCAs): the two funded efforts for the ocular model and long-acting injectable microspheres and the unfunded IVIVC effort, all described above under "GastroPlus".

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Pharmacometric modeling:

We have 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 model-based analysis of clinical trial data that we perform is different from the modeling analysis offered by GastroPlus; the former relies more on statistical and semi-mechanistic models, whereas the latter relies on very detailed mechanistic models. Statistical models rely on direct observation and mathematical equations that are used to fit data collected across multiple studies along with describing the variability within and between patients. 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 meetings held in 2014 by the FDA and other regulatory agencies, such agencies emphasized an interest in bringing physiologically based pharmacokinetics (PBPK) into clinical pharmacology.

Because of the synergies achieved through the integration of our Buffalo division (Cognigen) into Simulations Plus, our first full fiscal year of combined operations resulted in significantly increased revenues and earnings. Our clinical pharmacometricians in Buffalo, supported by our consulting team in California, are learning to use the PBPK modeling capabilities of GastroPlus and are performing such studies under new and expanded contracts with pharmaceutical customers.

PRODUCT DEVELOPMENT

Development of our software is focused on expanding product lines, designing enhancements to our core technologies, and integrating existing and new products into our principal software architecture and platform technologies. We intend to continue to offer regular updates to our products and to continue to look for opportunities to expand our existing suite of products and services.

To date, we have developed products internally, sometimes also licensing or acquiring products, or portions of products, from third parties. These arrangements sometimes require that we pay royalties to third parties. We intend to continue to license or otherwise acquire technology or products from third parties when it makes business sense to do so. We currently have one license agreement, with BIOVIA, a San Diego division of Dassault Systemes in France, pursuant to which a small royalty is paid to BIOVIA from revenues on each license for the Metabolite module in ADMET Predictor. This license agreement continues in perpetuity and either party has the right to terminate it.

In 1997 we entered into an exclusive software licensing agreement with TSRL, Inc. (aka Therapeutic Systems Research Laboratories), pursuant to which TSRL licensed certain software technology and databases to us, and we paid royalties to TSRL. On May 15, 2014, we and TSRL entered into a termination and non-assertion agreement pursuant to which the parties agreed to terminate the 1997 exclusive software licensing agreement. 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 agreement, and we agreed to pay TSRL total consideration of $6,000,000 as follows: (a) $3,500,000 by May 20, 2014, which amount was comprised of $2,500,000 in cash and $1,000,000 worth of our common stock (which was 164,745 shares based upon the April 25, 2014 closing price per share of $6.07 per share), (b) $750,000 payable on or before April 25, 2015, (c) $750,000 payable on or before April 25, 2016, and (d) $1,000,000 payable on or before April 25, 2017. Our payment obligation described above is non-interest-bearing and will be amortized at a constant rate of $150,000 per quarter until it is completely amortized, after which no further expense will be incurred. For most quarters, we expect that this will result in a savings over the royalty payments that would have been paid to TSRL if paid consistent with past practices.

MARKETING AND DISTRIBUTION

We distribute our products and offer our services in North America, South America, Europe, Japan, Australia, New Zealand, India, Singapore, and the People's Republic of China.

We market our pharmaceutical software and consulting services through attendance and presentations at scientific meetings, exhibits at trade shows, seminars at pharmaceutical companies and government agencies, through our website, and using various communication channels to our database of prospects and customers. At various scientific meetings around the world each year there are numerous presentations and posters presented in which the reported research was performed using our software. Many of these presentations were from industry and FDA scientists; some were from our staff.

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Our sales and marketing efforts are handled primarily internally with our scientific team and several senior management staff assisting our marketing and sales staff with trade shows, seminars, and customer training both online and on-site. We believe that this is more effective than a completely separate sales team for several reasons: (1) customers appreciate talking directly with software developers and consulting scientists who can answer a wide range of technical questions about methods and features in depth; (2) our scientists and engineers benefit from direct customer contact by gaining an appreciation for the environment and problems of the customer; and (3) we believe the relationships we build through scientist-to-scientist contact are stronger than relationships built through salesperson-to-scientist contacts. We also have one independent distributor in Japan and two independent representatives in China who also sell and market our products.

We provide support to the GastroPlus User Group in Japan, which was organized by Japanese researchers in 2009. In early 2013, a group of scientists in Europe and North America organized another group following the example set in Japan. Over 750 members have joined this group to date. We support this group through coordination of online meetings each month and managing the web site for exchange of information among members. These user groups provide us valuable feedback with respect to desired new features and suggested interface changes.

PRODUCTION

Our pharmaceutical software products are designed and developed by our development teams in California and New York, with locations in Lancaster, Petaluma, San Jose, San Diego, and Buffalo. In addition, we have one team member working out of North Carolina and our Chief Executive Officer works primarily from Auburn, Alabama.

The principal materials and components used in the manufacture of simulation software products include CD-ROMs and instruction manuals, which are also produced in-house and through outside contractors. In-house graphic art and engineering talent enables us to accomplish this production in a cost-efficient manner.

COMPETITION

In our pharmaceutical software and services business, we compete against a number of established companies that provide screening, testing and research services, and products that are not based on simulation software. There are also software companies whose products do not compete directly with, but are sometimes closely related to, ours. Our competitors in this field include some companies with financial, personnel, research, and marketing resources that are larger than ours. Our management believes there is currently no significant competitive threat to GastroPlus, DDDPlus, or MembranePlus; however, in spite of a high barrier to entry, one could be developed over time. Our upcoming PKPlus software product will compete with one major and a few minor software programs; however, the capabilities and design features of PKPlus, along with more affordable licensing, is expected to generate significant

interest, and we believe sales will begin quickly after the product is released in the third quarter. MedChem Studio, MedChem Designer, and ADMET Predictor/ADMET Modeler operate in a more competitive environment. Several other companies presently offer simulation or modeling software, or simulation-software-based services, to the pharmaceutical industry.

Major pharmaceutical companies conduct drug discovery and development efforts through their internal development staffs and through outsourcing. Smaller companies generally need to outsource a greater percentage of this research. Thus, we compete not only with other software suppliers, but also with the in-house development teams at some of the larger pharmaceutical companies.

Although competitive products exist, both new licenses and license renewals for GastroPlus have continued to grow. We believe that we enjoy a dominant market share in this segment. We believe that the success of our two NCE projects in which we successfully designed, synthesized, and tested new lead molecules to treat malaria as well as COX-2/COX-1 will further promote the abilities of our ADMET Design Suite for rapid and cost-effective design of lead compounds.

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We believe the key factors in our ability to successfully compete in this field are our ability to: (1) continue to invest in research and development, and develop and support industry-leading simulation and modeling software and related products and services to effectively predict activities and ADMET-related behaviors of new drug-like compounds, (2) design new molecules with acceptable activity and ADMET properties, (3) develop and maintain a proprietary database of results of physical experiments that serve as a basis for simulated studies and empirical models, (4) attract and retain a highly skilled scientific and engineering team, and (5) develop and maintain relationships with research and development departments of pharmaceutical companies, universities and government agencies.

We actively seek acquisitions to expand the pharmaceutical software and services business. We plan to continue our efforts to find strategic targets and alliances that will enhance our position in the industry.

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 Corporation of Buffalo, New York. 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.

In the fiscal year ended August 31, 2015 we distributed $0.20 per share in dividends to our shareholders. In November 2015 and February 2016 the board declared quarterly dividends of $0.05 per share. 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 quarterly dividend distribution and may decide to increase, decrease, or eliminate dividend distributions at any time.

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Results of Operations

Comparison of Three Months Ended February 29, 2016 and February 28, 2015.

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			
	02/29/16		02/28/15	
Net sales	$5,164	100.0%	$4,574	100.0%
Cost of sales	1,264	24.5	* 1,131	24.7
Gross profit	3,900	75.5	3,443	75.3
Selling, general and administrative	1,723	33.4	* 1,607	35.1
Research and development	461	8.9	361	7.9
Total operating expenses	2,184	42.3	1,968	43.0
Income from operations	1,716	33.2	1,475	32.3
Other income	(24)	(0.4)	(30)	(0.7)
Income from operations before taxes	1,692	32.8	1,445	31.6
(Provision for) income taxes	(547)	(10.6)	(475)	(10.4)
Net income	$1,145	22.2%	$970	21.2%

* Numbers in the prior year have been reclassified to conform to the current year presentation

Net Revenues

Consolidated net revenues increased by 12.9% or $590,000 to $5.16 million in the second fiscal quarter of Fiscal Year 2016 ("2QFY16") from $4.57 million in the second fiscal quarter of Fiscal Year 2015 ("2QFY15"). $245,000 of this increase was from revenues generated by our Buffalo Division, representing a 19.2% increase over 2QFY15. Net revenues of the Lancaster Division increased $344,000 or 10.4%, to $3.65 million in 2QFY16 from $3.30 million in 2QFY15. Consolidated software and software related sales increased $454,000 or 14.8%, while consolidated consulting and analytical study revenues increased $136,000 or 9.1% over 2QFY15.

Cost of Revenues

Consolidated cost of revenues increased by $133,000 in 2QFY16 to $1.26 million from $1.13 million in 2QFY15. Most of the increase is attributed to the first annual bonuses paid to employees in our Buffalo Division; $139,000 was paid to them during this period. There were no other significant changes to consolidated expenses in 2QFY16

compared to 2QFY15.

Cost of Revenues as a percentage of revenue remained substantially constant, decreasing by only 0.2% in 2QFY16 to 24.5% as compared to 2QFY15.

Gross Profit

Consolidated gross profit increased $457,000 or 13.3%, to $3.90 million in 2QFY16 from $3.44 million in 2QFY15. $105,000 of this increase in gross margin is from our Buffalo Division, which showed a 55.5% gross margin on $1.52 million in revenues. Our Lancaster Division accounted for $352,000 of the increase, which came mainly from increased software license sales. The Lancaster Division showed an 83.8% gross margin for the quarter.

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Selling, General and Administrative Expenses

Selling, general, and administrative (SG&A) expenses increased $116,000, or 7.2%, to $1.72 million in 2QFY16, from $1.61 million in 2QFY15.

The major increases in SG&A expenses this year compared to last year were:

·Commissions to our Japanese and Chinese dealers as they increased their sales. Commissions were up by $31,000.
·Marketing labor increased by $24,000 - more time was spent by scientific personnel on marketing-related activities
· Advertising increased by $24,000 – we increased our web presence and incurred other advertising-related costs
· Professional fees were up $24,000 – this was the result of the additional costs of a consolidated entity and other tax and accounting compliance-related issues

Major Decreases - There were no significant decreases in this quarter compared to last year.

Research and Development

We incurred approximately $739,000 of research and development costs during 2QFY16. Of this amount, $278,000 was capitalized software development costs and $461,000 was expensed. We incurred approximately $794,000 of research and development costs during 2QFY15. Of this amount, $433,000 was capitalized software development costs and $361,000 was expensed.

Other income (expense)

No significant changes

Provision for Income Taxes

The provision for income taxes was $547,000 for 2QFY16 compared to $475,000 for 2QFY15. Our effective tax rate remained fairly constant this period decreasing 0.4% to 32.3% in 2QFY16 from 32.7% in 2QFY15.

Net Income

Net income increased by $175,000, or 18.0%, in 2QFY16 to $1,145,000 from $970,000 in 2QFY15. We attribute the majority of this increase to the added software revenues from our Lancaster operations.

Comparison of Six Months Ended February 29, 2016 and February 28, 2015

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):

	Six Months Ended			
	02/29/16		02/28/15	
Net sales	$10,002	100.0%	$8,660	100.0%
Cost of revenues	2,347	23.5	* 2,176	25.1
Gross profit	7,655	76.5	6,484	74.9
Selling, general and administrative	3,399	34.0	* 3,626	41.9
Research and development	813	8.1	633	7.3
Total operating expenses	4,212	42.1	4,259	49.2
Income from operations	3,443	34.4	2,225	25.7
Other income	(34)	(0.3)	(34)	(0.4)
Income from operations before taxes	3,409	34.1	2,191	25.3
(Provision for) income taxes	(1,157)	(11.6)	(692)	(8.0)
Net income	$2,252	22.5%	$1,499	17.3%

* Numbers in the prior year have been reclassified to conform to the current year presentation

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Net Revenues

Consolidated net revenues increased by 15.5% or $1.34 million to $10.00 million in the first six months of Fiscal Year 2016 ("6moFY16") from $8.66 million in the first six months of Fiscal Year 2015 ("6moFY15). $538,000 of this increase was from revenues generated by our Buffalo Division, representing a 22.4% increase over 6moFY15. Net revenues of the Lancaster Division increased $804,000, or 12.9%, to $7.06 million for 6moFY16 from $6.25 million in 6moFY15. Consolidated software and software-related sales increased $798,000, or 13.5%, in 6moFY16, while consolidated consulting and analytical study revenues increased $545,000, or 19.8%, over 6moFY15.

Cost of Revenues

Consolidated cost of revenues increased by $172,000 in 6moFY16 to $2.35 million from $2.18 million in 6moFY15. The increase came mainly from the first annual bonuses paid to employees in our Buffalo Division; $139,000 was paid during the period. There were no other significant changes to consolidated expenses in 6moFY16 compared to 6moFY15.

Consolidated cost of revenues as a percentage of revenue decreased from 25.1% in 6moFY15 to 23.5% in 6moFY16. The change mainly comes from increased revenues, while costs remained fairly constant except as noted above.

Gross Profit

Consolidated gross profit increased $1.17 million or 18%, to $7.66 million in 6moFY16 from $6.48 million in 6moFY15. $1.34 million of this increase in gross margin is from our Buffalo Division, which showed a 59.2% gross margin on $2.94 million in revenues for 6moFY16. Our Lancaster Division accounted for $764,000 of the increase, which came mainly from increased software license sales. The Lancaster Division showed an 83.8% gross margin for the six-month period.

Selling, General and Administrative Expenses

Selling, general, and administrative (SG&A) expenses decreased $228,000, or 6.3%, to $3.40 million in 6moFY16 from $3.63 million in 6moFY15.

The major increases in SG&A expense were:

·Commissions to our Japanese and Chinese dealers as they increased their sales. Commissions were up by $27,000.
· Advertising increase by $42,000 - we increased our web presence and incurred other advertising-related costs

·Marketing labor increased by $38,000 - more time was spent by scientific personnel on marketing-related activities

· Software License expenses increased $28,000 due to new outside software licensing based on increased software volume tiers

The major decreases in SG&A expense were:

· Consulting Fees decreased by $397,000 - in 1QFY15, we paid approximately $400,000 in one-time fees and expenses to our financial advisor/business broker related to the Cognigen acquisition. There were no such expenses in the current reporting period.

Research and Development

We incurred approximately $1.36 million of research and development costs during 6moFY16. Of this amount, $545,000 was capitalized software development costs and $813,000 was expensed We incurred approximately $1.25 million of research and development costs during 6moFY15. Of this amount, $631,000 was capitalized software development costs and $633,000 was expensed.

Other income (expense)

No significant changes

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Provision for Income Taxes

The provision for income taxes was $1,157,000 for 6moFY16 compared to $692,000 for 6moFY15. Our effective tax rate increased to 34.0% in 6moFY16 from 31.3% in 6moFY15, 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 $752,000, or 50.2%%, to $2.25 million in 6moFY16 from $1.50 million in 6moFY15. The increase comes from two main sources: increased revenues of $1.34 million; and reduced SG&A expense in 2016, since in 2015 we incurred approximately $400,000 of one-time consulting costs associated with the Cognigen acquisition.

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. <u>Controls and Procedures</u>

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.

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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.

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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 denied 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. The Company planned to prepare a dismissal with prejudice to be signed on behalf of the plaintiff in the event the plaintiff did not discover evidence during a nine month period to and including August 31, 2015 that justified bringing the Company back into the litigation. The Company did not receive notification of any such discovery and is in the process of preparing documents for the plaintiff's final dismissal with prejudice.

Item 1A Risk factors

Not applicable

Item 2. Changes in Securities

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4.   <u>Mine Safety Disclosures</u>

N/A

Item 5. <u>Other Information</u>

N/A

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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 August 22, 2013. (9) (†)
10.7	Employment Agreement by and between the Company and Walter S. Woltosz, dated as of August 28, 2014. (12) (†)
10.8	Employment Agreement by and between the Company and Thaddeus H Grasela Jr. dated as of September 2, 2014. (12) (†)
10.9	Employment Agreement by and between the Company and Walter S. Woltosz, dated as of July 9, 2015. (14) (†)
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.

^	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.
(14)	Incorporated by reference to the Company's Form 8-K filed July 15, 2015.

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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 13, 2016.

Simulations Plus, Inc.

Date: April 13, 2016 By: */s/ John R Kneisel*

John R. Kneisel

Chief Financial Officer

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