SIMULATIONS PLUS INC
Form 10QSB
January 17, 2006

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, 2005 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.
(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 x No

The number of shares outstanding of the Issuer's common stock, par value $0.001 per share, as of January 13, 2006, was 3,674,448.

SIMULATIONS PLUS, INC.
FORM 10-QSB
FOR THE QUARTERLY PERIOD ENDED NOVEMBER 30, 2005

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PART I. FINANCIAL INFORMATION

SIMULATIONS PLUS, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEET
NOVEMBER 30, 2005
(UNAUDITED)

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ASSETS

CURRENT ASSETS	
Cash and cash equivalents (note 3)	$ 931,796
Accounts receivable, net of allowance for doubtful accounts	

of $21,208 (note 4)	814,557
Inventory (note 5)	313,290
Prepaid expenses and other current assets	86,007
Deferred tax	60,000
Total current assets	2,205,650
CAPITALIZED COMPUTER SOFTWARE DEVELOPMENT COSTS, net of accumulated amortization of $2,186,079	1,279,098
LONG TERM CONTRACTS RECEIVABLE, net of discounts of $13,341	288,439
PROPERTY AND EQUIPMENT, net (note 6)	88,897
CUSTOMER RELATIONSHIPS (note 13)	128,042
DEFERRED TAX	1,293,800
OTHER ASSETS	29,463
TOTAL ASSETS	$ 5,313,389

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

SIMULATIONS PLUS, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEET
NOVEMBER 30, 2005
(UNAUDITED)

LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES	
Accounts payable	$ 124,449
Accrued payroll and other expenses	381,530
Accrued bonuses to officers	38,680
Accrued warranty and service costs	32,017
Current portion of deferred revenue	65,416
Total current liabilities	642,092
Deferred revenue	5,715
Total liabilities	647,807
COMMITMENTS AND CONTINGENCIES (note 7)	
SHAREHOLDERS' EQUITY (note 8)	
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	
3,650,048 shares issued and outstanding	3,651
Additional paid-in capital	5,145,880
Accumulated deficit	(483,949)
Total shareholders' equity	4,665,582
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 5,313,389

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)

	2005	2004
NET SALES	$ 818,815	$ 1,066,474
COST OF SALES	331,597	322,128
GROSS PROFIT	487,218	744,346
OPERATING EXPENSES		
Selling, general, and administrative	628,756	631,945
Research and development	97,222	113,692
Total operating expenses	725,978	745,637
INCOME (LOSS) FROM OPERATIONS	(238,760)	(1,291)
OTHER INCOME (EXPENSE)		
Interest income	3,481	16,771
Miscellaneous income	50	--
Interest expense	--	(284)
Gain on sale of assets	--	5,200
Gain (Loss) on currency exchange	(5,302)	2,111
Total other income (expense)	(1,771)	23,798
INCOME (LOSS) BEFORE INCOME TAXES	(240,531)	22,507

BENEFIT FROM (PROVISION FOR) INCOME TAXES		
Benefit from (provision for) income tax	42,000	--
Release of valuation allowance	--	--
Total benefit from (provision for) income taxes	42,000	--
NET INCOME (LOSS)	$ (198,531)	$ 22,507
BASIC EARNINGS (LOSS) PER SHARE	$ (0.05)	$ 0.01
DILUTED EARNINGS (LOSS) PER SHARE	$ (0.05)	$ 0.01
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING		
BASIC	3,649,334	3,571,191
DILUTED	3,649,334	4,143,687

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

SIMULATIONS PLUS, INC. AND SUBSIDIAR
CONSOLIDATED STATEMENTS OF CASH FLOW
FOR THE THREE MONTHS ENDED NOVEMBER 30
(UNAUDITED

	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	$ (198,531)	$ 22,50
Adjustments to reconcile net income (loss) to net cash provided by operating activities		
Depreciation and amortization of property and equipment	11,860	10,69
Amortization of capitalized software development costs	45,709	31,86
(Gain) on sale of assets	--	(5,20
(Increase) decrease in		
Accounts receivable	442,031	314,60
Inventory	(31,890)	30,76
Deferred tax	(42,000)	-
Other assets	(23,316)	21,35
Increase (decrease) in		
Accounts payable	33,408	(17,53
Accrued payroll and other expenses	(17,127)	18,30
Accrued bonuses to officers	--	-
Accrued income taxes	(1,600)	-
Accrued warranty and service costs	4,278	(1,29

Deferred revenue	(69,854)	(2,85
Net cash provided by operating activities	152,968	423,21
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(10,656)	(23,52
Purchases of Bioreason's assets	(826,192)	-
Proceeds from sale of assets	2,218	7,89
Capitalized computer software development costs	(142,539)	(120,03
Net cash used in investing activities	(977,169)	(135,66
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments on capitalized lease obligations	--	-
Proceeds from the exercise of stock options	1,955	26,56
Net cash provided by financing activities	1,955	26,56

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

SIMULATIONS PLUS, INC. AND SUBSIDIAR
CONSOLIDATED STATEMENTS OF CASH FLOW
FOR THE THREE MONTHS ENDED NOVEMBER 30
(UNAUDITED

Net increase (decrease) in cash and cash equivalents	$ (822,246)	$ 314,11
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	1,754,042	734,26
CASH AND CASH EQUIVALENTS, END OF FISCAL QUARTER	$ 931,796	$ 1,048,37
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
INTEREST PAID	$ --	$ 28
INCOME TAXES PAID	$ 1,600	$ 1,60

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. For further information, refer to the financial statements for the year ended August 31, 2005 and the notes thereto included in the Company's Annual Report on Form 10-KSB.

Note 2: SIGNIFICANT 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, accounting for capitalized software development costs, and accounting for income taxes.

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.

Generally, we enter into one-year license agreements with our customers for the use of our software products. We recognize revenue on these contracts when all the criteria under SOP 97-2 are met.

From time to time, we enter into multi-year license agreements. We believe our history of collection with these customers is sufficient to overcome the presumption that revenue should be recognized in time with the expected cash

collections, and we have therefore recognized the entire license fees, net of an applicable discount, at the time of the software's release and acceptance by the customer. Going forward, however, we have advised investors through our press releases and conference calls that we will unlock and invoice software one year at a time for future multi-year licenses. This will eliminate the extreme variability in our reported revenues and earnings that we've experienced in the past.

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 $45,709 and $31,869 for the three months ended November 30, 2005 and 2004, respectively.

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 not in excess of the amount to be recovered through revenues. Any such excess of capitalized software development costs to expected net realizable value is expensed at that time.

Income Taxes

We utilize SFAS No. 109, "Accounting for Income Taxes," which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns.

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.

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.

Concentrations and Uncertainties

International sales accounted for 24% and 24% of net sales for the three months ended November 30, 2005 and 2004, respectively. For Simulations Plus, Inc., one customer accounted for 59% of net sales for the three months ended November 30, 2005, and for Words+, Inc., one government agency accounted for 16% of net sales during the first fiscal quarter of 2006.

We operate in the computer software industry, which is highly competitive and changes rapidly. Our operating results could be significantly affected by our ability to develop new products and find new distribution channels for new and existing products.

For a consolidated accounts receivable, one customer comprised 19% of total receivables. For Simulations Plus, four customers comprised 27%, 23%, 20% and 20% of accounts receivable at November 30, 2005. Three customers comprised 30%, 27% and 26% of accounts receivable at November 30, 2004. For Words+, one customer comprised 26% of accounts receivable at November 30, 2005. One customer comprised 32% of accounts receivable at November 30, 2004.

Our subsidiary, Words+, Inc., purchases components for the main computer products from a single Manufacture. 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 Words+ to obtain computers used in its products or to renew its licensing agreement to use pictographic symbols could negatively impact our financial position, results of operations, and cash flows.

Recently Issued Accounting Pronouncements

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, "Accounting for Stock Issued to Employees." SFAS 123R requires all companies to measure compensation expense for all share-based payments (including employee stock options and options issued pursuant to employee stock purchase plans) based upon the fair value of the stock-based awards at the date of grant, and is effective for the Company for fiscal year beginning after December 15, 2005. The impact of adoption of Statement 123R cannot be predicted at this time because it will depend on levels of share-based payments granted in the future.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections." This statement applies to all voluntary changes in accounting principles and requires retrospective application to prior periods' financial statements of changes in accounting principles, unless this would be impracticable. This statement also makes a distinction between "retrospective application" of an accounting principle and the "restatement" of financial statements to reflect the correction of an error. This statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company is evaluating the effect the adoption of this interpretation will have on its financial position, cash flows and results of operations.

Note 3: 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.

Note 4: 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, 2005 represents receivables which we have purchased as a part of Bioreason's assets.

Note 5: 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.

Note 6: PROPERTY AND EQUIPMENT

Furniture and equipment as of November 30, 2005 consisted of the following:

Equipment	$ 158,036
Computer equipment	301,871
Furniture and fixtures	57,705
Automobile	21,769
Leasehold improvements	42,660
Sub total	582,041
Less: Accumulated depreciation and amortization	(493,144)
Net Book Value	88,897

Note 7: COMMITMENTS AND CONTINGENCIES

Leases

The current office lease expired in August 2005, and we are now renting on a month-to-month basis at a base rate of $15,446 per month plus common area maintenance ("CAM") charges which are approximately $4,000 per month. We have signed a new lease for another building which is under construction and is expected to be completed by the end of January 2006. The new lease has a five-year term with two (2), three (3) year options to extend.

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.

As of November 30, 2005, the accrued bonuses due to officers were $38,680, which represented 5% of the Company's net income before bonuses and taxes for the fiscal year 2005 given to the Company's President, Walter Woltosz, as an annual bonus and 5% of the Company's net income before bonuses and taxes for the fiscal year 2005 given to the Corporate Secretary, Virginia Woltosz, as an annual bonus.

The agreement also provides that the Company may terminate the agreement upon 30days' 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 8: 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 250,000 shares of common stock were reserved for issuance. The shareholders approved an additional 250,000 shares that may be granted under the Option Plan in March 1999, 500,000 shares in February 2000, and 250,000 shares in December 2000. Thus, a total of 1,250,000 shares can be granted under the Option Plan. The Option Plan terminates in 2006, subject to earlier termination by the Board of Directors. Furthermore, on February 18, 2005 at an annual shareholders meeting, the shareholders approved an additional 250,000 shares to be reserved for issuance under the 1996 Stock Option Plan.

As of November 30, 2005, options to purchase 1,058,681 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 9,206 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 three months of fiscal year 2006, 1,200 options were exercised by employees.

Note 9: EARNINGS PER SHARE

We report earnings per share in accordance with SFAS No. 128, "Earnings per Share." Basic earnings (loss) per share is computed by dividing income (loss) available to common shareholders by the weighted-average number of common shares available. 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. Our common share equivalents consist of stock options.

Note 10: 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, "Accounting for Stock Issued to Employees," 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 will be effective for us for the year beginning September 1, 2006. For fiscal year 2006, we currently account for share-based payments to employees using APB25's intrinsic value method as permitted; therefore we do not recognize any compensation cost for employee stock options. Entities electing to remain with the accounting method of APB 25 must make pro forma disclosures of net income and earnings per share, as if the fair value method of accounting defined in SFAS No. 123 had been applied. We have elected to account for our stock-based compensation to employees under APB 25.

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

	Three Months FY 2006	Three Months FY 2005
Net income (loss)		
As reported	$ (198,531)	$ 22,507
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)	(62,988)
PRO FORMA NET INCOME (LOSS)	$ (235,419)	$ (40,481)
Earnings (loss) per common share		
Basic - as reported	$ (0.05)	$ 0.01
Basic - Pro forma	$ (0.06)	$ (0.01)
Diluted - as reported	$ (0.05)	$ 0.01
Diluted - Pro forma	$ (0.06)	$ (0.01)

Note 11: 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 nine months ended November 30, 2005 and November 30, 2004:

November 30, 2005

	Simulations Plus, Inc	Words +, Inc.	Eliminations	Total
Net Sales	198,889	619,926		818,815
Income (loss) from operations	(253,284)	14,524		(238,760)
Identifiable assets	5,601,917	1,468,626	(1,757,154)	5,313,389
Capital expenditures	9,446	6,211		15,657
Depreciation and Amortization	3,357	8,503		11,860

November 30, 2004

	Simulations Plus, Inc	Words +, Inc.	Eliminations	Total
Net Sales	523,452	543,022		1,066,474
Income (loss) from operations	41,405	(18,898)		22,507
Identifiable assets	5,584,743	1,237,573	(1,812,694)	5,009,622
Capital expenditures	3,354	20,175		23,529
Depreciation and Amortization	3,508	7,188		10,696

In addition, the Company allocates revenues to geographic areas based on the locations of its customers. Geographical revenues for the three months ended November 30, 2005 and November 30, 2004 were as follows (in thousands):

November 30, 2005

	North America	Europe	Asia	Oceania	South America	Total
Simulations Plus, Inc.	74	8	117	-0-	-0-	199
Words+, Inc.	551	47	10	10	2	620
Total	625	55	127	10	2	819

November 30, 2004

	North America	Europe	Asia	Oceania	South America	Total
Simulations Plus, Inc.	327	77	119	-0-	-0-	523
Words+, Inc.	494	30	15	8	-0-	543
Total	821	107	134	8	-0-	1,066

Note 12: SUBSEQUENT EVENT

Since December 1, 2005, an additional 24,400 stock options to purchase shares have been exercised by employees, including 19,900 options exercised by a retired employee prior to their expiration date.

Note 13: PURCHASE OF BIOREASON'S ASSETS

On November 4, 2005, we purchased certain secured assets of Bioreason, Inc., a technology company, for $826,192. Since the appraised value was greater than the actual purchase price, the remaining amount, after allocation to the contracts receivable, was allocated proportionally to the other assets purchased.

The purchase price was allocated as follows.

Assets	Allocated amounts
Long-Term contract receivables	$ 447,496
Property and equipment	5,001
Software	245,653
Customer relationship	128,042
Total	$ 826,192

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" or "us") 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. 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 five software products for pharmaceutical research: GastroPlus(TM), ADMET Predictor(TM), ADMET Modeler(TM), DDDPlus(TM) and ClassPharmer(TM).

GASTROPLUS

GastroPlus is a computer program for the simulation of the absorption and pharmacokinetics of drugs in the human gastrointestinal tract as well as in a number of standard laboratory animals. This sophisticated simulation has equations for the movement of the drug through the gastrointestinal tract, how fast it dissolves or precipitates along the way, whether it is converted to a different molecular form in the gastrointestinal tract prior to absorption, and

how fast it is absorbed through various regions of the intestinal wall into the blood stream. With additional inputs, it also simulates the concentration of drug in the blood plasma versus time. With an optional module called PDPlus(TM), the program can also simulate how a drug affects the body, such as reducing pain, reducing blood pressure, reducing depression, and adverse side effects.

GastroPlus is used from early drug discovery through development and into early clinical trials. The information provided through these simulations guides project decisions in various ways. Among the kinds knowledge gained through such simulation are: (1) 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, (2) whether the absorption process is affected by certain transporter proteins in the intestinal tract that may cause absorption to be very different from one region to another, (3) when certain properties of

a new compound can be adequately estimated through computer ("in silico") predictions or simple experiments rather than through more expensive and time-consuming experiments, (4) what the likely variations in blood concentration levels would be in a large population, in different age groups or in different ethnic groups, and (5) whether a new generic 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 is the industry "gold standard" for this type of simulation, enjoying a dominant position in the number of users worldwide. In addition to virtually every major pharmaceutical company, licenses include a 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. Version 5.0 with the new PBPKPlus(TM) module, released just after the end of this reporting period, further extends the utility of GastroPlus. 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.

ADMET PREDICTOR

In addition to simulation software, we produce software that consists of statistically significant numerical models that predict a variety of properties of chemical compounds from just their molecular structures. This kind of predictive capability means a chemist can merely draw a molecule diagram and get reasonable estimates of these properties, even though the molecule has never existed. When drug companies try to find new drugs, they search through millions of such molecular structures. The vast majority of these are not suitable as medicines. 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 in blood (like albumin) 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 the compounds and then run experiments to identify these weaknesses. Today, many molecules are eliminated on the basis of computer predictions, such as those provided by ADMET Predictor.

ADMET Predictor provides estimates for approximately 50 properties of new drug-like molecules from their structures. Recent product improvements included a state-of-the-art 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 many other properties, like solubility, permeability, and binding to various proteins. 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.

We added a series of six toxicity predictions to ADMET Predictor during the previous fiscal year. Toxicity prediction was identified as one of the critical needs for pharmaceutical research and development in a white paper called the "Critical Path Initiative" issued by the U.S. Food and Drug Administration in March 2004. During this reporting period, we added another important toxicity prediction for a particular form of cardiac toxicity associated with blocking a potassium channel protein known as hERG (human ether a-go-go). This has been the cause of severe cardiac toxicity and death, and is a high priority toxicity measurement required by the FDA for all new drugs. Identifying such likely failure modes for potential new drug molecules well before expensive experiments are run can help to reduce the high cost and long development time for new drugs.

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.

ADMET MODELER

Our third core product, ADMET Modeler, was 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 create very high quality predictive models.

DDDPLUS

We announced the release of our fourth core product, DDDPlus (Dose Disintegration and Dissolution Plus), 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. The market for this tool includes hundreds of drug delivery companies as well as all pharmaceutical and biotech companies.

Over 60 companies evaluated Version 1.0 of DDDPlus. This is an indication of the strong interest and business potential in this area. However to date, few licenses have been sold. Through the evaluation process, we received valuable feedback about what would be required for various customers to license the software, and we are now incorporating those improvements. We remain confident that 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.

CLASSPHARMER(TM)

In November 2005, we acquired certain secured assets of Bioreason, Inc. from its former creditors, including a software package called ClassPharmer. ClassPharmer is a molecule classification software program, similar in nature to ChemTK(TM), which we purchased from Sage Informatics in August 2005, but with more sophisticated and patented classification algorithms and various additional convenience features. ClassPharmer was programmed in a combination of programming languages that make it run much more slowly than ChemTK, and certain elements of the ChemTK user interface are more user-friendly and visually pleasing than ClassPharmer.

Our strategy for acquiring ChemTK from Sage was to eventually integrate it into ClassPharmer and make a single package, which will become ClassPharmer 4.0 (our current version is ClassPharmer 3.5). This effort has progressed well during this reporting period, and we expect to have a beta release in January 2006.

CONTRACT RESEARCH SERVICES

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. 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

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

(1) MULTIPLE PARTICLE SIZE DISSOLUTION MODEL

The current dissolution model in GastroPlus uses a single "effective" particle 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 software. We plan to incorporate it into GastroPlus as part of a Formulation Module in calendar 2006.

(2) DDDPLUS

The DDDPlus (Dose Disintegration and Dissolution Plus) software is being improved by incorporating additional functionality in accordance with comments and suggestions received from approximately 60 companies who evaluated the

initial release. A number of enhancements have been incorporated at this time and several more are in progress. We expect to release a much-enhanced version of DDDPlus in early calendar year 2006.

(3) ADMET PREDICTOR 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.

(4) 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. We have now progressed to the point where the simulation is 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 our product manager for GastroPlus took a position with another company, and the scientist responsible for MembranePlus was assigned to take over GastroPlus. She has done an excellent job with GastroPlus, completing the PBPKPlus Module and all of the many associated changes that accompanied it. She will continue to work on GastroPlus as needed, but will also work on MembranePlus again as GastroPlus activities allow. We are currently interviewing candidates for an additional position in this area to provide her with assistance on these two projects.

WORDS+

PRODUCTS

Our wholly owned subsidiary, Words+, Inc. has been an industry pioneer and

technology leader for over 24 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 Compaq 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 SAM and to offer it on additional platforms. At the CSUN conference in March 2005, we introduced the SAM Tablet XP1, our Windows XP-based tablet. At the Closing the Gap conference in October 2005, we announced the expected December release of our SAM for PC version, allowing SAM to be distributed on virtually any Windows XP desktop or laptop computer. All received enthusiastic responses from both potential customers and Words+ dealers alike.

RESULTS OF OPERATIONS

COMPARISON OF THREE MONTHS ENDED NOVEMBER 30, 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			
	11/30/05		11/30/04	
Net sales	$ 819	100%	$ 1,066	100%
Cost of sales	332	40.5	322	30.2
Gross profit	487	59.5	744	69.8
Selling, general and administrative	629	76.8	632	59.3
Research and development	97	11.8	114	10.7
Total operating expenses	726	88.6	746	70.0
Income (loss) from operations	(239)	(29.2)	(2)	(0.2)
Other income (expense)	(1)	0.0	24	2.3
Net income (loss) before taxes	(240)	(29.3)	22	2.1
Benefit from income taxes	42	5.1%	-	-

Net income (loss)	$ (198)	(24.2)%	$ 22	2.1%

NET SALES

Consolidated net sales decreased $247,000, or 23.2%, to $819,000 in the first fiscal quarter of 2006 (FY06) from $1,066,000 in the first fiscal quarter of 2005 (FY05). Our sales from pharmaceutical and educational software decreased approximately $324,000, or 62.0%; and our Words+, Inc. subsidiary's sales increased approximately $77,000, or 14.2%, for the quarter. We attribute the decrease in pharmaceutical software sales primarily to the delay in a large global renewal order, which we received in the first fiscal quarter last year, but was received in December, 2005 moving its revenue into the second fiscal quarter of 2006.

We attribute the increase in Words+ sales primarily an increase in sales of "Say-it! SAM" and "Freedom" products. Some decline in MessageMate products and increase in insurance discounts were offset by these increases.

COST OF SALES

Consolidated cost of sales increased $10,000, or 3.1%, to $332,000 in the first fiscal quarter of FY06 from $322,000 in the first fiscal quarter of FY05. The percentage of cost of sales in the first fiscal quarter of FY06 increased 10.3% from the first fiscal quarter of FY05. For Simulations Plus, absolute cost of sales decreased $17,000, or 36.4%. As a percentage, cost of sales increased to 15.2% in FY06 from 9.1% in FY05. A significant portion of cost of sales is the systematic amortization of capitalized software development costs, which is an independent fixed cost rather than variable cost related to sales. Thus, we attribute the increase in the percentage of cost of sales primarily to the decrease in sales.

For Words+, cost of sales increased $27,000, or 9.7%. As a percentage, cost of sales decreased 2.0% between the first fiscal quarter of FY06 and FY05. We attribute the percentage decrease in cost of sales for Words+ primarily to the ability to obtain purchase discounts by volume purchases of computers and PDAs, which are main parts of the systems we sell.

GROSS PROFIT

Consolidated gross profit decreased $257,000, or 34.5%, to $487,000 in the first fiscal quarter of FY06 from $744,000 in the first fiscal quarter of FY05. We attribute this decrease to the decrease in sales of pharmaceutical software which outweighed the increase in profit margin on Words+ products.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Consolidated selling, general and administrative expenses decreased $3,000, or 0.5%, to $629,000 in the first fiscal quarter of FY06 from $632,000 in the first fiscal quarter of FY05. For Simulations Plus, selling, general and administrative expenses increased $1,000, or 0.3%. The major increases in expenses were selling expenses, such as commissions to dealers and trade shows, salary and payroll-related expenses such as health insurance and payroll taxes, and rent and recruiting costs, which outweighed decreases in equipment rental, accounting, and investor relations.

For Words+, expenses decreased $4,000, or 1.7%, due primarily to decreases in salaries, selling expenses, equipment repairs, contributions, contract labor, and depreciation expenses. These decreases outweighed increases in commissions, rent, and technical service costs.

RESEARCH AND DEVELOPMENT

We incurred approximately $460,000 of research and development costs for both companies during the first fiscal quarter of FY06. Of this amount, $363,000, including an allocation of appraised value of $220,000 on ClassPharmer software, was capitalized and $97,000 was expensed. In the first fiscal quarter of FY05, we incurred $234,000 of research and development costs, of which $120,000 was capitalized and $114,000 was expensed. The increase of $226,000, or 96.6%, in research and development expenditures from the first fiscal quarter of FY05 to the first fiscal quarter of FY06 was due primarily to the purchase of the ClassPharmer software and some salary increases to existing staff.

OTHER INCOME (EXPENSE)

Net other income in the first fiscal quarter of FY06 decreased by $25,000, from net income of $24,000 to net expense of $1,000. This is due primarily to a decrease in the amortization of present value discount on long-term receivables

which we fully amortized by May 2005. We incurred other long-term receivables from a part of the Bioreason assets purchase, however their amortized interest was only $150 in the first fiscal quarter of FY06, while it was $15,000 in the first fiscal quarter of FY05.

BENEFIT FROM INCOME TAXES

We estimated a benefit of income tax for $42,000 in the first fiscal quarter of FY06, while there was no income tax benefit (or provision) in the first fiscal quarter of FY05.

NET INCOME

Consolidated net income for the three months' operations decreased by $220,000, or 1,000.0%, to a loss of $198,000 in the first quarter of FY06 compared to a profit of $22,000 in the first quarter of FY05. We attribute this decrease in profit primarily to the decreases in pharmaceutical software and other income along with the increases in cost of sales. Although there was a decrease in selling, and general and administrative expenses, research and development expenses, a benefit from income taxes, and an increase in Words+ product sales with improved profit margins, they did not overcome the decrease in consolidated net 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 did not renew a revolving line of credit for $500,000 from a bank in May 2005 because the Company did not use it during the prior year and did not expect to need it in the near future. The Company will consider re-applying for the line of credit when there is a need for it.

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

capital expenditures for the foreseeable future. Thereafter, if cash generated from operations is insufficient to satisfy the Company's capital requirements, the Company may apply for a loan from a bank and 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.

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 FY06. 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, we carried out an evaluation, under the supervision and with the participation of the Company's management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our 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 required to be included in our periodic SEC filings.

(b) CHANGES IN INTERNAL CONTROLS OVER FINANCIAL REPORTING. There was no change in our internal controls over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

While we may from time to time be involved in various claims,

lawsuits or disputes with third parties, we are not currently a party to any significant litigation. We have been contacted by a former Bioreason salesperson in France regarding his status and status of certain contracts after our acquisition of certain secured assets of Bioreason from its creditors, and we are working with our attorneys to resolve this matter at this time.

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 16, 2005.

Simulations Plus, Inc.

Date: January 16, 2006

By: /s/ MOMOKO BERAN
Momoko Beran
Chief Financial Officer