SIMULATIONS PLUS INC
Form 10-Q
July 15, 2010

SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

x Quarterly Report Pursuant to Section 13 or 15(d) of the Security Exchange Act of 1934 for the quarterly period ended May 31, 2010

OR

o Transmission Report Pursuant to Section 13 or 15(d) of the Security Exchange Act of 1937 for the transition period from _____ to _____

Commission file number: 001-32046

Simulations Plus, Inc.
(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.)

42505 10th Street West
Lancaster, CA 93534-7059
(Address of principal executive offices including zip code)

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

Indicate by check mark whether the registrant (1) 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 filings requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act (Check one):

o Large accelerated filer	o Accelerated filer
o Non-accelerated filer (Do not check if a smaller reporting company)	x Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No o

The number of shares outstanding of the registrant's common stock, par value $0.001 per share, as of July 12, 2010 was 15,800,007 and no shares of preferred stock were outstanding.

Simulations Plus, Inc.
FORM 10-Q Quarterly Report
For the Quarterly Period Ended May 31, 2010

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SIMULATIONS PLUS, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED BALANCE SHEETS
May 31, 2010 (Unaudited) and August 31, 2009 (Audited)

ASSETS		
	May 31, 2010	August 31, 2009
Current assets		
Cash and cash equivalents	$8,583,193	$7,473,485
Accounts receivable, net of allowance for doubtful accounts		
and estimated contractual discounts of $394,428 and $447,073	2,164,277	1,888,904
Contracts receivable	169,346	79,565
Income tax refund receivable	524,151	-
Inventory	408,741	325,926
Prepaid expenses and other current assets	101,332	158,738
Deferred income taxes	384,492	338,516
Total current assets	12,335,532	10,265,134
Capitalized computer software development costs,		
net of accumulated amortization of $4,321,641 and $3,843,743	2,154,995	1,942,893
Property and equipment, net (note 3)	44,340	53,220
Customer relationships, net of accumulated amortization of $115,574 and $104,728	12,468	23,314
Other assets	18,445	18,445
Total assets	$14,565,780	$12,303,006
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$281,387	$199,218
Accrued payroll and other expenses	520,463	552,431
Accrued bonuses to officers	60,000	60,000
Accrued warranty and service costs	40,731	43,236
Accrued income taxes	247,614	-
Deferred revenue	191,922	82,190
Total current liabilities	1,342,117	937,075
Long-Term liabilities		
Deferred income taxes	432,761	795,140
Total liabilities	1,774,878	1,732,215
Commitments and contingencies (note 4)		
Shareholders' equity (note 5)		
Preferred stock, $0.001 par value		
10,000,000 shares authorized		
no shares issued and outstanding	-	-

Common stock, $0.001 par value		
50,000,000 shares authorized		
15,852,464 and 15,700,382 shares issued and outstanding on May 31, 2010		
and August 31, 2009, respectively.	4,324	4,172
Additional paid-in capital	5,981,591	5,572,411
Retained earnings	6,804,987	4,994,208
Total shareholders' equity	12,790,902	10,570,791
Total liabilities and shareholders' equity	$14,565,780	$12,303,006

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

SIMULATIONS PLUS, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
For the Three and Nine Months Ended May 31,
(Unaudited)

	Three months ended		Nine months ended	
	2010	2009	2010	2009
Net sales	$3,118,936	$2,713,524	$8,505,707	$7,303,536
Cost of sales	699,402	582,954	2,006,766	1,768,804
Gross profit	2,419,534	2,130,570	6,498,941	5,534,732
Operating expenses				
Selling, general, and administrative	1,117,557	989,165	3,210,649	2,929,578
Research and development	234,318	294,284	747,741	849,484
Total operating expenses	1,351,875	1,283,449	3,958,390	3,779,062
Income from operations	1,067,659	847,121	2,540,551	1,755,670
Other income (expense)				
Interest income	27,433	20,105	73,479	73,098
Interest expense	-	-	(303)	-
Miscellaneous income	1,000	514	1,231	557
Gain on sales of property and equipment	969	-	1,993	-
Gain on currency exchange	14,955	20,233	130,149	70,449
Total other income (expense)	44,357	40,852	206,549	144,104
Income before provision for income taxes	1,112,016	887,973	2,747,100	1,899,774
Provision for income taxes	(371,903)	(318,840)	(936,321)	(650,846)
Net income	$740,113	$569,133	$1,810,779	$1,248,928
Basic earnings per share	$0.05	$0.04	$0.11	$0.08
Diluted earnings per share	$0.04	$0.03	$0.11	$0.07
Weighted-average common shares outstanding				
Basic	16,023,000	16,051,133	15,832,791	16,222,867
Diluted	16,830,281	16,925,581	16,499,813	17,194,349

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

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SIMULATIONS PLUS, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Nine Months Ended March 31,
(Unaudited)

	2010	2009
Cash flows from operating activities		
Net income	$1,810,779	$1,248,928
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization of property and equipment	19,440	16,609
Amortization of customer relationships	10,846	15,335
Amortization of capitalized computer software development costs	477,900	381,390
Bad debts	139,419	219,998
Stock-based compensation	81,175	129,660
Gain on sales of property and equipment	(1,024)	-
Deferred income taxes	198,071	65,100
(Increase) decrease in		
Accounts receivable	(479,996)	(764,257)
Inventory	(82,815)	38,741
Other assets	57,406	110,400
Increase (decrease) in		
Accounts payable	82,169	84,350
Accrued payroll and other expenses	(31,968)	(11,510)
Accrued income taxes	247,614	115,689
Accrued warranty and service costs	(2,505)	6,300
Deferred revenue	109,732	(41,000)
Net cash provided by operating activities	2,636,243	1,615,733
Cash flows from investing activities		
Purchases of property and equipment	(34,113)	(34,777)
Proceeds from sale of investments	-	750,000
Capitalized computer software development costs	(690,002)	(490,327)
Net cash provided by (used in) investing activities	(724,115)	224,896
Cash flows from financing activities		
Repurchase of common stock	(882,100)	(447,825)
Proceeds from the exercise of stock options	79,680	90,210
Net cash used in financing activities	(802,420)	(357,615)
Net increase in cash and cash equivalents	$1,109,708	$1,483,014
Cash and cash equivalents, beginning of year	7,473,485	5,889,601
Cash and cash equivalents, end of period	$8,583,193	$7,372,615

Supplemental disclosures of cash flow information		
Interest paid	$303	$-
Income taxes paid	$426,026	$377,216

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

Simulations Plus, Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1: GENERAL

This report on Form 10-Q for the quarter ended May 31, 2010, should be read in conjunction with the Company's annual report on Form 10-K for the year ended August 31, 2009, filed with the SEC on November 30, 2009 and its amendment filed on March 1, 2010. As contemplated by the Securities and Exchange Commission under Article 8 of Regulation S-X, 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 includes 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

Estimates
Our condensed 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. Significant accounting policies for us include revenue recognition, accounting for capitalized computer software development costs, valuation of stock options, and accounting for income taxes.

Principles of Consolidation
The condensed 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.

Revenue Recognition
We recognize revenues related to software licenses and software maintenance in accordance with Financial Accounting Standards Boards (“FASB”) Accounting Standards Codification (“ASC”) 985-605. Software products revenue is recorded when the following conditions are met: 1) evidence of arrangement exists, 2) delivery has been made, 3) the amount is fixed, and 4) collectability is probable. Post-contract customer support ("PCS") obligations are insignificant; therefore, revenue for PCS is recognized at the same time as the licensing fee, and the costs of providing such support services are accrued and amortized over the obligation period. For Words+ products, the revenue is recorded at the time of shipment, net of estimated allowances and returns.

As a byproduct of ongoing improvements and upgrades for the new programs and new modules of software, some modifications are provided to customers who have already purchased software at no additional charge. Other software modifications result in new, additional cost modules that expand the functionality of the software. These are licensed separately. We consider the modifications that are provided without charge to be minimal, as they do not significantly change the basic functionality or utility of the software, but rather add convenience, such as being able to plot some additional variable on a graph in addition to the numerous variables that had been available before, or adding some additional calculations to supplement the information provided from running the software. Such software modifications for any single product have typically occurred 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 revenue at the time the training or service call is provided.

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

Most license agreements have a term of one year; however, from time to time, we enter into multi-year license agreements. We generally unlock and invoice software one year at a time for multi-year licenses. Therefore, revenue is recognized one year at a time.

We recognize contract study revenue either equally over the term of the contract or using the percentage of completion method, depending upon how the contract studies are engaged, in accordance with FASB ASC 605-35. To recognize revenue using the percentage of completion method, we must determine whether we meet the following criteria: 1) there is a long-term, legally enforceable contract, 2) it is possible to reasonably estimate the total project costs, and 3) it is possible to reasonably estimate the extent of progress toward completion.

Reclassifications
Certain numbers in the prior year have been reclassified to conform to the current year's presentation.

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.

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. Management specifically analyzes the age of customer balances, historical bad debt experience, customer creditworthiness, and changes in customer payment terms when making estimates of the collectability of the Company's trade accounts receivable balances. If management determines that the financial conditions of any of its 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. We also estimate the contractual discount obligation for third-party funding such as Medicare, Medicaid, and private insurance companies. Those estimated discounts are reflected in the allowance for doubtful accounts and contractual discounts.

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.

Capitalized Computer Software Development Costs
Software development costs are capitalized in accordance with FASB ASC 985-20. 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 $477,900 and $381,390 for the nine months ended May 31, 2010 and 2009, respectively. We expect future amortization expense to vary due to increases in capitalized computer software development costs.

We test capitalized computer software costs for recoverability whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

Property and Equipment
Property and equipment are recorded at cost, less accumulated depreciation and amortization. Depreciation and amortization are provided using the straight-line method over the estimated useful lives as follows:

Equipment	5 years
Computer equipment	3 to 7 years
Furniture and fixtures	5 to 7 years
Leasehold improvements	Shorter of life of asset or lease

Maintenance and minor replacements are charged to expense as incurred. Gains and losses on disposals are included in the results of operations.

Fair Value of Financial Instruments
Assets and liabilities recorded at fair value in the Condensed Consolidated Balance Sheets are categorized based upon the level of judgment associated with the inputs used to measure their fair value. The categories, as defined by the standard are as follows:

Level Input:	Input Definition:
Level I	Inputs are unadjusted, quoted prices for identical assets or liabilities in active markets at the measurement date.
Level II	Inputs, other than quoted prices included in Level I, that are observable for the asset or liability through corroboration with market data at the measurement date.
Level III	Unobservable inputs that reflect management’s best estimate of what market participants would use in pricing the asset or liability at the measurement date.

The following table summarizes fair value measurements by level at May 31, 2010 for assets and liabilities measured at fair value on a recurring basis:

	Level I	Level II	Level III	Total
Cash and cash equivalents	$8,583,193	$-	$-	$8,583,193
Total	$8,583,193	$-	$-	$8,583,193

For certain of our financial instruments, including accounts receivable, accounts payable, accrued payroll and other expenses, accrued bonuses to officers, and accrued warranty and service costs, the amounts approximate fair value due to their short maturities.

Shipping and Handling
Shipping and handling costs, recorded as cost of sales, amounted to $88,944 and $75,058 for the nine months ended May 31, 2010 and 2009, respectively.

Research and Development Costs
Research and development costs are charged to expense as incurred until technological feasibility has been established. These costs consist primarily of salaries and direct payroll-related costs. It also includes purchased software which was developed by other companies and incorporated into, or used in the development of, our final products.

Income Taxes
We utilize FASB ASC 740-10 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.

Under this method, deferred income taxes are recognized for the tax consequences in future years of differences between the tax bases of assets and liabilities and their financial reporting amounts at each year-end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized. The provision for income taxes represents the tax payable for the period and the change during the period in deferred tax assets and liabilities.

The difference between income tax expense attributable to continuing operations and the amount of income tax expenses that would result from applying domestic federal statutory rates to pre-tax income is mainly related to state income taxes, offset by the utilization of research and development credits for federal and state purposes. Our policy is to include interest and penalties related to unrecognized tax benefits in income tax expense. Interest and penalties amounted to $731 and $1,028 for the nine months ended May 31, 2010 and 2009, respectively.

Customer relationships
We purchased customer relationships as a part of the acquisition of certain assets of Bioreason, Inc. in November 2005. Customer relationships was recorded at a cost of $128,042, and is being amortized over 78 months under the sum-of-the-years'-digits method. Amortization expense for the nine months ended May 31, 2010 and 2009 amounted to $10,847 and $15,335, respectively. Accumulated amortization as of May 31, 2010 and 2009 was $115,574 and $100,364, respectively.

Earnings per Share
We report earnings per share in accordance with FASB ASC 260-10. Basic earnings per share is computed by dividing income available to common shareholders by the weighted-average number of common shares available. Diluted earnings per share is computed similar to basic earnings 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. The components of basic and diluted earnings per share for the nine months ended May 31, 2010 and 2009 were as follows:

	05/31/2010	05/31/2009
Numerator		
Net income attributable to common shareholders	$1,810,779	$1,248,928
Denominator		
Weighted-average number of common shares outstanding during the year	15,832,791	16,222,867
Dilutive effect of stock options	667,022	971,482
Common stock and common stock equivalents used for diluted earnings per share	16,499,813	17,194,349

Stock-Based Compensation
Compensation costs related to stock options are determined in accordance with FASB ASC 718-10 using the modified prospective method. Under this method, compensation cost includes: (1) compensation cost for all share-based payments granted prior to, but not yet vested as of September 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123 amortized over the options' vesting period, and (2) compensation cost for all share-based payments granted subsequent to September 1, 2006, based on the grant-date fair value estimated in accordance FASB ASC 718-10, amortized on a straight-line basis over the options' vesting period. Stock-based compensation was $81,175 and $129,660 for the nine months ended May 31, 2010 and 2009, respectively, and is included in the condensed consolidated statements of operations as Salaries, Consulting, and Research and Development expense.

Concentrations and Uncertainties
International sales accounted for 31% of net sales for both of the nine months ended May 31, 2010 and 2009. For Simulations Plus, Inc. (pharmaceutical segment), one customer accounted for 14% of net sales during the nine months ended May 31, 2010, compared with two customers accounting for 14% each of net sales during the nine months ended May 31, 2009. We license our software on an annual basis, and two large customers renew their licenses during the first nine months of our fiscal year. Therefore, as a percentage of total revenue, the renewals from those two customers typically result in 23 ~ 28% percent of all Pharmaceutical revenue for the first nine months.

For Words+, Inc., third-party billing, which includes various government agencies as well as private insurance companies, accounted for 57% of net sales during the nine months ended May 31, 2010, compared with 60% of net sales during the nine months ended May 31, 2009. If changes are made in government funding policies for Words+ products, Words+ revenue may be impacted. We continually evaluate and monitor regulatory developments in funding matters, and we do not expect Medicare and Medicaid of all 50 states to discontinue their funding of Words+ products; however, there can be no assurances that the current level of revenue from third parties will continue.

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 Simulations Plus (pharmaceutical segment), three customers comprised 27%, 17%, and 14% (a dealer account representing various customers) of its accounts receivable at May 31, 2010, and three customers comprised 21% (one dealer account representing various customers), 18% and 17% of its accounts receivable at May 31, 2009. For Words+, third-party billing, which includes various government agencies, comprised 86% of its accounts receivable at May 31, 2010, and 88% of its accounts receivable at May 31, 2009. Collection of those accounts receivable in a timely manner is critical to Words+' cash flow and its operations. We have three dedicated funding/billing personnel who continually track such collections.

Our subsidiary, Words+, Inc., purchases components for its main computer products from four manufacturers. Words+, Inc. also uses a number of pictographic symbols that are used in its software products which are licensed from a third party. The inability of Words+ to obtain computers used in its products or to renew its licensing agreement to use pictographic symbols could negatively impact our financial position, results of operations, and cash flows.

Recently Issued Accounting Pronouncements
In September 2009, the FASB issued ASU 2009-14 which amends Statement of Position ("SOP") 97-2, "Software Revenue Recognition", to exclude tangible products containing software components and non-software components that function together to deliver the product's essential functionality. ASU 2009-14 applies to revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with early application permitted with EITF 08-1. We expect to adopt this standard in the first quarter of fiscal 2011. We are currently evaluating the impact ASU 2009-14 will have on our consolidated financial statements.

In September 2009, the FASB issued ASU 2009-13, "Revenue Arrangements with Multiple Deliverables" ("EITF 08-1"). ASU 2009-13 amends EITF 00-21, "Revenue Arrangements with Multiple Deliverables", to require an entity to use an estimated selling price when vendor-specific objective evidence or acceptable third-party evidence does not exist for any products or services included in a multiple element arrangement. The arrangement consideration should be allocated among the products and services based upon their relative selling prices, thus eliminating the use of the residual method of allocation. ASU 2009-13 also requires expanded qualitative and quantitative disclosures regarding significant judgments made and changes in applying the guidance. ASU 2009-13 applies to fiscal years beginning after June 15, 2010, with early application permitted. We expect to adopt this standard in the first quarter of fiscal 2011. We are currently evaluating the impact ASU 2009-13 will have on our consolidated financial statements.

Note 3: PROPERTY AND EQUIPMENT

Property and equipment as of May 31, 2010 consisted of the following:

Equipment	$80,830
Computer equipment	386,216
Furniture and fixtures	61,498
Automobile	21,769
Leasehold improvements	53,898
Sub total	604,211
Less: Accumulated depreciation and amortization	(559,871)
Net Book Value	44,340

Note 4: COMMITMENTS AND CONTINGENCIES

Employment Agreement
On August 31, 2009, we entered into an employment agreement with our President/Chief Executive Officer that expires in August 2011. The employment agreement provides for an annual base salary of $275,000 per year, and a performance bonus in an amount not to exceed 10% of the Employee's salary, or $27,500 per year, at the end of each fiscal year. The specific amount of the bonus to be awarded will be determined by the Compensation Committee of the Board of Directors, based on the financial performance and achievements of the Company for the previous fiscal year. The agreement also provides Employee stock options, exercisable for five years, to purchase fifty (50) shares of Common Stock for each one thousand dollars ($1,000) of net income before taxes at the end of each fiscal year up to a maximum of 120,000 options over the term of the agreement. We may terminate the agreement upon 30 days' written notice if termination is without cause. Our only obligation would be to pay the 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
We are not a party to any litigation at this time and we are not aware of any pending litigation of any kind.

Note 5: SHAREHOLDERS' EQUITY

Stock Repurchase
On October 23, 2008, the board of directors authorized a share repurchase program (Phase I) enabling the buyback of up to $2.5 million in shares during a 12-month period beginning Monday, October 27, 2008. The actual repurchase started on December 2, 2008; therefore the board of directors extended it through December 1, 2009 in order to have a full 12-month period. We opened an account with Morgan Stanley Smith Barney for the purchase of such securities. Funds for any stock purchases are drawn from our cash reserves.

On January 10, 2010, the board of directors authorized a renewed share repurchase program (Phase II) effective as of February 15, 2010. The renewed program enables the Company to buy back up to one million shares during a 12-month period.

The details of repurchases made during the nine months ended May 31, 2010 are listed in the following table:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Remaining Funds Available Under the Share Repurchase Plan (including broker's fees)
As of 08/31/09	846,842	$1.2569	$1,416,564
09/01/09 to 09/30/09	82,630	$1.6989	$1,274,155
10/01/09 to 10/31/09	52,364	$1.5685	$1,190,386
11/01/09 to 11/30/09	42,061	$1.4884	$1,126,560
12/01/09	2,586	$1.3823	$1,122,985
Phase I Total	1,026,483	$1.3182	

Period	Total Number of Shares Purchased	Average Price Paid per Share	Remaining Shares Authorized for Repurchase Under the Share Repurchase Plan – Phase II
04/01/10 to 04/30/10	86,976	$2.2237	913,024
05/01/10 to 05/31/10	170,101	$2.3515	742,923

Phase II Total	257,077	$2.3083

Stock Option Plan

In September 1996, the Board of Directors adopted, and the shareholders approved, the 1996 Stock Option Plan (the "Option Plan") under which a total of 1,000,000 shares of common stock had been 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 2,000,000. In February 2000, the shareholders approved an increase in the number of shares that may be granted under the Option Plan to 4,000,000. In December 2000, the shareholders approved an increase in the number of shares that may be granted under the Option Plan to 5,000,000. Furthermore, in February 2005, the shareholders approved an additional 1,000,000 shares, resulting in the total number of shares that may be granted under the Option Plan to 6,000,000. The 1996 Stock Option Plan terminated in September 2006 by its term.

On February 23, 2007, the Board of Directors adopted and the shareholders approved the 2007 Stock Option Plan under which a total of 1,000,000 shares of common stock had been reserved for issuance.

TRANSACTIONS IN FY 2010

	Number of Options	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Life (Years)
Outstanding, August 31, 2009	2,862,536	$ 0.97	
Granted	252,666	$ 1.79	
Exercised/Released	(885,000)	$ 0.60	
Cancelled/Forfeited	(27,000)	$ 1.47	
Expired	(617,000)	$ 1.47	
Outstanding, May 31, 2010	1,586,202	$ 1.11	4.4
Exercisable, May 31, 2010	1,014,736	$ 0.86	3.4

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which do not have vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. Because our employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of our employee stock options.

The weighted-average remaining contractual life of options outstanding issued under the Plan was 4.4 years at May 31, 2010. The exercise prices for the options outstanding at May 31, 2010 ranged from $0.26 to $3.02, and the information relating to these options is as follows:

Exercise Price		Awards Outstanding			Awards Exercisable		
Low	High	Quantity	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Quantity	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price
$0.26	$0.75	443,436	0.8 years	$0.37	443,436	0.8 years	$0.37
$0.76	$1.25	762,100	6.1 years	$1.08	530,100	5.2 years	$1.13
$1.26	$3.02	380,666	5.2 years	$2.04	41,200	7.8 years	$2.71
		1,586,202	4.4 years	$1.11	1,014,736	3.4 years	$0.86

Other Stock Options
As of May 31, 2010, the Board of Directors holds options to purchase 63,000 shares of common stock at exercise prices ranging from $0.30 to $6.68, which were granted prior to May 31, 2010.

TRANSACTIONS IN FY 2010

Transactions in FY10	Number of Options	Weighted-Average Exercise Price Per Share
Outstanding, August 31, 2009	51,000	$ 1.89
Granted	12,000	$ 1.67
Exercised	-	$ -
Expired	-	$ -
Outstanding, May 31, 2010	63,000	$ 1.85
Exercisable, May 31, 2010	42,000	$ 1.63

Note 6: SEGMENT AND GEOGRAPHIC REPORTING

We account for segments and geographic revenues in accordance with ASC 280-10. 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, 2010 and May 31, 2009 (in thousands):

May 31, 2010

	Simulations Plus, Inc	Words +, Inc.	Eliminations	Total
Net Sales	$6,287	$2,219		$8,506
Income (loss) from operations	2,763	(222)		2,541
Identifiable assets	14,496	1,590	$(1,520)	14,566
Capital expenditures	22	12		34
Depreciation and Amortization	466	42		508

May 31, 2009

	Simulations Plus, Inc	Words +, Inc.	Eliminations	Total
Net Sales	$5,194	$2,110		$7,304
Income (loss) from operations	1,326	(77)		1,249
Identifiable assets	12,417	2,045	$(1,687)	12,775
Capital expenditures	15	20		35
Depreciation and Amortization	374	39		413

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, 2010 and 2009 were as follows (in thousands):

May 31, 2010

	North America	Europe	Asia	Oceania	South America	Total
Simulations Plus, Inc.	$3,749	$1,680	$850	$-	$8	$6,287
Words+, Inc.	2,121	25	36	37	-	2,219
Total	$5,870	$1,705	$886	$37	$8	$8,506

May 31, 2009

	North America	Europe	Asia	Oceania	South America	Total
Simulations Plus, Inc.	$3,023	$1,457	$714	$-	$-	$5,194
Words+, Inc.	2,027	24	17	42	-	2,110
Total	$5,050	$1,481	$731	$42	$-	$7,304

Note 7: EMPLOYEE BENEFIT PLAN

We maintain a 401(K) Plan for all eligible employees, and make matching contributions equal to 100% of the employee's elective deferral, not to exceed 4% of total employee compensation. We can also elect to make a profit-sharing contribution. Our contributions to this Plan amounted to $62,864 and $60,661 for the nine months ended May 31, 2010 and May 31, 2009, respectively.

Note 8: SUBSEQUENT EVENT

In April 2010, we started buying back our own shares under the renewed repurchase program, and we plan to continue our share repurchase in accordance with the share repurchase plan, which authorizes up to 1 million shares through February 15, 2011. Our repurchases from June 1 through July 12, 2010 are summarized in the following table.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Remaining Shares Authorized to Purchase Under the Share Repurchase Plan
06/01/10 to 06/30/10	33,665	$ 2.3634	709,258

07/01/10 through 07/12/10	18,789	$	2.4433	690,469
Total	52,454	$	2.3920	

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

Forward-Looking Statements

This document and the documents incorporated in this document by reference contain forward-looking statements that are subject to risks and uncertainties. All statements other than statements of historical fact contained in this document and the materials accompanying this document are forward-looking statements.

The forward-looking statements are based on the beliefs of our management, as well as assumptions made by and information currently available to our management. Frequently, but not always, forward-looking statements are identified by the use of the future tense and by words such as “believes,” expects,” “anticipates,” “intends,” “will,” “may,” “cou “would,” “projects,” “continues,” “estimates” or similar expressions. Forward-looking statements are not guarantees of future performance and actual results could differ materially from those indicated by the forward-looking statements. Forward-looking statements involve known and unknown risks, uncertainties, and other factors that may cause our or our industry’s actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by the forward-looking statements.

The forward-looking statements contained or incorporated by reference in this document are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (“Securities Act”) and Section 21E of the Securities Exchange Act of 1934, as amended (“Exchange Act”) and are subject to the safe harbor created by the Private Securities Litigation Reform Act of 1995. These statements include declarations regarding our plans, intentions, beliefs or current expectations.

Among the important factors that could cause actual results to differ materially from those indicated by forward-looking statements are the risks and uncertainties described under “Risk Factors” in our Annual Report and elsewhere in this document and in our other filings with the SEC.

Forward-looking statements are expressly qualified in their entirety by this cautionary statement. The forward-looking statements included in this document are made as of the date of this document and we do not undertake any obligation to update forward-looking statements to reflect new information, subsequent events or otherwise.

General

BUSINESS

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

SIMULATIONS PLUS

PRODUCTS

We currently offer four software products for pharmaceutical research: ADMET Predictor™, ClassPharmer™, DDDPlus™, and GastroPlus™. In addition to pharmaceutical research products, we offer a personal productivity software, "Abbreviate!" through the on-line Apple store as well as a Windows XP version through our website. We also offer a product line called FutureLab™ that provides simulated experiments for middle school and high school general science classes.

ADMET Predictor

Every drug molecule that fails in clinical trials, and every approved drug that gets withdrawn from the market, was bad from the time its structure was first drawn by a chemist or generated by a computer. They don't become bad later. Thus, the ability to predict unsuitable characteristics of new molecules as early as possible offers the promise of avoiding costly programs that end up in late-stage failures. Although not every failure mode can be predicted in this manner, those that can provide a means to reduce the number of failures that frequently occur after years of work and millions of dollars (sometimes over $1.5 billion) have been spent.

ADMET (Absorption, Distribution, Metabolism, Excretion and Toxicity) Predictor provides a collection of highly sophisticated and statistically significant numerical models that predict various properties of chemical compounds from just their molecular structures. Our models are built using state-of-the-art machine learning approaches that are based primarily on artificial neural network ensembles (groups of artificial neural networks), using a proprietary training methodology that we have developed over the past 8 years. The quality of our models has been consistently evaluated in published scientific reports by independent third parties to provide the most accurate prediction capabilities available today.

This capability means a chemist can merely draw a molecule diagram and get estimates of a wide variety of properties, even though the molecule has never existed. Drug companies continually search through millions of such "virtual" molecular structures as they attempt to find new drugs. It has been estimated that there are somewhere on the order of 1062 possible drug-like molecular structures. That is such a huge number that it is difficult to comprehend. If we could evaluate a trillion molecules (1012) per second (we cannot), it would still take 1050 seconds to evaluate them all -- that's about 10,000,000,000,000,000,000,000,000,000,000,000,000,000,000,000 years. The age of the universe is said to be less than 100,000,000,000 years. Clearly, we will never be able to make and test all of them, so computerized methods are the only hope to even scratch the surface of the total "chemical space" for potential pharmaceutical products.

The vast majority of drug-like 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 cell walls 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 (such as albumin) in blood to such a high extent that little unbound drug is available to reach the target, and many will produce a variety of adverse effects. Identification of such properties in the computer ("in silico") enables researchers to eliminate poor compounds quickly and early before spending time and money to make them and run experiments to identify their weaknesses. Today, many potential new molecules can be eliminated on the basis of the properties predicted by ADMET Predictor without the need to actually make and test them.

Several independent studies have been published that compare the accuracy of software programs like ADMET Predictor. In almost every case, ADMET Predictor has been ranked first in accuracy. The specific set of molecules used in such studies, as well as the statistics used for comparison, often favors one program over others; however, across all published studies, ADMET Predictor has been top-ranked far more than any other program. This is a remarkable accomplishment, considering the greater size and resources of many of our competitors.

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ADMET Predictor includes ADMET Modeler™. ADMET Modeler was first released in July of 2003 as a separate product (with the name QMPRchitect™ back then), and was integrated into ADMET Predictor in 2006. This powerful program automates the training of the predictive models used in ADMET Predictor, so they are produced in a small fraction of the time once required. For example, new toxicity models were developed in a matter of a few hours once we completed the tedious effort of “cleaning up” the databases (which often contain a significant number of errors). Prior to the availability of ADMET Modeler, we would have needed as much as three months to develop each new model after cleaning the databases 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 performed by specialists. With ADMET Modeler integrated into ADMET Predictor, scientists without model-building experience can now use their own experimental data to quickly create high-quality predictive models.

ADMET Predictor is compatible with the popular Pipeline Pilot™ software offered by SciTegic, a subsidiary of Accelrys. This software serves as a tool to allow chemists to run several different software programs in series to accomplish a set workflow for large numbers of molecules. In early discovery, chemists often work with hundreds of thousands or millions of “virtual” molecules – molecules that exist only in computer files. The chemist needs to decide which few molecules from these large “libraries” should be made and tested. Using Pipeline Pilot with ADMET Predictor (and ClassPharmer™ – see below), perhaps in conjunction with other software products, the chemist can create and screen very large libraries faster and more efficiently than by running each program by itself. Many scientists believe that in silico molecule design is the wave of the future, and we believe we are at the forefront of this new technology.

During the third quarter, we have worked to bring to conclusion a nearly year-long effort to develop the next major release of ADMET Predictor, which will be called version 5.0. This new version has taken advantage of our work on our Small Business Innovation Research (SBIR) grant with the National Institutes of Health (NIH) to enhance the atomic partial charge calculations and the resultant improved descriptor set from which all models are built. We expect to release ADMET Predictor 5.0 in the fourth quarter with all new retrained models, additional models not currently offered, and a variety of user interface improvements to set this best-in-class software even further ahead of the competition. We’re also continuing to work on the ability to predict which atoms in a molecule are most likely to be affected by metabolism by certain enzymes. This is an exciting new capability that is a part of our SBIR grant effort, and we expect it will add an important new capability to ADMET Predictor when it is completed.

MedChem Studio™ (formerly ClassPharmer™)
We have renamed our former ClassPharmer product to MedChem Studio to reflect the greatly enhanced capabilities it now has over the original ClassPharmer product. MedChem Studio has become a powerful tool for medicinal and computational chemists for both data mining and for designing new drug-like molecules. Coupled with ADMET Predictor, the two programs provide an unmatched capability for chemists to search through huge libraries of compounds to find the most promising classes and molecules that are active against a particular target. In addition, MedChem Studio with ADMET Predictor can take an interesting (but not acceptable) molecule and very quickly generate and evaluate high quality analogs (i.e., similar new molecules) using several different algorithms. The result is new molecules that are predicted to be both active against the target as well as acceptable in a variety of ADMET properties.

MedChem Studio's molecule design capabilities provide a number of powerful ways for chemists to rapidly generate large numbers of novel chemical structures based on intelligence from compounds that have already been synthesized and tested, or from basic chemical reactions selected by the user. Export of results is available in Microsoft Excel™ format as well as other convenient file formats requested by users.

During the third quarter, the "refactoring" effort was substantially completed, with the result that the in-house test version of MedChem Studio is now both faster and more compact, and has a significant number of new powerful options for visualizing various types of information generated by the program. We believe the upcoming release of MedChem Studio will be received with considerable excitement. We presented results generated with it as part of a scientific poster session at the ADMET 2010 conference in Munich in April, and we have another poster to be presented at a scientific conference in Sheffield, England, in July.

DDDPlus
DDDPlus sales continue to grow as more and more formulation scientists recognize the value of this one-of–a–kind simulation software in their work. During 2009, improvements were added to further enhance the value of this product, including numerous user convenience features, as well as more sophisticated handling of dosage forms that incorporate multiple polymers for controlled release formulations.

Development efforts on DDDPlus continued to be minimal during the third quarter because of the heavy load of testing and documentation of the next release of GastroPlus (see below) as well as contract consulting studies that required staff time to complete on schedule. A few small improvements and minor bug fixes were implemented.

GastroPlus
GastroPlus continues to enjoy its "gold standard" status in the industry for its class of simulation software. During the third quarter we have been intensively working to finalize Version 7.0, which will include three major market-expanding capabilities that have been in development for over a year. Software development is essentially complete and a prerelease version is in full production use at several large pharmaceutical companies, all of whom funded various aspects of development for this new version. This release incorporates a highly sophisticated drug-drug interaction simulation capability funded by Roche, the ocular drug delivery model from our funded collaboration with Pfizer, and the pulmonary drug delivery model we developed under our funded collaboration with GlaxoSmithKline. We believe this combination of capabilities will put GastroPlus further in front of the limited competition we see in this market niche.

At an international conference in Shanghai, China, in May 2008, Pfizer scientists presented a scientific poster describing a two-year study in which all four commercially available PBPK (physiologically based pharmacokinetics) simulation programs were compared for their ability to predict human pharmacokinetics from preclinical (animal and in vitro) data. The study was divided into two arms: intravenous and oral dosing. GastroPlus was ranked first in both arms. No other software was ranked consistently second or third. This independent evaluation, which was accomplished via analysis of 21 Pfizer proprietary compounds with data from early discovery all the way through human trials, provides the strongest possible validation of the superiority of GastroPlus in pharmaceutical research and development. In a recent presentation by a Pfizer scientist at the American Association of Pharmaceutical Scientists in November 2009, the point was made that GastroPlus simulations were accepted by the FDA in lieu of an additional clinical trial – the cost and time savings from this type of study provide a very strong testimony to the value of simulation software in pharmaceutical development. We believe that it is experiences such as this that will continue to increase the use of simulation and modeling tools in pharmaceutical research and development so that the pharmaceutical industry will become more and more like the aerospace, automotive, and electronics industries, wherein simulation and modeling are standard tools for design and development.

The insight gained through GastroPlus simulations can guide project decisions in various ways. Among the kinds of knowledge gained through such simulations are: (1) the best estimate for “first dose in human” for a new drug prior to Phase I trials, (2) 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, (3) whether the absorption process is affected by certain enzymes and transporter proteins in the intestinal tract that may cause the amount of drug reaching the blood to be very different after absorption from one region of the intestine to another, (4) when certain properties of a new compound are probably adequately estimated through computer (“in silico”) predictions (such as from ADMET Predictor) or simple experiments rather than through more expensive and time-consuming in vitro or animal experiments, (5) what the likely variations in blood and tissue concentration levels of a new drug would be in a large population, in different age groups or in different ethnic groups, and (6) 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 and reorder history indicate that GastroPlus continues to dominate its market niche in the number of users worldwide. In addition to virtually every major pharmaceutical company, licenses include government agencies in the U.S and abroad, a growing number of smaller pharmaceutical and 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 we believe includes a few thousand companies, represents major growth potential for GastroPlus. Our experience has been that the number of new companies adopting GastroPlus has been growing steadily, adding to the base of annual license renewals each year. Recent consolidations by larger companies have not affected our sales to date. In fact, those companies have typically adopted in silico tools at ever-greater levels, with the result that licenses have increased at renewal time even in the face of such consolidation.

Contract Research and Consulting Services

Our recognized world-class expertise in oral absorption and pharmacokinetics is evidenced by the fact that our staff members have been speakers or presenters at over 50 prestigious scientific meetings worldwide in the past five years. We frequently conduct contracted studies for large customers (including several of the top 5 pharmaceutical companies) who have particularly difficult problems and who recognize our expertise in solving them, as well as for smaller customers who prefer to have studies run by our scientists rather than to license our software and train someone to use it, or. The demand for our consulting services has been increasing steadily, and we expect this trend to continue. Long-term collaborations and shorter-term consulting contracts serve both to showcase our technologies and as a way to build and strengthen customer relationships.

Government-Funded Research

We are well along in our $525,000 Phase II SBIR (Small Business Innovation Research) grant awarded by the NIH (National Institutes of Health). This SBIR grant has provided funds that allowed us to expand staff and grow the product line without adversely affecting earnings, because the expenses associated with the efforts in the grant study are funded largely through the grant with some company support.

WORDS+ SUBSIDIARY

PRODUCTS

Our wholly owned subsidiary, Words+, Inc., has been an industry pioneer and technology leader for over 28 years, focused on introducing and improving augmentative and alternative communication and computer access software and devices for people with disabilities. Following closely behind the introduction of four new products last quarter, Words+ introduced EyeProTM, an eyegaze product, at the national CSUN Conference in San Diego during March, 2010. Eyegaze technology allows people to operate a computer or communication device by simply looking at the screen, and has been a major breakthrough for people with severe disabilities. The introduction of an eyegaze product has been our goal for some time, but we were previously unable to negotiate a profitable deal with an outside manufacturer. We have now done so. We’re currently processing EyeProTM orders and shipping product. The addition of EyeProTM to our product line significantly increases the effectiveness of our sales network, as many of our distributors were previously selling a different eyegaze product, and our in-house sales employees had no eyegaze product to offer. We already have twenty EyeProTM products in the field being shown to customers by a trained sales force. When EyeProTM is combined with E Z KeysTM, it becomes one of the most powerful ways to operate standard Windows applications using only the eyes. The combination is more seamless than other eyegaze/communication software products on the market. EyeProTM also combines with the MindExpressTM software that we resell to allow students or anyone operating below the full professional productive mode to chat, send email, make phone calls, etc. from inside MindExpress using special features to make the process easier for people with disabilities. EyeProTM is already producing positive results.

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Results of Operations

Comparison of Three Months Ended May 31, 2010 and May 31, 2009.

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			
	05/31/10		05/31/09	
Net sales	$ 3,119	100%	$ 2,713	100%
Cost of sales	699	22.4	583	21.5
Gross profit	2,420	77.6	2,130	78.5
Selling, general and administrative	1,118	35.8	989	36.5
Research and development	234	7.5	294	10.8
Total operating expenses	1,352	43.4	1,283	47.3
Income from operations	1,068	34.2	847	31.2
Other income	44	1.4	41	1.5
Net income before taxes	1,112	35.7	888	32.7
(Provision for) income taxes	(372)	(11.9)	(319)	(11.8)
Net income	$ 740	23.7%	$ 569	20.9%

Net Sales

Consolidated net sales increased $406,000, or 14.9%, to $3,119,000 in the third fiscal quarter of 2010 (3QFY10) from $2,713,000 in the third fiscal quarter of 2009 (3QFY09). Our sales from pharmaceutical and educational software increased approximately $340,000, or 17.1%; and our Words+, Inc. subsidiary's sales also increased approximately $66,000, or 9.1%, for the quarter. We attribute the increase in pharmaceutical software sales to increases in number of licenses with new and existing customers, licensing of new modules to existing customers, and SBIR grant revenue which outweighed the decrease in corroborations/study contracts after completing major contracts. We attribute the increase in Words+ sales of our "Conversa" product with preloaded "Say-it! SAM" software. Increased revenues from these products outweighed decreased revenues from other products.

Cost of Sales

Consolidated cost of sales increased $116,000, or 20.0%, to $699,000 in 3QFY10 from $583,000 in 3QFY09. Cost of sales as a percentage of revenue for 3QFY10 increased 0.9% to 22.4% from 21.5% in 3QFY09. For Simulations Plus (pharmaceutical business), cost of sales increased $76,000, or 27.5%, and as a percentage of revenue, cost of sales also increased to 15.3% in 3QFY10 from 14.0% in 3QFY09. A significant portion of cost of sales for pharmaceutical software products 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 $32,000, or 41.0%, in 3QFY10 compared with 3QFY09. Royalty expense, a variable cost related to sales of our GastroPlus core program as well as our ADMET Predictor Enslein Metabolism module, increased approximately $50,000, or 12.0%, in 3QFY10 compared with 3QFY09. This increase is due to a price increase on which royalty calculations are based.

For Words+, cost of sales increased $40,000, or 13.1%. As a percentage of revenue, cost of sales increased to 43.4% in 3QFY10 from 41.8% in 3QFY09. We attribute the percentage increase in cost of sales for Words+ to sales generated from products with lower margins. As we mentioned in the sales discussion above, we experienced increased revenue from our “Conversa” product, which has a lower margin, resulting in a higher cost of sales.

Gross Profit

Consolidated gross profit increased $290,000, or 13.6%, to $2,420,000 in 3QFY10 from $2,130,000 in 3QFY09. We attribute this increase to increased sales of pharmaceutical software and services in addition to increased sales of Words+ products, which outweighed the increase in cost of goods sold.

Selling, General and Administrative Expenses

Consolidated selling, general and administrative (SG&A) expenses increased $129,000, or 13.0%, to $1,118,000 in 3QFY10 from $989,000 in 3QFY09. For Simulations Plus, SG&A increased $40,000, or 6.2%; however as a percentage of sales, SG&A decreased to approximately 29.0% in 3QFY10 from approximately 31.6% in 3QFY09. The major increases in SG&A expenses were investor relations, salaries and payroll related expenses, such as payroll tax and health insurance, which outweighed decreases in travel expenses, consultant fees, and professional fees.

For Words+, SG&A expenses increased $89,000, or 25.1%, due to increases in travel, commissions, salaries and payroll related expenses. These increases outweighed decreases in allowances for bad debts.

Research and Development

We incurred approximately $468,000 of research and development costs for both companies during 3QFY10. Of this amount, $234,000 was capitalized and $234,000 was expensed. In 3QFY09, we incurred $432,000 of research and development costs, of which $138,000 was capitalized and $294,000 was expensed. The increase of $36,000, or 8.3%, in total research and development expenditures from 3QFY09 to 3QFY10 was due to hiring outside R&D contractors, salary of a new hire and salary increases to existing staff.

Other income (expense)

Net other income (expense) increased by $3,000, or 8.6%, to $44,000 in 3QFY10 from $41,000 in 3QFY09. This is due to increased interest revenues from our Money Market account, which outweighed decreases in gains from currency exchange.

Provision for Income Taxes

The provision for income taxes increased by $53,000, or 16.6%, to $372,000 in 3QFY10 from $319,000 in 3QFY09 due to our estimation of higher provision for income tax in fiscal year 2010. The tax rate used in this report is somewhat lower than the standard rate because of various tax credits generated and used during this reporting period.

Net Income

Consolidated net income increased by $171,000, or 30.0%, to $740,000 in 3QFY10 from $569,000 in 3QFY09. We attribute this increase in profit to the increases in gross profits from pharmaceutical software/services and Words+ products, other income, and decrease in R&D expense which outweighed increases in SG&A expense and tax provision.

Comparison of Nine months Ended May 31, 2010 and May 31, 2009.

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			
	05/31/10		05/31/09	
Net sales	$8,506	100%	$7,303	100%
Cost of sales	2,007	23.6	1,769	24.2
Gross profit	6,499	76.4	5,534	75.8
Selling, general and administrative	3,210	37.7	2,929	40.1
Research and development	748	8.8	849	11.6
Total operating expenses	3,958	46.5	3,778	51.7
Income from operations	2,541	29.9	1,756	24.0
Other income	206	2.4	144	2.0
Net income before taxes	2,747	32.3	1,900	26.0
(Provision for) income taxes	(936)	(11.0)	(651)	(8.9)
Net income	$1,811	21.3%	$1,249	17.1%

Net Sales

Consolidated net sales increased $1,203,000, or 16.5%, to $8,506,000 in the first nine months of fiscal year 2010 (9moFY10) from $7,303,000 in the first nine months of fiscal year 2009 (9moFY09). Our sales from pharmaceutical software and services increased approximately $1,093,000, or 21.0%, and our Words+, Inc. subsidiary's sales increased approximately $110,000, or 5.2%, for 9moFY10.

We attribute the increase in pharmaceutical software sales to increased licenses to new customers, to licenses both for new modules and additional licenses to renewal customers, to SBIR grant revenues, and to collaborations/contract studies. We attribute the increase in Words+ sales to sales of our new "Allora", "ConversaTM" with Say-It! SAM software and "MessageMates" ordered from Japan. Those increases outweighed decreases in "Freedom" and "TuffTalker" product sales.

Cost of Sales

Consolidated cost of sales increased $238,000, or 13.5%, to $2,007,000 in 9moFY10 from $1,769,000 in 9moFY09. Cost of sales as a percentage of revenue in 9moFY10 decreased 0.6% to 23.6% from 24.2% in 9moFY09. For Simulations Plus, cost of sales increased $126,000, or 15.4%; however, as a percentage of revenue, cost of sales decreased to 15.1% in 9moFY10 from 15.8% in 9moFY09. A significant portion of cost of sales for pharmaceutical software products 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 $96,000, or 27.6%, in 9moFY10 compared with 9moFY09. Royalty expense, which is a variable cost related to sales of our GastroPlus core program as well as our new ADMET Predictor Enslein Metabolism Module, increased approximately $52,000, or 15.9%, in 9moFY10 compared with 9moFY09.

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For Words+, cost of sales increased $112,000, or 11.8%. As a percentage of revenue, cost of sales also increased to 47.8% in 9moFY10 from 44.9% in 9moFY09. We attribute the percentage increase in cost of sales for Words+ to increased percentage of sales generated from products with lower margins. As we mentioned in the sales discussion above, we sold MessageMates to our distributor in Japan with a volume discount. Increased revenue from our "Conversa" product which has a lower margin, also resulted in higher cost of sales.

Gross Profit

Consolidated gross profit increased $965,000, or 17.4%, to $6,499,000 in 9moFY10 from $5,534,000 in 9moFY09. We attribute this increase to increased sales of pharmaceutical software and services with healthy gross margins, which outweighed the decrease in gross profit from Words+ products.

Selling, General and Administrative Expenses

Consolidated selling, general and administrative (SG&A) expenses increased $281,000, or 9.6%, to $3,210,000 in 9moFY10 from $2,929,000 in 9moFY09. For Simulations Plus, SG&A increased $108,000, or 6.1%; however, as a percentage of sales, SG&A decreased 4.3%, from 34.2% in 9moFY09 to 29.9% in 9moFY10. The major increases in SG&A expenses were salaries and payroll-related expenses, investor relations, recruiting, equipment rental, professional fees, and consultant fees, which outweighed decreases in commissions and customer relations in 9moFY10.

For Words+, SG&A expenses increased $173,000, or 15.0%, to $1,328,000 in 9moFY10 from $1,155,000 in 9moFY09. We attribute this increase in SG&A to an increase in restructured dealer commission expense to be competitive with other companies in the industry, travel, repairs, contract labor, salaries and payroll-related expenses which outweighed decreases in allowance for bad debts, technical service costs, and equipment rental.

Research and Development

We incurred approximately $1,425,000 of research and development costs for both companies in 9moFY10. Of this amount, $677,000 was capitalized and $748,000 was expensed. In 9moFY09, we incurred $1,340,000 of research and development costs, of which $491,000 was capitalized and $849,000 was expensed. The increase of $85,000, or 6.3%, in total research and development expenditures from 9moFY09 to 9moFY10 was due to a combination of salaries for new hires and salary increases to existing staff.

Other income

Net other income in 9moFY10 increased by $62,000, or 44.0%, from $144,000 to $206,000. This is due to increased interest revenues from a gain on currency exchange from the billing in foreign currencies at the request of our customers.

Provision for Income Taxes

The provision for income taxes increased by $285,000, or 43.9%, to $936,000 in 9moFY10 from $651,000 in 9moFY09. This increase is due to our estimation of higher provision for income tax in fiscal year 2010. The tax rate of approximately 34% used in this report is somewhat lower than the standard rate because of various tax credits generated and used during this reporting period.

Net Income (loss)

Consolidated net income increased by $562,000, or 45.1%, to $1,811,000 in 9moFY10 from $1,249,000 in 9moFY09. We attribute this increase in profit to the increases in revenue from pharmaceutical software/services and Words+ products, other income, and decreases in R&D expense which outweighed increase in cost of sales, SG&A, and tax provision.

Liquidity and Capital Resources

Our principal sources of capital have been cash flows from our operations. We have achieved continuous positive operating cash flow in the last six fiscal years. We believe that our existing capital and anticipated funds from operations will be sufficient to meet our anticipated cash needs for working capital and capital expenditures for the foreseeable future. Thereafter, if cash generated from operations is insufficient to satisfy our capital requirements, we may open a revolving line of credit with a bank, or we 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 us, or, if available, that it will be in amounts and on terms acceptable to us. If cash flows from operations became insufficient to continue operations at the current level, and if no additional financing was obtained, then management would restructure the Company in a way to preserve its pharmaceutical and disability businesses while maintaining expenses within operating cash flows.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Our risk from exposure to financial markets is limited to foreign exchange variances and fluctuations in interest rates. We may be subject to some foreign exchange risks. Most of our business transactions are in U.S. dollars, although we generate significant revenues from customers overseas. The exception is that we were compensated in Japanese yen by some Japanese customers and in Euros by one European customer. As a result, we experienced a larger gain in 9moFY10 than 9moFY09 from currency exchange. 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

We are responsible for maintaining disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Disclosure controls and procedures are controls and other procedures designed to ensure that the information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure. In designing and evaluating disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Based on management’s evaluation (with the participation of our chief executive officer and chief financial officer) of our disclosure controls and procedures as required by Rule 13a-15 under the Exchange Act, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures were effective.

Management's Report on Internal Control over Financial Reporting
Our management is responsible for establishing and maintaining adequate internal controls over financial reporting, as defined in Exchange Act Rule 13a-15(f). Our internal controls over financial reporting are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with generally accepted accounting principles.

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No changes were made in our internal controls over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) during our most recent fiscal quarter that have materially affected or are reasonably likely to materially affect, our internal controls over financial reporting.

Our management, including our CEO and CFO, does not expect that our disclosure controls or internal controls over financial reporting will prevent all errors or all instances of fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within our company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple errors or mistakes. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and any design may not succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitation of a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings
The Company is not a party to any legal proceedings and is not aware of any pending legal proceedings of any kind.

Item 1A. Not applicable.

Item 2. Changes in Securities
Since December 2008, the Company has been buying back its own shares, and plans to continue its share repurchase in accordance with its share repurchase plan. Under the original repurchase program, the Company has bought back 1,026,483 shares by the end of December 2009. On January 10, 2010, the board of directors authorized a renewed share repurchase program effective as of February 15, 2010. The renewed program enables the Company to buy back up to one million shares during a 12-month period. As of May 31, 2010, the Company had bought back 257,077 shares under this renewed repurchase program.

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

EXHIBIT NUMBER	DESCRIPTION
3.1	Articles of Incorporation of Simulations Plus, Inc. (1)
3.2	Amended and Restated Bylaws of Simulations Plus, Inc. (1)
4.1	Articles of Incorporation of Simulations Plus, Inc. (incorporated by reference to Exhibit 3.1 hereof) and Bylaws of Simulations Plus, Inc. (incorporated by reference to Exhibit 3.2 hereof)
4.2	Form of Common Stock Certificate (1)
4.3	Share Exchange Agreement (1)
10.1	Simulations Plus, Inc. 1996 Stock Option Plan (the “Option Plan”) and forms of agreements relating thereto (1
10.24	Exclusive License Software Agreement by and between Simulations Plus, Inc. and Therapeutic Systems Research Laboratories dated June 30, 1997. (2)
10.43	Lease Agreement by and between Simulations Plus, Inc. and Venture Freeway, LLC. (4)
10.45	Employment Agreement by and between the Company and Walter S. Woltosz (5)
10.46	Simulations Plus, Inc. 2007 Stock Option Plan (the “2007 Option Plan”) (6)
21.1	List of Subsidiaries (7)
31.1	Rule 13a-14(a)/15d-14(a) – Certification of Chief Executive Officer (CEO). (7)
31.2	Rule 13a-14(a)/15d-14(a) – Certification of Chief Financial Officer (CFO). (7)
32	Section 1350 – Certification of CEO and CFO. (7)

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(1) Incorporated by reference to the Company's Registration Statement on Form SB-2 (Registration No. 333-6680) filed on March 25, 1997.
(2) Incorporated by reference to the Company's Form 10-KSB for the fiscal year ended August 31, 1997.
(3) Incorporated by reference to the Company's Registration Statement on Form S-8 (Registration No. 333-91592) filed on June 28, 2002.
(4) Incorporated by reference to the Company's Form 10-KSB for the fiscal year ended August 31, 2006.
(5) Incorporated by reference to the Company's Form 10-K for the fiscal year ended August 31, 2009.
(6) Incorporated by reference to the Company's Form 10-Q for the fiscal quarter ended November 30, 2009.
(7) Filed herewith.

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 15, 2010.

Simulations Plus, Inc.

Date: July 15, 2010

By: /s/ MOMOKO BERAN
Momoko Beran
Chief Financial Officer
(Principal Financial Officer)