Simulations Plus

SLP: NasdaqGS

Analyst: Peter Ostrowski
Sector: Information Technology

BUY

Price Target: $11.05

Key Statistics as of 10/21/2015

Market Price:	$9.30
Industry:	Software
Market Cap:	$159 Million
52-Week Range:	$5.52-10.27
Beta:	.47

Thesis Points:

- Acquisition of Cognigen
- Long Term Growth Opportunities
- Financials

Company Description:

Simulations Plus, Inc. develops and produces software for use in pharmaceutical research and for education, and provides consulting and contract research services to the pharmaceutical industry. It engages in the drug discovery and development simulation and modeling software, which is licensed to and used in the conduct of drug research by pharmaceutical, biotechnology, agrochemical, and food industry companies worldwide. The company also provides personal productivity software program called Abbreviate. Simulations Plus was founded by Walter S. Woltosz & Virginia E. Woltosz on July 17, 1996 and is headquartered Lancaster, CA.

Thesis

SLP is a leader in the development of simulation software; primarily in the healthcare industry. Since SLP had their inception in 1996 they have been able to formulate successful projects that have fortified their success in the software market. With the recent acquisition of Cognigen, SLP has been able to increase revenue and income. SLP's expanding portfolio of future and continued projects along with consistent profitability and liquidity, will lead to further growth of the company.

Acquisition of Cognigen

In 2014 Simulations Plus acquired Cognigen Corporation as a wholly owned subsidiary. Cognigen is a leading provider of population modeling and simulation contract research services for the pharmaceutical and biotechnology industries. The acquisition of Cognigen came with 48 active projects and increased the number of SLP scientists from 30 to 65. These projects offer simulations on clinical development. Before this acquisition; SLP mainly operated on preclinical development simulations. The addition of Cognigen scientists will allow SLP to enhance their ability to see things in different perspectives and propose new ideas to clients. The acquisition was done through \$2.4 million in cash and \$4.6 million in newly offered shares. This purchase has already proven to be profitable. Revenues increased in the third quarter by \$2.2 Million or 58.9% as compared to the 3rd quarter of 2014. Cognigen accounted for \$1.4 million of this increase in revenue. Net income and EBITA also increased as a result of this. Net income increased 41.7% or \$545,000 to 1.85 million from 1.3 million in 2014. 47% of this increase was from Cognigen. Before this acquisition SLP mainly operated on preclinical development simulations.

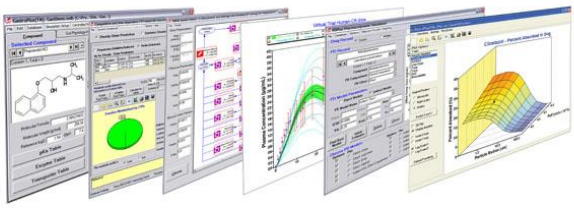
Cognigen's product KIWI is an innovative new outlook on cloud computing. "KIWI was created as a cloud-based, validated platform to efficiently and consistently organize, process, and communicate pharmacometric results and the story in front of the pharmacometric analyses." KIWI is releasing a beta for their update in November with the actual release taking place in January. SLP has a software renewal rate of 99%. This is expected to immediately generate revenue.

Long Term Growth Opportunities

SLP is primarily in the pharmaceutical market. This is highly important as pharmaceutical research and development spending is expected to have a 16% annual growth over the next four years. All top 20 pharmaceutical companies in the world hold product licenses in SLP. This is an immediate indicator of a high probability of increased sales during the next four years for SLP. It currently costs on average \$350-900 million to bring a new drug to the market. As SLP already has licenses with the United States FDA, the Japanese FDA and the Chinese FDA; it is highly effective for companies to use SLP's simulation software as there is increasing pressure to reduce the use of animals in pharmaceutical research.

SLP was recently awarded \$200,000 from the FDA office of generic drugs to develop improved modeling and simulation capabilities for dosage forms that are designed to be administered to the eye. This is a three year project that is only 3 quarters through. The importance of this is due to the significant growth in diseases of the eye. In 2012 the ophthalmic drug market was valued at \$16 billion and is expected to grow to \$21 billion in 2018. It is also expected that as companies develop drugs, the enhanced capabilities of SLP's program will help for both the development strategies of the drug and also the regulatory review of subsequent submissions that go into regulatory agencies.

SLP's flagship program GastroPlus™ has been a success since its inception. This is mainly due to its innovative ideology. "GastroPlus is a mechanistically based, PBPK modeling & simulation software package that simulates intravenous, oral, oral cavity, ocular, inhalation, and dermal/subcutaneous absorption, pharmacokinetics, and pharmacodynamics in human and animals." Gastroplus is able to show how quickly a drug will metabolize, understand appropriate dosage levels and understand food effects. This is the future of simulation technology as SLP continues to add to it with expansions and modules. Below one can see an example of the layout of the technology.



Two projects that are in the process of gathering funds and potential clients include Aeromodeller and MRImodeller. Aeromodeller is a different kind of project for SLP as it deals with simulating planes and missiles. It has the ability to predict aerodynamic force coefficients for missiles and can identify issues with planes before takeoff. SLP has used this product with NASA and the Airforce and was able to identify key issues in both. Aeromodeller is currently being shown in conferences across the globe as it is still very young. MRImodeller is another simulation project; it helps technicians to quickly run through MRI data to determine if a person is healthy or unhealthy. This project is currently waiting on funds to complete and begin marketing.

Financials

Simulations Plus maintains a strong cash position at \$7.7 million. This has allowed SLP to have the ability to give out dividends every quarter since 2012. The strong cash positions main importance is that it allows SLP to renegotiate agreements and also take on new projects or acquisitions. SLP has a very high current ratio at 6.9. This is important because it shows that SLP has an adequate amount of working capital every quarter to avoid any possible threat of missed payments or even bankruptcy. The risk of bankruptcy is even lower due to the fact the SLP has a non-debt balance sheet and consistently has positive cash flows.

Porter's Five Forces

The Porter's five forces show that the bargaining power of suppliers is low. This is because SLP is a software company and needs a very small amount of supplies as most of the supplies are human capital which are found within the company.

The bargaining power of customers is neutral as there is not an overwhelming customer base; however, SLP has a 99% software renewal rate. SLP also has a few products such as ADMET predictor which is the industry's number one ranked QSAR modeling software and DDDPlus which is the industry's only in vitro dissolution software.

The intensity of existing rivalry is high as stated in the 10-k, "we operate in the computer software industry, which is highly competitive and changes rapidly."

The threat of substitutes is low as there are a limited amount of substitute products for the healthcare simulation field. To switch products is expensive as the investing company would have to completely change their software. Also any substitutes if any would be of lower quality as SLP is the leading developer of most of their products.

The threat of new competitors is low. This is due to the issue with the advanced technology required. It is also essential to have extremely experienced scientists in the field of healthcare simulations. Patents also heavily limit new competitors and customers appear to be loyal to SLP.

Conclusion

I recommend a buy for Simulations Plus due to their generation of new revenue from Cognigen. This acquisition will lead to further growth and continued positive cash flows. The diversity of new and current projects also gives SLP stability in the event of a crisis and the ability to take off in the event of successful projects including Aeromodeller and MRImodeller. Lastly, it is important to focus on the financials as they show further stability because of their high current ratio.

CENTER FOR GLOBAL FINANCIAL STUDIES

Simulations Plus, Inc.	slp	Analyst	Current Price	Intrinsic Value	Target Value	Divident Yield	1-y Return: 22.78%	NEUTRAL
		Peter Ostrowski	$9.18	$10.82	$11.05	2%		

General Info

Sector	Healthcare
Industry	Health Care Technology
Last Guidance	(Invalid Identifier)
Next earnings date	November 25, 2015

Market Data

Enterprise value	$148.64
Market Capitalization	$155.07
Daily volume	0.04
Shares outstanding	16.89
Diluted shares outstanding	16.94
% shares held by institutions	19.43%
% shares held by insiders	39.77%
Short interest	0.45%
Days to cover short interest	1.08
52 week high	$10.27
52-week low	$5.52
5y Beta	0.25
6-month volatility	40.14%

Peers

Peers	Market Cap.
Sebring Software, Inc.	$1.03
MeVis Medical Solutions AG	$41.71
Medical Transcription Billing, Corp.	$16.85
DATATRAK International, Inc.	$7.80
Streamline Health Solutions, Inc.	$38.75
Ifa Systems Ag	$32.04
Medasys SA	$15.46
Nightingale Informatix Corporation	$4.74
Medtech Global Limited	$7.02

Current Capital Structure

Total debt/Common Equity (LTM)	0.23
Cost of Borrowing (LTM)	0.00%
Estimated Cost of new Borrowing	0.00%
Altman's Z	9.89
Estimated Debt Rating	AAA
Current levered Beta	0.50
LTM WACC	4.92%

Management

Professional	Title	Comp. FY2012	Comp. FY2013	Comp. FY2014
Woltosz, Walter	Co-Founder, Chairman and Chief Executive	$475,059	$363,221	$479,264
Woltosz, Virginia	Co-Founder, Treasurer and Secretary	$60,000	$60,000	$60,000
Kneisel, John	Chief Financial Officer	$0	$0	$169,061
DiBella, John	Vice President of Marketing and Sales	$162,117	$178,460	$324,290
Grasela, Thaddeus	President and Director	$0	$0	$0
Bolger, Michael	Chief Scientist	$197,028	$211,647	$0

Past Earning Surprises

	Revenue	EBITDA	Norm. EPS	Standard Error of "Surprise"
Last Quarter	6.83%	0.00%	0.00%	2.28%
Last Quarter-1	-0.65%	0.00%	0.00%	0.22%
Last Quarter -2	3.28%	0.00%	0.00%	1.09%
Last Quarter -3	10.50%	0.00%	-50.00%	18.66%
Last Quarter -4	6.86%	0.00%	0.00%	2.29%
Standard error	1.9%	0.0%	10.0%	3.57%
Standard Error of Revenues prediction	1.9%			
Imputed Standard Error of Op. Cost predictio	NM			
Imputed Standard Error of Op. Cost predictio	10.0%			

Proforma Assumptions

Convergence Assumptions

All base year ratios linearly converge towards the Industry ratios over an explicit period of 10 years

General Assumptions

Money market rate (as of today)	0.35%
Risk-Free rate (long term estimate)	2.92%
Annual increase (decrease) in interest rates	0.1%
Marginal Tax Rate	34.0%
Country Risk Premium	5.5%

Forecast Year	Revenue Growth Forecast	Revenue ($) Forecast
LTM		$16.60
FY2015	12.8%	$18.97
FY2016	11.8%	$21.44
FY2017	10.9%	$24.04
FY2018	9.9%	$26.75
FY2019	8.9%	$29.55
FY2020	7.9%	$32.42
FY2021	6.9%	$35.36
FY2022	5.9%	$38.33
FY2023	5.0%	$41.34
FY2024	4.0%	$44.38
Continuing Period	3.0%	$47.35

Items' Forecast Assumptions

	Base year (LTM)	Convergence period (Industry)	Adjustment per year
Operating Cash/Rev.	0.00%	3.03%	0.3%
NWV/Rev.	22.16%	9.52%	-1.3%
NPPE/Rev.	2.53%	11.63%	0.9%
Dpr/NPPE	42.81%	36.47%	-0.6%
NOPAT MARGIN	32.29%	15.13%	-1.7%
Op. Exp./Rev.	60.00%	68.00%	0.8%
SBC/Rev.	1.63%	1.91%	0.0%
Rent Exp./Rev.	1.78%	2.68%	0.1%
R&D/Rev.	8.12%	10.01%	0.2%
E&D/Rev.	0.00%	0.00%	0.0%
SG&A/Rev.	35.86%	34.31%	-0.2%
ROIC	41%	27.95%	-1.34%
EV/Rev.	5.62x	4.89x	-0.07x
EV/EBITA	12.71x	21.35x	0.86x
Debt/Equity	23%	65%	4.2%
Unlevered beta	0.43	0.75	0.03
Cost of Borrowing	0%	5%	0.5%
Dividends/REV	20%	6%	-1.4%

Other Assumptions

Tobin's Q	80%
Excess cash reinvestment	Cost of capital
Other claims on the firm's assets	$0.00

Capitalization

100% of all rent expenses are capitalized and amortized 'straightline' over 10 years
100% of all R&D expenses are capitalized and amortized 'straightline' over 10 years
E&P expenses are not capitalized
SG&A expenses are not capitalized

Valuation Focus

DCF Valuation	100%
Relative valuation	0%
Distress Valuation	0%

Monte Carlo Simulation Assumptions

Revenue Growth deviation	Normal (0%, 1%)
Operating expense deviation	Normal (0%, 1%)
Continuing Period growth	Triangular (5.335%, 5.5%, 5.665%)
Country risk premium	Triangular (2.91%, 3%, 3.09%)
Intrinsic value $\sigma(\varepsilon)$	$0.05
1-year target price $\sigma(\varepsilon)$	$0.05

Valuation

Forecast Year	ROIC	WACC	Invested Capital	Implied Enterprise Value	Net Claims on Assets and Dilution Costs	Shares Outstanding	Price per Share
LTM	41.4%	4.9%	$12.62	$192.81	$10.65	16.89	$10.89
FY2015	48.3%	4.9%	$12.82	$196.42	$11.22	16.89	$11.10
FY2016	53.0%	5.0%	$15.65	$202.35	$11.85	16.89	$11.37
FY2017	47.4%	5.1%	$19.04	$208.72	$12.52	16.89	$11.66
FY2018	42.3%	5.2%	$23.01	$215.58	$8.59	16.89	$12.10
FY2019	37.7%	5.4%	$27.59	$223.04	$9.23	16.89	$12.42
FY2020	33.6%	5.5%	$32.82	$231.18	$9.66	16.89	$12.78
FY2021	30.1%	5.6%	$38.74	$240.13	$10.31	16.89	$13.16
FY2022	27.0%	5.7%	$45.40	$250.02	$10.94	16.89	$13.59
FY2023	24.2%	5.8%	$52.84	$260.98	$9.58	16.89	$14.12
FY2024	21.8%	5.9%	$61.10	$273.18	$10.62	16.89	$14.67
Continuing Period	27.9%	5.8%	$25.63				

Monte Carlo Simulation Results

The $3\sigma(\varepsilon)$-adjusted intrinsic value is $10.82; the $3\sigma(\varepsilon)$-adjusted target price is $11.05; and the analysts' median target price is $9.15

Sensitivity Analysis

Revenue growth variations account for 95.9% of total variance
Risk premium's variations account for 2.5% of total variance
Operating expenses' variations account for 1.4% of total variance
Continuing period growth variations account for 0.2% of total variance