SIMULATIONS PLUS INC
Form 10QSB
July 11, 2005

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, 2005 or

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

For the transition period from _____ to _____

Commission file number: 001-32046

SIMULATIONS PLUS, INC.
(Name of small business issuer in its charter)

CALIFORNIA	95-4595609
(State or other jurisdiction of Incorporation or Organization)	(I.R.S. Employer identification No.)

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

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

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

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

Yes x No

The number of shares outstanding of the Issuer's common stock, par value $0.001 per share, as of July 08, 2005, was 3,634,143.

SIMULATIONS PLUS, INC.
FORM 10-QSB
FOR THE QUARTERLY PERIOD ENDED MAY 31, 2005

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SIMULATIONS PLUS, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEET
AT MAY 31, 2005
(UNAUDITED)

ASSETS

CURRENT ASSETS

Cash and cash equivalents	$1,348,491
Accounts receivable, net of allowance for doubtful accounts of $18,884	1,392,912
Inventory (Note 7)	300,558
Prepaid expenses and other current assets	66,724
Deferred tax	186,000
Total current assets	3,294,685
CAPITALIZED COMPUTER SOFTWARE DEVELOPMENT COSTS, net of accumulated amortization of $2,095,062 (Note 4)	713,051
PROPERTY AND EQUIPMENT, net (Note 8)	88,401
DEFERRED TAX (Note 5)	1,160,000
OTHER ASSETS	11,150
TOTAL ASSETS	$5,267,287

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

SIMULATIONS PLUS, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEET
AT MAY 31, 2005
(UNAUDITED)

LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES	
Accounts payable	$ 182,283
Accrued payroll and other expenses	276,937
Accrued warranty and service costs	28,508
Current portion of deferred revenue	11,416
Other current liabilities	3,965
Total current liabilities	503,109
DEFERRED REVENUE	11,423
Total liabilities	514,532
COMMITMENTS AND CONTINGENCIES	--
SHAREHOLDERS' EQUITY (Note 10)	
Preferred stock, $0.001 par value	
10,000,000 shares authorized	
no shares issued and outstanding	--
Common stock, $0.001 par value	
20,000,000 shares authorized	
3,632,943 shares issued and outstanding	3,633

Additional paid-in capital	5,092,265
Accumulated deficit	(343,143)
Total shareholders' equity	4,752,755
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 5,267,287

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

SIMULATIONS PLUS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE AND NINE MONTHS ENDED MAY 31,
(UNAUDITED)

	Three months ended		
	2005	2004	2
NET SALES	$ 1,424,438	$ 1,233,220	$ 3,
COST OF SALES	428,266	382,731	1,
GROSS PROFIT	996,172	850,489	2,
OPERATING EXPENSES			
Selling, general, and administrative	644,502	622,005	1,
Research and development	134,007	117,972	
Total operating expenses	778,509	739,977	2,
INCOME FROM OPERATIONS	217,663	110,512	
OTHER INCOME (EXPENSE)			
Interest income	7,114	22,445	
Miscellaneous income	1,189	1,189	
Interest expense	(259)	(383)	
Gain (loss) on sale of assets	2,201	--	
Gain (loss) on currency exchange	(4,658)	--	
Total other income (expense)	5,587	22,062	
INCOME BEFORE BENEFIT FROM (PROVISION FOR) INCOME TAXES	223,250	132,574	

BENEFIT FROM (PROVISION FOR) INCOME TAXES			
Provision for income tax	(50,000)	--	
Total benefit from (provision for) income taxes	(50,000)	--	
NET INCOME	$ 173,250	$ 132,574	$
BASIC EARNINGS PER SHARE	$ 0.05	$ 0.04	$
Diluted earnings per share	$ 0.04	$ 0.03	$
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING			
BASIC	3,627,811	3,536,406	3,
DILUTED	3,958,063	4,046,223	3,

The accompanying notes are an integral part of these financial statements

SIMULATIONS PLUS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED MAY 31,
(UNAUDITED)

	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 204,593	$ 230,896
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization of property and equipment	34,538	27,289
Amortization of capitalized software development costs	119,077	141,112
(Gain) on sale of assets	(7,401)	--
Deferred tax	50,000	--
(Increase) decrease in		
Accounts receivable	312,121	176,988
Inventory	58,032	(173,524)
Other assets	49,320	(81,514)
Increase (decrease) in		
Accounts payable	29,397	(43,436)
Accrued payroll and other expenses	58,933	44,835
Accrued bonuses to officers	(77,626)	(133,538)

Accrued income taxes	(1,600)	--
Accrued warranty and service costs	(3,988)	(8,125)
Deferred revenue	(8,562)	(12,162)
Net cash provided by operating activities	816,834	168,821
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(60,144)	(24,015)
Sale of property and equipment	10,972	4,084
Capitalized computer software development costs	(255,648)	(143,713)
Net cash used in investing activities	(304,820)	(163,644)
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments on capitalized lease obligations	--	(3,191)
Proceeds from the exercise of stock options	102,211	139,339
Net cash provided by financing activities	102,211	136,148

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

SIMULATIONS PLUS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED MAY 31,
(UNAUDITED)

Net increase in cash and cash equivalents	$ 614,225	$ 141,325
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	734,266	260,733
CASH AND CASH EQUIVALENTS, END OF QUARTER	$1,348,491	$ 402,058
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
INTEREST PAID	$ 543	$ 767
INCOME TAXES PAID	$ 1,600	$ 1,600

SUPPLEMENTAL SCHEDULE OF NON-CASH TRANSACTIONS

1 In FY04, Minolta copier with a zero book value was traded-in for a new Ricoh copier/printer. The remaining obligation of $8,177 was assumed by

the lessor of Ricoh copier/printer in the exchange for a higher per print cost.

2 In FY04, The Company purchased all of the rights, title, and interest in the Say-it! SAM augmentative communication device developed by SAM Communications, LLC, for 35,000 shares of Simulations Plus restricted common stock at $4.65 per share equal to the closing price on the date when the agreement was signed.

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

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

Note 1: GENERAL

As contemplated by the Securities and Exchange Commission under Item 310(b) of Regulation S-B, the accompanying financial statements and footnotes have been condensed and therefore do not contain all disclosures required by generally accepted accounting principles. The interim financial data are unaudited; however, in the opinion of Simulations Plus, Inc. ("we", "our"), the interim data include all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the results for the interim periods. Results for interim periods are not necessarily indicative of those to be expected for the full year.

Note 2: CRITICAL ACCOUNTING POLICIES

Our consolidated financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America. Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. These estimates and assumptions are affected by management's application of accounting policies. Actual results could differ from those estimates. Critical accounting policies for us include revenue recognition (see Note 3), accounting for capitalized software development costs (see Note 4), and accounting for income taxes (see Note 5).

Note 3: REVENUE RECOGNITION

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

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

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

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

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

Note 4: CAPITALIZED COMPUTER SOFTWARE DEVELOPMENT COSTS

Capitalized computer software development costs are capitalized in accordance with SFAS No. 86, "Accounting for the Cost of Computer Software to be Sold, Leased, or Otherwise Marketed". Capitalization of software development costs begins upon the establishment of technological feasibility and is discontinued when the product is available for sale. The establishment of technological feasibility and the ongoing assessment for recoverability of capitalized software development costs require considerable judgment by management including, but not limited to, technological feasibility, anticipated future gross revenues, estimated economic life, and changes in software and hardware technologies. Any changes to these estimates could materially impact the amount of amortization expense, research and development expense recognized in the consolidated statement of operations and the amount recognized as capitalized software development costs in the consolidated balance sheet.

Amortization of capitalized software development costs is provided on a product-by-product basis on the straight-line method over the estimated economic life of the products, which varies product to product, not exceeding five years. Management periodically compares estimated net realizable value by product with the amount of software development costs capitalized for that product to ensure the amount capitalized is recoverable through revenues. Any excess of development costs to expected net realizable value is expensed at that time.

We have reassessed economic life of our pharmaceutical software based on our actual experience, and we have determined that the estimated economic life of the products should be five years starting at September 1, 2004. Accordingly, we began amortizing the net book value of capitalized software development costs over a sixty-month period using the straight-line method. As a result, we

amortized our pharmaceutical software development costs for $18,615 in the third quarter of fiscal year 2005. If we had not changed our expected economic life, we would have amortized $38,366.

Note 5: INCOME TAX

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

Note 6: ACCOUNTS RECEIVABLE

We maintain an allowance for doubtful accounts for estimated losses that may arise if any of its customers are unable to make required payments. We specifically analyze the age of customer balances, historical bad debt experience, customer credit-worthiness, and changes in customer payments terms when making estimates of the uncollectability of our trade accounts receivable balances. If we determine that the financial conditions of any of its customers deteriorated, whether due to customer specific or general economic issues, increase in the allowance may be made. Accounts receivable are written off when all collection attempts have failed.

Our long-term receivables are discounted at the present value. The discount is amortized over the life of the receivable and recognized as interest income. As of May 31, 2005, the discount amount on such receivable was fully amortized and the receivables of $544,000 were collected in June 2005.

Note 7: INVENTORY

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

Note 8: PROPERTY AND EQUIPMENT

Furniture and equipment as of May 31, 2005 consisted of the following:

Equipment	$ 156,637
Computer equipment	298,510
Furniture and fixtures	52,704
Automobile	21,769
Leasehold improvements	38,215
Sub total	567,835
Less: Accumulated depreciation and amortization	(479,434)
Net Book Value	88,401

Note 9: STOCKHOLDERS' EQUITY

Stock Option Plan

In September 1996, the Board of Directors adopted and the shareholders approved the 1996 Stock Option Plan (the "Option Plan") pursuant to which a total of 250,000 shares of common stock were reserved for issuance. The shareholders approved additional 250,000 shares that may be granted under the Option Plan in March 1999, 500,000 shares in February 2000, and 250,000 shares in December 2000, thus a total of 1,250,000 shares can be granted under the Option Plan. The Option Plan terminates in 2006, subject to earlier termination by the Board of Directors. Furthermore, on February 18, 2005 at an annual shareholders meeting, the shareholders approved an additional 250,000 shares to be reserved for issuance under the 1996 Stock Option Plan.

As of May 31, 2005, options to purchase 972,687 shares have been issued and were outstanding to various employees at an exercise price equal to the fair market value of our stock price at the date of each grant, with five-year vesting periods. Also, in accordance with the by-laws of the corporation, a total of 8,206 options to purchase shares have been issued to the Board of Directors at exercise prices ranging from $1.20 to $5.25, with a three-year vesting period. During the first nine months of fiscal year 2005, 68,500 options were exercised by employees.

Note 10: EARNINGS PER SHARE

The Company utilizes SFAS No. 128, "Earnings per Share." Basic earnings (loss) per share is computed by dividing income (loss) available to common stockholders by the weighted-average number of common shares outstanding. Diluted earnings (loss) per share is computed similar to basic earnings (loss) per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential common shares had been issued and if the additional common shares were dilutive. Common equivalent shares are excluded from the computation if their effect is anti-dilutive. The Company's common share equivalents consist of stock options.

Note 11: STOCK-BASED COMPENSATION

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

The table below represents a reconciliation of the company's pro forma net

income giving effect to the estimated compensation expense related to stock options that would have been reported if the Company utilized the fair value method:

	Nine Months 2005	Ni
Net income		
As reported	$ 204,593	$
Stock based employee compensation cost, net of related tax effects, that would have been included in the determination of net income if the fair value method had been applied	(189,707)	
PRO FORMA NET INCOME (LOSS)	$ 14,886	$
Earnings (loss) per common share		
Basic – as reported	$ 0.05	$
Basic – Pro forma	$ 0.04	$
Diluted – as reported	$ 0.00	$
Diluted – Pro forma	$ 0.00	$

Note 12: SEGMENT AND GEOGRAPHIC REPORTING

The Company accounts for segments and geographic revenues in accordance with SFAS No. 131, "Disclosure about Segments of an Enterprise and Related Information." The Company's reportable segments are strategic business units that offer different products and services. Results for each segment and consolidated results are as follows for the nine months ended May 31, 2005 and May 31, 2004:

	May 31, 2005			
	Simulations Plus, Inc.	Words +, Inc.	Eliminations	
Net Sales	1,596,018	1,926,670		
Income (loss) from operations	110,661	100,022		
Identifiable assets	5,712,036	1,398,712	(1,793,461)	
Capital expenditures	6,733	53,411		
Depreciation and Amortization	10,065	24,473		

	May 31, 2004			
	Simulations Plus, Inc.	Words +, Inc.	Eliminations	
Net Sales	1,987,646	1,753,057		
Income (loss) from operations	478,182	(317,722)		
Identifiable assets	4,836,230	1,103,627	(1,594,926)	
Capital expenditures	3,447	20,568		
Depreciation and Amortization	11,181	16,108		

In addition, the Company allocates revenues to geographic areas based on the locations of its customers. Geographical revenues for the nine months ended May 31, 2005 and May 31, 2004 were as follows (in thousands):

	May 31, 2005				
	North America	Europe	Asia	Oceania	South America
Simulations Plus, Inc.	875	357	364	-0-	-0-
Words+, Inc.	1,698	159	53	17	-0-
Total	2,573	516	417	17	-0-

	May 31, 2004				
	North America	Europe	Asia	Oceania	South America
Simulations Plus, Inc.	900	560	528	-0-	-0-
Words+, Inc.	1,543	143	45	16	6
Total	2,443	703	573	16	6

Note 13: SUBSEQUENT EVENT

Since June 1, 2005, an additional 1,200 stock options to purchase shares have been exercised by employees.

On June 22, 2005, the Company issued 72,000 stock options to employees at an exercise price equal to the fair market value of our stock price at the date of grant.

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

FORWARD-LOOKING STATEMENTS

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

GENERAL

BUSINESS

Simulations Plus, Inc. (the "Company" or "Simulations Plus", or "we" or "our") and its wholly owned subsidiary, Words+, Inc. ("Words+") produce different types of products: (1) Simulations Plus, incorporated in 1996, develops and produces modeling and simulation software for use in pharmaceutical research and for education, and also provides contract research services to the pharmaceutical industry, and (2) Words+, founded in 1981, produces computer software and specialized hardware for use by persons with disabilities, as well as a personal productivity software program called Abbreviate! for the retail market.

SIMULATIONS PLUS

PRODUCTS

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

GastroPlus is a computer program that simulates how drugs are absorbed in the human gastrointestinal tract and in a number of standard laboratory animals. The simulation involves pharmacokinetics (what happens to the drug when it gets into the body) and pharmacodynamics (what happens to the body when the drug gets into the body). The basic absorption simulation has equations for the movement of the drug through the gastrointestinal tract, how fast it dissolves in the stomach and intestines, whether it is converted to a different molecular form by chemical reactions or by metabolism by enzymes in the gastrointestinal tract, and how fast it is absorbed through the intestinal wall into the blood stream.

With additional inputs, it also simulates the amount of drug in the blood plasma versus time, and how the drug affects the body, such as reducing pain, reducing blood pressure, reducing depression, and adverse side effects.

We believe GastroPlus is the "gold standard" for simulation of oral drug absorption in the pharmaceutical industry. In addition to virtually every major pharmaceutical company, recent sales have included a growing number of generic drug companies and drug delivery companies (companies that design the tablet or capsule for a drug compound that was developed by another company). Although these companies are considerably smaller than the pharmaceutical giants, they can also save considerable time and money using our software tools. We believe this part of the industry, which includes hundreds of companies, represents major growth potential for GastroPlus.

We are aware that other companies have developed competitive software; however, based on customer feedback, we believe that the competitive threat to GastroPlus is limited. We believe that the Metabolism and Transporter Module, the PDPlus module, and the ongoing upgrades we have made to the core simulation have been significant advances in the state-of-the-art of oral drug absorption, pharmacokinetics, and pharmacodynamics analysis.

The PBPKPlus(TM) module has been in extended beta testing for a number of months and we believe is now nearly ready to release. This powerful module will further extend the utility of GastroPlus within the industry by simulating the amount of drug reaching specific tissues in human and in laboratory animals. With the release of this new module, we have also incorporated a number of other major changes to the user interface and program capabilities. As a result, this release has been delayed longer than we had originally planned; however, we believe that this next version (GastroPlus 5.0) will be well worth the wait.

We announced the release of our fourth core product, DDDPlus (Dose Disintegration and Dissolution Plus), in February 2005. DDDPlus simulates how different tablets and capsules disintegrate and dissolve during in vitro (laboratory) dissolution experiments. The program also simulates the effects of changing formulation excipients (additives that are not the active drug), and changing the experimental apparatus and fluids used in the experiment. We believe this tool will be a valuable asset for formulation scientists as they search for optimum formulations that provide desirable properties at minimum cost, as well as optimum experimental conditions under which to measure disintegration and dissolution to best predict what will happen in human. The market for this tool includes hundreds of drug delivery companies as well as all pharmaceutical and biotech companies. Although a significant number of companies have been evaluating DDDPlus, no sales have been realized through the end of the third quarter. We remain confident that sales of DDDPlus licenses will begin to ramp up in the near future.

Our recognized expertise in oral absorption and pharmacokinetics is evidenced by the fact that our staff members have been invited speakers or presenters at over 40 prestigious scientific meetings worldwide in the past three years. We also conduct contracted studies for customers who prefer to have studies run by our scientists rather than to license our software and train someone to use it.

In addition to simulation software, we produce software that consists of statistically significant numerical models that predict various properties of chemical compounds from just their molecular structures. ADMET Predictor(TM) (formerly known as QMPRPlus(TM)) provides estimates for approximately 50

properties of new drug-like molecules with only their structures as input. The ability to predict many properties from just a structure drawing enables researchers to eliminate large numbers of compounds before expensive testing, saving considerable time and money.

Recent product improvements included an advanced prediction of ionization constants ("pKa's") for molecules, which tells chemists whether the molecules will ionize (add or give up hydrogen atoms) at different pH levels in the body. Ionization is especially important because it has a major effect on some other properties, like solubility. ADMET Predictor is now one of the few programs available in the world that provides accurate prediction of pKas, and we believe the predictive accuracy of the pKa model and the additional information regarding probabilities of various microspecies (different ionized forms of the molecule that exist in different proportions) provided by our approach in ADMET Predictor are unsurpassed.

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

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

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

ADMET Modeler(TM) (formerly QMPRchitect(TM)), was originally released in July of 2003. This powerful program is used to generate the predictive models used in ADMET Predictor in a small fraction of the time once required to build these models. For example, the six new toxicity models in ADMET Predictor were developed in a matter of a few weeks. Most of that time was spent in cleaning up the databases (which seem to always contain a number of errors). Prior to the availability of ADMET Modeler, we would have needed as much as three months for each one of the six models to obtain similar results, or a total of about 18 months. New toxicity models are in development at this time, and will be released as upgrades to ADMET Predictor as they are completed.

Pharmaceutical companies spend enormous amounts of money conducting a wide variety of experiments each year. Using such data to build predictive models provides a second return on investment; however, in the past, model-building has traditionally been a tedious activity that required a specialist. With ADMET Modeler, scientists with no model-building experience can use their own experimental data to quickly create very high quality predictive models. ADMET Modeler 1.0 was released just after the end of the third quarter. Prior to that release, we were still shipping the earlier QMPRchitect product.

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

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

CONTRACT RESEARCH SERVICES

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

PHARMACEUTICAL SIMULATIONS SOFTWARE PRODUCT DEVELOPMENT

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

(1) PBPKPlus(TM) Module

The PBPKPlus Module for GastroPlus was demonstrated at the American Association of Pharmaceutical Scientists conference in early November 2004. We had expected the module to be released for sale in the third quarter; however, release has been slipped to the fourth quarter. This powerful module enables researchers to predict the amount of drug that reaches different body tissues and organs. This is an important new capability because it is one of the most promising technologies for predicting human pharmacokinetics from animal data (pharmacokinetics refers to what happens to the drug after it enters the body). With actual human data, this capability will enable scientists to predict the concentration of drug in various body tissues, which should contribute to a better understanding of both therapeutic and adverse effects. Without the ability to predict these effects, clinical trial costs can soar when trials must be repeated to determine proper dosing levels. We believe the integration of the GastroPlus absorption model with a complete PBPK capability provides the most

comprehensive simulation capability currently available. This capability has been developed in response to customer requests from several of the largest pharmaceutical companies in the world, and two large companies have been involved in beta testing the new version.

(2) Multiple Particle Size Dissolution Model

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

(3) ADMET Predictor(TM) upgrades

We will continue to add new molecular descriptors and new predicted ADMET properties to ADMET Predictor. We announced the release of ADMET Predictor 1.0 in December 2004 with structure drawing depiction and six toxicity predictions, as well as improved pKa prediction and other user convenience improvements. We expect to add a number of user conveniences as well as additional toxicity models and prediction of other ADMET properties in the coming months. Further improvements were completed during the third quarter and we expect to release Version 1.2 during the fourth quarter.

RESULTS OF OPERATIONS

COMPARISON OF THREE MONTHS ENDED MAY 31, 2005 AND MAY 31, 2004.

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

	Three Months Ended		
	05/31/05		05/3
Net sales	$ 1,424	100%	$ 1,233
Cost of sales	428	30.1	383

Gross profit	996	69.9	850
Selling, general and administrative	645	45.3	622
Research and development	134	9.4	118
Total operating expenses	779	54.7	740
Income from operations	217	15.2	110
Other income	6	0.4	22
Net income before taxes	223	15.6	132
Provision for income taxes	50	3.5	-
Net income	$ 173	12.1%	$ 132

NET SALES

Consolidated net sales increased $191,000, or 15.5%, to $1,424,000 in the third fiscal quarter of 2005 (FY05) from $1,233,000 in the third fiscal quarter of 2004 (FY04). Our sales from pharmaceutical and educational software increased approximately $59,000, or 9.8%; and our Words+, Inc. subsidiary's sales increased approximately $132,000, or 20.9%, for the quarter. Management attributes the increase in pharmaceutical software sales primarily to the increase in new customers and additional module sales to the existing customers.

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

COST OF SALES

Consolidated cost of sales increased $45,000, or 11.8%, to $428,000 in the third fiscal quarter of FY05 from $383,000 in the third fiscal quarter of FY04. The percentage of cost of sales in the third fiscal quarter of FY05 decreased 1.0% from the third fiscal quarter of FY04. For Simulations Plus, cost of sales increased $5,000, or 7.4%. A significant portion of cost of sales is the systematic amortization of capitalized software development costs, which decreased $5,000, or 22.0%, while royalty expense increased by $10,000, or 22.4%, which represents royalty payments to TSRL. As a percentage, cost of sales

slightly decreased from 11.7% in FY04 to 11.5% in FY05. Management attributes this decrease in percentage of cost of sales primarily to a change in estimate of pharmaceutical software product life, which, based on our demonstrated product lives, we reassessed to be 5 years beginning with the first fiscal quarter of FY05. Thus, quarterly amortization of capitalized software development costs decreased even though there is an additional amortization expense for our newly released DDDPlus product beginning in this quarter.

For Words+, cost of sales increased $40,000, or 12.9%. As a percentage, cost of sales decreased 3.3% between the third fiscal quarter of FY05 and FY04. Management attributes the percentage decrease in cost of sales for Words+

primarily to the price increases instituted as part of our restructuring of Words+ in fiscal year 2004.

GROSS PROFIT

Consolidated gross profit increased $146,000, or 17.2%, to $996,000 in the third fiscal quarter of FY05 from $850,000 in the third fiscal quarter of FY04. Management attributes this increase to sales increases in both pharmaceutical software and Words+ products along with improvement in profit margin on Words+ products.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Consolidated selling, general and administrative expenses increased $23,000, or 3.7%, to $645,000 in the third fiscal quarter of FY05 from $642,000 in the third fiscal quarter of FY04. For Simulations Plus, selling, general and administrative expenses increased $78,000, or 30.6%. The major increases in expenses were selling expenses, such as commissions to dealers, trade shows, and travel, equipment lease, salary for an added employee in Marketing department, and payroll taxes and insurances, which outweighed decreases in legal, accounting, and bank charges. Foreign taxes also decreased as the result of an enactment of a new tax treaty between the USA and Japan.

For Words+, expenses decreased $55,000, or 15.0%, due primarily to reductions in salaries and payroll-related expenses such as health insurance, payroll taxes and 401(k) matching contributions, which were all a part of the restructuring of Words+ in fiscal year 2004. These decreases outweighed increases in commissions, contract labor, and repairs.

RESEARCH AND DEVELOPMENT

We incurred approximately $191,000 of research and development costs for both companies during the third fiscal quarter of FY05. Of this amount, $57,000 was capitalized and $134,000 was expensed. In the third fiscal quarter of FY04, we incurred $172,000 of research and development costs, of which $51,000 was capitalized and $121,000 was expensed. The increase of $19,000, or 11.1%, in research and development expenditure from the third fiscal quarter of FY04 to the third fiscal quarter of FY05 was due primarily to the hiring of additional scientist/programmer for new product development and salary increases to existing staff.

OTHER INCOME (EXPENSE)

Net other income (expense) in the third fiscal quarter of FY05 decreased by $16,000. This is due primarily to the decrease in the amortization of present value discount on long-term receivables, which are fully amortized by the end of this fiscal quarter.

PROVISION FOR INCOME TAXES

We have estimated income tax provision of $50,000 approximately for the third quarter of FY05 while there was no provision for the third quarter of FY04.

NET INCOME

Consolidated net income for the three months' operations increased by $41,000,

or 31.1%, to $173,000 in the third quarter of FY05 compared to $132,000 in the third quarter of FY04. Management attributes this increase in profit primarily to the increases in both pharmaceutical software and Words+ product sales with improved profit margins, which outweighed increases in selling, general and administrative expenses, research and development expenses, income tax provision, and a decrease in other income.

COMPARISON OF NINE MONTHS ENDED MAY 31, 2005 AND MAY 31, 2004.

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

	Nine months Ended		
	05/31/05		05/3
Net sales	$ 3,523	100%	$ 3,741
Cost of sales	1,121	31.8	1,194
Gross profit	2,402	68.2	2,547
Selling, general and administrative	1,812	51.4	1,962
Research and development	379	10.8	415
Total operating expenses	2,191	62.2	2,377
Income from operations	211	6.0	170
Other income	44	1.2	61
Net income before taxes	255	7.2	231
Provision for income taxes	50	1.4	-
Net income	$ 205	5.8%	$ 231

NET SALES

Consolidated net sales decreased $218,000, or 5.8%, to $3,523,000 for the nine months ended May 31, 2005 compared to $3,741,000 for the nine months ended May 31, 2004. Our sales from pharmaceutical and educational software decreased approximately $392,000, or 19.7%; however, our Words+, Inc. subsidiary's sales increased approximately $174,000, or 9.9%, for the nine months. Management

attributes the decrease in pharmaceutical software sales primarily to the revenue we received from a two-year order worth just under $500,000 in FY04, which has not been duplicated in FY05. The amount of the new one-year global license order we received in FY05 from a different customer was less than the amount we received from the multi-year "ADME Partners" license in FY04. Although the amount of sales decreased, the number of new customers increased in FY05, so we expect an expansion in future annual license renewal revenues.

Management attributes the increase in Words+ sales primarily to the sales growth in our "Say-it! SAM" and "TuffTalker" products, which accounted for 36% of total sales in FY05, compared with 13% of total sales in FY04. This increase outweighed a decline in "Freedom" and "MessageMate" products.

COST OF SALES

Consolidated cost of sales decreased $73,000, or 6.1%, to $1,121,000 for the nine months of FY05 from $1,194,000 for the nine months of FY04. The percentage of cost of sales for FY05 is almost identical to that for FY04, decreasing 0.1%. For Simulations Plus, cost of sales decreased $78,000, or 30.4%. A significant portion of cost of sales is the systematic amortization of capitalized software development costs, which decreased $73,000, or 62% and royalty expense decreased by $5,000, or 4% which represents royalty payments to TSRL. As a percentage, cost of sales decreased from 13.0% in FY04 to 11.3% in FY05. Management attributes this decrease in percentage of cost of sales primarily to a change in estimate of pharmaceutical software product life, which, based on our demonstrated product lives, we reassessed to be 5 years beginning with the first fiscal quarter of FY05. Thus, nine months' amortization of capitalized software development costs decreased even though there is an additional amortization expense for the new DDDPlus product beginning in the third fiscal quarter of FY05.

For Words+, cost of sales increased $5,000, or 0.6%. As a percentage, cost of sales decreased 4.5% for the nine months operations between FY05 and FY04. Management attributes the percentage decrease in cost of sales for Words+ primarily to the price increases instituted as part of our restructuring of Words+ in fiscal year 2004.

GROSS PROFIT

Consolidated gross profit decreased $291,000, or 17.2%, to $1,405,000 in the first nine months of FY05 from $1,696,000 in the first nine months of FY04. Management attributes this decrease to lower pharmaceutical software sales which outweighed an increase in gross profit generated by Words+ products.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Consolidated selling, general and administrative expenses decreased $150,000, or 7.6%, to $1,812,000 in the first nine months of FY05 from $1,962,000 in the first nine months of FY04. For Simulations Plus, selling, general and administrative expenses increased $80,000, or 8.9%. The major increases in expenses were in the categories of selling expenses such as commissions and trade shows, equipment lease, investor relations fees, and salary increases along with payroll-related expenses such as health insurance, payroll taxes, and 401(k) matching contributions. These increases outweighed decreases in legal and accounting, printing, and workers compensation insurance.

For Words+, expenses decreased $230,000, or 21.6%, due to reductions in salaries and payroll-related expenses such as health insurance, payroll taxes and 401(k) matching contributions, commission, travel expenses and catalog expenses. These decreases outweighed increases in contract labor, equipment repair, and depreciation expenses.

RESEARCH AND DEVELOPMENT

We incurred approximately $635,000 of research and development costs for both companies during the first nine months of FY05. Of this amount, $256,000 was capitalized and $379,000 was expensed. In the first nine months of FY04, we incurred $722,000 of research and development costs, of which $307,000 was capitalized and $415,000 was expensed. The decrease of $87,000, or 12.1%, in research and development expenditure from the first nine months of FY04 to the first nine months of FY05 was due primarily to our purchase of the Say-it! SAM technology which was incurred in FY04, while no such expense was incurred in FY05. This decrease outweighed the salary increases in Research and Development.

OTHER INCOME (EXPENSE)

The net of other income (expense) in the first nine months of FY05 decreased by $17,000. The amortization of present value discount on long-term receivables decreased by $23,000. We recognized a loss of $2,000 on currency exchange and a gain of $7,000 on sale of equipment and $1,000 of miscellaneous revenue in the first nine months of FY05 while there were no such income and expenses in FY04.

PROVISION FOR INCOME TAXES

We have estimated income tax provision of $50,000 approximately for the first nine months of FY05 while there was no provision for the same period of FY04.

NET INCOME

Consolidated net income for the nine months' operations decreased by $26,000, or 11.3%, to $205,000 in the first nine months of FY05 compared to $231,000 in the first nine months of FY04. Management attributes this decrease in profit primarily to the decrease in sales and other income which outweighed the decreases in cost of sales, selling, general and administrative expenses, and research and development expenses.

LIQUIDITY AND CAPITAL RESOURCES

The Company's principal sources of capital have been cash flows from its operations and a bank line of credit. The Company did not renew a revolving line of credit for $500,000 from a bank because the Company did not use it during the prior year and did not expect to need it in the near future. The Company is considering re-applying for the line of credit when there is a need for it.

The Company believes that existing capital and anticipated funds from operations will be sufficient to meet its anticipated cash needs for working capital and capital expenditures for the foreseeable future. Thereafter, if cash generated from operations is insufficient to satisfy the Company's capital requirements, the Company may apply for a loan from a bank and may have to sell additional equity or debt securities or obtain expanded credit facilities. In the event such financing is needed in the future, there can be no assurance that such financing will be available to the Company, or, if available, that it will be in amounts and on terms acceptable to the Company. If cash flows from operations became insufficient to continue operations at the current level, and if no additional financing was obtained, then management would restructure the Company in a way to preserve its pharmaceutical and disability businesses while maintaining expenses within operating cash flows.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Our risk from exposure to financial markets is limited to foreign exchange variances and fluctuations in interest rates. We may be subject to some foreign exchange risks. Most of our business transactions are in U.S. dollars, although we generate significant revenues from customers overseas. The exception is that we were compensated in Japanese yen by some Japanese customers. As a result, we experienced a small loss from currency exchange in the first nine months of FY05. In the future, if foreign currency transactions increase significantly, then we may mitigate this effect through foreign currency forward contracts whose market-to-market gains or losses are recorded in "Other Income or expense" at the time of the transaction. To date, exchange rate exposure has not resulted in a material impact.

Item 4. Controls and Procedures

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

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

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:

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

SIGNATURE

In accordance with Section 13 or 15 (d) of the Securities Exchange Act of 1934, the Registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Lancaster, State of California, on July 08, 2005.

Simulations Plus, Inc.

Date: July 08, 2005 By: /s/ MOMOKO BERAN

Momoko Beran
Chief Financial Officer