SIMULATIONS PLUS INC
Form 10QSB
July 11, 2006

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-QSB

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

For the quarterly period ended May 31, 2006 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.)

42505 10TH STREET WEST
LANCASTER, CA 93534-7059
(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 11, 2006, was 3,704,748.

SIMULATIONS PLUS, INC.
FORM 10-QSB
FOR THE QUARTERLY PERIOD ENDED MAY 31, 2006

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PART I. FINANCIAL INFORMATION

SIMULATIONS PLUS, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEET
at May 31, 2006
(Unaudited)

ASSETS

CURRENT ASSETS	
Cash and cash equivalents (Note 3)	$1,099,182

Accounts receivable, net of allowance for doubtful accounts of $20,160 (Note 4)	1,571,312
Inventory (Note 5)	231,870
Prepaid expenses and other current assets	54,759
Current portion of deferred tax	83,000
Total current assets	3,040,123
CAPITALIZED COMPUTER SOFTWARE DEVELOPMENT COSTS, net of accumulated amortization of $2,342,391 (Note 4)	1,322,203
LONG TERM CONTRACTS RECEIVABLE, net of discounts of $6,787	294,373
PROPERTY AND EQUIPMENT, net (Note 6)	102,783
CUSTOMER RELATIONSHIPS (Note 13)	109,216
DEFERRED TAX	1,145,739
OTHER ASSETS	19,470
TOTAL ASSETS	$6,033,907

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

SIMULATIONS PLUS, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEET
at May 31, 2006
(Unaudited)

LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES	
Accounts payable	$ 159,410
Accrued payroll and other expenses	308,589
Accrued bonuses to officers	57,681
Accrued warranty and service costs	32,463
Current portion of deferred revenue	73,298
Other current liabilities	1,157
Total current liabilities	632,598
DEFERRED REVENUE	--
Total liabilities	632,598
COMMITMENTS AND CONTINGENCIES (Notes 7 and 12)	--
SHAREHOLDERS' EQUITY (Note 8)	
Preferred stock, $0.001 par value 10,000,000 shares authorized no shares issued and outstanding	--

Common stock, $0.001 par value	
20,000,000 shares authorized	
3,702,748 shares issued and outstanding	3,703
Additional paid-in capital	5,246,954
Retained Earnings	150,652
Total shareholders' equity	5,401,309
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$6,033,907

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

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	Three months ended		
	2006	2005	20
NET SALES	$ 1,788,284	$ 1,424,438	$ 4,0
COST OF SALES	433,496	428,266	1,1
GROSS PROFIT	1,354,788	996,172	2,9
OPERATING EXPENSES			
Selling, general, and administrative	795,547	644,502	2,1
Research and development	118,707	134,007	3
Total operating expenses	914,254	778,509	2,4
INCOME FROM OPERATIONS	440,534	217,663	4
OTHER INCOME (EXPENSE)			
Interest income	4,447	7,114	
Miscellaneous income	58	1,189	
Interest expense	(40)	(259)	
Gain on sale of assets	4,613	2,201	
Gain (loss) on currency exchange	10,076	(4,658)	

Total other income (expense)	19,154	5,587	
INCOME BEFORE BENEFIT FROM (PROVISION FOR) INCOME TAXES	459,688	223,250	5
BENEFIT FROM (PROVISION FOR) INCOME TAXES			
Provision for income tax	(73,550)	(50,000)	(
Change in valuation allowance	--	--	
Total benefit from (provision for) income taxes	(73,550)	(50,000)	(
NET INCOME	$ 386,131	$ 173,250	$ 4
BASIC EARNINGS PER SHARE	$ 0.10	$ 0.05	$
Diluted earnings per share	$ 0.09	$ 0.04	$
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING			
BASIC	3,695,771	3,627,811	3,6
DILUTED	4,113,033	3,958,063	4,0

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)

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 436,070	$ 204,593
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization of property and equipment	33,829	34,538
Amortization of customer relationships	18,826	--
Amortization of capitalized software development costs	202,022	119,077
(Gain) on sale of assets	(7,739)	(7,401)
(Increase) decrease in		

Accounts receivable	(320,658)	312,121
Inventory	49,530	58,032
Deferred tax	83,061	50,000
Other assets	17,925	49,320
Increase (decrease) in		
Accounts payable	68,369	29,397
Accrued payroll and other expenses	(88,911)	58,933
Accrued bonuses to officers	19,001	(77,626)
Accrued income taxes	(1,600)	(1,600)
Accrued warranty and service costs	4,724	(3,988)
Deferred revenue	(67,687)	(8,562)
Net cash provided by operating activities	446,762	816,834
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(51,979)	(60,144)
Purchase of Bioreason's assets	(826,192)	--
Proceed from sale of property and equipment	15,425	10,972
Capitalized computer software development costs	(341,957)	(255,648)
Net cash used in investing activities	(1,204,703)	(304,820)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from the exercise of stock options	103,081	102,211
Net cash provided by financing activities	103,081	102,211
Net increase (decrease) in cash and cash equivalents	$ (654,860)	$ 614,225
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	1,754,042	734,266
CASH AND CASH EQUIVALENTS, END OF QUARTER	$ 1,099,182	$ 1,348,491
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
INTEREST PAID	$ 40	$ 543
INCOME TAXES PAID	$ 1,600	$ 1,600

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

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

Note 1: GENERAL

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

Note 2: SIGNIFICANT ACCOUNTING POLICIES

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

Revenue Recognition

We recognize revenues related to software licenses and software maintenance in accordance with the American Institute of Certified Public Accountants ("AICPA") Statement of Position (SOP) No. 97-2, "Software Revenue Recognition." Product revenue is recorded at the time of unlocking the software on the customer's computer(s), net of estimated allowances and returns. Post-contract customer support ("PCS") obligations are insignificant; therefore, revenue for PCS is recognized at the same time, and the costs of providing such support services are accrued and amortized over the obligation period.

As a by-product of ongoing improvements and upgrades for our software, some modifications are provided to customers who have already licensed software at no additional charge. We consider these modifications to be minimal, as they are not changing the basic functionality or utility of the software, but rather adding convenience, such as being able to plot some additional variable on a graph in addition to the numerous variables that had been available before. Such software modifications for any single product have been typically once or twice per year, sometimes more, sometimes less. Thus, they are infrequent. We provide, for a fee, additional training and service calls to our customers and recognize such revenues at the time the training or service call is provided.

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

From time to time, we enter into multi-year license agreements. We believe our history of collection with these customers is sufficient to overcome the presumption that revenue should be recognized in time with the expected cash collections, and we have in the past therefore recognized the entire license fees, net of an applicable discount, at the time of the software's release and acceptance by the customer. Beginning with the current fiscal year, however, we have advised investors through our press releases and conference calls that we will unlock and invoice software one year at a time for future multi-year

licenses. This will eliminate the extreme variability in our reported revenues and earnings that we've experienced in the past.

Capitalized Computer Software Development Costs

Software development costs are capitalized in accordance with SFAS No. 86, "Accounting for the Cost of Computer Software to be Sold, Leased, or otherwise Marketed." Capitalization of software development costs begins upon the establishment of technological feasibility and is discontinued when the product is available for sale.

The establishment of technological feasibility and the ongoing assessment for recoverability of capitalized software development costs require considerable judgment by management with respect to certain external factors including, but not limited to, technological feasibility, anticipated future gross revenues, estimated economic life, and changes in software and hardware technologies. Capitalized software development costs are comprised primarily of salaries and direct payroll related costs and the purchase of existing software to be used in our software products.

Amortization of capitalized software development costs is provided on a product-by-product basis on the straight-line method over the estimated economic life of the products (not to exceed five years). Amortization of software development costs amounted to $202,022 and $119,077 for the nine months ended May 31, 2006 and 2005, respectively.

Management periodically compares estimated net realizable value by product with the amount of software development costs capitalized for that product to ensure the amount capitalized is not in excess of the amount to be recovered through revenues. Any such excess of capitalized software development costs to expected net realizable value is expensed at that time.

Income Taxes

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

The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns. Judgment is required in assessing the future tax consequences of events that have been recognized in our financial statements or tax returns. Fluctuations in the actual outcome of these future tax consequences could materially impact our financial position or our results of operations.

Principles of Consolidation

The consolidated financial statements include the accounts of Simulations Plus, Inc. and its wholly owned subsidiary, Words+, Inc. All significant intercompany accounts and transactions are eliminated in consolidation.

Comprehensive Income

We utilize Statement of Financial Accounting Standards ("SFAS") No. 130, "Reporting Comprehensive Income." This statement establishes standards for reporting comprehensive income and its components in a financial statement. Comprehensive income as defined includes all changes in equity (net assets) during a period from non-owner sources. Examples of items to be included in comprehensive income, which are excluded from net income, include foreign currency translation adjustments and unrealized gains and losses on available-for-sale securities. Comprehensive income is not presented in our financial statements since we did not have any of the items of comprehensive income in any period presented.

Concentrations and Uncertainties

International sales accounted for 37% and 27% of net sales for the third quarter of fiscal year 2006 (FY06) and 2005 (FY05), respectively. For Simulations Plus, Inc., three customers accounted for 25%, 25%, and 19% of net sales for the third quarter of FY06, and for Words+, Inc., one government agency accounted for 17% of net sales during the third quarter of FY06.

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

For consolidated accounts receivable, three customers comprised 17%, 13%, and 10% of accounts receivable at May 31, 2006, and one government agency accounted for 9% of total receivables. For Simulations Plus, four customers comprised 29%, 22%, 16%, and 12% of accounts receivable at May 31, 2006, comparing with three customers comprised 32%, 19% and 17% of accounts receivable at May 31, 2005. For Words+, one government agency accounted for 23% of accounts receivable at May 31, 2006 comparing with 25% at May 31, 2005.

Recently Issued Accounting Pronouncements

In December 2004, the FASB issued Statement of Accounting Standard No. 123R, "Share-Based Payment", a revision of SFAS No. 123, "Accounting for Stock-Based Compensation." SFAS 123R supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees." SFAS 123R requires all companies to measure compensation expense for all share-based payments (including employee stock options and options issued pursuant to employee stock purchase plans) based upon the fair value of the stock-based awards at the date of grant, and is effective for the Company for the fiscal year beginning after December 15, 2005. The impact of adoption of Statement 123R cannot be predicted at this time because it will depend on levels of share-based payments granted in the future.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections." This statement applies to all voluntary changes in accounting principles and requires retrospective application to prior periods' financial statements of changes in accounting principles, unless this would be impracticable. This statement also makes a distinction between "retrospective application" of an accounting principle and the "restatement" of financial statements to reflect the correction of an error. This statement is effective for accounting changes and corrections of errors made in fiscal years beginning

after December 15, 2005. The Company is evaluating the effect the adoption of this interpretation will have on its financial position, cash flows and results of operations.

Note 3: CASH AND CASH EQUIVALENTS

For purposes of the statements of cash flows, we consider all highly liquid investments purchased with original maturities of three months or less to be cash equivalents.

Note 4: ACCOUNTS RECEIVABLE

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

Our long-term receivables are discounted at the present value. The discount is amortized over the life of the receivable and recognized as interest income. The balance as of May 31, 2006 represents receivables which we purchased as a part of Bioreason's assets.

Note 5: INVENTORY

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

Note 6: PROPERTY AND EQUIPMENT

Furniture and equipment as of May 31, 2006 consisted of the following:

Equipment	$ 154,488
Computer equipment	311,287
Furniture and fixtures	57,705
Automobile	21,769
Leasehold improvements	56,888
Sub total	602,137
Less: Accumulated depreciation and amortization	(499,354)
Net Book Value	102,783

Note 7: COMMITMENTS AND CONTINGENCIES

Leases

We signed a new lease and moved to a new building on February 3, 2006. This lease has a five-year term with two (2), three (3) year options to extend.

Future minimum lease payments under the non-cancelable lease are as follows:

Fiscal Year	Lease Commitment
2006	$ 68,730
2007	281,335
2008	292,588
2009	304,292
2010	316,463

Employee Agreement

On August 9, 2005, the Company entered into an employment agreement with its President/CEO that expires in August 2007. The employment agreement provides for an annual salary of $172,000 and an annual bonus equal to 5% of the Company's net income before taxes, not to exceed $150,000. As of May 31, 2006, included in accrued bonuses to officers was $57,681, which represented 10% of the Company's net income before bonuses and taxes, payable to the Company's President, Walter Woltosz and Corporate Secretary, Virginia Woltosz as the annual bonuses.

The agreement also provides that the Company may terminate the agreement upon 30 days' written notice if termination is without cause. The Company's only obligation would be to pay its President the greater of a) 12 months salary or b) the remainder of the term of the employment agreement from the date of notice of termination.

Litigation

On April 6, we received a notice from a liquidator for the former French subsidiary of Bioreason, Bioreason SARL, saying that the liquidator has initiated legal action against Simulations Plus in the French courts with respect to ClassPharmer distribution rights to European customers, and is claiming commissions and legal fees with respect to European customers. We have been working through our U.S. attorneys and a law firm in Paris. We have claimed our rights against Bioreason SARL's assets by sending a debt recovery declaration to the liquidator on June 15, 2006. We believe the documentation from our purchase of certain secured assets of Bioreason clearly shows our rights to the disputed accounts. Although we are pursuing our rights aggressively, there can be no assurance that its outcome will be a favorable result to us.

Note 8: STOCKHOLDERS' EQUITY

Stock Option Plan

In September 1996, the Board of Directors adopted and the shareholders approved the 1996 Stock Option Plan (the "Option Plan") pursuant to which a total of 250,000 shares of common stock were reserved for issuance. The shareholders approved an additional 250,000 shares that may be granted under the Option Plan in March 1999, an additional 500,000 shares in February 2000, and an additional 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 September 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, 2006, options to purchase 930,242 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. The outstanding options reflect the cancellation of 110,345 shares, of which 78,945 shares were due to forfeiture because they were not exercised within their respective terms. Also, in accordance with the by-laws of the corporation, a total of 9,206 options to purchase shares have been issued to the Board of Directors at exercise prices ranging from $1.20 to $5.25, with a three-year vesting period. During the third quarter of FY06, 11,800 options were exercised by employees.

Note 9: EARNINGS PER SHARE

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

Note 10: STOCK-BASED COMPENSATION

In December 2004, the FASB issued Statement of Accounting Standard No. 123R, "Share-Based Payment", a revision of SFAS No. 123, "Accounting for Stock-Based Compensation." SFAS 123R supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees," and requires all companies to measure compensation expense for all share-based payments, including employee stock options, based upon the fair value of the stock-based awards at the date of grant. SFAS 123R will be effective for us for the year beginning September 1, 2006. For fiscal year 2006, we currently account for share-based payments to employees using APB 25's intrinsic value method as permitted; therefore we do not recognize any compensation cost for employee stock options. Entities electing to remain with the accounting method of APB 25 must make pro forma disclosures of net income and earnings per share, as if the fair value method of accounting defined in SFAS No. 123 had been applied. We have elected to account for our stock-based compensation to employees under APB 25.

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

	Nine Months FY 2006	Nine Months FY 2005
Net income (loss)		
As reported	$ 436,070	$ 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	(98,056)	(189,707)
PRO FORMA NET INCOME (LOSS)	$ 338,014	$ 14,886
Earnings (loss) per common share		
Basic – as reported	$ 0.12	$ 0.05
Basic – Pro forma	$ 0.09	$ 0.04
Diluted – as reported	$ 0.11	$ 0.00
Diluted – Pro forma	$ 0.08	$ 0.00

Note 11: SEGMENT AND GEOGRAPHIC REPORTING

We account for segments and geographic revenues in accordance with SFAS No. 131, "Disclosure about Segments of an Enterprise and Related Information." Our reportable segments are strategic business units that offer different products and services. Results for each segment and consolidated results are as follows for the nine months ended May 31, 2006 and May 31, 2005:

	May 31, 2006		
	Simulations Plus, Inc	Words +, Inc.	Eliminations
Net Sales	2,179,379	1,909,511	
Income from operations	328,600	160,448	
Identifiable assets	6,166,713	1,599,912	(1,732,718)
Capital expenditures	33,090	23,890	
Depreciation and Amortization	10,439	23,390	

	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		

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, 2006 and May 31, 2005 were as follows (in thousands):

	May 31, 2006				
	North America	Europe	Asia	Oceania	South America
Simulations Plus, Inc.	1,089	581	510	-0-	-0-
Words+, Inc.	1,631	215	37	17	9
Total	2,720	796	547	17	9

	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-

Note 12: PURCHASE OF BIOREASON'S ASSETS

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

The purchase price was allocated as it follows.

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

Note 13: SUBSEQUENT EVENT

Press Release

We announced preliminary results for our third fiscal quarter on Tuesday, June 20, followed by an 8K filing with the SEC on June 21, 2006.

Litigation

On April 6, 2006, we received a notice from a liquidator for the former French subsidiary of Bioreason, Bioreason SARL, saying that the liquidator has initiated legal action against Simulations Plus in the French courts with respect to ClassPharmer distribution rights to European customers, and is claiming commissions and legal fees with respect to European customers. We have been working through our U.S. attorneys and a law firm in Paris to aggressively pursue our rights. We have claimed our rights against the former Bioreason SARL's assets by sending a debt recovery declaration to the liquidator on June 15, 2006. We believe the documentation from our purchase of certain secured assets of Bioreason clearly shows our rights to the disputed accounts. Although we are pursuing our rights aggressively, there can be no assurance that its outcome will be a favorable result to us.

Item 2. Management's Discussion and Analysis or Plan of Operations
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FORWARD-LOOKING STATEMENTS

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

GENERAL

BUSINESS

Simulations Plus, Inc. (the "Company" or "Simulations Plus", or "we" or "our" or "us") and its wholly owned subsidiary, Words+, Inc. ("Words+") produce different types of products: (1) Simulations Plus, incorporated in 1996, develops and produces modeling and simulation software for use in pharmaceutical research and for education, and also provides contract research services to the pharmaceutical industry, and (2) Words+, founded in 1981, produces computer software and specialized hardware for use by persons with disabilities, as well as a personal productivity software program called Abbreviate! for the retail market. For the purposes of this document, we sometimes refer to the two businesses as "Simulations Plus" when referring to the business that is primarily pharmaceutical software and services, and "Words+" when referring to the business that is primarily assistive technologies for persons with disabilities.

Simulations Plus

PRODUCTS

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

ADMET MODELER

ADMET (Absorption, Distribution, Metabolism and Excretion and Toxicity) Modeler was first released in July of 2003. This powerful program is used to generate the predictive models used in ADMET Predictor in a small fraction of the time once required to build these models. For example, the new toxicity models were developed in a matter of a few hours once we completed the tedious effort of "cleaning up" the databases (which seem to always contain a number of errors). Prior to the availability of ADMET Modeler, we would have needed as much as three months after cleaning the databases for each new model to obtain similar results.

Pharmaceutical companies spend enormous amounts of money conducting a wide variety of experiments on new molecules each year. Using such data to build predictive models provides a second return on this investment; however, in the past, model-building has traditionally been a tedious activity that required a specialist. With ADMET Modeler, scientists without model-building experience can now use their own experimental data to create very high quality predictive models.

During the third quarter, a new version of ADMET Modeler was released. This version improves the support vector machine ensemble modeling to include classification models (e.g., high/medium/low classes for a predicted property) as well as regression models (i.e., models that predict a continuous numerical value for a property). In addition, the ability for scientists to see the sensitivity of the predictive models to the values of various molecular

descriptors used in the artificial neural network ensemble models was added. We believe this is a unique capability. In the past, some scientists were reluctant to use "black box" models employing powerful artificial neural network ensembles because they did not allow them to understand how modifying molecules would affect the predicted properties. With this new capability, scientists can now see an intuitive graphical representation of descriptor sensitivity.

ADMET PREDICTOR

ADMET Predictor consists of a library of statistically significant numerical models that predict various properties of chemical compounds from just their molecular structures. This capability means a chemist can merely draw a molecule diagram and get reasonable estimates of these properties, even though the molecule has never existed. Drug companies search through millions of such "virtual" molecular structures as they attempt to find new drugs. The vast majority of these molecules are not suitable as medicines for various reasons. Some have such low solubility that they will not dissolve well, some have such low permeability through the intestinal wall that they will not be absorbed well, some degrade so quickly that they are not stable enough to have a useful shelf life, some bind to proteins (like albumin) in blood to such a high extent that little unbound drug is available to reach the target, and some will be toxic in various ways. Identification of such properties as early as possible enables researchers to eliminate poor compounds without spending time and money to make them and then run experiments to identify these weaknesses. Today, many molecules can be eliminated on the basis of computer predictions, such as those provided by ADMET Predictor.

During the 2nd and 3rd quarters, numerous improvements were made to the program, including a convenient model editor and to add an algorithm whereby scientists can now add their own data and extend any of the predictive models into their own "chemical space" when it is significantly different from that of the data used to train the model. A sensitivity depiction was also added to allow scientists to see to which particular descriptors (molecular features) a property is most sensitive. This information is helpful to chemists to enable them to see how different molecular structural features affect various ADMET properties. This version was released in the 3rd quarter.

Work is now underway to integrate ADMET Predictor and ADMET Modeler into a single program for greater user convenience. The two programs were designed to work together from the start, so this integration will simply make it easier to use the model-building capabilities of ADMET Modeler. In addition, we believe that integration of the two into a single package will enhance the competitive posture of ADMET Predictor.

CLASSPHARMER(TM)

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

ClassPharmer.

Our strategy for acquiring ChemTK from Sage was to integrate it with ClassPharmer and make a single package. This effort was completed during this reporting period, and we released ClassPharmer 4.0 in March 2006. Version 4.1 has been in development since that time with additional capabilities that have been requested by our customers. We expect release of version 4.1 early in the 4th quarter.

DDDPLUS

DDDPlus (Dose Disintegration and Dissolution Plus) was first released in February 2005. DDDPlus simulates how different tablets and capsules disintegrate and dissolve during IN VITRO (laboratory) dissolution experiments. The program also simulates the effects of changing formulation excipients (additives that are not the active drug), and changing the experimental apparatus and fluids used in the experiment. We believe this tool will be a valuable asset for formulation scientists as they search for optimum formulations that provide desirable properties at minimum cost, as well as optimum experimental conditions under which to measure disintegration and dissolution to best predict what will happen in human. The market for this tool includes hundreds of drug delivery companies as well as all pharmaceutical and biotech companies.

Over 60 companies evaluated Version 1.0 of DDDPlus. This is an indication of the strong interest and business potential in this area. However to date, few licenses have been sold. Through the evaluation process, we received valuable feedback about what would be required for various customers to license the software, and we have now incorporated those improvements. We have also added significant new functionality by enabling formulation scientists to optimize experimental conditions to achieve a desired dissolution-time profile, and to handle polymer matrix formulations that are often used in controlled release formulations. Version 2.0 was released in the 3rd quarter and is now being evaluated at a number of potential customer sites.

We continue to remain confident that significant sales of DDDPlus licenses will take place. The initial release served us well to stimulate interest in this first-of-its-kind software and to get formulation scientists thinking about how to use such a capability in their work. Because such scientists have never used software like DDDPlus before, this is an educational process to show them how such a tool can actually save time and money, similar to the process we had with GastroPlus ten years ago.

GASTROPLUS

GastroPlus simulates the absorption and pharmacokinetics of drugs in the human gastrointestinal tract as well as in a number of standard laboratory animals. This sophisticated simulation has equations for the movement of the drug through the gastrointestinal tract, how fast it dissolves or precipitates along the way, whether it is converted to a different molecular form (i.e., degraded) in the gastrointestinal tract prior to absorption, and how fast it is absorbed through various regions of the intestinal wall into the blood stream. With additional inputs, it also simulates the concentration of drug in the blood plasma versus time. With the optional PBPKPlus(TM) Module, released during this reporting period, concentrations in a variety of tissues and organs can now also be predicted. With the optional PDPlus(TM) module, the program can also simulate how a drug affects the body, such as reducing pain, reducing blood pressure, reducing depression, and causing adverse side effects.

We believe GastroPlus is the "gold standard" in the industry for its class of simulation software. It is used from early drug discovery through development and into early clinical trials. The information provided through GastroPlus simulations guides project decisions in various ways. Among the kinds of knowledge gained through such simulations are: (1) whether a potential new drug compound is likely to be absorbed at high enough levels to achieve the desired blood concentrations needed for effective therapy, (2) whether the absorption process is affected by certain transporter proteins in the intestinal tract that may cause absorption to be very different from one region to another, (3) when certain properties of a new compound can be adequately estimated through computer ("in silico") predictions or simple experiments rather than through more expensive and time-consuming experiments, (4) what the likely variations in blood and tissue concentration levels would be in a large population, in different age groups or in different ethnic groups, and (5) whether a new formulation for an existing approved drug is likely to demonstrate "bioequivalence" (equivalent blood concentration versus time) to the currently marketed dosage form in a human trial.

Our marketing intelligence indicates that GastroPlus enjoys a dominant position in the number of users worldwide. In addition to virtually every major pharmaceutical company, licenses include a growing number of smaller phla nd biotech companies, 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 smaller than the pharmaceutical giants, they can also save considerable time and money through simulation. We believe this part of the industry, which includes hundreds of companies, represents major growth potential for GastroPlus. Our experience has been that the number of new companies adopting GastroPlus shows steady growth, adding to the base of annual licenses each year.

During the third quarter, we released version 5.1, which added a "particle size distribution" model that had been requested by our customers. This allows formulation scientists to simulate the dissolution of solid drug particles of various sizes, rather than using an average size to represent all particles. Smaller particles dissolve faster than larger ones, and for slow-dissolving drugs, the differences in simulated results can be significant.

We are aware that other companies have developed competitive software; however, based on customer feedback, we believe that the competitive threat to GastroPlus is limited. Version 5.0 with the new PBPKPlus(TM) module, released in December 2005, further extended the utility of GastroPlus. Version 5.1 added additional functionality and user convenience, and we are now working on version 5.2, which expands the program's utility further in response to customer requests for added features. At their request, we are currently negotiating with one of our large pharmaceutical company partners to cover one full-time equivalent (FTE) to expand the capabilities of GastroPlus.

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

CONTRACT RESEARCH SERVICES

In addition to our software products, we also offer contract research services to the pharmaceutical industry in the area of gastrointestinal absorption, pharmacokinetics, structure-property model building, and related technologies. These studies provide us an additional source of revenue, as well as a means to introduce our software products to new customers. Such studies are also beneficial to us to validate and enhance our products by studying actual data in the pharmaceutical industry. The business of contracted studies is growing, and we believe it could contribute significantly to our revenues and earnings; however, we plan to control growth in this area such that it does not adversely impact our product development stream. We are also adding scientific staff, with two new Ph.D. scientists having already accepted offers and plans to hire three or four more. This will increase our life sciences department from seven to 12 or 13.

PHARMACEUTICAL SIMULATIONS SOFTWARE PRODUCT DEVELOPMENT

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

(1) ADMET PREDICTOR UPGRADES

The initial toxicity predictions in ADMET Predictor were released during fiscal year 2005, and we have continued to add new toxicity models steadily. At this time, we are working on additional such models, but we are not revealing their nature for competitive reasons.

(2) MEMBRANEPLUS(TM)

MembranePlus is a computer program that simulates IN VITRO experiments that measure the permeability of new drug-like molecules through a layer of living cells or through an artificial membrane. These experiments are conducted in order to estimate the permeability of new drug compounds through the human intestinal wall and into the blood. However, such experiments do not produce results that are easily translated into human permeabilities. We believe that a detailed mechanistic simulation of these IN VITRO experiments will provide the insight and understanding needed to provide reasonably accurate estimates of permeability in different regions of the human intestinal tract from IN VITRO data.

This development effort accelerated during fiscal year 2005 with the hiring of a new Ph.D. scientist who focused on this program. We have now progressed to the point where the simulation is predicting the movement of drug molecules through the bulk fluid, into the membranes at the surface of a cell layer, through the surface membrane, through the interior of the cell, into the opposite surface membrane, and through it to the bulk fluid on the opposite side of the cell layer. Although a few technical issues remain to be resolved, we are optimistic that the simulation will become a unique tool for the analysis of data from these experiments, and will enable researchers to more accurately human intestinal permeability from these IN VITRO experiments. We are not aware of any other effort to produce a product of this nature.

This project was put on hold in September 2005 because the previous product manager for GastroPlus took a position with another company, and the scientist responsible for MembranePlus was assigned to take over GastroPlus. She has done an excellent job with GastroPlus, completing the PBPKPlus Module and all of the many associated changes that accompanied it during this reporting period. She will continue to work on GastroPlus as needed, but will also work on MembranePlus again as GastroPlus activities allow. We are currently interviewing

several candidates to expand our life sciences team, with at least one in this area to provide her with assistance on these two projects.

WORDS+

PRODUCTS

Our wholly owned subsidiary, Words+, Inc. has been an industry pioneer and technology leader for over 24 years in introducing and improving augmentative and alternative communication and computer access software and devices for disabled persons. We intend to continue to be at the forefront of the development of new products. We will continue to enhance our major software products, E Z Keys and Say-it! SAM, as well as our growing line of hardware products. We will also consider acquisitions of other products, businesses and companies that are complementary to our existing augmentative and alternative communication and computer access business lines. We purchased the Say-it! SAM technologies from SAM Communications, LLC of San Diego in December 2003. This acquisition gave us our smallest, lightest augmentative communication system, which is based on a Hewlett-Packard iPAQ personal digital assistant (PDA). PDA-based communication devices have been very successful in the augmentative communication market, and this technology purchase has enabled us to move into this market segment faster and at lower cost than developing the product ourselves. SAM-based products now account for a significant share of our growing Words+ revenues.

Since the acquisition of the Say-it! SAM technologies, we have continued to add new functionality to the SAM software and to offer it on additional hardware platforms. At the CSUN conference in March 2005, we introduced the SAM Tablet XP1, our Windows XP-based tablet. At the Closing the Gap conference in October 2005, we announced the expected December release of our SAM for PC version, allowing SAM to be distributed on virtually any Windows XP desktop or laptop computer. All received enthusiastic responses from both potential customers and Words+ dealers alike.

RESULTS OF OPERATIONS

COMPARISON OF THREE MONTHS ENDED MAY 31, 2006 AND 2005.

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

	Three Months Ended		
	05/31/06		05/3
Net sales	$ 1,788	100%	$ 1,424
Cost of sales	433	24.2	428
Gross profit	1,355	75.8	996
Selling, general and administrative	795	44.5	645

Research and development	119	6.7	134
Total operating expenses	914	51.1	779
Income (loss) from operations	441	24.7	217
Other income	19	1.1	6
Net income before taxes	460	25.7	223
Provision for income taxes	74	4.1	50
Net income	$ 386	21.6%	$ 173

NET SALES

Consolidated net sales increased $364,000, or 25.6%, to $1,788,000 in the third fiscal quarter of 2006 (3Q FY06) from $1,424,000 in the third fiscal quarter of 2005 (3Q FY05). Our sales from pharmaceutical and educational software increased approximately $434,000, or 65.5%; and our Words+, Inc. subsidiary's sales decreased approximately $70,000, or 9.2%, for the quarter. We attribute a portion of the increase in pharmaceutical software sales to a multi-year global renewal order from a large customer. In FY04, we recognized their 2-year license in full because we delivered the product by unlocking the license for 2 years, resulted in no income from this customer in FY05. In this third fiscal quarter of FY06, we have received a renewal of another 2-year license from the same customer with an increase over the FY2004 order. We no longer unlock such multi-year licenses for the full term; rather we have unlocked the software only for the first year term, thus recognizing revenue for one year only, and deferring the second year license till FY07. Therefore, the one-year term of license revenue in FY06 comparing with no revenue in FY05 from this customer resulted in an increase in FY06 from FY05, in addition to new revenues generated from ClassPharmer software which we acquired in November 2005, and an increase in revenue from ADMET Predictor/Modeler.

We attribute the small decrease in Words+ sales primarily a decrease in sales of "TuffTalker", "Freedom" products, and increases in insurance discounts which outweighed increases in sales of "Say-it-SAM!" and "TuffTalker Plus" products.

COST OF SALES

Consolidated cost of sales increased $5,000, or 1.2%, to $433,000 in the 3Q FY06 from $428,000 in the 3Q FY05. The percentage of cost of sales in the 3Q FY06 decreased 5.9% from the 3Q FY05. For Simulations Plus, absolute cost of sales increased $57,000, or 74.8%. As a percentage of sales, cost of sales increased to 12.1% in FY06 from 11.5% in FY05. A significant portion of cost of sales is the systematic amortization of capitalized software development costs, which is an independent fixed cost rather than a variable cost related to sales. This amortization cost increased approximately $39,000, or 208.1%, in the 3Q FY06 compared with the same period in FY05.

For Words+, cost of sales decreased $52,000, or 14.6%. As a percentage of sales, cost of sales decreased 2.7% between the 3Q FY06 and 3Q FY05. We attribute the

percentage decrease in cost of sales for Words+ primarily to the ability to obtain purchase discounts by volume purchases of computers and PDAs, which are main components of the systems we sell.

GROSS PROFIT

Consolidated gross profit increased $359,000, or 36.0%, to $1,355,000 in the 3Q FY 06 from $996,000 in the 3Q FY05. We attribute this increase to the increase in sales of pharmaceutical software in addition to an increase in profit margin on Words+ products.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Consolidated selling, general and administrative expenses increased $150,000, or 23.3%, to $795,000 in the 3Q FY06 from $645,000 in the 3Q FY05. For Simulations Plus, selling, general and administrative expenses increased $186,000, or 56.2%. One of the major increases in expenses was accrued bonuses to officers for $57,681, which represented 10% of the Company's net income before bonuses and taxes, payable to the Company's President, Walter Woltosz and Corporate Secretary, Virginia Woltosz as the annual bonuses. Other increases include legal fees incurred for a litigation brought up by an attorney/liquidator in France, who represented the former French subsidiary of Bioreason and who is contesting our ClassPharmer distribution rights in Europe, an accounting fee which was incurred for a value assessment of the Bioreason assets provided by an independent firm, commissions to a dealer, travel expenses, salary and payroll taxes, rent, dues and subscriptions, and recruiting costs, which outweighed decreases in investor relations, repairs, and insurances.

For Words+, selling, general and administrative expenses decreased $35,000, or 11.2%, due primarily to decreases in commission, trade shows, insurances, and technical service costs. These decreases outweighed increases in contributions, depreciation, rent, salaries and payroll taxes.

RESEARCH AND DEVELOPMENT

We incurred approximately $215,000 of research and development costs for both companies during the 3Q FY06. Of this amount, $96,000 was capitalized and $119,000 was expensed. In the 3Q FY05, we incurred $191,000 of research and development costs, of which $57,000 was capitalized and $134,000 was expensed. The increase of $24,000, or 12.6%, in research and development expenditures from the 3Q FY05 to the 3Q FY06 was due primarily to salaries for additional staff in our Life Science Department.

OTHER INCOME

Net other income in the 3Q FY06 increased by $13,000, from net income of $6,000 to net income of $19,000. This is due primarily to the increase in currency exchange, from loss of $5,000 in the 3Q FY05 to a $10,000 gain in 3Q FY06. The net change of $15,000 was offset by the decreases in interest income, which was the amortization of present value discounts on long-term receivables, and miscellaneous income.

PROVISION FOR INCOME TAX

We estimated income taxes of $83,000 at the end of May 31, 2006. Since we have

already recorded $9,000 in income tax based on the estimation at the end of the second fiscal quarter of FY06, we recorded an additional $74,000 as an estimated income tax. At the end of 3Q FY05, we estimated income tax of $50,000.

NET INCOME

Consolidated net income for the three months' operations increased by $213,000, or 123.1%, to $386,000 in the 3Q FY06 compared to $173,000 in the 3Q FY05. We attribute this increase in profit primarily to the increases in pharmaceutical software and other income along with the improvement in gross margin. Although there were increases in selling, general and administrative expense, research and development expenditures, and provision for income taxes, the increase in revenues combined with improved profit margins outweighed increased expenses.

COMPARISON OF NINE MONTHS ENDED MAY 31, 2006 AND 2005.

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		
	05/31/06		05/3
Net sales	$ 4,089	100%	$ 3,523
Cost of sales	1,152	28.2	1,121
Gross profit	2,937	71.8	2,402
Selling, general and administrative	2,112	51.7	1,812
Research and development	336	8.2	379
Total operating expenses	2,448	59.9	2,191
Income from operations	489	12.0	211
Other income	30	0.7	44
Net income before taxes	519	12.7	255
Provision for income taxes	83	2.0	50
Net income	$ 436	10.7%	$ 205

NET SALES

Consolidated net sales increased $566,000, or 16.1%, to $4,089,000 in the first nine months of fiscal year 2006 (FY06) from $3,523,000 in the first nine months of fiscal year 2005 (FY05). Our sales from pharmaceutical and educational software increased approximately $583,000, or 36.6%; while our Words+, Inc. subsidiary's sales decreased approximately $17,000, or 0.9%, for the nine months

ended May 31, 2006. We attribute the increase in pharmaceutical software sales primarily to the revenues from ClassPharmer sales, and a renewal from a large pharmaceutical company discussed above in the 3-month comparison.

We attribute the decrease in Words+ sales primarily a decrease in sales of "TuffTalker" and "Freedom" product sales which outweighed the increase in sales of "Say-it! SAM" and "TuffTalker Plus."

COST OF SALES

Consolidated cost of sales increased $31,000, or 2.8%, to $1,152,000 in the first nine months of FY06 from $1,121,000 in the first nine months of FY05. The percentage of cost of sales in the first nine months of FY06 decreased 3.6% from the first nine months of FY05. For Simulations Plus, absolute cost of sales increased $118,000, or 66.0%. As a percentage, cost of sales increased to 13.7% in FY06 from 11.2% in FY05. A significant portion of cost of sales is the systematic amortization of capitalized software development costs, which is an independent fixed cost rather than a variable cost related to sales. This amortization cost increased approximately $83,000, or 185.1%, in the first nine months of FY06 compared with the same period in FY05.

For Words+, cost of sales decreased $87,000, or 9.3%. As a percentage, cost of sales decreased 4.2% between the first nine months of FY06 and FY05. We attribute the percentage decrease in cost of sales for Words+ primarily to the ability to obtain purchase discounts through volume purchases of computers and PDAs, which are main parts for the systems we sell.

GROSS PROFIT

Consolidated gross profit increased $535,000, or 22.3%, to $2,937,000 in the first nine months of FY06 from $2,402,000 in the first nine months of FY05. We attribute this increase to the increase in sales of pharmaceutical software in addition to an increase in profit margin on Words+ products.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Consolidated selling, general and administrative expenses increased $300,000, or 16.6%, to $2,112,000 in the first nine months of FY06 from $1,812,000 in the first nine months of FY05. For Simulations Plus, selling, general and administrative expenses increased $316,000, or 32.4%. The major increases in expenses were accrued bonuses to officers for $57,681, which represented 10% of the Company's net income before bonuses and taxes, payable to the Company's President, Walter Woltosz and Corporate Secretary, Virginia Woltosz as the annual bonuses, commissions, trade shows and travel, legal fees which were incurred for the acquisition of assets from Sage Informatics and Bioreason, and legal fee incurred for ClassPharmer distribution rights in Europe, as well as salary and payroll-related expenses such as health insurance and payroll taxes, rent, and recruiting costs, which outweighed decreases in investor relations and equipment repairs.

For Words+, selling, general and administrative expenses decreased $16,000, or 0.9%, due primarily to decreases in commissions, trade shows, contract labor, and insurances. These decreases outweighed increases in contribution, rent, technical service costs, supplies, salaries and payroll tax.

RESEARCH AND DEVELOPMENT

We incurred approximately $924,000 of research and development costs for both companies during the first nine months of FY06. Of this amount, $588,000, including allocation of the appraised value of $245,653 on the ClassPharmer software, was capitalized and $336,000 was expensed. In the first nine months of FY05, we incurred $635,000 of research and development costs, of which $256,000 was capitalized and $379,000 was expensed. The increase of $289,000, or 45.5%, in research and development expenditures from the first nine months of FY05 to the first nine months of FY06 was due primarily to our acquisition of the ClassPharmer software and additional salaries to new hires in our Life Science Department.

OTHER INCOME (EXPENSE)

Net other income in the first nine months of FY06 decreased by $14,000, from net income of $44,000 to $30,000. This is due primarily to the decrease in the amortization of present value discounts on long-term receivables which we had fully amortized by May 2005. We incurred other long-term receivables from a part of the Bioreason assets purchase; however, their amortized interest was $6,000 in the first nine months of FY06, while the amortized interest revenue we had in the same period of FY05 was $32,000. There were increases in gains from currency exchange and sales of assets in the first nine months of FY06 compared with the same period of FY05, however the these increases did not exceed the decreases in interest income .

PROVISION FOR INCOME TAX

We estimate an income tax of $83,000 for the first nine months of FY 06, while we estimated $50,000 for the first nine months of FY05.

NET INCOME

Consolidated net income for the first nine months of FY06 increased by $231,000, or 112.7%, to $436,000 compared to $205,000 in the first nine months of FY05. We attribute this increase in profit primarily to increased sales of pharmaceutical software licenses in addition to an increase in profit margin on Words+ products, which outweighed increases in operating expenses and income taxes, and decreases in other income.

LIQUIDITY AND CAPITAL RESOURCES

The Company's principal sources of capital have been cash flows from its operations and a bank line of credit. The Company did not renew a revolving line of credit for $500,000 from a bank in May 2005 because the Company did not use it during the prior year and did not expect to need it in the near future. The Company will consider re-applying for the line of credit when there is a need for it.

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

maintaining expenses within operating cash flows.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Our risk from exposure to financial markets is limited to foreign exchange variances and fluctuations in interest rates. We may be subject to some foreign exchange risks. Most of our business transactions are in U.S. dollars, although we generate significant revenues from customers overseas. The exception is that we were compensated in Japanese yen by most Japanese customers. As a result, we experienced a gain from currency exchange in the first nine months of FY06. In the future, if foreign currency transactions increase significantly, then we may mitigate this effect through foreign currency forward contracts whose market-to-market gains or losses are recorded in "Other Income or expense" at the time of the transaction. To date, exchange rate exposure has not resulted in a material impact.

Item 4. Controls and Procedures

(a) EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES. As of the end of the period covered by this report, 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 were no changes in the Company's internal controls over financial reporting during the Company's most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

On April 6, 2006, we received a notice from a liquidator for the former French subsidiary of Bioreason, Bioreason SARL, saying that the liquidator has initiated legal action against Simulations Plus in the French courts with respect to ClassPharmer distribution rights to European customers, and is claiming commissions and legal fees with respect to European customers. We have been working through our U.S. attorneys and a law firm in Paris to aggressively pursue our rights. We claimed our rights against Bioreason SARL's assets by sending a debt recovery declaration to the liquidator on June 15, 2006. We believe the documentation from our purchase of certain secured assets of Bioreason clearly shows our rights to the disputed accounts, and we are pursuing our rights aggressively. Although we are pursuing our rights aggressively, there can be no assurance that its outcome will be a favorable result to us.

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

(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 11, 2006.

Simulations Plus, Inc.

Date: July 11, 2006

By: /s/ MOMOKO BERAN

Momoko Beran
Chief Financial Officer

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