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SIMULATIONS PLUS INC  
Form 10QSB  
January 14, 2005

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

FORM 10-QSB

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

For the quarterly period ended November 30, 2004 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  
(State or other jurisdiction of  
Incorporation or Organization)

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

1220 W. AVENUE J  
LANCASTER, CA 93534-2902  
(Address of principal executive offices including zip code)

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

NOT APPLICABLE  
(Former Name, Former Address and Former Fiscal Year, if Changed Since  
Last Report)

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  No

The number of shares outstanding of the Issuer's common stock, par value \$0.001  
per share, as of January 14, 2005, was 3,616,143.

SIMULATIONS PLUS, INC.  
FORM 10-QSB  
FOR THE QUARTERLY PERIOD ENDED NOVEMBER 30, 2004

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SIMULATIONS PLUS, INC. AND SUBSIDIARY  
CONSOLIDATED BALANCE SHEET  
at November 30, 2004  
(Unaudited)

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### ASSETS

#### CURRENT ASSETS

Cash and cash equivalents	\$1,048,378
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Accounts receivable, net of allowance for doubtful accounts of \$14,406 and present value discount of \$17,135 (note 6)	1,390,432
Inventory (note 7)	327,829
Prepaid expenses and other current assets	94,686
Deferred tax	186,000
	-----
Total current assets	3,047,325
CAPITALIZED COMPUTER SOFTWARE DEVELOPMENT COSTS, net of accumulated amortization of \$2,007,854 (note 4)	664,643
PROPERTY AND EQUIPMENT, net (note 8)	76,504
DEFERRED TAX	1,210,000
OTHER ASSETS	11,150
	-----
TOTAL ASSETS	\$5,009,622
	=====

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

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SIMULATIONS PLUS, INC. AND SUBSIDIARY  
CONSOLIDATED BALANCE SHEET  
at November 30, 2004  
(Unaudited)

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### LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES	
Accounts payable	\$ 135,353
Accrued payroll and other expenses	237,714
Accrued bonuses to officers	77,626
Accrued income taxes	1,600
Accrued warranty and service costs	31,197
Current portion of deferred revenue	11,416
	-----
Total current liabilities	494,906
Deferred revenue	17,131
Other long-term liabilities (note 10)	2,561
	-----
Total liabilities	514,598
	-----

### COMMITMENTS AND CONTINGENCIES

#### SHAREHOLDERS' EQUITY

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	

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3,581,343 shares issued and outstanding (note 9)	3,582
Additional paid-in capital	5,016,671
Accumulated deficit	(525,229)

Total shareholders' equity	4,495,024
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TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 5,009,622
--	--------------

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

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### SIMULATIONS PLUS, INC. AND SUBSIDIARY CONSOLIDATED STATEMENTS OF OPERATIONS For the Three Months Ended November 30, (Unaudited)

	2004	2003
NET SALES	\$ 1,066,474	\$ 1,138,733
COST OF SALES	322,128	351,746
GROSS PROFIT	744,346	786,987
OPERATING EXPENSES		
Selling, general, and administrative	631,945	605,823
Research and development	113,692	143,393
Total operating expenses	745,637	749,216
INCOME (LOSS) FROM OPERATIONS	(1,291)	37,771
OTHER INCOME (EXPENSE)		
Interest income	16,771	20,487
Interest expense	(284)	(366)
Gain on exchange of currency	2,111	--
Gain on sale of assets	5,200	--
Total other income	23,798	20,121
INCOME BEFORE BENEFIT FROM INCOME TAXES	22,507	57,892
BENEFIT FROM INCOME TAXES		

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Benefit from (provision for) income tax	--	(11,173)
Change in valuation allowance	--	--
	-----	-----
Total provision for income taxes	--	(11,173)
	-----	-----
NET INCOME	\$ 22,507	\$ 46,719
	=====	=====
BASIC EARNINGS PER SHARE	\$ 0.01	0.01
	=====	=====
Diluted earnings per share	\$ 0.01	\$ 0.01
	=====	=====
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING		
BASIC	3,571,191	3,417,202
	=====	=====
DILUTED	4,143,687	4,128,092
	=====	=====

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

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SIMULATIONS PLUS, INC. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
For the Three Months Ended November 30,  
(Unaudited)

	2004	2003
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 22,507	\$ 46,719
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization of property and equipment	10,696	8,060
Amortization of capitalized software development costs	31,869	52,552
(Gain) or loss on sale of assets	(5,200)	--
(Increase) decrease in		
Accounts receivable	314,601	140,788
Inventory	30,761	(44,571)
Other assets	21,358	44,382
Increase (decrease) in		
Accounts payable	(17,533)	(962)
Accrued payroll and other expenses	18,306	5,097
Accrued bonuses to officers	--	(133,538)
Accrued income taxes	--	--
Accrued warranty and service costs	(1,299)	(5,571)

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Deferred revenue	(2,854)	(6,454)
	-----	-----
Net cash provided by operating activities	423,212	106,502
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(23,529)	(2,970)
Proceeds from sale of assets	7,895	--
Capitalized computer software development costs	(120,032)	(48,209)
	-----	-----
Net cash used in investing activities	(135,666)	(51,179)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from the exercise of stock options	26,566	36,798
	-----	-----
Net cash provided by financing activities	26,566	36,798
	-----	-----

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

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SIMULATIONS PLUS, INC. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
For the Three Months Ended November 30,  
(Unaudited)

	2004	2003
	-----	-----
Net increase in cash and cash equivalents	\$ 314,112	\$ 92,121
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	734,266	260,733
	-----	-----
CASH AND CASH EQUIVALENTS, END OF THE THREE MONTHS	\$ 1,048,378	\$ 352,854
	=====	=====
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
INTEREST PAID	\$ 284	\$ 366
	-----	-----
INCOME TAXES PAID	\$ 1,600	\$ 47,000
	=====	=====

SUPPLEMENTAL SCHEDULE OF NON-CASH TRANSACTIONS

- During the first fiscal quarter of 2004, Minolta copier with a zero book value was traded-in for a new Ricoh copier/printer. The remaining obligation of \$8,177 was assumed by the lessor of Ricoh copier/printer in the exchange for a higher per print cost.

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

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### 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"), 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: CRITICAL ACCOUNTING POLICIES

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 (see Note 3), accounting for capitalized software development costs (see Note 4), and accounting for income taxes (see Note 5).

#### Note 3: REVENUE RECOGNITION

We account for the licensing of software in accordance with American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 97-2, "SOFTWARE REVENUE RECOGNITION". The application of SOP 97-2 requires judgment, including whether a software arrangement includes multiple elements, and if so, whether vendor-specific objective evidence (VSOE) of fair value exists for those elements.

The end users receive certain elements of our products over a period of time. These elements include free post-delivery telephone support and the right to receive unspecified upgrades/enhancements. In accordance with SOP 97-2, we have evaluated these agreements and we have recognized the entire license fee on the date the software is delivered to and accepted by the customer. In order to recognize the fee in this manner, we have met all the criteria required, including:

- o The Post Contract Customer Support ("PCS") fee is included in the initial licensing fee,
- o The PCS included with the license is for one year or less,
- o The estimated cost of providing the PCS during the arrangement is insignificant, and
- o Unspecified upgrades/enhancements during the PCS arrangements have been and are expected to continue to be minimal and infrequent.

Changes to the elements in a software arrangement, the ability to identify VSOE for those elements, the fair value of the respective elements, the costs associated with providing PCS and changes to a product's estimated life cycle could materially impact the amount of earned and unearned revenue. Judgment is also required to assess whether future releases of certain software represent new products or upgrades and enhancements to existing products.

From time to time, we offer certain customers multi-year contracts with extended payment terms. SOP 97-2 requires us to evaluate these contracts to determine if they qualify for recognition of revenue in a manner similar to our one-year contracts. On these contracts, we evaluate the collection and concession history with these customers and products to overcome the presumption that revenue should be recognized in line with cash collections. To date, we have recognized these contracts on delivery to and acceptance by the customer of the product. Substantial judgment is required in evaluating the relevant history and contract economics of these extended contracts, and could materially impact recorded revenue and unearned revenue in our financial statements.

Note 4: CAPITALIZED COMPUTER SOFTWARE DEVELOPMENT COSTS

Capitalized computer 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 including, but not limited to, technological feasibility, anticipated future gross revenues, estimated economic life, and changes in software and hardware technologies. Any changes to these estimates could materially impact the amount of amortization expense, research and development expense recognized in the consolidated statement of operations and the amount recognized as capitalized software development costs in the consolidated balance sheet.

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, which varies product to product, not exceeding five years. Management periodically compares estimated net realizable value by product with the amount of software development costs capitalized for that product to ensure the amount capitalized is recoverable through revenues. Any excess of development costs to expected net realizable value is expensed at that time.

We have reassessed economic life of our pharmaceutical software based on our actual experience, and we have determined that the estimated economic life of the products should be five years starting at September 1, 2004. Accordingly, we began amortizing the net book value of capitalized software development costs over a sixty-month period using the straight-line method. As a result, we amortized our pharmaceutical software development costs for \$7,383 in the first quarter of fiscal year 2005. If we had not changed our expected economic life, we would have amortized \$24,899.



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### Note 5: INCOME TAX

SFAS No. 109, "ACCOUNTING FOR INCOME TAXES", establishes financial accounting and reporting standards for the effect of income taxes. The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns. Judgment is required in assessing the future tax consequences of events that have been recognized in our financial statements or tax returns. Fluctuations in the actual outcome of these future tax consequences could materially impact our financial position or our results of operations.

### Note 6: ACCOUNTS RECEIVABLE

We maintain an allowance for doubtful accounts for estimated losses that may arise if any of its customers are unable to make required payments. We specifically analyze the age of customer balances, historical bad debt experience, customer credit-worthiness, and changes in customer payments terms when making estimates of the uncollectability of our 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, 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. As of November 30, 2004, the unamortized discount amount on such receivable was \$17,135. The discounted balance of long-term receivables of \$526,865 is due to be collected before the end of fiscal year 2005.

### Note 7: INVENTORY

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

### Note 8: PROPERTY AND EQUIPMENT

Furniture and equipment as of November 30, 2004 consisted of the following:

Equipment	\$	165,300
Computer equipment		295,131
Furniture and fixtures		52,704
Leasehold improvements		38,215
		-----
		551,350
Less accumulated depreciation and amortization		(474,846)
		-----
	\$	76,504
		=====

### Note 9: 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") pursuant to which a total of

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250,000 shares of common stock were 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 the number of shares to be granted under the Option Plan to be 1,000,000 shares. Furthermore, in December 2000, the shareholders approved an increase in number of shares that may be granted under the Option Plan to 1,250,000. The Option Plan terminates in 2006, subject to earlier termination by the Board of Directors.

As of November 30, 2004, options to purchase 1,029,616 shares have been issued and were outstanding to various employees at an exercise price equal to the fair market value of our stock price at the date of each grant, with five-year vesting periods. Also, in accordance with the by-laws of the corporation, a total of 8,206 options to purchase shares have been issued to the Board of Directors at exercise prices ranging from \$1.20 to \$5.25, with a three-year vesting period. During the first fiscal quarter of 2005, 16,900 options were exercised by employees.

### Note 10: EARNINGS PER SHARE

The Company utilizes SFAS No. 128, "Earnings per Share." Basic earnings (loss) per share is computed by dividing income (loss) available to common stockholders by the weighted-average number of common shares outstanding. Diluted earnings (loss) per share is computed similar to basic earnings (loss) 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. Common equivalent shares are excluded from the computation if their effect is anti-dilutive. The Company's common share equivalents consist of stock options.

### Note 11: STOCK-BASED COMPENSATION

SFAS No. 123, "Accounting for Stock-Based Compensation," establishes and encourages the use of the fair-value-based method of accounting for stock-based compensation arrangements under which compensation cost is determined using the fair value of stock-based compensation determined as of the date of grant and is recognized over the periods in which the related services are rendered. The statement also permits companies to elect to continue using the current intrinsic value accounting method specified in Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," to account for stock-based compensation. The Company has elected to use the intrinsic value-based method and has disclosed the pro forma effect of using the fair-value-based method to account for its stock-based compensation.

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The table below represents a reconciliation of the company's pro forma net income giving effect to the estimated compensation expense related to stock options that would have been reported if the Company utilized the fair value method:

	Three Months 2004	Three Months 2003
	-----	-----
Net income		
As reported	\$ 22,507	\$ 46,719
Stock based employee compensation cost, net of		

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related tax effects, that would have been included in the determination of net income if the fair value method had been applied

(62,988)                      (63,252)

PRO FORMA NET LOSS

\$ (40,481)                      \$ (16,533)

Earnings (loss) per common share

Basic - as reported

\$ 0.01                      \$ 0.01

Basic - Pro forma

\$ (0.01)                      \$ (0.00)

Diluted - as reported

\$ 0.01                      \$ 0.01

Diluted - Pro forma

\$ (0.01)                      \$ (0.00)

### Note 12: Segment and Geographic Reporting

The Company accounts for segments and geographic revenues in accordance with SFAS No. 131, "Disclosure about Segments of an Enterprise and Related Information." The Company's 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, 2004 and November 30, 2003:

November 30, 2004

	Simulations Plus, Inc	Words +, Inc.	Eliminations
Net Sales	523,452	543,022	
Income (loss) from operations	41,405	(18,898)	
Identifiable assets	5,584,743	1,237,573	(1,812,694)
Capital expenditures	3,354	20,175	
Depreciation and Amortization	3,508	7,188	

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November 30, 2003

	Simulations Plus, Inc	Words +, Inc.	Eliminations
Net Sales	642,293	496,440	
Income (loss) from operations	135,148	(97,377)	
Identifiable assets	4,219,623	651,521	(963,279)
Capital expenditures	-	2,970	
Depreciation and Amortization	3,957	4,103	

In addition, the Company allocates revenues to geographic areas based on the locations of its customers. Geographical revenues for the three months ended

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November 30, 2004 and November 30, 2003 were as follows (in thousands):

	November 30, 2004				
	North America	Europe	Asia	Oceania	South America
Simulations Plus, Inc.	327	77	119	-0-	-0-
Words+, Inc.	494	30	15	8	-0-
Total	821	107	134	8	-0-
	November 30, 2003				
	North America	Europe	Asia	Oceania	South America
Simulations Plus, Inc.	172	52	418	-0-	-0-
Words+, Inc.	431	45	8	7	5
Total	603	97	426	7	5

### Note 13: SUBSEQUENT EVENT

Since December 1, 2004, an additional 33,700 stock options to purchase shares have been exercised by employees.

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### 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.

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### GENERAL

### BUSINESS

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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 modeling and simulation 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.

### SIMULATIONS PLUS

### PRODUCTS

-----

We currently offer three software products for pharmaceutical research: GastroPlus(TM), ADMET Predictor(TM), and ADMET Modeler(TM).

GastroPlus is a computer program that simulates how drugs are absorbed in the human gastrointestinal tract and in a number of standard laboratory animals. The simulation involves pharmacokinetics (what happens to the drug when it gets into the body) and pharmacodynamics (what happens to the body when the drug gets into the body). The basic absorption simulation has equations for the movement of the drug through the gastrointestinal tract, how fast it dissolves in the stomach and intestines, whether it is converted to a different molecular form by chemical reactions or by metabolism by enzymes in the gastrointestinal tract, and how fast it is absorbed through the intestinal wall into the blood stream. With additional inputs, it also simulates the amount of drug in the blood plasma versus time, and how the drug affects the body, such as reducing pain, reducing blood pressure, reducing depression, and adverse side effects.

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We believe GastroPlus is the "gold standard" for simulation of oral drug absorption in the pharmaceutical industry. In addition to virtually every major pharmaceutical company, recent sales have included a growing number of 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 considerably smaller than the pharmaceutical giants, they can also save considerable time and money using our software tools. We believe this part of the industry, which includes hundreds of companies, represents major growth potential for GastroPlus.

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 believe that the Metabolism and Transporter Module, the PDPlus module, and the ongoing upgrades we have made to the core simulation have been significant advances in the state-of-the-art of oral drug absorption, pharmacokinetics, and pharmacodynamics analysis. The PBPKPlus(TM) module now in final development will further extend the utility of GastroPlus within the industry. Our recognized expertise in oral absorption and pharmacokinetics is evidenced by the fact that our staff members have been invited speakers or presenters at over 40 prestigious scientific meetings worldwide in the past three years. We also conduct contracted studies for customers who prefer to have

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studies run by our scientists rather than to license our software and train someone to use it.

In addition to simulation software, we produce software that consists of statistically significant numerical models that predict various properties of chemical compounds from just their molecular structures. ADMET Predictor(TM) (formerly known as QMPRPlus(TM)) provides estimates for approximately 50 properties of new drug-like molecules with only their structures as input. Recent product improvements included the prediction of ionization constants ("pKa's") for molecules, which tells chemists whether the molecules will ionize (add or give up hydrogen atoms) at different pH levels in the body. Ionization is especially important because it has a major effect on some other properties, like solubility. ADMET Predictor is now one of the few programs available in the world that provides accurate prediction of pKas, and we believe the predictive accuracy of the pKa model in ADMET Predictor is unsurpassed.

With the recent release of ADMET Predictor 1.0, we have added an important new capability for toxicity prediction. Toxicity prediction was identified by the U.S. Food and Drug Administration as a critical need in a white paper released in March 2004. We released our first toxicity prediction in the fourth quarter, which predicts whether new molecules are expected to bind to the estrogen receptor. The new capability provides six different toxicity models based on data sets released to the public domain by the U.S. Environmental Protection Agency and the U.S. Food and Drug Administration in 2004.

With these new capabilities, we believe ADMET Predictor combines the most comprehensive and accurate set of predictions for Absorption, Distribution, Metabolism, Excretion and Toxicity (ADMET) available today.

GastroPlus and/or ADMET Predictor have been licensed by virtually every major pharmaceutical company and a growing number of smaller companies in the U.S., Europe, and Japan. Our number of customers has grown continuously since our first product releases in 1998.

Our third core product, ADMET Modeler(TM), (formerly QMPRchitect(TM)), was released in July of 2003. This powerful program is used to generate the predictive models used in ADMET Modeler in a small fraction of the time once required to build these models. For example, the six new toxicity models in ADMET Predictor were developed in a matter of a few weeks. Most of that time was spent in 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 for each one of the six models to obtain similar results.

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Pharmaceutical companies spend enormous amounts of money conducting a wide variety of experiments each year. Using such data to build predictive models provides a second return on investment; however, in the past, model-building has traditionally been a tedious activity that required a specialist. With ADMET Modeler, scientists with no model-building experience can use their own experimental data to quickly create very high quality predictive models.

We continue to enhance GastroPlus, ADMET Predictor, and ADMET Modeler, and we are developing new core products to add to our catalog of software for pharmaceutical research. Two products scheduled to be released in early 2005 are DDDPlus(TM) and MembranePlus(TM). These products are described further below.

In addition to our pharmaceutical software, we also produce a set of award-winning science experiment simulations (computer programs for Windows and

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Macintosh computers) for middle school and high school students under the umbrella name of FutureLab(TM). These simulations incorporate the equations of chemistry and physics for each experiment (optics, electrical circuits, gravity, universal gravitation, and ideal gases), and allow students to design and conduct their own experiments in a virtual laboratory environment. Although development of FutureLab software was discontinued in 1998, low-level sales have continued through distributors in the U.S., U.K. Australia, and New Zealand.

### CONTRACT RESEARCH SERVICES

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We offer contract research services to the pharmaceutical industry in the area of gastrointestinal absorption, pharmacokinetics, structure-property model building, and related technologies. These studies provide us an additional source of revenue, as well as a means to introduce our software products to new customers. Such studies are also beneficial to us to validate and enhance our products by studying actual data in the pharmaceutical industry. In the fourth quarter of fiscal year 2004, we received our largest study contract to date. We believe the results of that study saved our customer from conducting a human trial that would have inevitably failed. The business of contracted studies is growing, and we believe it could contribute significantly to our revenues and earnings; however, we plan to control growth in this area such that it does not adversely impact our product development stream.

### PHARMACEUTICAL SIMULATIONS SOFTWARE PRODUCT DEVELOPMENT

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In the area of simulation software for pharmaceutical research, we are developing additional capabilities for GastroPlus, ADMET Predictor, and ADMET Modeler. Although all of our development work cannot be disclosed for competitive reasons, some of our development efforts include:

#### (1) PBPKPlus(TM) Module

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The PBPKPlus Module for GastroPlus was demonstrated at the American Association of Pharmaceutical Scientists conference in early November 2004. We expect the module to be released for sale in early 2005. This module enables researchers to predict the amount of drug that reaches different body tissues and organs. This is an important new capability because it is one of the most promising technologies for predicting human pharmacokinetics from animal data

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(pharmacokinetics refers to what happens to the drug after it enters the body). With actual human data, this capability will enable scientists to predict the concentration of drug in various body tissues, which should contribute to a better understanding of both therapeutic and adverse effects. Without the ability to predict these effects, clinical trial costs can soar when trials must be repeated to determine proper dosing levels. We believe the integration of the GastroPlus absorption model with a complete PBPK capability provides the most comprehensive simulation capability currently available. This capability was developed in response to customer requests from several of the largest pharmaceutical companies in the world.

#### (2) Multiple Particle Size Dissolution Model

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The current dissolution model in GastroPlus uses a single "effective" particle

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size. While this has adequately represented the dissolution of most tablets, capsules, and suspensions to date, formulation researchers know that real dosage forms do not consist of particles that are all one size. Instead, there is a distribution of particle sizes from smaller than average to larger than average. Smaller particles dissolve faster than larger particles. For some drugs, this results in dissolution behavior that is not well-modeled with a single effective particle size. This new model will allow formulation researchers to assess the effects of different particle size distributions on dissolution and absorption. The multiple particle size model has already been demonstrated in our DDDPlus(TM) software described below. We plan to incorporate it into GastroPlus in calendar 2005.

### (3) DDDPlus(TM)

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The DDDPlus (Dose Disintegration and Dissolution Plus) project originally began in 2000, and proceeded at a slow pace until 2003, in between other higher priority projects. We demonstrated a nearly final version of DDDPlus at the American Association of Pharmaceutical Scientists conference in early November 2004. We expect to release the full version by the end of calendar 2004. DDDPlus simulates how different tablets and capsules disintegrate and dissolve during in vitro (laboratory) dissolution experiments. The program includes 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've been encouraged by the level of interest we've received as we've demonstrated beta versions of the software at various shows and customer sites.

### (4) ADMET Predictor(TM) upgrades

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We will continue to add new molecular descriptors and new predicted ADMET properties to ADMET Predictor. We recently announced the release of ADMET Predictor 1.0 with structure drawing depiction and six toxicity predictions, as well as improved pKa prediction and other user convenience improvements.

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### WORDS+

### PRODUCTS

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Our wholly owned subsidiary, Words+, Inc. has been an industry technology leader for over 23 years in introducing and improving augmentative and alternative communication and computer access software and devices for disabled persons and intends 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 Talking Screen, 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 announced the purchase of 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 Compaq iPAQ personal digital assistant (PDA). PDA-based communication devices



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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. Say-it! SAM sales grew rapidly in 2004 and we expect this product to continue to be successful in 2005.

At the Closing the Gap conference in October 2004, we demonstrated our new Windows CE tablet-computer-based augmentative communication system, called the SAM Tablet. This received enthusiastic responses from both potential customers and Words+ dealers alike. We believe that tablet-based communication systems are in high demand in this market, and that this addition fills a hole we had in our product line.

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### RESULTS OF OPERATIONS

#### COMPARISON OF THREE MONTHS ENDED NOVEMBER 30, 2004 AND 2003.

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			
	11/30/04		11/30/03	
Net sales	\$ 1,066	100%	\$ 1,139	100%
Cost of sales	322	30.2	352	30.9
Gross profit	744	69.8	787	69.1
Selling, general and administrative	632	59.3	606	53.3
Research and development	114	10.7	143	12.6
Total operating expenses	746	70.0	749	65.9
Income (loss) from operations	(2)	(0.2)	38	3.3
Other income (expenses)	24	2.3	20	1.7
Net income before taxes	22	2.1	58	5.1
Provision for income taxes	-	-	11	1.0
Net income	\$ 22	2.1%	\$ 47	4.1%

### NET SALES

Consolidated net sales decreased \$73,000, or 6.4%, to \$1,066,000 in the first fiscal quarter of 2005 (FY05) from \$1,139,000 in the first fiscal quarter of 2004 (FY04). Our sales from pharmaceutical and educational software decreased approximately \$119,000, or 18.5%; however, our Words+, Inc. subsidiary's sales increased approximately \$46,000, or 9.3%, for the quarter. Management attributes

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the decrease in pharmaceutical software sales to three factors: (1) analytical study contract revenues was zero in FY05, while we had \$32,000 in study contract revenues in FY04, (2) the amount of the new one-year global license in FY05 was somewhat less than the amount we received from a multi-year "ADME Partners" license in FY04, and (3) revenues from renewal orders were much lower in FY05 compared with FY04 because four customers slipped their renewals into the second quarter in FY 05. Despite these decreases, pharmaceutical revenues in FY05 were sustained with orders from new customers, which expands the foundation for future annual license renewal revenues, upon which our compound growth is based.

Management attributes the increase in Words+ sales primarily to the sales growth in products of "Say-it! SAM" and "TuffTalker", which accounted over 40% of total sales in FY04, compared with less than 5% of total sales in FY03. This increase outweighed the decrease in Freedom product sales.

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### COST OF SALES

Consolidated cost of sales decreased \$30,000, or 8.5%, to \$322,000 in the first fiscal quarter of FY05 from \$352,000 in the first fiscal quarter of FY04. The percentage of cost of sales in the first fiscal quarter of FY05 is almost the same as the first fiscal quarter of FY04. For Simulations Plus, cost of sales decreased \$30,000, or 39.0%. A significant portion of cost of sales is the systematic amortization of capitalized software development costs, which decreased \$39,000, or 83.9%, and an increase in royalty expense of \$8,000, or 25.0% which represents royalty payments to TSRL. As a percentage, cost of sales decreased from 12.1% in FY04 to 9.1% in FY05. Management attributes this decrease in percentage of cost of sales primarily to a change in estimate of pharmaceutical software product life, which we reassessed to be 5 years beginning with this quarter. Thus, quarterly amortization of capitalized software development costs decreased.

For Words+, cost of sales increased \$1,000, or 0.4%. As a percentage, cost of sales decreased 4.5% between the first fiscal quarter of FY05 and FY04. Management attributes the percentage decrease in cost of sales for Words+ primarily to the price increases instituted as part of our restructure of Words+ in fiscal year 2004.

### GROSS PROFIT

Consolidated gross profit decreased \$43,000, or 5.5%, to \$744,000 in the first quarter of FY05 from \$787,000 in the first quarter of FY04. Management attributes this decrease to lower pharmaceutical software sales which outweighed an increase in gross profit generated by Words+ products.

### SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Consolidated selling, general and administrative expenses increased \$26,000, or 4.3%, to \$632,000 in the first fiscal quarter of FY05 from \$606,000 in the first fiscal quarter of FY04. For Simulations Plus, selling, general and administrative expenses increased \$51,000, or 16.9%. The major increases in expenses were in the categories of equipment lease, insurance, legal and accounting, investor relation's fees, and salary increases along with payroll-related expenses such as health insurance, payroll taxes, and 401(k) matching contributions. These increases outweighed small decreases in bank charges, employee benefits, and depreciation.

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For Words+, expenses decreased \$25,000, or 8.1%, due to a reduction in salary and payroll related expenses such as health insurance, payroll taxes and 401(k) matching contributions, catalog expenses, and dues/subscriptions. These decreases outweighed increases in selling expenses, such as commissions to sales reps, trade shows and travel expenses.

### RESEARCH AND DEVELOPMENT

We incurred approximately \$234,000 of research and development costs for both companies during the first quarter of FY05. Of this amount, \$120,000 was capitalized and \$114,000 was expensed. In the first quarter of FY04, we incurred \$191,000 of research and development costs, of which \$48,000 was capitalized and \$143,000 was expensed. The increase of \$43,000, or 22.5%, in research and development expenditure from the first quarter of FY04 to the first quarter of FY05 was due to salary increases and purchase of software development tools.

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### OTHER INCOME (EXPENSE)

The net of other income (expense) in the first quarter of FY05 increased by \$3,000. The amortization of present value discount on long-term receivables decreased by \$4, however we gained \$5,000 on sale of equipments and \$2,000 on currency exchange.

### PROVISION FOR INCOME TAXES

Although the Company had a Net Operating Loss (NOL) carried forward which was applied to the Company's Federal income tax liability, the State of California suspended the NOL carry forward for two years beginning with fiscal years that began after January 2003, resulting in a \$11,000 tax due to the state of California for the first quarter FY04. We do not expect any tax due to the state of California for the first quarter of FY05.

### NET INCOME

Consolidated net income for the three months' operations decreased by \$25,000, or 53.2%, to \$22,000 in the first quarter of FY05 compared to \$47,000 in the first quarter of FY04. Management attributes this decrease in profit primarily to the decrease in sales, and increases in selling, general and administrative expenses which outweighed decreases in cost of sales, research and development expenses, provision for income taxes, and increase in other income.

### LIQUIDITY AND CAPITAL RESOURCES

The Company's principal sources of capital have been cash flows from its operations and a bank line of credit. The Company has available a \$500,000 revolving line of credit from a bank. Interest is payable on a monthly basis at the bank's prime rate plus 1.5%. At November 30, 2004, the outstanding balance under the revolving line of credit was zero. The revolving line of credit is secured by the Company's assets, consisting of tangible personal property (except goods in transit), is personally guaranteed by the Company's President, and expires in May 2005.

The Company believes that existing capital and anticipated funds from operations will be sufficient to meet its anticipated cash needs for working capital and

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capital expenditures for the foreseeable future. Thereafter, if cash generated from operations is insufficient to satisfy the Company's capital requirements, the Company 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 the Company, or, if available, that it will be in amounts and on terms acceptable to the Company. 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.

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### Item 3. Quantitative and Qualitative Disclosures about Market Risk

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Our risk from exposure to financial markets risk 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 the U.S. dollars although we generate significant revenues from customers overseas. The exception is that we were compensated in Japanese yen by one of Japanese customers. As a result, we experienced a small gain from currency exchange gain in the first fiscal quarter of 2005. In the future, if the foreign currency transactions increase significantly increase, then we may mitigate this effect through foreign currency forward contracts whose market-to-market gains or losses are recorded in "Other Income" at the time of the transaction. To date, exchange rate exposure has not resulted in a material impact.

### Item 4. Controls and Procedures

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- (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 Director of Finance 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 was no change in Company's internal control over financial reporting during the Company's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's Internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings  
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In the normal course of business, the Company is subject to various lawsuits and claims. The Company believes that the final outcomes of these matters, either individually or in the aggregate, will not have a material effect on the financial statements. The Company is not involved in any such litigation at this time.

Item 2. Changes in Securities  
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None.

Item 3. Defaults Upon Senior Securities  
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None.

Item 4. Submission of Matters to a Vote of Security Holders  
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None.

Item 5. Other Information  
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None.

Item 6. Exhibits and Reports on form 8-K  
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(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

99.1 Press release dated September 3, 2004. (Incorporated by reference to the Company's Form 8-K filed on September 3, 2004.)

(b) Reports on Form 8-K

On September 3, 2004, Simulations Plus, Inc. issued a press release announcing changes in independent auditor. Following the press release, Form 8K was filed on September 3, 2004.

On September 22, 2004, Simulations Plus, Inc. filed Form 8K/A revising our documents in response to SEC's comments regarding Form 8K filed on September 3, 2004.

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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 January 14, 2005.

Simulations Plus, Inc.

Date: January 14, 2005

By: /s/ MOMOKO BERAN

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Momoko Beran  
Chief Financial Officer