SIMULATIONS PLUS INC
Form 10QSB
January 14, 2002

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-QSB

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

For the quarterly period ended November 30, 2001 or

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

For the transition period from _____ to _____

Commission file number: 000-21665

SIMULATIONS PLUS, INC.
(Exact name of registrant as specified in its charter)

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

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

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

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

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

Yes x No

The number of shares outstanding of the Issuer's common stock, par value $0.001 per share, as of January 11, 2002, was 3,408,331.

SIMULATIONS PLUS, INC.
FORM 10-QSB
FOR THE QUARTERLY PERIOD ENDED NOVEMBER 30, 2001

Table of Contents

SIMULATIONS PLUS, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEET
November 30, 2001
(Unaudited)

ASSETS	
Current assets:	
Cash and cash equivalents (note 2)	$ 51,905
Accounts receivable, net of allowance for doubtful accounts of $14,363	621,182
Prepaid expenses	47,626
Inventory	182,711
Total current assets	903,424
Capitalized computer software development costs,	

net of accumulated amortization (note 3)	318,196
Furniture and equipment, net (note 4)	82,550
Other assets	13,257
Total assets	$ 1,317,427
LIABILITIES AND SHAREHOLDER'S EQUITY	
Current liabilities:	
Advance line of credit	$ 99,966
Accounts payable	272,789
Accrued payroll and other expenses	350,036
Accrued compensation due to officers	225,916
Accrued warranty and service costs	43,960
Current portion of capitalized lease obligations	13,697
Total current liabilities	1,006,364
Capitalized lease obligations, net of current portion	17,588
Total liabilities	1,023,952
Shareholders' equity	
Preferred stock: $0.001 par value, authorized 10,000,000 shares, no shares issued and outstanding	0
Common stock: $0.001 par value, authorized 20,000,000 shares, issued and outstanding 3,408,331 (note 5)	3,409
Additional paid-in capital	4,654,756
Accumulated deficit	(4,364,690)
Total shareholders' equity	293,475
Total liabilities and stockholders' equity	$ 1,317,427

The accompanying footnotes are an integral part of these statements.

SIMULATIONS PLUS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS
For the three months ended November 30, 2001 and 2000
(Unaudited)

	Three months ended	
	11/30/01	11/30/00
Net sales	$ 1,007,288	$ 1,058,323
Cost of sales	372,545	478,250
Gross profit	634,743	580,073

Operating expenses:		
Selling, general & administrative	525,207	500,576
Research and development	93,989	89,154
Total operating expenses	619,196	589,730
Profit (loss) from operations	15,547	(9,657)
Other income (expenses):		
Interest revenue	7	12
Interest expense	(5,048)	(6,133)
Profit (loss) before provision for income taxes	10,506	(15,778)
Provision for income taxes	0	0
Net profit (loss)	$ 10,506	$ (15,778)
Basic net profit (loss) per common share	$ 0.00	$ (0.00)
Diluted net profit (loss) per common share	$ 0.00	$ (0.00)
Basic weighted average # of common shares outstanding	3,394,299	3,384,968
Diluted weighted average # of common shares outstanding	3,394,299	3,384,968

The accompanying footnotes are an integral part of these statements.

SIMULATIONS PLUS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the three months ended November 30, 2001 and 2000
(Unaudited)

	Three months ended	
	11/30/00	11/30/00
Cash flows from operating activities:		
Net profit (loss)	$ 10,506	$ (15,778)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization of furniture and equipment	14,900	15,486
Amortization of capitalized software development costs	30,974	52,268
(Increase) decrease in:		
Accounts receivable	(176,782)	(7,921)
Inventory	(353)	(17,803)
Other assets	(22,603)	10,230
Increase (decrease) in:		
Accounts payable	8,484	40,770
Accrued expenses	38,132	1,385

Accrued payroll for officers	12,500	
Accrued warranty and service costs	(1,496)	(1,437)
Deferred revenue	(5,836)	(26,847)
Net cash provided by (used in) operating activities	(91,574)	50,353
Cash flows from investing activities:		
Purchase of equipment	(6,182)	
Capitalized computer software development cost	(14,869)	(32,338)
Net cash used in investing activities	(21,051)	(32,338)
Cash flows from financing activities:		
Proceeds from line of credit	1,007	44
Payments on capitalized lease obligations	(3,129)	(5,064)
Net cash used in financing activities	(2,122)	(5,020)
Net increase (decrease) in cash	(114,747)	12,995
Cash and cash equivalents, beginning of period	166,652	37,535
Cash and cash equivalents, end of period	$ 51,905	$ 50,530

The accompanying footnotes are an integral part of these statements.

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

Note 1: GENERAL

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

Note 2: CASH AND CASH EQUIVALENTS

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

Note 3: CAPITALIZED COMPUTER SOFTWARE DEVELOPMENT COSTS

Software development costs are capitalized in accordance with Statement of Financial Accounting Standards ("SFAS") No. 86, "Accounting for the Cost of Computer Software to be Sold, Leased, or Otherwise Marketed." Capitalization of software development costs begins upon the establishment of technological feasibility and is discontinued when the product is available for sale. The establishment of technological feasibility and the ongoing assessment for recoverability of capitalized software development costs require considerable judgement by management with respect to certain external factors including, but not limited to, technological feasibility, anticipated future gross revenue, estimated economic life, and changes in software and hardware technologies. Capitalized software development costs are comprised primarily of salaries and the purchase of existing software to be used in the Company's software products.

Amortization of capitalized software development costs is provided on a product-by-product basis on the straight-line method over the estimated economic life of the products, not exceeding three years. Management periodically compares estimated net realizable value by product with the amount of software development costs capitalized for that product to ensure the amount capitalized is recoverable through revenues. Any excess of development costs to expected net realizable value is expensed at that time. The Company expensed $126,296 in fiscal year 2000 when it was required to write off as an impairment loss related to capitalized software costs for HelixGen, and included in selling, general, and administrative expenses.

Note 4: FURNITURE AND EQUIPMENT

Furniture and equipment as of November 30, 2001 consisted of the following:

Equipment	$ 104,236
Computer equipment	304,982
Furniture and fixtures	45,036
Leasehold improvements	38,215
	492,469
Less accumulated depreciation	(409,919)
	$ 82,550

Note 5: STOCKHOLDERS' EQUITY

ISSUANCE OF WARRANTS

In January 1997, the Company entered into Subscription Agreements whereby the Company issued notes in the amount of $1,100,000 and issued 280,000 warrants to purchase common stock. The warrants are exercisable at $2.50 per share, are subject to a 12-month-lock-up period, and expire five years from the grant date. The notes were repaid upon the completion of the Company's stock offering. As of January 1, 2002, these warrants expired. A previous Subscription with warrants expired in September 2001. Accordingly, there are no longer any exercisable warrants for the Company's stock.

STOCK OPTION PLAN

In September 1996, the Board of Directors adopted and the shareholders approved the 1996 Stock Option Plan (the "Option Plan") pursuant to which a total of

250,000 shares of common stock were reserved for issuance. In March 1999, the shareholders approved an increase in the number of shares that may be granted under the Option Plan to 500,000. In February 2000, the shareholders approved the number of shares to be granted under the Option Plan to be 1,000,000 shares. Furthermore, in December 2000, the shareholders approved an increase in number of shares that may be granted under the Option Plan to 1,250,000. The Option Plan terminates in 2006, subject to earlier termination by the Board of Directors.

As of November 30, 2001, 1,148,923 shares have been issued to various employees at an exercise price equal to the fair market value of the Company's stock price at the date of grant with five-year vesting periods. Also, a total of 5,206 shares have been issued to the Board of Directors at exercise prices ranging from $1.50 to $5.25 with a three-year vesting period. As of today, 2,300 options have been exercised.

The Company entered into an investor relations agreement during fiscal year 1999 for $4,000 per month and 30,000 stock options at an exercise price of $1, the fair market value on the date of grant. During the fiscal year 2001, 22,500 shares were exercised in exchange for cash of $22,500 and the remaining 7,500 shares expired.

Note 6: Income Taxes

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

Note 7: Earnings Per Share

Effective February 28, 1998, the Company adopted SFAS No. 128 "Earnings Per Share." All prior periods presented have been restated to confirm with SFAS No. 128.

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

FORWARD-LOOKING STATEMENTS

The following discussion should be read in conjunction with the financial statements and the notes thereto appearing elsewhere in this quarterly report on Form 10-QSB for the quarter ended November 30, 2001 (the "Form 10-QSB"). In addition to historical information, this Form 10-QSB contains forward-looking statements. The forward-looking statements contained herein are subject to certain risks and uncertainties that could cause actual results to differ materially from those reflected in the forward-looking statements. Factors that might cause such a difference include, but are not limited to those discussed in the section entitled "Management's Discussion and Analysis or Plan of Operations." Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's analysis only as of the date hereof. Simulations Plus, Inc. undertakes no obligation to publicly revise these forward-looking statements, or to reflect events or circumstances that arise after the date hereof. Readers should carefully review the risk factors described in other documents that the Company has filed and will continue to

file from time to time with the Securities and Exchange Commission.

GENERAL

BUSINESS

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

DESCRIPTION OF SIMULATION SOFTWARE

The types of simulation software produced by the Company are based on the equations of chemistry and physics that describe or "model" the behavior of things in the real world. The Company's GastroPlus(TM) pharmaceutical software simulates the movement, dissolution/precipitation, chemical/metabolic degradation and absorption of orally-dosed drug compounds in the gastrointestinal tract of humans and several laboratory animal species, and with additional inputs, it also simulates the blood plasma concentration-time history of the drug after it reaches the central circulation. The Company recently completed the development of, and has now begun to sell licenses for, an important new extension module for GastroPlus, called the Metabolism and Transporter Module. This module extends the basic simulation to include enzyme-specific metabolism in both the liver and in intestinal walls, as well as the effects of transporter proteins that line the intestinal tract and serve to

promote or inhibit drug absorption. The Company's QMPRPlus(TM) program estimates the values of several important physicochemical characteristics of new drug-like molecules with only the structures of the molecules as input. Recent additions to this program include the prediction of permeability in a special line of cells called MDCK cells. This predictive model was developed during the past fiscal year under a funded collaboration with the Affymax Research Institute. Two new important predicted properties were also added to QMPRPlus: plasma protein binding and volume of distribution. GastroPlus and QMPRPlus are used by almost every major and a number of smaller pharmaceutical companies in the U.S., Europe, and Japan.

The Company's award-winning FutureLab(TM) science experiment simulations for middle school and high school students incorporate the equations of chemistry and physics for each experiment (optics, electrical circuits, gravity, ideal gases, acid/base titration, etc.), and allow students to design and conduct their own experiments in a virtual laboratory environment. Although development of FutureLab software was discontinued in 1998, low-level sales continue through distributors in the U.S., U.K. Australia, and New Zealand.

The development of simulation software involves (1) identifying and understanding the underlying chemistry, physics, biology, and physiology of the processes to be simulated, (2) breaking those processes down into the lowest practical level of individual sub-processes at which the behaviors can be well-represented mathematically, (3) developing appropriate mathematical relationships/equations, and (4) converting them into computer subroutines. The software subroutines representing these individual processes are then integrated

into an overall simulation program, with appropriate coordination between modules and design of user-friendly interface for inputs and outputs. The predictions of these programs are then compared to known results in order to calibrate the simulations and to demonstrate the validity of the models as useful tools for predicting new results.

PRODUCTS

The Company's pharmaceutical software provides cost-effective solutions to a number of critical problems in pharmaceutical research, and also serves in the education of pharmacy and medical students. The Company's software products and services to date are focused on the area of pharmaceutical research known as ADMET (Absorption, Distribution, Metabolism, Elimination, and Toxicity). The Company released its first pharmaceutical software product, GastroPlus, in August 1998 and immediately received enthusiastic interest from researchers in large pharmaceutical companies such as Astra, Glaxo Wellcome, Pfizer, Pharmacia, The Roche Group, SmithKline Beecham and Zeneca. Since then, 19 of the world's largest pharmaceutical companies and a number of smaller companies have licensed the software. Some of these companies have merged to become single companies (e.g., AstraZeneca and GlaxoSmithKline), which give the appearance of fewer customers, but the Company's software is licensed on an annual basis by geographic location, so there was no actual loss in sales. An Optimization Module for GastroPlus was released in November 1998. Two additional modules, IVIV Correlation and PKPlus(TM) were released in November 2000. The Metabolism and Transporter Module was released in June 2001. The majority of new sales now

include these additional extra-cost modules, contributing significantly to revenue growth. GastroPlus has now become the "gold standard" for simulation of oral drug absorption and pharmacokinetics, and is in use throughout the industry in the U.S., Japan, and Europe. Recent sales have included a number of drug delivery companies (companies that design the actual tablet or capsule for a drug that was usually developed by another company). Although these companies are considerably smaller than the pharmaceutical giants, they can realize significant savings in cost and time through accurate simulation of their drug delivery technologies. The Company believes this part of the industry, which includes hundreds of companies, represents major growth potential for GastroPlus.

QMPRPlus (Quantitative Molecular Permeability Relationships), which can be used as a companion program to GastroPlus or by itself, takes as inputs the structures of molecules, and provides estimates for human effective permeability, octanol-water partition coefficient (logP), solubility, diffusivity, blood-brain barrier penetration, plasma protein binding, and volume of distribution. Most of these are inputs to GastroPlus. QMPRPlus thereby extends the utility of GastroPlus into early drug discovery, during which pharmaceutical companies may not have even made many of the molecules that have been identified as potential drug candidates. The Company recently completed the development of a new permeability model for a special line of cell culture experiments using Manin-Darby Canine Kidney (MDCK) cells under contract to the Affymax Research Institute, at the time a division of GlaxoSmithKline. This unique model, based on high quality data for over 300 compounds from Affymax's laboratories, was presented at the American Chemical Society meeting in San Diego during the first week of April 2001. The Company also completed the development of the blood-brain barrier permeation model during this fiscal year, as well as the plasma protein binding and volume of distribution model, and it updated all earlier models with enhanced artificial neural network predictions. By providing estimates of physicochemical properties from structure alone, QMPRPlus, by itself or coupled with GastroPlus, allows researchers to rank order

large numbers of candidate compounds in terms of their potential for human intestinal absorption. Because pharmaceutical companies are dealing with many millions of compounds per year, and because the area of ADMET has become a bottleneck, high throughput screening on the computer ("IN SILICO") is becoming not just a convenience, but a necessity.

In 1998, the Company executed a License Agreement with Therapeutic Systems Research Laboratories, Inc. ("TSRL"), Ann Arbor, Michigan, to obtain exclusive rights to TSRL's technology and database, including measurements of drug permeability from nearly 60 laboratory experiments to measure the intestinal permeability of drug compounds in human and/or rat small intestines. As a part of this License Agreement, the Company is also receiving consulting assistance in the development and further enhancement of the GastroPlus absorption simulation model from TSRL staff, including Dr. Gordon Amidon and Dr. John Crison. The Company believes that the strategic advantage of exclusive access to TSRL's technology and expertise, combined with the Company's now well-developed and continually growing expertise in absorption and pharmacokinetics simulation, have resulted in GastroPlus becoming recognized as the standard for oral drug absorption simulation and analysis within the

pharmaceutical industry. The Company is aware that other companies began to develop similar software; however, management believes there is no significant direct competition for GastroPlus at this time. The Company believes that the addition of the Metabolism and Transporter Module and the accompanying upgrade of the core simulation in Version 3.0, which was released in June 2001, are major advances in the state-of-the-art of oral drug absorption and pharmacokinetics analysis. The Company's recognized expertise in oral absorption and pharmacokinetics is evidenced by the fact that Company staff members have been invited speakers at over 20 prestigious scientific meetings worldwide in the past year alone.

CONTRACT RESEARCH SERVICES

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

PHARMACEUTICAL SIMULATIONS SOFTWARE PRODUCT DEVELOPMENT

In the area of simulation software for pharmaceutical research, the Company is currently pursuing the development of additional modules for GastroPlus and QMPRPlus, as well as a third program called HelixGen(TM), which predicts the 3-dimensional receptor structure of certain transmembrane proteins known as G-protein coupled receptors (GPCR's). Although all of our development work cannot be disclosed for competitive reasons, some of our development efforts include:

(1) PDPlus(TM) Module

The PDPlus Module for GastroPlus is well under way. Prior versions of

GastroPlus have dealt with absorption and pharmacokinetics (what happens to the drug when it gets into the body). PDPlus calculates the pharmacodynamics for the drug (what happens to the body when the drug gets into the body) - i.e., what kind of therapeutic effect does it produce to treat a disease. This is an important new capability because it opens up the market to researchers who deal in late stage clinical trials, and who routinely perform PK/PD (pharmacokinetic/pharmacodynamic) analyses. Until now, these analyses were performed using models that treated absorption and its related process with very simplified models - often so simplified that calculations were in error. With PDPlus in GastroPlus, researchers will be able to perform highly sophisticated simulations and analyses to determine the complex interactive effects of factors that change the amount of drug that is absorbed and how fast it is metabolized after it is absorbed. These can result in significant variations in pharmacodynamic effect. Without the ability to predict these effects, excess costs in clinical trials can result when trials must be repeated to determine proper dosing levels. PDPl(TM) will enable researchers to better understand the

complex interplay among absorption, pharmacokinetics, and pharmacodynamics, and to better estimate the dosing levels to use in clinical trials prior to the start of the trials. This additional-cost module is expected to be released early in calendar year 2002.

(2) Multiple Particle Size Dissolution Model

The current dissolution model in GastroPlus uses a single "effective" particle size. While this model has well represented most tablets, capsules, and suspensions we have dealt with to date, formulation researchers know that real dosage forms do not consist of particles that are all one size. Instead, there is a distribution of particle sizes over some range from smaller than the average size to larger than the average size. Smaller particles dissolve faster than larger particles. For some drugs, this results in dissolution behavior that is not well modeled with a single effective particle size. This new model will allow formulation researchers to asses the effects of different particle size distributions on dissolution and absorption.

(3) QMPRPlus(TM) upgrades

We continue to add new molecular descriptors and new predicted ADMET properties to QMPRPlus(TM). We are now developing the ability for researchers to add their own data to refine the predictions for ADMET properties. We are also negotiating with several companies to develop additional models based on their experimental data. These models may be proprietary to each company, or they may result in additional predictions that can be licensed to other users, as we did with the MDCK model developed under contract to Affymax. A Data Mining Module is in development, which will allow researchers to see the distribution of their chemicals in up to four dimensions (3D plus color). This is a highly valuable capability that will complement the predictive capabilities of QMPRPlus nicely. This extra-cost module is expected to be released in early 2002.

(4) HelixGen(TM)

HelixGen is a program that is designed to predict the 3-dimensional geometry (i.e., the position of each atom) of a special class of transmembrane proteins known as G-protein coupled receptors (GPCR's). This type of protein serves as a channel for passage of certain molecules through the walls of nerve cells and other cells, and is a target for the majority of neurogenic drugs.

Drugs that bind to GPCR's can prevent the flow of certain molecules into and out of the cell, and in so doing may relieve pain, reduce tremors, improve memory, or affect other such nerve-related functions. The ability to predict the geometry of GPCR's in the computer will enable researchers to identify likely new drug molecules that could bind to them prior to actually synthesizing the molecules for experimental testing. Development of HelixGen was postponed in order to focus on the improvements to GastroPlus and QMPRPlus described above. Development of the program is expected to resume at some time in the future when resources and priorities allow. Because of accounting standards, and the continued postponement of development activities on this program, the Company was required to expense $126,296 in the 2nd quarter of FY2001 to write off all of the previously capitalized software development costs for HelixGen.

DISABILITY PRODUCT DEVELOPMENT

The Company's wholly owned subsidiary, Words+, Inc. has been an industry technology leader for over 20 years in introducing and improving augmentative and alternative communication and computer access software and devices for disabled persons and intends to continue to be at the forefront of the development of new products. The Company will continue to enhance its major software products, E Z Keys and Talking Screen, as well as its growing line of hardware products. The Company is well along in developing new versions of its software products for the new Microsoft XP operating system. The Company will also consider acquisitions of other products, businesses and companies that are complementary to its existing augmentative and alternative communication and computer access business lines.

RESULTS OF OPERATIONS

COMPARISON OF THREE MONTHS ENDED NOVEMBER 30, 2001 AND 2000.

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

	Three Months Ended		
	11/30/01		11/30/00
Net sales	$ 1,007	100%	$1,058
Cost of sales	372	36.9	478
Gross Profit	635	63.1	580
Selling, general and administrative	525	52.1	501
Research and development	94	9.3	89
Total operating expenses	619	61.5	590
Profit (loss) from operations	16	1.6	(10)
Interest expense	(5)	(0.5)	(6)

Net profit (loss)	$ 11	1.1%	$ (16)

NET SALES

The consolidated net sales decreased $51,000, or 4.8%, to $1,007,000 in the first fiscal quarter of 2002 (FY02) from $1,058,000 in the first fiscal quarter of 2001 (FY01). Simulations Plus, Inc.'s sales, from pharmaceutical and educational software, increased approximately $169,000, or 76.5%. However, Words+, Inc.'s sales decreased approximately $220,000, or 26.3% for the quarter. The increase in the Company's leading pharmaceutical software sales is attributable to a combination of additional license sales to existing customers, new customers, new modules, and four major upgrades to existing products. Management attributes the decrease in Words+ sales primarily to the tragic incidents on September 11, personnel changes in two key sales representatives, and overall slowing in the economy during this time period.

COST OF SALES

Consolidated cost of sales decreased $106,000, or 22.2%, to $372,000 in the first fiscal quarter of FY02 from $478,000 in the first fiscal quarter of FY01. The percentage of cost of sales decreased by 8.3%. For Simulations Plus, cost of sales decreased $13,000, or 16.9%, of which the significant portion of the cost of sales is the systematic amortization of capitalized software cost, which resulted in a 40.4% decrease in amortization cost. Another factor of cost of sales is royalty expense increasing $8,000, or 32.0%, due increased GastroPlus sales and the agreement between the Company and TSRL which includes royalty payments on GastroPlus sales. However the decrease in amortization cost outweighed the increase in royalty expense resulting in lower cost of sales than the previous year, despite the increase in sales. For Words+, cost of sales decreased $93,000, or 23.2%. The change in percentage of cost of sales between the first fiscal quarter of FY02 and FY01 is increased by 2.1%. Management attributes the percentage increase in cost of sales for Words+ primarily to the fact that the percentage of sales generated by product items with lower profit margins was greater than the items with higher profit margins.

GROSS PROFIT

The consolidated gross profit increased $55,000, or 9.5%, to $635,000 in the first quarter of FY02 from $580,000 in the first quarter of FY01. Management attributes this increase to a significant increase in pharmaceutical software sales, while there is a decrease in its cost of sales, resulting in over 125% increase in gross profit for these sales. This increase outweighed the decrease in gross profit generated by Words+ products.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Consolidated selling, general and administrative expenses increased $24,000, or 4.8%, to $525,000 in the first fiscal quarter of FY02 from $501,000 in the first fiscal quarter of FY01. For Simulations Plus, the selling, general and administrative expenses decreased $13,000, or 6.9%. The major decreases in expenses were in the categories of public relations and other taxes. The public relations expense decreased due to the elimination of an outside public relations firm, and other taxes, which are income taxes due to foreign countries, were not applicable in this quarter. These decreases outweighed increases in contract labor, travel expense, and health insurance. For Words+, expenses increased $37,000, or 11.9%, due to increases in catalog printing, commissions to independent sales reps, trade shows, auto lease expenses, health

insurance, and contact labor. These increases outweighed decreases in travel expense, telephone, salaries and wages, payroll taxes, and supplies.

RESEARCH AND DEVELOPMENT

The Company incurred approximately $109,000 of research and development costs for both companies during the first quarter of FY02. Of this amount, $15,000 was capitalized and $94,000 was expensed in this period. In the first quarter of

FY01, the Company incurred $118,000 of research and development costs, of which $32,000 was capitalized and $86,000 was expensed. The decrease of $9,000, or 7.6% in research and development expenditure from the first quarter of 2001 to the first quarter of 2002 was primarily due to the less supply expense in the first quarter of FY02.

INTEREST EXPENSE

Interest expense for the first quarter of FY02 decreased by $1,000, to $5,000 from $6,000 in the first quarter of FY01. This decrease is attributable primarily to a lower interest rate on a revolving line of credit.

NET LOSS

The consolidated net profit for the three months operations increase by $27,000, or 168.8%, to profit of $11,000 in the first quarter of FY02 compared to loss of $16,000 in the first quarter of FY01. Management attributes this increase in profit primarily to the lower cost of sales, thus higher gross profit, which outweighed increases in expenses.

LIQUIDITY AND CAPITAL RESOURCES

The Company's principal sources of capital have been cash flows from its operations, a bank line of credit, a government grant, cash loans from the officers on an as-needed basis, and accruing and not paying portions of salaries to certain executive officers and managers.

The Company has available a $100,000 revolving line of credit from a bank. Interest is payable on a monthly basis at the bank's prime rate plus 3.0%. At November 30, 2001, the outstanding balance under the revolving line of credit was approximately $100,000, and it was $99,000 at November 30, 2000. The revolving line of credit is not secured by any of the assets of the Company but is personally guaranteed by Mr. Walter S. Woltosz, the Company's Chief Executive Officer, President and Chairman of the Board of Directors.

Beginning in August 1998, certain executive officers and managers accepted reduced salaries on a temporary basis in order to protect the cash assets of the Company. The unpaid portions of salaries are being accrued and will be paid at such future time as management deems the Company's cash flow and cash reserves are sufficient to make such payment without adverse effects to the Company's financial position. As of this time, only the Company's CEO and CFO are receiving reduced salaries, with the unpaid amounts being accrued. As of November 30, 2001, the amount of accrued and unpaid salaries due to the Company's executive officers and one manager was $386,000.

The Company believes that existing capital and anticipated funds from operations and temporary salary reductions for senior management will be sufficient to meet its anticipated cash needs for working capital and capital expenditures for at least the next 13 months. Thereafter, if cash generated from operations is insufficient to satisfy the Company's capital requirements, the

Company may have to sell additional equity or debt securities or obtain expanded

credit facilities. In the event such financing is needed in the future, there can be no assurance that such financing will be available to the Company, or, if available, that it will be in amounts and on terms acceptable to the Company. If cash flows from operations are insufficient to continue operations at the current level, and if no additional financing is obtained, then management will restructure the Company in a way to preserve its pharmaceutical and disability businesses while maintaining expenses within operating cash flows.

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

Because the company's securities are listed on the bulletin board, they are subject to Rule 15g-9 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), which imposes additional sales practice requirements on broker-dealers which sell such securities to persons other than established customers and "accredited investors" (generally, individuals with net worth in excess of $1,000,000 or annual incomes exceeding $200,000, or $300,000 together with their spouses). For transactions covered by this rule, a broker-dealer must make a special suitability determination for the purchaser and have received the purchaser's written consent to the transaction prior to the sale. Consequently, the rule may adversely affect the ability of broker-dealers to sell the Company's securities acquired hereby in the secondary market.

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

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

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 2. Changes in Securities

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits and Reports on form 8-K

(a) Exhibits:

None

(b) Reports on Form 8-K

None.

SIGNATURE

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

Simulations Plus, Inc.

Date: January 14, 2002 By: /s/ MOMOKO BERAN

Momoko Beran
Chief Financial Officer