SIMULATIONS PLUS INC
Form 10QSB
July 14, 2003

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 May 31, 2003 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	95-4595609
(State or other jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

1220 W. AVENUE J
LANCASTER, CA 93534
(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 [X] No [ ]

The number of shares outstanding of the Issuer's common stock, par value $0.001 per share, as of July 14, 2003, was 3,411,881.

SIMULATIONS PLUS, INC.
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FOR THE QUARTERLY PERIOD ENDED MAY 31, 2003

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Item 1. Financial Statements

SIMULATIONS PLUS, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEET
May 31, 2003
(Unaudited)

ASSETS	
Current assets:	
Cash and cash equivalents (note 2)	$ 103,600
Accounts receivable, net of allowance for doubtful accounts of $23,643	845,164
Inventory (note 3)	197,352
Prepaid expenses	46,313
Total current assets	1,192,429

Capitalized computer software development costs, net of accumulated amortization (note 4)	348,588
Furniture and equipment, net (note 5)	83,560
Other assets	10,150
Total assets	$ 1,634,727
LIABILITIES AND SHAREHOLDER'S EQUITY	
Current liabilities:	
Accounts payable	80,682
Accrued payroll and other expenses	246,455
Accrued warranty and service costs	42,698
Current portion of deferred income	18,616
Current portion of capitalized lease obligations	9,551
Total current liabilities	398,002
Deferred income	34,255
Capitalized lease obligations, net of current portion	2,673
Total liabilities	434,930
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 3,411,881 (note 6)	3,412
Additional paid-in capital	4,659,429
Accumulated deficit	(3,463,044)
Total shareholders' equity	1,199,797
Total liabilities and shareholders' equity	$ 1,634,727

The accompanying footnotes are an integral part of these statements.

SIMULATIONS PLUS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS
For the three and nine months ended May 31, 2003 and 2002
(Unaudited)

	Three months ended		Nine months ended	
	05/31/03	05/31/02	05/31/03	05/31/0
Net sales	$ 1,260,592	$ 1,119,967	$ 3,458,137	$ 3,233,8

Cost of sales	414,299	373,064	1,118,892	1,078,7
Gross profit	846,293	746,903	2,339,245	2,155,1
Operating expenses:				
Selling, general & administration	540,183	540,337	1,639,110	1,534,7
Research and development	73,801	94,929	264,984	270,4
Total operating expenses	613,984	635,266	1,904,094	1,805,2
Income from operations	232,309	111,637	435,151	349,9
Other income (expenses):				
Interest income	37	1	72	
Interest expense	(3,046)	(2,601)	(5,674)	(12,4
Gain (loss) on sale of assets	(2,312)	0	(2,312)	
Income before provision for income taxes	226,988	109,037	427,237	337,4
Provision for income taxes	0	0	0	
Net income	$ 226,988	$ 109,037	$ 427,237	$ 337,4
Basic net income per common share	$ 0.07	$ 0.03	$ 0.13	$ 0.
Diluted net income per common share	$ 0.06	$ 0.03	$ 0.11	$ 0.
Basic weighted average # of common shares outstanding	3,411,390	3,408,331	3,409,527	3,408,3
Diluted weighted average # of common shares outstanding	3,716,906	3,408,331	3,716,906	3,408,3

The accompanying footnotes are an integral part of these statements.

SIMULATIONS PLUS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the nine months ended May 31, 2003 and 2002
(Unaudited)

	Nine months ended	
	05/31/03	05/31/02
Cash flows from operating activities:		
Net Income	$ 427,237	$ 337,474
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization of furniture and equipment	33,379	43,310

Amortization of capitalized software development costs	114,142	101,034
(Increase) decrease in:		
Accounts receivable	83,073	(194,147)
Inventory	11,253	(18,097)
Other assets	(6,600)	(65)
Increase (decrease) in:		
Accounts payable	(65,016)	(161,905)
Deferred revenue	(4,605)	(5,836)
Accrued expenses	(63,309)	4,471
Accrued payroll for officers	(198,916)	24,833
Accrued bonuses	(54,057)	0
Accrued warranty and service costs	11,702	(2,186)
Net cash provided by operating activities	288,283	128,886
Cash flows from investing activities:		
Purchase of furniture and equipment	(56,059)	(13,105)
Proceeds from the sale of equipment	1,559	
Capitalized computer software development cost	(161,955)	(90,697)
Net cash used in investing activities	(216,455)	(103,802)
Cash flows from financing activities:		
Payments on line of credit, net	0	(98,959)
Payments on capitalized lease obligations	(8,976)	(9,731)
Proceeds from exercise of stock options	4,676	0
Net cash provided by (used in) financing activities	(4,300)	(108,690)
Net increase (decrease) in cash	67,528	(83,606)
Cash and cash equivalents, beginning of period	36,072	166,652
Cash and cash equivalents, end of period	$ 103,600	$ 83,046

The accompanying footnotes are an integral part of these 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. (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

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: INVENTORY

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

Note 4: CAPITALIZED COMPUTER SOFTWARE DEVELOPMENT COSTS

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.

Note 5: FURNITURE AND EQUIPMENT

Furniture and equipment as of May 31, 2003 consisted of the following:

Equipment	$ 135,961
Computer equipment	327,855
Furniture and fixtures	52,704
Leasehold improvements	38,215
	554,735
Less accumulated depreciation	(471,175)
	$ 83,560

Note 6: STOCKHOLDERS' EQUITY

STOCK OPTION PLAN

In September 1996, the Board of Directors adopted and the shareholders approved the 1996 Stock Option Plan (the "Option Plan") pursuant to which a total of 250,000 shares of common stock were reserved for issuance. In March 1999, the shareholders approved an increase in the number of shares that may be granted under the Option Plan to 500,000. In February 2000, the shareholders approved the number of shares to be granted under the Option Plan to be 1,000,000 shares. Furthermore, in December 2000, the shareholders approved an increase in number of shares that may be granted under the Option Plan to 1,250,000. The Option Plan terminates in 2006, subject to earlier termination by the Board of Directors.

As of May 31, 2003, 1,120,928 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 6,206 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. As of today, 4,850 options have been exercised.

Note 7: REVENUE RECOGNITION

The Company recognized revenues related to software licenses and software maintenance in accordance with the American Institute of Certified Public Accountants ("AICPA") Statements of Position No. 97-2, "Software Revenue Recognition." Product revenue is recorded at the time of shipment, net of estimated allowances and returns. Post-contract customer support ("PCS") obligations are insignificant; therefore, revenue for PCS is recognized at the time of shipment, and the costs of providing such support services are accrued and amortized over the obligation period. The Company provides, for a fee, additional training and service calls to its customers and recognizes revenue at the time the training or service call is provided.

Note 8: INCOME TAXES

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

Note 9: EARNINGS PER SHARE

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

Note 10: LINE OF BUSINESS

For internal reporting purposes, management segregates the Company into two divisions as follows for the nine months and three months ended May 31, 2003 and 2002:

May 31, 2003

	Simulations Plus, Inc.	Words +, Inc.	Eliminations	Total
Net Sales	1,703,358	1,754,779		3,458,13
Income (loss) from operations	549,225	(114,074)		435,15
Identifiable assets	1,857,184	728,126	(950,583)	1,634,72
Capital expenditures	35,231	20,827		56,05
Depreciation and amortization	109,018	38,503		147,52

May 31, 2002

	Simulations Plus, Inc.	Words +, Inc.	Eliminations	Total
Net Sales	1,448,288	1,785,589		3,233,87
Income (loss) from operations	475,591	(138,117)		337,47
Identifiable assets	1,317,467	617,008	(589,051)	1,345,42
Capital expenditures	9,570	3,535		13,10
Depreciation and amortization	122,676	21,668		144,34

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

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 May 31, 2003 (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 differences 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

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 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.

DESCRIPTION OF SIMULATION AND MODELING SOFTWARE

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 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.

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. In 2002, the Company released a module called PDPlus(TM), which extends the utility of GastroPlus into pharmacodynamic modeling, which is the modeling of how a drug affects the body in terms of both therapeutic effect and adverse side effects. This extended the market for GastroPlus into Clinical Pharmacology departments in addition to the use it already enjoys in early discovery and middle development. Recent developments have focused on improving the physiological model within GastroPlus and adding the ability to simulate enterohepatic recirculation, which occurs when a drug is absorbed into the blood, but is then removed by the liver and secreted back into the intestinal tract via the gall bladder, only to be absorbed again. Such behavior occurs often enough to warrant adding it to the core simulation.

A second type of software consists of statistically significant models that allow prediction of various properties of a chemical compound from just its molecular structure. These models are not simulations, but instead are formed from a variety of mathematical functions and relationships, including linear, nonlinear, and artificial neural network models.

The Company's QMPRPlus(TM) program is the second type of program, and it

provides estimates for the values of several important physicochemical characteristics of new drug-like molecules with only the structures of the molecules as input. An optional module for this program predicts permeability in a special line of cells called MDCK cells. This predictive model was developed under a funded collaboration with the Affymax Research Institute, at that time a division of Glaxo Wellcome. During 2002, the Company announced the release of a powerful "4D Data Mining" module for QMPRPlus, which further extends the utility of the software through enhanced data visualization and statistical analysis. Both the MDCK module and the 4D Data Mining module are additional-cost options to the program. Recent developments have included adding a prediction of the fraction of standard dose sizes that would be absorbed, based on a small simulation, and the addition of the prediction of ionization constants ("pKa's") for molecules.

GastroPlus and QMPRPlus are used by almost every major and a number of smaller pharmaceutical companies in the U.S., Europe, and Japan. The number of licensee continues to grow each quarter, and revenues reflect the cumulative effect of annual license renewals added to new sales.

The Company is now completing the development of one new core product called QMPRchitect(TM), and is conducting research toward a new additional-cost module for GastroPlus called PBPKPlus(TM).

PBPKPlus will be a module for GastroPlus that will enable the program to simulate the distribution of drug to various tissues in the body, such as brain, heart, lungs, pancreas, liver, spleen, and reproductive organs. The ability to integrate such detail into GastroPlus will enable researchers to more accurately predict the pharmacokinetic effects (what happens to the drug when it gets into the body) and the pharmacodynamic effects (what happens to the body when the drug gets into the body) of new drugs and new dosing regimens.

QMPRchitect will allow users to build their own ensemble artificial neural network models using a highly sophisticated, state-of-the-art model-building engine that automates the process of finding the most effective artificial neural network models for a particular database, using the fast descriptor engine that is part of QMPRPlus to generate the inputs needed to build the model. In-house testing of QMPRchitect has demonstrated a reduction in the time required to build very high quality ensemble artificial neural network (i.e., multiple artificial neural networks whose outputs are averaged) from 60-90 days to as little as a single day. This significant reduction in both labor and calendar time is expected to revolutionize artificial neural network model building for structure-to-property predictions. Initial customer presentations in the U.S., Europe, and Japan have received very enthusiastic responses. Although the company expected to complete the development of QMPRchitect in the third quarter, a rewrite of the software to eliminate the dependence on a third-party software supplier and to speed up the program was undertaken in mid-May. This effort has been successful, resulting in complete elimination of the need for any third-party software, as well as eliminating the costs associated with them. In addition, the speed of the program has been enhanced significantly, with run times reduced by a factor of 40-50 over the previous version for the largest data sets.

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, universal gravitation, ideal gases, 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 have continued

through distributors in the U.S., U.K. Australia, and New Zealand.

PRODUCTS

The Company's pharmaceutical software products provide cost-effective solutions to a number of critical problems in pharmaceutical research, and also serve in the education of pharmacy and medical students. The Company's pharmaceutical 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 world's largest pharmaceutical companies and a steadily growing number of smaller companies have licensed the software. Some of these companies have merged to become single companies (e.g., AstraZeneca and GlaxoSmithKline, Pfizer and Parke-Davis, and soon, Pfizer and Pharmacia), 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 as divisions who had the software demonstrate its use to those who did not.

The 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 PDPlus(TM) Module was released during the 4th quarter of last fiscal year.

The majority of new sales now include these additional extra-cost modules, contributing significantly to the company's demonstrated revenue and earnings 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 Property 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 generated by 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. 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, ultra 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 data from nearly 60 laboratory experiments to measure the intestinal permeability of drug compounds in human and/or rat small intestines. As a part 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. The Company believes that the strategic advantage of exclusive access to TSRL's database, technology and expertise, combined with the Company's now well-developed expertise in absorption, pharmacokinetics, and pharmacodynamics simulation, have resulted in GastroPlus becoming the de facto standard for oral drug absorption simulation and analysis within the pharmaceutical industry. The Company is aware that other companies have developed competitive software; however, based on customer feedback, management believes there is no significant competition for GastroPlus at this time. The Company believes that the addition of the Metabolism and Transporter Module last year, the recently released PDPlus module, and ongoing upgrades of the core simulation are advances in the state-of-the-art of oral drug absorption, pharmacokinetics, and pharmacodynamics analysis. The PBPKPlus module now in development will further extend the utility of GastroPlus within the industry. 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 30 prestigious scientific meetings worldwide in the past two years, and they continue to be invited to present at a variety of meetings worldwide. The Company conducts contracted studies for a number of customers who prefer to have the studies run by the Company's scientists rather than to acquire the software and train someone to use it.

CONTRACT RESEARCH SERVICES

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 a variety of pharmaceutical and biotechnology 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 recently completed two study contracts to analyze drugs that are now in clinical trials. A services contract with a major pharmaceutical company was recently signed. This company has numerous software licenses, but desires additional consultation assistance from Company scientists with certain complex simulation problems.

PHARMACEUTICAL SIMULATIONS SOFTWARE PRODUCT DEVELOPMENT

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

(1) PBPKPlus(TM) Module

The PBPKPlus Module for GastroPlus is in early development now. This module will enable researchers to predict the amount of drug that reaches different body tissues and organs, enabling more accurate estimation of therapeutic and adverse effects for different dosing regimens. 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 PBPK (physiologically based pharmacokinetic) and PD (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 PBPKPlus integrated with the sophisticated absorption model in GastroPlus, researchers will be able to perform more accurate simulations and analyses to better understand how a drug partitions from the blood into different tissues and organs. Without the ability to predict these effects, clinical trial costs can soar when trials must be repeated to determine proper dosing levels. The Company expects to release this additional-cost module later this year.

(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) DDDPlus(TM)

The DDDPlus project was originally begin in 2000, and has proceeded at a slow pace since, in between other higher priority projects. DDDPlus (Dose Disintegration and Dissolution Plus) will simulate the in vitro disintegration and dissolution of various forms of capsules and tablets, and will include the effects of a variety of formulation excipients (additives that are not the actrive drug, but which give a capsule or tablet desirable roperties such as longer shelf life, better large-scale processing behavior, better disintegration and dissolution, etc.). This tool will be a valuable asset for formulation scientists as they search for optimum formulations that provide desirable properties at minimum cost.

(4) QMPRPlus(TM) upgrades

We continue to add new molecular descriptors and new predicted ADMET properties to QMPRPlus(TM). Last year we completed the development of a new, additional-cost "4D Data Mining" module.

The number of molecular descriptors has been increased in beta versions of

QMPRPlus by about 25%. These new descriptors include over 60 electrotopological indices that the Company believes will be valuable in building new models for pharmacokinetic and metabolism properties, as well as certain other descriptors that will be described at a later date. The company is now finalizing the next release of QMPRPlus, which will offer an additional-cost module for the predict of fraction absorbed at doses of 1, 10, 100, and 1000 milligrams. The next release will also offer another additional-cost module for the prediction of ionization constants ("pKa's") - an important property for which very few predictive software programs exist. The integration of pKa prediction with the other properties predicted by QMPRPlus will enhance its value and convenience and provide smoother transition from QMPRPlus to GastroPlus for early drug discovery.

(5) QMPRchitect(TM)

QMPRchitect is now in final testing and documentation. This new core product will allow researchers to build their own ensemble artificial neural network models from their own data using a highly sophisticated, state-of-the-art process for identifying critical descriptors and training ensemble artificial neural network models in the most efficient way. Users can have such new models included in the output of QMPRPlus along with the existing predicted ADME properties. Through the automation provided in the proprietary software for this module, we have demonstrated a reduction in the time to build high quality ensemble artificial neural network models from many weeks to hours or days. The company has received strong indications of interest from customers for this new capability. The Company expects to release this new core product during the fourth fiscal quarter.

DISABILITY PRODUCT DEVELOPMENT

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 Windows XP version of the Company's Talking Screen software has just been completed at the time of this writing. 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

COMPARISON OF THREE MONTHS ENDED MAY 31, 2003 AND 2002.

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			
	05/31/03		05/31/02	
Net sales	$1,260	100.0%	$1,120	
Cost of sales	414	32.9	373	
Gross profit	846	67.1	747	
Selling, general and administrative	540	42.9	540	
Research and development	74	5.9	95	
Total operating expenses	614	48.7	635	
Income from operations	232	18.4	112	
Interest expense	(3)	(0.2)	(3)	
Loss on sale of assets	(2)	(0.2)	0	
Net income	$227	18.0%	$109	

NET SALES

Consolidated net sales increased $140,000, or 12.5%, to $1,260,000 in the third fiscal quarter of 2003 from $1,120,000 in the third fiscal quarter of 2002. Simulations Plus, Inc.'s sales from pharmaceutical and educational software increased approximately $110,000, or 21.9%; and Words+ net sales for the third quarter increased approximately $30,000, or 4.9% compared to the third quarter of fiscal 2002. The increase in the 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 increase in Words+ sales primarily to a contract with Intel to develop a Windows XP-compatible version of the 1985 Words+ Equalizer software for Professor Steven Hawking and an increase in TuffTalker sales with the new Windows XP version of our Talking Screen software.

COST OF SALES

Consolidated cost of sales increased $41,000, or 11.0%, to $414,000 in the third fiscal quarter of 2003 from $373,000 in the third fiscal quarter of 2002. The percentage of cost of sales decreased by 0.4%. For Simulations Plus, the cost of sales decreased $1,000, or 0.2%. Cost of sales as a percentage of revenues decreased by 3.0%. Management attributes the decrease in the cost of sales primarily to a decline in royalty expense due to the fact that more sales were generated from additional modules for GastroPlus, and sales of QMPRPlus, which are not subject to the royalty that is paid on the core GastroPlus product, compared to the sales mix in the third fiscal quarter of 2002. For Words+, the cost of sales increased $42,000 or 14.3%; and in term of the percentage of cost

of sales, it increased by 4.4%. Approximately $19,000 in Production wages was understated erroneously in the 3rd fiscal quarter of 2002. It was posted into the account of General & Administrative salaries & wages. Restating this error, the percentage of cost of sales for the 3rd fiscal quarter of 2002 would be 51.1%, resulting in a 1.4% increase, which reflects the changes in product mix sold. The percentage of sales generated by product items with lower profit

margins was greater than for items with higher profit margins.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

There was no change in consolidated selling, general and administrative expenses between the third fiscal quarters of 2003 and 2002. For Simulations Plus, selling, general and administrative expenses increased $43,000, or 25.1% primarily due to increases in travel expense, investor relations fees, which began in the last fiscal quarter of this year, a transfer of administrative personnel wages from Words+ to Simulations Plus for internal tracking purposes, and payroll-related expenses such as 401(k) and payroll taxes. For Words+, expenses decreased $43,000, or 11.7%, due to decreases in administrative personnel wages, depreciation expense, travel expense, trade shows, and building repairs. Although there were increases in commission expense and insurance expense, overall decreases in expenses outweighed increases.

RESEARCH AND DEVELOPMENT

The Company incurred approximately $149,000 of research and development costs for the two companies during the third quarter of 2003. Of this amount, $75,000 was capitalized and $74,000 was expensed in this period. In the third quarter of 2002, the Company incurred $129,000 of research and development costs, of which $34,000 was capitalized and $95,000 was expensed. The increase of $20,000, or 15.5%, in research and development expenditure from the third quarter of 2002 to the third quarter of 2003 was primarily due to a new hire and a small increase in wages and payroll-related expenses.

INTEREST EXPENSE

Interest expense for the third fiscal quarters of 2003 and 2002 were the same. Interest expenses represent payments for long-term leases.

NET INCOME (LOSS)

The consolidated net income for the three months ended May 31, 2003 increased by $118,000, to a profit of $227,000 in the third fiscal quarter of 2003 compared to a profit of $109,000 in the third fiscal quarter of 2002. Management attributes this increase primarily to strong increases in sales, while maintaining fixed costs such as selling, general and administrative expenses.

COMPARISON OF NINE MONTHS ENDED MAY 31, 2003 AND 2002.

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.)

	Nine Months Ended		
	05/31/03		05/
Net sales	$3,458	100.0%	$3,234
Cost of sales	1,119	32.4	1,079
Gross profit	2,339	67.6	2,155

Selling, general and administrative	1,639	47.4	1,535
Research and development	265	7.7	270
Total operating expenses	1,904	55.1	1,805
Income from operations	435	12.6	350
Interest expense	(6)	(0.2)	(13)
Loss on sales of assets	(2)	(0.1)	0
Net income	$427	12.3%	$337

NET SALES

Consolidated net sales increased $224,000 or 6.9%; to $3,458,000 for the nine months ended May 31, 2003 compared to $3,234,000 for the nine months ended May 31, 2002. Simulations Plus, Inc.'s sales increased approximately $255,000, or 17.6%; however Words+, Inc.'s sales decreased approximately $31,000, or 1.7% for the nine months ended May 31, 2003. Management attributes the increase in pharmaceutical software sales partially to a Roche order in November for a new product package called the "ADME Partners" program, which provides virtually unlimited licenses for the use of GastroPlus, QMPRPlus and all modules coupled with product training and consultation for one year. Additionally, the average order size has increased with new orders and renewals from existing customers due to additional module licenses. Management attributes the decrease in Words+ sales primarily to the delay in development of Talking Screen for Windows XP, which was completed at the end of the second quarter of FY03, as well as overall slowing in the economy during this time period. The company began receiving revenue from Talking Screen in the 3rd fiscal quarter of 2003.

COST OF SALES

Consolidated cost of sales increased $40,000, or 3.7%, to $1,119,000 in the third fiscal quarter of 2003 from $1,079,000 in the third fiscal quarter of 2002. As a percent of total revenues, cost of sales decreased by 1.0%. For Simulations Plus, the cost of sales decreased $1,000, or 0.5%. As a percent of revenues, cost of sales decreased by 2.2%. A significant portion of the cost of sales was amortization of capitalized software development costs, which produced

a 2.4% decrease; however, this decrease was partially offset by an increase in royalty cost. For Words+, the cost of sales increased $41,000, or 4.6%. Expressed as a percentage of sales, the change in cost of sales for Words+ between the nine months operations ended May 31, 2003 and 2002 was an increase of 3.1%. Management attributes this percentage increase for Words+ primarily to decreased sales of higher margin items and increased sales of lower margin items during the first nine months of FY 2003. It is also due to the fact that sales through governmental funding (e.g., Medicare, Medicaid) increased in proportion to total sales. Governmental funding requires significant discounts, resulting in a higher cost of sales.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Consolidated selling, general and administrative expenses increased $104,000, or 6.8%, to $1,639,000 for the nine months ended May 31, 2003 from $1,535,000 for the nine months ended May 31, 2002. For Simulations Plus, selling, general and administrative expenses increased $193,000, or 38.8% primarily due to increases in commissions paid in accordance with an exclusive alliance agreement, new

investor relations and public relations services, transfer of administrative personnel wages from Words+, general increases in salaries over last year, payroll related expenses, and health insurance expenses. These increases outweighed decreased expenses for depreciation and legal/accounting fees. For Words+, expenses decreased $89,000, or 8.6%, due primarily to transfer of administrative personnel wages to Simulations Plus, payroll related expenses, decreases in travel expenses, trade shows, catalogs, depreciation expense, and building repairs. These decreases outweighed increases in commission expenses, health insurance, rent and utilities.

RESEARCH AND DEVELOPMENT

The Company incurred approximately $427,000 of research and development costs for both companies for the nine months ended May 31, 2003. Of this amount, $162,000 was capitalized and $265,000 was expensed in this period. In the same period of 2002, the Company incurred $354,000 of research and development costs, of which $84,000 was capitalized and $270,000 was expensed. The increase of $73,000, or 20.6% in research and development expenditures for the nine months ended May 31, 2003 compared to the same period of 2002 was due to a new hire, payroll increases for existing staff members, and costs associated with a project to develop a Windows XP version of our 1985 Equalizer software under contract with Intel for Professor Steven Hawking.

INTEREST EXPENSE

Interest expense for the nine months ended May 31, 2003 decreased by $7,000, or 53.8%, to $6,000 for the nine months ended May 31, 2003 from $13,000 for the nine months ended May 31, 2002. This decrease is attributable primarily to a decrease in interest on the Company's revolving line of credit, and the completion of payments on one lease.

NET INCOME

Net income for the nine months ended May 31, 2003 increased by $90,000, or 26.7%, to $427,000 for the nine months ended May 31, 2003 compared to $337,000 for the nine months ended May 31, 2002. Management attributes this increase primarily to the significant increase in pharmaceutical software and services revenues while maintaining expenses relatively low with respect to revenue increases.

LIQUIDITY AND CAPITAL RESOURCES

The Company's principal sources of capital have been cash flows from its operations and a bank line of credit. The Company has available a $500,000 revolving line of credit from a bank. Interest is payable on a monthly basis at the bank's prime rate plus 1.5%. At May 31, 2003, the outstanding balance under the revolving line of credit was zero. The revolving line of credit is secured by the Company's assets consisting of tangible personal property (except goods in transit) located or domiciled at the Company's address.

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 were repaid at time as

management deemed the Company's cash flow and cash reserves were sufficient to make such payments without adverse effects to the Company's financial position. All such accrued and unpaid salaries due to the Company's executive officers were repaid as of May 31, 2003.

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 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.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 2. Changes in Securities

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

None

(b) Reports on Form 8-K

None.

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.

Date: July 14, 2003

Simulations Plus, Inc.

By: /s/ Momoko Beran

Momoko Beran
Chief Financial Officer

STATEMENT PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002
BY
PRINCIPAL EXECUTIVE OFFICER AND PRINCIPAL FINANCIAL OFFICER
REGARDING FACTS AND CIRCUMSTANCES RELATING TO EXCHANGE ACT FILINGS

I, Walter Woltosz, certify that:
---

1. I have reviewed this quarterly report on Form 10-QSB of May 31, 2003;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its

consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 45 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: July 14, 2003

/s/ Walter Woltosz

Walter S. Woltosz
Chief Executive Officer

STATEMENT PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002
BY
PRINCIPAL EXECUTIVE OFFICER AND PRINCIPAL FINANCIAL OFFICER
REGARDING FACTS AND CIRCUMSTANCES RELATING TO EXCHANGE ACT FILINGS

I, Momoko Beran, certify that:
---

1. I have reviewed this quarterly report on Form 10-QSB of May 31, 2003;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 45 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: July 14, 2003

/s/ Momoko Beran

Momoko A. Beran
Chief Financial Officer

Item 6 (a) - Exhibit

Regulation FD Disclosure

On July , 2003, Simulations Plus, Inc. (the "Company" "we," us" or "our") filed our Quarterly Report on Form 10-QSB for the fiscal quarter ended May 31, 2002 (the "Report") with the Securities and Exchange Commission (the "Commission"). In connection with the filing of the Report, we have furnished the certifications set forth below to the Commission, to accompany the Report, as required by 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002:

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Walter S. Woltosz, Chief Executive Officer of Simulations Plus, Inc. (the "Company"), do hereby certify, in accordance with 18 U.S.C. Section 1350, as created pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) the Quarterly Report on Form 10-QSB of the Company for the third quarter ended May 31, 2003 (the "Report") fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Simulations Plus, Inc.

Dated: July 14, 2003

By: /s/ Walter S. Woltosz

Walter S. Woltosz
Chief Executive Officer

The foregoing certification is being furnished herewith solely to accompany the Report, pursuant to 18 U.S.C. 1350, and is not being filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and is not to be incorporated by reference into any filing of the Company with the Securities and Exchange Commission, whether filed prior to or after the furnishing of the foregoing certification, regardless of any general or specific incorporation language in any such filing.

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Item 6 (a) - Exhibit

Regulation FD Disclosure

On July , 2003, Simulations Plus, Inc. (the "Company" "we," us" or "our") filed our Quarterly Report on Form 10-QSB for the fiscal quarter ended May 31, 2003 (the "Report") with the Securities and Exchange Commission (the "Commission"). In connection with the filing of the Report, we have furnished the certifications set forth below to the Commission, to accompany the Report, as required by 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002:

CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Momoko A. Beran, Chief Financial Officer of Simulations Plus, Inc. (the "Company"), do hereby certify, in accordance with 18 U.S.C. Section 1350, as created pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) the Quarterly Report on Form 10-QSB of the Company for the third quarter ended May 31, 2003 (the "Report") fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Simulations Plus, Inc.

Dated: July 14, 2003

By: /s/ Momoko Beran

Momoko A. Beran
Chief Financial Officer

The foregoing certification is being furnished herewith solely to accompany the Report, pursuant to 18 U.S.C. 1350, and is not being filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and is not to be incorporated by reference into any filing of the Company with the Securities and Exchange Commission, whether filed prior to or after the furnishing of the foregoing certification, regardless of any general or specific incorporation language in any such filing.