SIMULATIONS PLUS INC
Form 10QSB
January 16, 2007

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-QSB

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended November 30, 2006 or

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1937

For the transition period from _____ to _____

Commission file number: 001-32046

SIMULATIONS PLUS, INC.
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(Name of small business issuer 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
(Issuer's telephone number, including area code)

Check whether the issuer: (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No [ ]

The number of shares outstanding of the Issuer's common stock, par value $0.001 per share, as of January 15, 2007, was 7,479,548.

SIMULATIONS PLUS, INC.
FORM 10-QSB
FOR THE QUARTERLY PERIOD ENDED NOVEMBER 30, 2006

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PART I. FINANCIAL INFORMATION

SIMULATIONS PLUS, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEET
(UNAUDITED)
NOVEMBER 30, 2006

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ASSETS

| | |
|---|---|
| CURRENT ASSETS | |
| Cash and cash equivalents | $ 2,102,782 |
| Accounts receivable, net of allowance for doubtful accounts and estimated contractual discounts of $32,711 | 1,214,114 |
| Current portion of contracts receivable, net of discounts of $2,242 | 186,138 |
| Inventory | 233,906 |
| Prepaid expenses and other current assets | 56,897 |

| | |
|---|---|
| Current portion of deferred tax | 190,034 |
| Total current assets | 3,983,871 |
| CAPITALIZED COMPUTER SOFTWARE DEVELOPMENT COSTS, net of accumulated amortization of $2,534,905 | 1,400,231 |
| PROPERTY AND EQUIPMENT, net (note 4) | 102,278 |
| CONTRACTS RECEIVABLE, net of discounts of $161 | 47,219 |
| CUSTOMER RELATIONSHIPS, net of accumulated amortization of $36,156 | 91,886 |
| DEFERRED TAX | 889,816 |
| OTHER ASSETS | 18,445 |
| TOTAL ASSETS | $ 6,533,746 |

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



SIMULATIONS PLUS, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEET
(UNAUDITED)
NOVEMBER 30, 2006

LIABILITIES AND SHAREHOLDERS' EQUITY

| | |
|---|---|
| CURRENT LIABILITIES | |
| Accounts payable | $ 140,548 |
| Accrued payroll and other expenses | 373,561 |
| Accrued bonuses to officers | 10,430 |
| Accrued warranty and service costs | 34,852 |
| Deferred revenue | 157,173 |
| Total current liabilities | 716,564 |
| LONG TERM DEFERRED REVENUE | 62,501 |
| Total liabilities | 779,065 |
| 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 | |
| 20,000,000 shares authorized | |
| 7,449,496 shares issued and outstanding | 3,802 |
| Additional paid-in capital | 5,287,207 |
| Retained Earnings | 463,672 |

| | |
|---|---|
| Total shareholders' equity | 5,754,681 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | $ 6,533,746 |

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



SIMULATIONS PLUS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS ENDED NOVEMBER 30,
(UNAUDITED)

| | 2006 | 2005 |
|---|---|---|
| NET SALES | $ 1,456,451 | $ 818,815 |
| COST OF SALES | 441,440 | 331,597 |
| GROSS PROFIT | 1,015,011 | 487,218 |
| OPERATING EXPENSES | | |
| Selling, general, and administrative | 756,777 | 628,756 |
| Research and development | 183,627 | 97,222 |
| Total operating expenses | 940,404 | 725,978 |
| INCOME (LOSS) FROM OPERATIONS | 74,607 | (238,760) |
| OTHER INCOME (EXPENSE) | | |
| Interest income | 15,928 | 3,481 |
| Miscellaneous income | 358 | 50 |
| Gain (Loss) on currency exchange | 2,972 | (5,302) |
| Total other income (expense) | 19,258 | (1,771) |
| INCOME (LOSS) BEFORE INCOME TAXES | 93,865 | (240,531) |
| BENEFIT FROM (PROVISION FOR) INCOME TAXES | | |
| Benefit from (provision for) income tax | (20,650) | 42,000 |
| Total benefit from (provision for) income taxes | (20,650) | 42,000 |
| NET INCOME (LOSS) | $ 73,215 | $ (198,531) |
| BASIC EARNINGS (LOSS) PER SHARE | $ 0.01 | $ (0.03) |

| | | |
|---|---|---|
| Diluted earnings (loss) per share | $ 0.01 | $ (0.03) |
| WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING* | | |
| BASIC | 7,444,551 | 7,298,668 |
| DILUTED | 8,548,560 | 7,298,668 |

* The number of shares at November 30, 2005 have been retroactively restated to reflect a 2-for-1 stock split that occurred on August 14, 2006.

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



SIMULATIONS PLUS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED NOVEMBER 30,
(UNAUDITED)

| | 2006 | 2005 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income (loss) | $ 73,215 | $ (198,531) |
| Adjustments to reconcile net income to net cash provided by operating activities | | |
| Depreciation and amortization of property and equipment | 11,604 | 11,860 |
| Amortization of customer relationships | 8,478 | -- |
| Amortization of capitalized software development costs | 107,178 | 45,709 |
| Stock-based compensation | 6,451 | -- |
| Contribution of Equipment at book value | 774 | -- |
| (Increase) decrease in | | |
| Accounts receivable | 372,475 | 442,031 |
| Inventory | 3,142 | (31,890) |
| Deferred tax | 20,650 | (42,000) |
| Other assets | 24,399 | (23,316) |
| Increase (decrease) in | | |
| Accounts payable | (74,870) | 33,408 |
| Accrued payroll and other expenses | 8,649 | (17,127) |
| Accrued bonuses to officers | (88,323) | -- |
| Accrued income taxes | (1,600) | (1,600) |
| Accrued warranty and service costs | 100 | 4,278 |
| Deferred revenue | 90,213 | (69,854) |
| Net cash provided by operating activities | 562,535 | 152,968 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Purchases of property and equipment | (18,272) | (10,656) |
| Purchases of Bioreason's assets | -- | (826,192) |
| Proceeds from sale of assets | -- | 2,218 |

| | | |
|---|---|---|
| Capitalized computer software development costs | (132,967) | (142,539) |
| Net cash used in investing activities | (151,239) | (977,169) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Proceeds from the exercise of stock options | 6,450 | 1,955 |
| Net cash provided by financing activities | 6,450 | 1,955 |
| Net increase (decrease) in cash and cash equivalents | $ 417,746 | $ (822,246) |

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



SIMULATIONS PLUS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED NOVEMBER 30,
(UNAUDITED)

| | 2006 | 2005 |
|---|---|---|
| CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR | 1,685,036 | 1,754,042 |
| CASH AND CASH EQUIVALENTS, END OF PERIODS | $ 2,102,782 | $ 931,796 |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION | | |
| INTEREST PAID | $ -- | $ -- |
| INCOME TAXES PAID | $ 1,600 | $ 1,600 |

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



SIMULATIONS PLUS, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS
(Unaudited)

Note 1: GENERAL

As contemplated by the Securities and Exchange Commission under Item 310(b) of

Regulation S-B, the accompanying financial statements and footnotes have been condensed and therefore do not contain all disclosures required by generally accepted accounting principles. The interim financial data are unaudited; however, in the opinion of Simulations Plus, Inc. ("we", "our", "us"), the interim data include all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the results for the interim periods. Results for interim periods are not necessarily indicative of those to be expected for the full year.

Note 2: SIGNIFICANT ACCOUNTING POLICIES

Estimates
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Our 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. Critical accounting policies for us include revenue recognition, accounting for capitalized software development costs, and accounting for income taxes.

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

Revenue Recognition
---

We recognize revenues related to software licenses and software maintenance in accordance with the American Institute of Certified Public Accountants ("AICPA") Statements of Position (SOP) No. 97-2, "Software Revenue Recognition." Product revenue is recorded at the time of unlocking the software on the customer's computer(s), net of estimated allowances and returns. Post-contract customer support ("PCS") obligations are insignificant; therefore, revenue for PCS is recognized at the same time, and the costs of providing such support services are accrued and amortized over the obligation period.

As a by-product of ongoing improvements and upgrades for our software, some modifications are provided to customers who have already licensed software at no additional charge. We consider these modifications to be minimal, as they are not changing the basic functionality or utility of the software, but rather adding convenience, such as being able to plot some additional variable on a graph in addition to the numerous variables that had been available before. Such software modifications for any single product have been typically once or twice per year, sometimes more, sometimes less. Thus, they are infrequent. We provide, for a fee, additional training and service calls to our customers and recognize revenue at the time the training or service call is provided.



We enter into one-year license agreements with most of our customers for the use of our pharmaceutical software products. However, from time to time, we enter into multi-year license agreements. We now unlock and invoice software one year at a time for multi-year licenses. Therefore, revenue is now recognized one year at a time. This eliminates the extreme variability in our reported revenues and earnings that we experienced in the past caused by booking multi-year license

revenues up front.

Cash and Cash Equivalents

For purposes of the statements of cash flows, we consider all highly liquid investments purchased with original maturities of three months or less to be cash equivalents.

Accounts Receivable

We maintain an allowance for doubtful accounts for estimated losses that may arise if any of our customers are unable to make required payments. We specifically analyze the age of customer balances, historical bad debt experience, customer credit-worthiness, and changes in customer payment terms when making estimates of the uncollectability of our trade accounts receivable balances. If we determine that the financial conditions of any of our 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.

Our long-term receivables are discounted at the present value. The discount is amortized over the life of the receivable and recognized as interest income. The balance as of November 30, 2006 represents receivables which we purchased as a part of Bioreason's assets.

Inventory

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

Capitalized Computer Software Development Costs

Software development costs are capitalized in accordance with SFAS No. 86, "Accounting for the Cost of Computer Software to be Sold, Leased, or otherwise Marketed." Capitalization of software development costs begins upon the establishment of technological feasibility and is discontinued when the product is available for sale.

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

Amortization of capitalized software development costs is provided on a product-by-product basis on the straight-line method over the estimated economic life of the products (not to exceed five years). Amortization of software development costs amounted to $107,178 and $45,709 for the three months ended November 30, 2006 and 2005, respectively. We expect future amortization expense to vary due to increases in capitalized computer software development costs.

We test capitalized computer software costs for recoverability whenever events or changes in circumstances indicate that the carrying amount may not be recoverable within a reasonable time. As a result, we have written off $1,763 during this fiscal quarter.

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 | 5 years |

Maintenance and minor replacements are charged to expense as incurred. Gains and losses on disposals are included in the results of operations.

Fair Value of Financial Instruments

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

Shipping and Handling

Shipping and handling costs, recorded as cost of sales, amounted to $8,191 and $9,000 for the three months ended November 30, 2006 and 2005, respectively.

Research and Development Costs

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

Income Taxes

The Company utilizes SFAS No. 109, "Accounting for Income Taxes," which requires the recognition of deferred tax assets and liabilities for 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.

At the end of fiscal year 2006, we recorded $1,100,500 in deferred tax assets. For the first quarter of fiscal year 2007 (FY07), we recorded a provision for deferred taxes in the amount of $20,650, resulting in a deferred tax asset of $1,079,850 at November 30, 2006. The evaluation of the deferred tax assets is based on our history of generating taxable profits and our projections of future profits as well as expected future tax rates to determine if the realization of the deferred tax asset is more-likely-than-not. Significant judgment is required in these evaluations, and differences in future results from our estimates, could result in material differences in the realization of these assets.

Principles of Consolidation

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

Customer relationships

The Company purchased customer relationships as a part of the acquisition of certain assets of Bioreason, Inc. in November 2005. Customer relationships was recorded at a cost of $128,042, and is being amortized over 66 months. Amortization expense and accumulated amortization as of November 30, 2006 amounted to $8,478 and $36,156, respectively.

Earnings per Share

The Company reports earnings per share in accordance with SFAS No. 128, "Earnings per Share." 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 years ended August 31, 2006 and 2005 were as follows (the number of shares reflects the effect of a 2-for-1 stock split for comparison purpose):

| | 2006 | 2005 |
|---|---|---|
| Numerator | | |
| Net income (loss) attributable to common shareholders | $ 73,215 | $ (198, |
| Denominator | | |
| Weighted-average number of common shares outstanding during the year | 7,444,551 | 7,298, |
| Dilutive effect of stock options | 1,104,009 | |
| Common stock and common stock equivalents used for diluted earning per share | 8,548,560 | 7,298, |

Stock-Based Compensation

Prior to September 1, 2006, we accounted for employee stock options grants in accordance with APB No. 25, and adopted the disclosure-only provision of SFAS No. 123, "Accounting for Stock-Based Compensation."

In December 2004, the FASB issued Statement of Accounting Standard No. 123R, "Share-Based Payment", a revision of SFAS No. 123, "Accounting for Stock-Based Compensation." SFAS 123R supersedes APB Opinion No. 25, and requires all companies to measure compensation expense for all share-based payments, including employee stock options, based upon the fair value of the stock-based awards at the date of grant. SFAS 123R is effective for the Company for Fiscal Year 2007, beginning September 1, 2006. Subsequent to the effective date, the pro forma disclosures previously permitted under SFAS No. 123 are no longer an alternative to financial statement recognition.

Effective September 1, 2006, we adopted SFAS No. 123R using the modified prospective method. Under this method, compensation cost recognized during the three months ended November 30, 2006 includes: (1) compensation cost for all share-based payments granted prior to, but not yet vested as of September 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123 amortized over the options' vesting period, and (2) compensation cost for all share-based payments granted subsequent to September 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123R amortized on a straight-line basis over the options' vesting period. As a result of adopting SFAS No. 123R on September 1, 2006, our stock-based compensation was $6,451 for the three months ended November 30, 2006, and included in the condensed consolidated statements of operations as Research and development expense.

The table below represents our pro forma net income giving effect to the estimated compensation expense related to stock options that would have been reported if we had applied the fair value recognition provisions of SFAS No. 123 for the three months ended November 30, 2005.

| | Three Mont Ended November 3 2005 |
|---|---|
| Net income (loss) | |
| As reported | $ (198,531 |
| Stock based employee compensation cost, net of related tax effects, that would have been included in the determination of net income if the fair value method had been applied | (36,888 |
| Pro forma net income (loss) | $ (235,419 |
| Earnings (loss) per common share | |
| Basic - as reported | $ (0.05 |
| Basic - Pro forma | $ (0.06 |
| Diluted - as reported | $ (0.05 |
| Diluted - Pro forma | $ (0.06 |

For the three months ended November 30, 2006, the stock-based employee compensation expense using the fair value recognition method under SFAS No. 123R is included in the condensed consolidated statements of operations. Therefore, it is not presented in the pro forma table above.

Concentrations and Uncertainties

International sales accounted for 29% and 24% of net sales for the three months ended November 30, 2006 and 2005, respectively. For Simulations Plus, Inc., one customer accounted for 22% of net sales during the three months ended November 30, 2006, and for Words+, Inc., one government agency accounted for 27.9% of net

sales during the three months ended November 30, 2006.

The Company operates in the computer software industry, which is highly competitive and changes rapidly. The Company's operating results could be significantly affected by its ability to develop new products and find new distribution channels for new and existing products.



For Simulations Plus, four customers comprised 41%, 13%, 11% and 10% of its accounts receivable at November 30, 2006. Four customers comprised 27%, 23%, 20% and 20% of its accounts receivable at November 30, 2005. For Words+, one government agency comprised 30% and 26% of accounts receivable at November 30, 2006 and 2005, respectively.

The Company's subsidiary, Words+, Inc., purchases components for its main computer products from three manufacturers. Words+, Inc. also uses a number of pictographic symbols that are used in its software products which are licensed from a third party. The inability of the Company to obtain computers used in its products or to renew its licensing agreement to use pictographic symbols could negatively impact the Company's financial position, results of operations, and cash flows.

Recently Issued Accounting Pronouncements
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In June 2006, the Financial Accounting Standards Board ("FSAB) issued FASB interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement No. 109" ("FIN 48"), which clarifies the accounting for uncertainty in income tax positions. The provisions of FIN 48 are effective for the Company on September 1, 2007, with the cumulative effect of the change in accounting principle, if any, recorded as an adjustment to opening retained earnings. We are currently evaluating the impact of adopting FIN 48; however we believe that adoption of FIN 48 will not have a material impact on our consolidated financial statement.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106, and 132(R), ("SFAS 158"), which requires the recognition of the overfunded or underfunded status of a defined benefit postretirement plan in a company's balance sheet. This portion of the new guidance is effective on December 31, 2006. Additionally, the pronouncement eliminates the option for companies to use a measurement date prior to their fiscal year-end effective December 31, 2008. Since we do not have any defined benefit pension or postretirement plans that are subject to SFAS 158, we do not expect the pronouncement to have a material impact on our consolidated financial statements.

In September 2006, The Securities and Exchange Commission ("SEC") released Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). SAB 108 provides interpretive guidance on the SEC's views on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The provisions of SAB 108 will be effective for the Company for the fiscal year ended August 2007. We are currently evaluating the impact of applying SAB 108; however, we believe that the application of SAB 108 will not have a material effect on our consolidated financial statements.

Note 3: CASH AND CASH EQUIVALENTS

The Company maintains cash deposits at banks located in California. Deposits at each bank are insured by the Federal Deposit Insurance Corporation up to $100,000 per company. At November 30, 2006, the uninsured portions aggregated to $1,729,000. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk on cash and cash equivalents.



Note 4: PROPERTY AND EQUIPMENT

Furniture and equipment as of November 30, 2006 consisted of the following:

| | |
|---|---|
| Equipment | $ 165,409 |
| Computer equipment | 319,540 |
| Furniture and fixtures | 61,928 |
| Automobile | 21,769 |
| Leasehold improvements | 53,898 |
| Sub total | 622,544 |
| Less: Accumulated depreciation and amortization | (520,266) |
| Net Book Value | 102,278 |

Note 5: COMMITMENTS AND CONTINGENCIES

Employee Agreement

On August 9, 2005, the Company entered into an employment agreement with its President/CEO that expires in August 2007. The employment agreement provides for an annual salary of $172,000 and an annual bonus equal to 5% of the Company's net income before taxes, not to exceed $150,000. The agreement also provides that the Company may terminate the agreement upon 30 days' written notice if termination is without cause. The Company's only obligation would be to pay its President the greater of a) 12 months salary or b) the remainder of the term of the employment agreement from the date of notice of termination.

Note 6: STOCKHOLDERS' EQUITY

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 250,000 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 500,000. In February 2000, the shareholders approved an increase in the number of shares that may be granted under the Option Plan to 1,000,000. In December 2000, the shareholders approved an increase in the number of shares that may be granted under the Option Plan to 1,250,000. Furthermore, in February 2005, the shareholders approved additional 250,000 shares, resulting to the total number of shares that may be granted under the Option Plan to 1,500,000. All of the preceding numbers of options are based on numbers of options prior to the two-for-one stock split on August 14, 2006. The Option Plan terminated in September 2006 by its term.

All of the following numbers of options are based on numbers of options after the two-for-one stock split on August 14, 2006. On August 18, 2006, the Company accelerated the vesting of stock options previously awarded for which the

underlying shares are registered, excluding 500,000 options for shares of unregistered stock. As a result, Options to purchase approximately 505,000 shares of common stock were accelerated, representing approximately 25% of all outstanding options. The Company's decision for this acceleration was to eliminate future compensation expense that the Company would otherwise recognize with respect to these options following the Company's adoption of SFAS 123(R), Share-Based Payment. The Company adopted FAS No. 123(R) on September 1, 2006, which is the beginning of the Company's 2007 fiscal year.



The following summarized the stock option transactions.

| | Number of Options | Weighted-Average Exercise Price Per Share |
|---|---|---|
| Outstanding, August 31, 2006 | 2,040,072 | $ 1.33 |
| Granted | 100,000 | $ 2.15 |
| Exercised | (8,000) | $ 0.81 |
| Expired/Canceled | (1,000) | $ 2.25 |
| Outstanding, November 30, 2006 | 2,131,072 | $ 1.37 |
| Exercisable, November 30, 2006 | 1,951,072 | $ 1.37 |

| | Options Outstanding & Unvested at November 30, 2006 | | |
|---|---|---|---|
| | Number Outstanding | Remaining Contractual Life (in years) | Weigh Avera Exercise |
| Non Vested before 9/1/2006 | 100,000 | | $ 1.6 |
| Granted | 100,000 | | $ 2.1 |
| Forfeited | 1,000 | | $ 2.2 |
| Vested | 20,000 | | $ 1.6 |
| Non Vested at 11/30/2006 | 180,000 | 9.29 | $ 1.9 |

The fair value of the options granted during the three months ended November 30, 2006 is estimated at $81,860. The fair value of these options was estimated at the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions for the three months ended November 30, 2006: dividend yield of 0%, expected volatility of 11%, risk-free interest rate of 4.72%, and expected life of ten years. The weighted-average fair value of options granted during the first fiscal quarter of FY07 was $0.82, and the weighted-average exercise price was $2.15.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which do not have vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's

opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.



The weighted-average remaining contractual life of options outstanding issued under the Plan was 5.1 years at November 30, 2006. The exercise prices for the options outstanding at November 30, 2006 ranged from $0.53 to $2.48, and the information relating to these options is as follows:

| Exercise Price | Stock Options Outstanding | Stock Options Exercisable | Weighted-Average Remaining Contractual Life of Options Outstanding | Weighted-Av Exercise Price of Options Outstandin |
|---|---|---|---|---|
| $0.53 - 1.00 | 789,672 | 789,672 | 3.5 years | $ 0 |
| $1.00 - 1.50 | 668,400 | 668,400 | 3.2 years | $ 1 |
| $1.50 - 2.50 | 673,000 | 493,000 | 9.0 years | $ 2 |
| | 2,131,072 | 1,951,072 | | |

Other Stock Options

As of November 30, 2006, the independent members of the Board of Directors hold options to purchase 22,412 shares of common stock at exercise prices ranging from $0.60 to $2.63, which options were granted on or before August 31, 2006.

| | Number of Options | Weighted average exercise price |
|---|---|---|
| Options Outstanding | 22,412 | $ 1.44 |
| Options exercisable | 18,412 | $ 1.28 |

Note 7: SEGMENT AND GEOGRAPHIC REPORTING

We account for segments and geographic revenues in accordance with SFAS No. 131, "Disclosure about Segments of an Enterprise and Related Information." 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 months ended November 30, 2006 and 2005:

| | November 30, 2006 | | | |
|---|---|---|---|---|
| | Simulations Plus, Inc | Words +, Inc. | Eliminations | |
| Net Sales | 824,303 | 632,148 | | |
| Income (loss) from operations | 109,089 | (34,482) | | |
| Identifiable assets | 6,515,286 | 1,793,374 | (1,774,914) | |

| | | | | |
|---|---|---|---|---|
| Capital expenditures | 5,874 | 12,398 | | |
| Depreciation and Amortization | 4,598 | 7,544 | | |

| November 30, 2005 | | | |
|---|---|---|---|
| | Simulations Plus, Inc | Words +, Inc. | Eliminations |
| Net Sales | 198,889 | 619,926 | |
| Income (loss) from operations | (253,284) | 14,524 | |
| Identifiable assets | 5,601,917 | 1,468,626 | (1,757,154) |
| Capital expenditures | 9,446 | 6,211 | |
| Depreciation and Amortization | 3,357 | 8,507 | |



In addition, the Company allocates revenues to geographic areas based on the locations of its customers. Geographical revenues for the nine months ended November 30, 2006 and 2005 were as follows (in thousands):

| November 30, 2006 | | | | | |
|---|---|---|---|---|---|
| | North America | Europe | Asia | Oceania | South America |
| Simulations Plus, Inc. | 471 | 173 | 180 | -0- | -0- |
| Words+, Inc. | 563 | 49 | 18 | -0- | 2 |
| Total | 1,034 | 222 | 198 | -0- | 2 |

| November 30, 2005 | | | | | |
|---|---|---|---|---|---|
| | North America | Europe | Asia | Oceania | South America |
| Simulations Plus, Inc. | 74 | 8 | 117 | -0- | -0- |
| Words+, Inc. | 551 | 47 | 10 | 10 | 2 |
| Total | 625 | 55 | 127 | 10 | 2 |

Note 8: EMPLOYEE BENEFIT PLAN

We maintain a 401(K) Plan for all eligible employees. 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. Contributions by the Company to this Plan amounted to $14,703 and

$11,765 for the three months ended November 30, 2006 and 2005, respectively.

Note 9: SUBSEQUENT EVENT

Since December 1, 2006, an additional 30,052 stock options to purchase shares have been exercised by employees.



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

### FORWARD-LOOKING STATEMENTS

CERTAIN STATEMENTS IN THIS QUARTERLY REPORT ON FORM 10-QSB, OR THE "REPORT," ARE "FORWARD-LOOKING STATEMENTS." THESE FORWARD-LOOKING STATEMENTS INCLUDE, BUT ARE NOT LIMITED TO, STATEMENTS ABOUT THE PLANS, OBJECTIVES, EXPECTATIONS AND INTENTIONS OF SIMULATIONS PLUS, INC., A CALIFORNIA CORPORATION (REFERRED TO IN THIS REPORT AS THE "COMPANY") AND OTHER STATEMENTS CONTAINED IN THIS REPORT THAT ARE NOT HISTORICAL FACTS. FORWARD-LOOKING STATEMENTS IN THIS REPORT OR HEREAFTER INCLUDED IN OTHER PUBLICLY AVAILABLE DOCUMENTS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION, OR THE "COMMISSION," REPORTS TO OUR STOCKHOLDERS AND OTHER PUBLICLY AVAILABLE STATEMENTS ISSUED OR RELEASED BY US INVOLVE KNOWN AND UNKNOWN RISKS, UNCERTAINTIES AND OTHER FACTORS WHICH COULD CAUSE OUR ACTUAL RESULTS, PERFORMANCE (FINANCIAL OR OPERATING) OR ACHIEVEMENTS TO DIFFER FROM THE FUTURE RESULTS, PERFORMANCE (FINANCIAL OR OPERATING) OR ACHIEVEMENTS EXPRESSED OR IMPLIED BY SUCH FORWARD-LOOKING STATEMENTS. SUCH FUTURE RESULTS ARE BASED UPON MANAGEMENT'S BEST ESTIMATES BASED UPON CURRENT CONDITIONS AND THE MOST RECENT RESULTS OF OPERATIONS. WHEN USED IN THIS REPORT, THE WORDS "EXPECT," "ANTICIPATE," "INTEND," "PLAN," "BELIEVE," "SEEK," "ESTIMATE" AND SIMILAR EXPRESSIONS ARE GENERALLY INTENDED TO IDENTIFY FORWARD-LOOKING STATEMENTS, BECAUSE THESE FORWARD-LOOKING STATEMENTS INVOLVE RISKS AND UNCERTAINTIES. THERE ARE IMPORTANT FACTORS THAT COULD CAUSE ACTUAL RESULTS TO DIFFER MATERIALLY FROM THOSE EXPRESSED OR IMPLIED BY THESE FORWARD-LOOKING STATEMENTS, INCLUDING OUR PLANS, OBJECTIVES, EXPECTATIONS AND INTENTIONS AND OTHER FACTORS.

### GENERAL

### BUSINESS

Simulations Plus, Inc. (the "Company" or "Simulations Plus", or "we" or "our") and its wholly owned subsidiary, Words+, Inc. ("Words+") produce different types of products: (1) Simulations Plus, incorporated in 1996, develops and produces software for use in pharmaceutical research and for education, and also provides contract research services to the pharmaceutical industry, and (2) Words+, founded in 1981, produces computer software and specialized hardware for use by persons with disabilities, as well as a personal productivity software program called Abbreviate! for the retail market. For the purposes of this document, we sometimes refer to the two businesses as "Simulations Plus" when referring to the business that is primarily pharmaceutical software and services, and "Words+" when referring to the business that is primarily assistive technologies for persons with disabilities.

### Simulations Plus

PRODUCTS

We currently offer four software products for pharmaceutical research: ADMET Predictor(TM)/ ADMET Modeler(TM), ClassPharmer(TM), DDDPlus(TM), and GastroPlus(TM).

ADMET PREDICTOR/ADMET MODELER

ADMET (Absorption, Distribution, Metabolism and Excretion and Toxicity) Predictor consists of a library of statistically significant numerical models that predict various properties of chemical compounds from just their molecular structures. This capability means a chemist can merely draw a molecule diagram and get estimates of these properties, even though the molecule has never



existed. Drug companies search through millions of such "virtual" molecular structures as they attempt to find new drugs. The vast majority of these molecules are not suitable as medicines for various reasons. Some have such low solubility that they will not dissolve well, some have such low permeability through the intestinal wall that they will not be absorbed well, some degrade so quickly that they are not stable enough to have a useful shelf life, some bind to proteins (like albumin) in blood to such a high extent that little unbound drug is available to reach the target, and some will be toxic in various ways. Identification of such properties as early as possible enables researchers to eliminate poor compounds without spending time and money to make them and then run experiments to identify these weaknesses. Today, many molecules can be eliminated on the basis of computer predictions, such as those provided by ADMET Predictor.

ADMET Predictor 2.0 with integrated ADMET Modeler was released at the beginning of this reporting period. The two programs are now combined into a single offering for greater user convenience and to enhance the ADMET Predictor product in a very competitive market.

ADMET MODELER

ADMET Modeler was first released in July of 2003. This powerful program is used to generate the predictive models used in ADMET Predictor in a small fraction of the time once required to build these models. For example, the new toxicity models were developed in a matter of a few hours once we completed the tedious effort of "cleaning up" the databases (which seem to always contain a number of errors). Prior to the availability of ADMET Modeler, we would have needed as much as three months after cleaning the databases for each new model to obtain similar results.

Pharmaceutical companies spend enormous amounts of money conducting a wide variety of experiments on new molecules each year. Using such data to build predictive models provides a second return on this investment; however, in the past, model-building has traditionally been a tedious activity that required a specialist. With ADMET Modeler, scientists without model-building experience can now use their own experimental data to quickly create high quality predictive models.

In addition to the recent integration of ADMET Modeler into ADMET Predictor, we have also added a number of important improvements to ADMET Modeler, including: (1) a new, state-of-the-art modeling method known as Kernel Partial Least Squares (KPLS); (2) an advanced method for selecting the best model among a matrix of models that each use different numbers of inputs and different model architectures; (3) improved methods for the sensitivity analysis that helps to

select the most important inputs for a particular model, and (4) an integrated Model Editor that allows users to easily hide or display models, as well as to change the "tooltips" (helpful hints) that appear when the mouse is paused over any model column.

CLASSPHARMER(TM)

In November 2005, we acquired certain secured assets of Bioreason, Inc. from its former creditors, including two patents governing classification algorithms, a proprietary database curated from the literature of over 5,000 compounds with measured mutagenicity in various strains of Salmonella (the experiment for this is known as the "Ames test" in the industry), and a software package called ClassPharmer. ClassPharmer is a molecule classification software program, similar in nature to ChemTK(TM), which we had acquired from Sage Informatics, LLC in August 2005, but with more sophisticated proprietary classification algorithms and various additional convenience features. The Bioreason version of ClassPharmer was programmed in a combination of programming languages that made it run much more slowly than ChemTK, and certain elements of the ChemTK user interface were more user-friendly and visually pleasing than ClassPharmer.



We integrated ChemTK and ClassPharmer into a single program and released ClassPharmer 4.0 in March 2006. Additional improvements based on customer feedback were incorporated into Version 4.1, which was released just after the end of the 4th quarter. As announced in our press release of October 9, 2006, monies received from ClassPharmer sales and acquired accounts payable had exceeded one million dollars at that time, this exceeding the original acquisition costs in only 11 months.

DDDPLUS

DDDPlus (Dose Disintegration and Dissolution Plus) was first released in February 2005. DDDPlus simulates how different tablets and capsules disintegrate and dissolve during IN VITRO (laboratory) dissolution experiments. The program also simulates the effects of changing formulation excipients (additives that are not the active drug), and changing the experimental apparatus and fluids used in the experiment. We believe this tool will be a valuable asset for formulation scientists as they search for optimum formulations that provide desirable properties at minimum cost, as well as optimum experimental conditions under which to measure disintegration and dissolution to best predict what will happen in human. We believe the market for this tool includes hundreds of drug delivery companies as well as all pharmaceutical and most biotech companies.

Over 60 companies evaluated Version 1.0 of DDDPlus. This was an indication of the strong interest and business potential in this area. Through the evaluation process, we received valuable feedback about what would be required for various customers to license the software, and we have now incorporated those improvements. We have also added significant new functionality by enabling formulation scientists to optimize experimental conditions to achieve a desired dissolution-time profile, and to handle polymer matrix formulations that are often used in controlled release formulations. Version 2.0 was released in the 3rd quarter and was evaluated at several potential customer sites. A number of additional suggestions were received and incorporated into Version 2.1, which is now shipping. Sales of DDDPlus began to increase following the release of Version 2.0, along with the number of potential new customers evaluating the program.

We continue to remain confident that significant sales of DDDPlus licenses will take place. The initial release served us well to stimulate interest in this

first-of-its-kind software and to get formulation scientists thinking about how to use such a capability in their work. Because such scientists have never used software like DDDPlus before, this is an educational process to show them how such a tool can actually save time and money, similar to the process we had with GastroPlus ten years ago.

GASTROPLUS

GastroPlus simulates the absorption and pharmacokinetics of drugs in the human gastrointestinal tract as well as in a number of animals. This sophisticated simulation has equations for the movement of the drug through the gastrointestinal tract, dissolution and precipitation along the way, degradation by chemical or metabolic processes in the gastrointestinal tract prior to absorption, and rate of absorption through various regions of the intestinal wall into the blood stream. After absorption for oral administration, or direct injection into the blood via intravenous administration, the program simulates the concentration of drug in the blood plasma versus time, accounting for the distribution of the drug into various tissues and its elimination by various routes (pharmacokinetics). The program also enables fitting models for and simulating how a drug affects the body (pharmacodynamics), such as reducing pain, reducing blood pressure, reducing depression, and causing adverse side effects.



We believe GastroPlus is the "gold standard" in the industry for its class of simulation software. It is used from early drug discovery through preclinical development and into early clinical trials. The information provided through GastroPlus simulations guides project decisions in various ways. Among the kinds of knowledge gained through such simulations are: (1) the best "first dose in human" for a new drug prior to Phase I trials, (2) whether a potential new drug compound is likely to be absorbed at high enough levels to achieve the desired blood concentrations needed for effective therapy, (3) whether the absorption process is affected by certain enzymes and transporter proteins in the intestinal tract that may cause the amount of drug reaching the blood to be very different from one region of the intestine to another, (4) when certain properties of a new compound are probably adequately estimated through computer ("in silico") predictions or simple experiments rather than through more expensive and time-consuming IN VITRO or animal experiments, (5) what the likely variations in blood and tissue concentration levels would be in a large population, in different age groups or in different ethnic groups, and (6) whether a new formulation for an existing approved drug is likely to demonstrate "bioequivalence" (equivalent blood concentration versus time) to the currently marketed dosage form in a human trial.

Our marketing intelligence indicates that GastroPlus enjoys a dominant position in the number of users worldwide. In addition to virtually every major pharmaceutical company, licenses include a growing number of smaller pharmaceutical and biotech companies, generic drug companies, and drug delivery companies (companies that design the tablet or capsule for a drug compound that was developed by another company). Although these companies are smaller than the pharmaceutical giants, they can also save considerable time and money through simulation. We believe this part of the industry, which includes hundreds of companies, represents major growth potential for GastroPlus. Our experience has been that the number of new companies adopting GastroPlus shows steady growth, adding to the base of annual licenses each year.

During this reporting period, we released version 5.2, adding several new user convenience features as well as additional simulation capabilities.

We are aware that other companies have developed competitive software; however, based on customer feedback, we believe that the competitive threat to GastroPlus is limited. We continue working on improving GastroPlus under the two-year (one full-time equivalent) contract we announced on August 31, 2006, as well as our own internal product improvement efforts.

CONTRACT RESEARCH SERVICES

Our recognized expertise in oral absorption and pharmacokinetics is evidenced by the fact that our staff members have been speakers or presenters at over 40 prestigious scientific meetings worldwide in the past three years. We conduct contracted studies for 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 increasing steadily, and we expect this trend to continue. Consulting contracts serve both to showcase our technologies and as a way to build relationships with new customers, as well as strengthening relationships with our existing customers.

PHARMACEUTICAL SIMULATIONS SOFTWARE PRODUCT DEVELOPMENT

Although all of our development work cannot be disclosed for competitive reasons, some of our development efforts during this reporting period included:

(1) ADMET Predictor/ADMET Modeler upgrades

The initial toxicity predictions in ADMET Predictor were released during fiscal year 2005, and we have continued to add new toxicity models steadily. At this time, we are working on additional such models, but we are not revealing their nature for competitive reasons. We are also working on other improvements to ADMET Predictor/ADMET Modeler that will be announced in the coming months.



(2) DDDPlus

We have continued to improve DDDPlus by adding capabilities and features requested by our customers and potential customers who have been conducting beta testing, as well as capabilities and features identified in-house.

(3) MembranePlus(TM)

MembranePlus is a computer program that simulates IN VITRO experiments that measure the permeability of new drug-like molecules through a layer of living cells or through an artificial membrane. These experiments are conducted in order to estimate the permeability of new drug compounds through the human intestinal wall and into the blood. However, such experiments do not produce results that are easily translated into human permeabilities. We believe that a detailed mechanistic simulation of these IN VITRO experiments will provide the insight and understanding needed to provide reasonably accurate estimates of permeability in different regions of the human intestinal tract from IN VITRO data.

This development effort accelerated during fiscal year 2005 with the hiring of a new Ph.D. scientist who focused on this program. The simulation is currently predicting the movement of drug molecules through the bulk fluid, into the membranes at the surface of a cell layer, through the surface membrane, through the interior of the cell, into the opposite surface membrane, and through it to the bulk fluid on the opposite side of the cell layer. Although a few technical issues remain to be resolved, we are optimistic that the simulation will become a unique tool for the analysis of data from these experiments, and will enable

researchers to more accurately human intestinal permeability from these IN VITRO experiments. We are not aware of any other effort to produce a product of this nature.

This project was put on hold in September 2005 because the scientist responsible for MembranePlus, Dr. Viera Lukacova, was assigned to take over GastroPlus when the previous product manager left the company. She has done an outstanding job with GastroPlus, and has been promoted to Simulation Technologies Team leader. We are interviewing candidates to expand the Simulation Technologies Team, one of whom will work on MembranePlus under Dr. Lukacova's direction.

WORDS+
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PRODUCTS
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Our wholly owned subsidiary, Words+, Inc. has been an industry pioneer and technology leader for over 25 years in introducing and improving augmentative and alternative communication and computer access software and devices for disabled persons. We intend to continue to be at the forefront of the development of new products. We will continue to enhance our major software products, E Z Keys and Say-it! SAM, as well as our growing line of hardware products. We will also consider acquisitions of other products, businesses and companies that are complementary to our existing augmentative and alternative communication and computer access business lines. We purchased the Say-it! SAM technologies from SAM Communications, LLC of San Diego in December 2003. This acquisition gave us our smallest, lightest augmentative communication system, which is based on a Hewlett-Packard iPAQ personal digital assistant (PDA). PDA-based communication devices have been very successful in the augmentative communication market, and this technology purchase has enabled us to move into this market segment faster and at lower cost than developing the product ourselves. SAM-based products now account for a significant share of our growing Words+ revenues. Since the acquisition of the Say-it! SAM technologies, we have continued to add new functionality to the SAM software and to offer it on additional hardware platforms.



RESULTS OF OPERATIONS

COMPARISON OF THREE MONTHS ENDED NOVEMBER 30, 2006 AND 2005.

The following table sets forth our consolidated statements of operations (in thousands) and the percentages that such items bear to net sales:

| | Three Months Ended | | |
|---|---|---|---|
| | 11/30/06 | | 11/ |
| Net sales | $ 1,456 | 100% | $ 819 |
| Cost of sales | 441 | 30.3 | 332 |
| Gross profit | 1,015 | 69.7 | 487 |
| Selling, general and administrative | 757 | 52.0 | 629 |
| Research and development | 183 | 12.6 | 97 |

| | | | |
|---|---|---|---|
| Total operating expenses | 940 | 64.6 | 726 |
| Income (loss) from operations | 75 | 5.2 | (239) |
| Other income (expense) | 19 | 1.3 | (1) |
| Net income (loss) before taxes | 94 | 6.5 | (240) |
| Benefit from (provision for) income taxes | (21) | (1.4)% | 42 |
| Net income (loss) | $ 73 | 5.0% | $ (198) |

NET SALES

Consolidated net sales increased $637,000, or 77.8%, to $1,456,000 in the first fiscal quarter of 2007 (1QFY07) from $819,000 in the first fiscal quarter of 2006 (1QFY06). Our sales from pharmaceutical and educational software increased approximately $625,000, or 314.5%; and our Words+, Inc. subsidiary's sales increased approximately $12,000, or 2.0%, for the quarter. We attribute the increase in pharmaceutical software sales primarily to increased licenses, both to new customers and for new modules and additional licenses to renewal customers.

We attribute the increase in Words+ sales primarily to an increase in sales of "Say-it! SAM", "MessageMates" and "Freedom" products. Some declines in software sales and "TuffTalker Plus" products were offset by these increases.

COST OF SALES

Consolidated cost of sales increased $109,000, or 32.8%, to $441,000 in the first fiscal quarter of FY07 from $332,000 in the first fiscal quarter of FY06. The percentage of cost of sales in the first fiscal quarter of FY07 decreased 10.2% from the first fiscal quarter of FY06. For Simulations Plus, cost of sales increased $86,000, or 286.9%. However, as a percentage of revenues, cost of sales decreased to 14.2% in 1QFY07 from 15.2% in 1QFY06. A significant portion of cost of sales for pharmaceutical software products is the systematic amortization of capitalized software development costs, which is an independent fixed cost rather than a variable cost related to sales. Thus, we attribute the decrease in the percentage of cost of sales primarily to the increase in sales.



For Words+, cost of sales increased $23,000, or 7.7%. As a percentage, cost of sales increased 2.7% between the first fiscal quarter of FY06 and FY05. We attribute the percentage increase in cost of sales for Words+ primarily to the increased costs of computers and PDAs which are main parts for the systems we sell. Last fiscal year, we were able to obtain purchase discounts by volume purchases of computers and PDAs; however such discounts were not available to us when the new models came on the market and the previous models were discontinued.

GROSS PROFIT

Consolidated gross profit increased $528,000, or 108.4%, to $1,015,000 in the first fiscal quarter of FY07 from $487,000 in the first fiscal quarter of FY06. We attribute this increase to the increase in sales of pharmaceutical software which outweighed a decrease in profit margin on Words+ products.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Consolidated selling, general and administrative (SG&A) expenses increased $128,000, or 20.4%, to $757,000 in the first fiscal quarter of FY07 from $629,000 in the first fiscal quarter of FY06. For Simulations Plus, SG&A increased $78,000, or 22.2%. As a percentage of sales, SG&A decreased from approximately 177% in the first fiscal quarter of FY06 to approximately 53% in the first fiscal quarter of FY07. The major increases in SG&A expenses were selling expenses, such as commissions to dealers and trade shows, as well as printer rental, salaries, and payroll-related expenses such as health insurance and payroll taxes, which outweighed decreases in professional fees.

For Words+, SG&A expenses increased $40,000, or 14.2%, due primarily to increases in commissions, catalogs, marketing consultant fees, telephone and supplies. These increases outweighed decreases in depreciation, technical service costs, and dues and subscriptions.

RESEARCH AND DEVELOPMENT

We incurred approximately $317,000 of research and development costs for both companies during the first fiscal quarter of FY07. Of this amount, $133,000 was capitalized and $184,000 was expensed. In the first fiscal quarter of FY06, we incurred $460,000 of research and development costs, of which $363,000, including an allocation of appraised value of $246,000 on ClassPharmer software, was capitalized and $97,000 was expensed. The decrease of $143,000, or 31.1%, in total research and development expenditures from the first fiscal quarter of FY06 to the first fiscal quarter of FY07 was due primarily to the purchase of ClassPharmer software in FY06, which outweighed increases in salaries because of new hires and salary increases to existing staff since the first fiscal quarter of FY06. The increase of $86,000 in expensed R&D from $97,000 to $183,000 is primarily to staff additions in our Life Sciences department.

OTHER INCOME (EXPENSE)

Net other income (expense) in the first fiscal quarter of FY07 increased by $20,000, from net expense of $1,000 to net income of $19,000. This is due primarily to increased interest revenue from Money Market accounts, which outweighed a loss on currency exchange.

BENEFIT FROM (PROVISION FOR) INCOME TAXES

We estimated a provision for income tax for $21,000 in the first fiscal quarter of FY07, while there was a benefit of income tax for $42,000 in the first fiscal quarter of FY06.



NET INCOME (LOSS)

Consolidated net income for the three months' operations increased by $271,000 to an income of $73,000 in the first quarter of FY07 compared to a loss of $198,000 in the first quarter of FY06. We attribute this increase in profit primarily to the increases in pharmaceutical software and other income, which outweighed increases in cost of sales, selling, and general and administrative expenses, research and development expenses, provision for income taxes, and a loss from Words+ operations.

LIQUIDITY AND CAPITAL RESOURCES

Our principal sources of capital have been cash flows from our operations. We

have achieved continuous positive operating cash flow in the last six 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 and disability businesses 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 were compensated in Japanese yen by some Japanese customers. As a result, we experienced a small loss from currency exchange in the first three months of FY07. In the future, if foreign currency transactions increase significantly, then we may mitigate this effect through foreign currency forward contracts whose market-to-market gains or losses are recorded in "Other Income or expense" at the time of the transaction. To date, exchange rate exposure has not resulted in a material impact.

Item 4. Controls and Procedures

(a) EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES.
As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company required to be included in the Company's periodic SEC filings.

(b) CHANGES IN INTERNAL CONTROLS OVER FINANCIAL REPORTING.
There were no changes in the Company's internal controls over financial reporting during the Company's most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.



PART II. OTHER INFORMATION

Item 1. Legal Proceedings
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On April 6, 2006 we received notice from a liquidator for the former French subsidiary of Bioreason (Bioreason SARL), saying that the liquidator had initiated legal action against Simulations Plus in the French courts with respect to ClassPharmer distribution rights to European customers, and is claiming commissions and legal fees with respect to European customers. We have been working through our U.S. attorneys and a law firm in Paris. We have filed a counterclaim for our rights and lost sales against Bioreason SARL's assets by sending a debt recovery declaration to the liquidator on June 15, 2006. We believe the documentation from our purchase of certain secured assets of Bioreason clearly shows our rights to the disputed accounts. Although we are pursuing our rights aggressively, there can be no assurance that the outcome will be favorable. We expect resolution of this issue in 2007.

Item 2. Changes in Securities

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits and Reports on form 8-K

(a) Exhibits:

31.1 -2 Certification of Chief Executive Officer and Chief Financial Officer
32 Certification pursuant to Sec. 906 of the Sarbanes-Oxley Act of 2002



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 January 15, 2007.

Simulations Plus, Inc.

Date: January 15, 2007 By: /s/ MOMOKO BERAN

Momoko Beran
Chief Financial Officer