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SIMULATIONS PLUS INC  
Form 10QSB  
April 10, 2002

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 February 28, 2002 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: 000-21665

SIMULATIONS PLUS, INC.  
(Exact name of registrant as specified 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  
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant: (1) has filed all reports  
required to be filed by Section 13 or 15(d) of the Securities Exchange Act of  
1934 during the preceding 12 months (or for such shorter period that the  
registrant was required to file such reports), and (2) has been subject to such  
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 April 9, 2002, was 3,408,331.

SIMULATIONS PLUS, INC.  
FORM 10-QSB  
FOR THE QUARTERLY PERIOD ENDED FEBRUARY 28, 2002

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### Item 1. Financial Statements

#### SIMULATIONS PLUS, INC. AND SUBSIDIARY CONSOLIDATED BALANCE SHEET February 28, 2002 (Unaudited)

#### ASSETS

##### Current assets:

Cash and cash equivalents (note 2)	\$ 126,724
Accounts receivable, net of allowance for doubtful accounts of \$14,363	670,150
Prepaid expenses	27,749
Inventory	214,410

Total current assets	----- 1,039,033 -----
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Capitalized computer software development costs, net of accumulated amortization (note 3)	321,528
Furniture and equipment, net (note 4)	71,902
Other assets	13,257
	-----
Total assets	\$ 1,445,720 =====
LIABILITIES AND SHAREHOLDER'S EQUITY	
Current liabilities:	
Advance line of credit	\$ 99,966
Accounts payable	194,262
Accrued payroll and other expenses	334,297
Accrued compensation due to officer-directors	233,916
Accrued warranty and service costs	43,826
Current portion of capitalized lease obligations	13,369
	-----
Total current liabilities	919,636 -----
Capitalized lease obligations, net of current portion	14,675
	-----
Total liabilities	934,311 -----
Shareholders' equity	
Preferred stock: \$0.001 par value, authorized 10,000,000 shares, no shares issued and outstanding	0
Common stock: \$0.001 par value, authorized 20,000,000 shares, issued and outstanding 3,408,331 (note 5)	3,409
Additional paid-in capital	4,654,756
Accumulated deficit	(4,146,756)
	-----
Total shareholders' equity	511,409 -----
Total liabilities and stockholders' equity	\$ 1,445,720 =====

The accompanying footnotes are an integral part of these statements.

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SIMULATIONS PLUS, INC. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF OPERATIONS  
For the three and six months ended February 28, 2002 and February 28, 2001

(Unaudited)

	Three months ended		Six months ended	
	02/28/02	02/28/01	02/28/02	02/28/01
	-----	-----	-----	-----
Net sales	\$ 1,106,622	\$ 1,062,426	\$ 2,113,910	\$ 2,120,000
Cost of sales	333,098	428,082	705,642	906,000
	-----	-----	-----	-----
Gross profit	773,524	634,344	1,408,268	1,214,000

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Operating expenses:				
Selling, general & administration	469,248	532,288	994,456	1,032,182
Research and development	81,534	93,447	175,524	182,182
Total operating expenses	550,782	625,735	1,169,980	1,215,364
Income (loss) from operations	222,742	8,609	238,288	(12,731)
Other income (expenses):				
Interest income	8	39	15	
Interest expense	(4,819)	(5,601)	(9,867)	(11,257)
Income (loss) before provision for income taxes	217,931	3,047	228,436	(12,731)
Provision for income taxes	0	0	0	0
Net income (loss)	\$ 217,931	\$ 3,047	\$ 228,436	\$ (12,731)
Basic net income (loss) per common share	\$ 0.06	\$ 0.00	\$ 0.07	\$ (0.04)
Diluted net income (loss) per common share	\$ 0.06	\$ 0.00	\$ 0.06	\$ (0.04)
Basic weighted average # of common shares outstanding	3,408,331	3,385,831	3,408,331	3,385,831
Diluted weighted average # of common shares outstanding	3,571,564	3,436,161	3,571,564	3,385,831

The accompanying footnotes are an integral part of these statements.

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SIMULATIONS PLUS, INC. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
For the six months ended February 28, 2002 and February 28, 2001  
(Unaudited)

	Six months ended	
	02/28/02	02/28/01
Cash flows from operating activities:		
Net income (loss)	\$ 228,436	\$ (12,731)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization of furniture and equipment	28,940	30,972
Amortization of capitalized software development costs	69,704	230,835

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(Increase) decrease in:		
Accounts receivable	(225,750)	(144,696)
Inventory	(32,052)	(83,065)
Other assets	(2,726)	12,873
Increase (decrease) in:		
Accounts payable	(70,043)	54,294
Accrued payroll and other expenses	(183)	(22,037)
Accrued payroll for officer-directors	39,833	23,500
Accrued warranty and service costs	(1,630)	643
Deferred revenue	(2,593)	(34,840)
	-----	-----
Net cash provided by operating activities	31,936	55,748
	-----	-----
Cash flows from investing activities:		
Purchase of furniture and equipment	(9,570)	0
Capitalized computer software development cost	(56,931)	(66,448)
	-----	-----
Net cash used in investing activities	(66,501)	(66,448)
	-----	-----
Cash flows from financing activities:		
Borrowed from line of credit, net	1,007	3
Payments on capitalized lease obligations	(6,370)	(8,751)
	-----	-----
Net cash used in financing activities	(5,363)	(8,748)
	-----	-----
Net decrease in cash	(39,928)	(19,448)
Cash and cash equivalents, beginning of period	166,652	37,535
	-----	-----
Cash and cash equivalents, end of period	\$ 126,724	\$ 18,087
	=====	=====

The accompanying footnotes are an integral part of these statements.

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SIMULATIONS PLUS, INC.  
NOTES TO CONDENSED FINANCIAL STATEMENTS  
(Unaudited)

Note 1: GENERAL

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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. (the "Company"), 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: CASH AND CASH EQUIVALENTS

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The Company maintains cash deposits at banks located in California. Deposits at each bank are insured by the Federal Deposit Insurance Corporation up to \$100,000. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk on cash and cash equivalents.

### Note 3: CAPITALIZED COMPUTER SOFTWARE DEVELOPMENT COSTS

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Software development costs are capitalized in accordance with Statement of Financial Accounting Standards ("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 judgement by management with respect to certain external factors including, but not limited to, technological feasibility, anticipated future gross revenue, estimated economic life, and changes in software and hardware technologies. Capitalized software development costs are comprised primarily of salaries and the purchase of existing software to be used in the Company's 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 exceeding three 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. The Company expensed \$126,296 in fiscal year 2001 when it was required to write off as an impairment loss related to capitalized software costs for HelixGen, and included in cost of sales.

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### Note 4: FURNITURE AND EQUIPMENT

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Furniture and equipment as of February 28, 2002 consisted of the following:

Equipment	\$ 104,236
Computer equipment	308,370
Furniture and fixtures	45,036
Leasehold improvements	38,215
	-----
	495,857
Less accumulated depreciation	(423,955)
	-----
	\$ 71,902
	=====

### Note 5: STOCKHOLDERS' EQUITY

#### STOCK OPTION PLAN

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As of February 28, 2002, 1,193,899 shares have been issued to various employees at an exercise price equal to the fair market value of the Company's stock price at the date of grant with five-year vesting periods. Also, a total of 5,206 shares have been issued to the Board of Directors at exercise prices equal to the fair market value of the Company's stock price at the date of grant ranging

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from \$1.50 to \$5.25 with a three-year vesting period. As of today, 2,300 options have been exercised.

### Note 6: Income Taxes

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The Company uses the liability method of accounting for income taxes pursuant to SFAS No. 109 "Accounting for Income Taxes."

### Note 7: Earnings Per Share

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Effective February 28, 1998, the Company adopted SFAS No. 128 "Earnings Per Share."

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

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### FORWARD-LOOKING STATEMENTS

The following discussion should be read in conjunction with the financial statements and the notes thereto appearing elsewhere in this quarterly report on Form 10-QSB for the quarter ended February 28, 2001 (the "Form 10-QSB"). In addition to historical information, this Form 10-QSB contains forward-looking statements. The forward-looking statements contained herein are subject to certain risks and uncertainties that could cause actual results to differ materially from those reflected in the forward-looking statements. Factors that might cause such a difference include, but are not limited to, those discussed in the section entitled "Management's Discussion and Analysis or Plan of Operations." Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's analysis only as of the date hereof. Simulations Plus, Inc. undertakes no obligation to publicly revise these forward-looking statements, or to reflect events or circumstances that arise after the date hereof. Readers should carefully review the risk factors described in other documents that the Company has filed and will continue to file from time to time with the Securities and Exchange Commission.

### GENERAL

### BUSINESS

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Simulations Plus, Inc. (the "Company" or "Simulations Plus") and its wholly owned subsidiary, Words+, Inc. ("Words+") produce two types of products: (1) Simulations Plus, incorporated in 1996, develops and produces 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.

### DESCRIPTION OF SIMULATION SOFTWARE

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The development of simulation software involves (1) identifying and understanding the underlying chemistry, physics, biology, and physiology of the processes to be simulated, (2) breaking those processes down into the lowest practical level of individual sub-processes at which the behaviors can be

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well-represented mathematically, (3) developing appropriate mathematical relationships/equations, and (4) converting them into computer subroutines. The software subroutines representing these individual processes are then integrated into an overall simulation program, with appropriate coordination between modules and design of user-friendly interface for inputs and outputs. The predictions of these programs are then compared to known results in order to calibrate the simulations and to demonstrate the validity of the models as useful tools for predicting new results.

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The types of simulation software produced by the Company are based on the equations of chemistry and physics that describe or "model" the behavior of things in the real world.

The Company's GastroPlus(TM) pharmaceutical software simulates the movement, dissolution/precipitation, chemical/metabolic degradation and absorption of orally-dosed drug compounds in the gastrointestinal tract of humans and several laboratory animal species, and with additional inputs, it also simulates the blood plasma concentration-time history of the drug after it reaches the central circulation. In 2001, the Company completed the development of, and is now selling licenses for, an important new extension module for GastroPlus called the Metabolism and Transporter Module. This module extends the basic simulation to include enzyme-specific metabolism in both the liver and in intestinal walls, as well as the effects of transporter proteins that line the intestinal tract and serve to promote or inhibit drug absorption.

The Company's QMPRPlus(TM) program estimates the values of several important physicochemical characteristics of new drug-like molecules with only the structures of the molecules as input. Recent additions to this program include the prediction of permeability in a special line of cells called MDCK cells. This predictive model was developed during the past fiscal year under a funded collaboration with the Affymax Research Institute, at that time a division of GlaxoSmithKline. Two new important predicted properties were also added to QMPRPlus: plasma protein binding and volume of distribution.

GastroPlus and QMPRPlus are used by almost every major and a number of smaller pharmaceutical companies in the U.S., Europe, and Japan.

The Company's award-winning FutureLab(TM) science experiment simulations for middle school and high school students incorporate the equations of chemistry and physics for each experiment (optics, electrical circuits, gravity, ideal gases, acid/base titration, etc.), 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 continue through distributors in the U.S., U.K. Australia, and New Zealand.

### PRODUCTS

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The Company's pharmaceutical software provides cost-effective solutions to a number of critical problems in pharmaceutical research, and also serves in the education of pharmacy and medical students. The Company's software products and services to date are focused on the area of pharmaceutical research known as ADMET (Absorption, Distribution, Metabolism, Elimination, and Toxicity). The Company released its first pharmaceutical software product, GastroPlus, in August 1998 and immediately received enthusiastic interest from researchers in large pharmaceutical companies such as Astra, Glaxo Wellcome, Pfizer, Pharmacia, The Roche Group, SmithKline Beecham and Zeneca. Since then, the majority of the



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world's largest pharmaceutical companies and a number of smaller companies have licensed the software. Some of these companies have merged to become single companies (e.g., AstraZeneca and GlaxoSmithKline), which give the appearance of fewer customers, but the Company's software is licensed on an annual basis by geographic location, so no actual loss in sales has resulted from these mergers. In fact, several of these mergers have resulted in increased licenses and new geographic locations.

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An Optimization Module for GastroPlus was released in November 1998. Two additional modules, IVIV Correlation and PKPlus(TM) were released in November 2000. The Metabolism and Transporter Module was released in June 2001. The majority of new sales now include these additional extra-cost modules, contributing significantly to revenue growth. GastroPlus has now become the "gold standard" for simulation of oral drug absorption and pharmacokinetics, and is in use throughout the industry in the U.S., Japan, and Europe. Recent sales have included a number of drug delivery companies (companies that design the actual 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 realize significant savings in cost and time through accurate simulation of their drug delivery technologies. The Company believes this part of the industry, which includes hundreds of companies, represents major growth potential for GastroPlus.

QMPRPlus (Quantitative Molecular Permeability Relationships), which can be used as a companion program to GastroPlus or by itself, takes as inputs the structures of molecules, and provides estimates for human intestinal permeability, octanol-water partition coefficient (logP), solubility, diffusivity, blood-brain barrier penetration, plasma protein binding, and volume of distribution. The ability to predict these properties prior to running wet lab experiments allows screening of undesirable compounds much faster and at much lower cost than using traditional experimental methods.

Most of the estimated parameters from QMPRPlus are inputs to GastroPlus. QMPRPlus thereby extends the utility of GastroPlus into early drug discovery, during which pharmaceutical companies may not have even made many of the molecules that have been identified as potential drug candidates. During the previous fiscal year, the Company completed the development of a new intestinal permeability model for a special line of cell culture experiments using Manin-Darby Canine Kidney (MDCK) cells under contract to the Affymax Research Institute, at that time a division of GlaxoSmithKline. This unique model, based on high quality data for over 350 compounds, was presented at the American Chemical Society meeting in San Diego during the first week of April 2001. The Company also completed the development of the blood-brain barrier permeation model during the last fiscal year, as well as models for plasma protein binding and volume of distribution, and it updated all earlier models with enhanced artificial neural network predictions. By providing estimates of physicochemical properties from structure alone, QMPRPlus, by itself or coupled with GastroPlus, allows researchers to rank order large numbers of candidate compounds in terms of their potential for human intestinal absorption. Because pharmaceutical companies are dealing with many millions of compounds per year, and because the area of ADMET has become a bottleneck, high throughput screening on the computer ("IN SILICO") is becoming not just a convenience, but a necessity.

In 1998, the Company executed a License Agreement with Therapeutic Systems Research Laboratories, Inc. ("TSRL"), Ann Arbor, Michigan, to obtain exclusive rights to TSRL's technology and database, including measurements of drug permeability from nearly 60 laboratory experiments to measure the intestinal permeability of drug compounds in human and/or rat small intestines. As a part

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of this License Agreement, the Company is also entitled to ongoing consulting assistance in the development and further enhancement of the GastroPlus absorption simulation model from TSRL staff, including Dr. Gordon Amidon and Dr. John Crison. The Company believes that the strategic advantage of exclusive

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access to TSRL's technology and expertise, combined with the Company's now well-developed and continually growing expertise in absorption and pharmacokinetics simulation, have resulted in GastroPlus becoming the standard for oral drug absorption simulation and analysis within the pharmaceutical industry. The Company is aware that other companies began to develop similar software; however, management believes there is no significant direct competition for GastroPlus at this time. The Company believes that the addition of the Metabolism and Transporter Module and ongoing upgrades of the core simulation, are major advances in the state-of-the-art of oral drug absorption and pharmacokinetics analysis. The Company's recognized expertise in oral absorption and pharmacokinetics is evidenced by the fact that Company staff members have been invited speakers at over 20 prestigious scientific meetings worldwide in the past year alone, and they continue to be invited to present at a variety of meetings worldwide.

### CONTRACT RESEARCH SERVICES

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The Company offers contract research services to the pharmaceutical industry in the area of gastrointestinal absorption, pharmacokinetics, and related technologies. The Company continues to perform study contracts for both major and smaller pharmaceutical companies. These studies provide an additional source of revenue for the Company, as well as a means to introduce the Company's software products to new customers. These studies are also beneficial to the Company to validate and enhance its products by studying actual data in the pharmaceutical industry. The company is currently completing two study contracts to analyze drugs that are now in clinical trials.

### PHARMACEUTICAL SIMULATIONS SOFTWARE PRODUCT DEVELOPMENT

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In the area of simulation software for pharmaceutical research, the Company is pursuing the development of additional modules for GastroPlus and QMPRPlus. Although all of our development work cannot be disclosed for competitive reasons, some of our development efforts include:

#### (1) PDPlus(TM) Module

-----

The PDPlus Module for GastroPlus is nearly completed. Prior versions of GastroPlus have dealt with absorption and pharmacokinetics (what happens to the drug when it gets into the body). PDPlus calculates the pharmacodynamics for the drug (what happens to the body when the drug gets into the body) - i.e., what kind of therapeutic (or adverse) effect does it produce. This is an important new capability because it opens up the market to researchers who deal in later stage clinical trials, and who routinely perform PK/PD (pharmacokinetic/pharmacodynamic) analyses. Until now, these analyses were performed using models that treated absorption and its related processes with simplified models - often so simplified that calculations were in error. With PDPlus in GastroPlus, researchers will be able to perform highly sophisticated simulations and analyses to determine the complex interactive effects of factors that change the amount of drug that is absorbed and how fast it is metabolized after it is absorbed. These can result in significant variations in

pharmacodynamic effect. Without the ability to predict these effects, clinical trial costs can soar when trials must be repeated to determine proper dosing levels. PDPlus will enable researchers to better understand the complex interplay among absorption, pharmacokinetics, and pharmacodynamics, and to better estimate the dosing levels to use in clinical trials prior to the start of the trials. The Company expects to release this additional-cost module in the first half of calendar 2002.

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

The current dissolution model in GastroPlus uses a single "effective" particle size. While this model has well represented most tablets, capsules, and suspensions we have dealt with 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 over some range from smaller than the average size to larger than the average size. 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.

(3) QMPRPlus(TM) upgrades  
-----

We continue to add new molecular descriptors and new predicted ADMET properties to QMPRPlus(TM). We have just completed the development of a new, additional-cost "4D Data Mining" module, which is in final testing and will be released in April 2002. We are also developing the ability for researchers to add their own data to refine the predictions for ADMET properties. And we are in discussions with several companies to develop additional models based on their experimental data. If contracted for, these models may be proprietary to each company, or they may result in additional predictions that can be licensed to other users, as we did with the MDCK model developed under contract to Affymax.

DISABILITY PRODUCT DEVELOPMENT  
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The Company's wholly owned subsidiary, Words+, Inc. has been an industry technology leader for over 20 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. The Company will continue to enhance its major software products, E Z Keys and Talking Screen, as well as its growing line of hardware products. The Company announced the release of its new version of E Z Keys for the new Microsoft XP operating system at the "Technologies for Persons with Disabilities Conference" in Los Angeles in late March 2002. The Company will also consider acquisitions of other products, businesses and companies that are complementary to its existing augmentative and alternative communication and computer access business lines.

RESULTS OF OPERATIONS

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COMPARISON OF THREE MONTHS ENDED FEBRUARY 28, 2002 AND FEBRUARY 28, 2001.

The following table sets forth the Company's consolidated statements of operations (in thousands) and the percentages that such items bear to net sales: (Due to rounding, the numbers appearing in the following table may not foot; please refer to the Company's consolidated statements of operations.)

	Three Months Ended			
	02/28/02		02/28/01	
Net sales	\$ 1,107	100.0%	\$ 1,062	100.0%
Cost of sales	333	30.1	428	40.3
Gross profit	774	69.9	634	59.7
Selling, general and administrative	469	42.4	532	50.1
Research and development	82	7.4	94	8.9
Total operating expenses	551	49.8	626	58.9
Income from operations	223	20.1	8	0.8
Interest expense	(5)	(0.5)	(5)	(0.5)
Net income	\$ 218	19.7%	\$ 3	0.3%

### NET SALES

Consolidated net sales increased \$45,000, or 4.2%, to \$1,107,000 in the second fiscal quarter of 2002 (FY02) from \$1,062,000 in the second fiscal quarter of 2001 (FY01). Simulations Plus, Inc.'s sales, from pharmaceutical and educational software and services, increased approximately \$181,000, or 48.6%; however, Words+, Inc.'s sales decreased approximately \$136,000, or 19.9% for the quarter. The increase in the Company's leading pharmaceutical software sales is attributable to a combination of additional license sales to existing customers, new customers, new modules, and four major upgrades to existing products. Management attributes the decrease in Words+ sales primarily to personnel changes in two key sales representatives, delays in assistive technology orders by a number of school districts and state agencies nationwide, and overall slowing in the economy during this time period.

### COST OF SALES

Consolidated cost of sales decreased \$95,000, or 22.2%, to \$333,000 in the second fiscal quarter of FY02 from \$428,000 in the second fiscal quarter of FY01. The percentage of cost of sales decreased by 10.2%. For Simulations Plus, the cost of sales decreased \$122,000, or 114.6%. A significant portion of the cost of sales is the systematic amortization of capitalized software cost, which resulted in an 82.5% decrease in amortization cost. This decrease is due to the fact that the Company was required to expense \$126,296 in the second fiscal quarter of FY01 for the capitalized development cost of HelixGen because its development had been postponed. Without this charge last year, cost of sales for

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Simulations Plus would have increased by \$4,000. For Words+, the cost of sales increased \$27,000, or 11.7%. Management attributes the percentage increase in cost of sales for Words+ primarily to the fact that the percentage of sales generated by product items with lower profit margins was greater than the items with higher profit margins. In addition, there was a temporary reduction in the cost of a significant component of the Freedom2000 during the second fiscal quarter of 2001, resulting in temporary higher gross margin during that quarter as compared with this year's second quarter.

### GROSS PROFIT

The consolidated gross profit increased \$140,000, or 22.1%, to \$774,000 in the second quarter of FY02 from \$634,000 in the second quarter of FY01. Management attributes this increase to a significant increase in pharmaceutical software sales, while there is a decrease in cost of sales because of the HelixGen write off last year, resulting in significant increase in gross profit for these sales. This increase outweighed the decrease in gross profit generated from Words+ products.

### SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Consolidated selling, general and administrative expenses decreased \$63,000, or 11.8%, to \$469,000 in the second quarter of FY02 from \$532,000 in the second quarter of FY01. For Simulations Plus, selling, general and administrative expenses decreased \$39,000, or 20.4% primarily due to decreases in legal fees, public relations, and administrative personnel wages by consolidating some tasks. Although there are increases in insurance expense and overseas taxes associated with sales, overall reductions in expenses outweighed increases. For Words+, expenses decreased \$24,000, or 7.0%, due to a decrease in travel, telephone, repairs, and wages. These decreases outweighed increases in other expenses such as catalogs, commissions and depreciation expenses, resulting in an overall lower selling, general and administrative expense than last year.

### RESEARCH AND DEVELOPMENT

The Company incurred approximately \$116,000 of research and development costs for both companies during the second quarter of FY02. Of this amount, \$35,000 was capitalized and \$81,000 was expensed in this period. In the second quarter of FY01, the Company incurred \$128,000 of research and development costs, of which \$34,000 was capitalized and \$94,000 was expensed. The decrease of \$12,000, or 9.0%, in research and development expenditure from the second quarter of FY01 to the second quarter of FY02 was due to one research and development staff member who left the company and was not replaced, thus decreasing wages and associated payroll expenses.

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### INTEREST EXPENSE

Interest expense for the second quarter of FY02 and FY01 are the same. The interest expense was related to the Company's revolving line of credit with its bank.

### NET INCOME

The consolidated net income for the three months ended February 28, 2002 increased by \$215,000, or 7,166.7%, to \$218,000 in the second quarter of FY02 compared to \$3,000 in the second quarter of FY01. Management attributes this increase primarily to the significant increase in pharmaceutical software sales while lowering all expenses.

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COMPARISON OF SIX MONTHS ENDED FEBRUARY 28, 2002 AND FEBRUARY 28, 2001.

The following table sets forth the Company's consolidated statements of operations (in thousands) and the percentages that such items bear to net sales: (Due to rounding, the numbers appearing in the following table may not foot; please refer to the Company's consolidated statements of operations.)

	Six Months Ended			
	02/28/02		02/28/01	
Net sales	\$ 2,114	100.0%	\$ 2,121	100.0%
Cost of sales	706	33.4	906	42.7
Gross profit	1,408	66.6	1,215	57.3
Selling, general and administrative	994	47.0	1,033	48.7
Research and development	176	8.3	183	8.6
Total operating expenses	1,170	55.3	1,216	57.3
Income (loss) from operations	238	11.3	(1)	0.0
Interest expense	(10)	(0.5)	(12)	(0.1)
Net income (loss)	\$ 228	10.8%	\$ (13)	(0.1)%

### NET SALES

Consolidated net sales decreased \$7,000, or 0.3%, to \$2,114,000 for the six months ended February 28, 2002 compared to \$2,121,000 for the six months ended February 28, 2001. Simulations Plus, Inc.'s sales from pharmaceutical software and services and educational software increased approximately \$350,000, or 58.9%, however, Words+, Inc.'s sales decreased approximately \$357,000, or 23.4% for the six months ended February 28, 2002. Management attributes the increase in pharmaceutical software sales to a combination of new customers, new modules, and license renewals because of major upgrades to existing products, and fees received for product training. Management attributes the decrease in Words+ sales primarily to the tragic incidents on September 11, personnel changes in two key sales representatives, delays in assistive technology orders from numerous school districts and state agencies, and overall slowing in the economy during this time period.

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### COST OF SALES

Consolidated cost of sales decreased \$200,000, or 22.1%, to \$706,000 for the six months ended February 28, 2002 from \$906,000 for the six months ended February 28, 2001. The percentage of cost of sales decreased by 9.3%. For Simulations Plus, the cost of sales decreased \$135,000, or 49.0%. A significant portion of the cost of sales is the systematic amortization of capitalized software cost, which resulted in a 72.9% decrease in amortization cost. This decrease is primarily due to the fact that the Company was required to expense \$126,296 in the second fiscal quarter of last year for the capitalized development cost of

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HelixGen because its development was postponed. For Words+, the cost of sales decreased \$65,000, or 10.4%. Expressed as a percentage, the change in cost of sales for Words+ between the six months operations ended February 28, 2002 and February 28, 2001 is an increase of 7.0%. Management attributes this percentage increase primarily to increased sales of lower margin items during the first six months compared to the same period of the previous fiscal year. There was a temporary reduction in the cost of a significant component of the Freedom2000 during the second fiscal quarter of 2001, resulting in a temporary higher gross margin.

### GROSS PROFIT

The consolidated gross profit increased \$193,000, or 15.9%, to \$1,408,000 for the six months ended February 28, 2002 from \$1,215,000 for the six months ended February 28, 2001. Management attributes this increase to a significant increase in pharmaceutical software and services sales, while there is a decrease in its cost of sales largely caused by last year's HelixGen write-off, resulting in significantly increased gross profit for these sales. This increase outweighed the decrease in gross profit generated by Words+ products.

### SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Consolidated selling, general and administrative expenses decreased \$39,000, or 3.8%, to \$994,000 for the six months ended February 28, 2002 from \$1,033,000 for the six months ended February 28, 2001. For Simulations Plus, selling, general and administrative expenses decreased \$52,000, or 13.7% primarily due to decreases in depreciation, legal fees and public relations. Although there are increases in overseas taxes associated with sales, consultant fees, and travel expense, overall reductions in expenses outweighed increases. For Words+, expenses increased \$13,000, or 2.1%, primarily due to increases in catalog printing, trade shows, contract labor, insurance, and commissions outweighing reduction in other expenses such as travel expenses, salaries/wages and related payroll tax, postages, and telephone expense.

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### RESEARCH AND DEVELOPMENT

The Company incurred approximately \$226,000 of research and development costs for both companies for the six months ended February 28, 2002. Of this amount, \$50,000 was capitalized and \$176,000 was expensed in this period. In the same period of 2001, the Company incurred \$249,000 of research and development costs, of which \$66,000 was capitalized and \$183,000 was expensed. The decrease of \$23,000, or 9.2% in research and development expenditure from the six months operations in the fiscal year 2001 to 2002 was due to one research and development staff member who left the company has not yet been replaced, thus decreasing wages and payroll related expenses.

### INTEREST EXPENSE

Interest expense for the six months ended February 28, 2002 decreased by \$2,000, or 16.7%, to \$10,000 from \$12,000 for the six months ended February 28, 2001. This decrease is attributable primarily to a decrease in interest rate on the Company's revolving line of credit.

### NET INCOME

Consolidated net profit for the six months ended February 28, 2002 increased by \$241,000, to a net profit of \$228,000 for the six months ended February 28, 2002 compared to the net loss of \$13,000 for the six months ended February 28, 2001.

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Management attributes this increase primarily to the significant increase in pharmaceutical software and services sales while lowering all expenses.

### LIQUIDITY AND CAPITAL RESOURCES

The Company's principal sources of capital have been cash flows from its operations, a bank line of credit, and accruing and not paying portions of salaries to certain executive officers and managers.

The Company has available a \$100,000 revolving line of credit from a bank. Interest is payable on a monthly basis at the bank's prime rate plus 3.0%. At February 28, 2002, the outstanding balance under the revolving line of credit was approximately \$100,000, and it was \$99,000 at February 28, 2001. This amount was completely paid off in March 2002, eliminating the Company's largest external debt. The revolving line of credit is not secured by any of the assets of the Company but is personally guaranteed by Mr. Walter S. Woltosz, the Company's Chief Executive Officer, President and Chairman of the Board of Directors.

Beginning in August 1998, certain executive officers and managers accepted reduced salaries on a temporary basis in order to protect the cash assets of the Company. The unpaid portions of salaries were accrued and will be paid at such future time as management deems the Company's cash flow and cash reserves are sufficient to make such payment without adverse effects to the Company's financial position. The amount of such accrued and unpaid salaries due to the Company's executive officers and one manager was \$393,000. Effective as of March 1, 2002, all employees and officers salaries have been restored to their full levels. Accrued amounts will be paid as described above.

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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. If cash generated from operations becomes 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.

Since July 2, 1999, trading in the shares of the Company's Common Stock has been conducted on the Nasdaq's "Electronic Bulletin Board." Consequently, the liquidity of the Company's securities may be impaired, not only in the number of securities which can be bought and sold, but also through delays in the timing of the transactions, reductions in security analysts' and the media's coverage of the Company, and lower prices for the Company's securities than otherwise may be attained.

Because the company's securities are listed on the bulletin board, they are subject to Rule 15c-9 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), which imposes additional sales practice requirements on broker-dealers which sell such securities to persons other than established customers and "accredited investors" (generally, individuals with net worth in excess of \$1,000,000 or annual incomes exceeding \$200,000, or \$300,000 together with their spouses). For transactions covered by this rule, a broker-dealer must



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make a special suitability determination for the purchaser and have received the purchaser's written consent to the transaction prior to the sale. Consequently, the rule may adversely affect the ability of broker-dealers to sell the Company's securities acquired hereby in the secondary market.

Securities and Exchange Commission ("Commission") regulations define a "penny stock" to be any non-Nasdaq equity security that has a market price (as therein defined) of less than \$5.00 per share or with an exercise price of less than \$5.00 per share, subject to certain exceptions. For any transaction involving a penny stock, unless exempt, the rules require delivery, prior to any transaction in a penny stock, of a disclosure schedule prepared by the Commission relating to the penny stock market. Disclosure is also required to be made about commissions payable to both the broker-dealer and the registered representative and current quotations for the securities. Finally, monthly statements are required to be sent disclosing recent price information for the penny stock held in the account and information on the limited market in penny stocks.

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The foregoing required penny stock restrictions will not apply to the Company's securities if such securities are listed on Nasdaq and have certain price and volume information provided on a current and continuing basis or meet certain minimum tangible assets or average revenue criteria. There can be no assurance that the Company's securities will qualify for exemption from these restrictions. In any event, even if the Company's securities were exempt from such restrictions, it would remain subject to Section 15(b)(6) of the Exchange Act, which gives the Commission the authority to prohibit any person that is engaged in unlawful conduct while participating in a distribution of penny stock from associating with a broker-dealer or participating in the distribution of a penny stock, if the Commission finds that such a restriction would be in the public interest.

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### PART II. OTHER INFORMATION

#### Item 1. Legal Proceedings

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In the normal course of business, the Company may be 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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On February 21, 2002, the Registrant held its annual meeting of shareholders. The following proposals were submitted to a vote of

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security holders at the meeting.

- (1) Election of directors  
Walter S. Woltosz  
Virginia E. Woltosz  
Dr. David Z. D'Argenio  
Dr. Richard Weiss
  
- (2) Ratification of the appointment of Singer, Lewak, Greenbaum & Goldstein, LLP as Independent public accountants.

All of the above proposals were approved and the results of the balloting at the meeting are summarized in the following table.

Proposal	Yes	No	Abstain	Broker Non-Votes	Total
(1)	3,132,380	-	30,900	66,430	3,229,710
(2)	3,151,050	11,600	630	66,430	3,229,710

Item 5. Other Information

None.

Item 6. Exhibits and Reports on form 8-K

None.

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SIGNATURE

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Simulations Plus, Inc.

Date: April 9, 2002

By: /s/ MOMOKO BERAN

Momoko Beran  
Chief Financial Officer