

## Research Report – Update

*Investors should consider this report as only a single factor in making their investment decision.*

### Simulations Plus, Inc.

**Rating: Speculative Buy**

Howard Halpern

December 14, 2007

**SLP \$4.83 — (AMEX)**

	FY (08/05*) A	FY (08/06*) A	FY (08/07*) A	FY (08/08) E
Net sales (in millions)	\$4.75	\$5.86	\$8.86	<b>\$11.54</b>
Earnings per share	\$0.02	\$0.04	\$0.08	<b>\$0.12</b>

52-Week range*	\$8.63 – \$1.60	Fiscal year ends:	August
Shares outstanding <small>a/o 12/13/07*</small>	16.04 million	Revenue/shares (ttm)*	\$0.49
Approximate float*	8.76 million	Price/Sales (ttm)*	9.9X
Market Capitalization	\$77 million	Price/Sales (2008)E*	7.8X
Tangible Book value/shr	\$0.49	Price/Earnings (ttm)*	60.0X
Price/Book*	9.9X	Price/Earnings (2008)E*	40.3X

\* All per share figures reflect the 2-1 stock splits effective August 14, 2006 and October 2, 2007.

*Simulations Plus, Inc., based in Lancaster, California, is a developer of drug discovery and development software, which is licensed to and used in the conduct of drug research by major pharmaceutical and biotechnology companies worldwide. The Company operates a wholly-owned subsidiary called Words+, Inc. that is focused on producing computer software and specialized hardware for use by people with disabilities. Web address: [www.simulations-plus.com](http://www.simulations-plus.com)*

#### Key Investment Considerations:

***We reiterate our Speculative Buy rating on shares of Simulations Plus, Inc. (AMEX: SLP), as we continue to forecast positive growth trends for fiscal 2008. We are adjusting our twelve-month price target to \$6.40 per share (prior was \$6.38 per share – adjusted for the 2-1 stock split on October 2, 2007) based on our sales and EBITDA forecasts for fiscal 2008.***

***On November 29, 2007, Simulations Plus announced that F. Hoffmann-LaRoche issued a purchase order to renew their global software license for another year. Investors should note that last year's order was in Q2'07 and this year the order will occur in Q1'08. This means a revenue shift will occur from the second quarter of fiscal 2008 into the first quarter of fiscal 2008.***

***On November 26, 2007, the Company announced fiscal 2007 net sales increased by 51.3% to \$8.858 million versus \$5.855 million in fiscal 2006. Top line growth was led by pharmaceutical software sales, which increased on a year-over-year basis by 80.7%. Net income increased to \$1.466 million or \$0.08 per diluted share versus \$0.676 million or \$0.04 per diluted share in fiscal 2006.***

***We are adjusting our estimates for fiscal 2008, given current licensing trends, renewals, and potential for new customers, as well as growth of contract services. Our revised net sales and net income forecasts are \$11.540 million and \$2.275 million or \$0.12 per diluted share. Our prior forecast called for net sales of \$11.100 million and net income of \$2.975 million or \$0.16 per diluted share. The reduction in our bottom line forecast is due to a tax rate of 44.2% versus our prior estimate of 23.8%. The change resulted from the Company's net loss carryforwards coming to an end (because of the net income generated over past periods).***

***\* Please view our disclaimer located on page 13.***

## *The Company*

Simulations Plus, Inc. (AMEX: SLP), founded in 1996, went public during June of 1997 through a \$5.0 million initial public offering. The Company, which has 34 employees (31 full-time and 3 part-time), includes 16 professionals in research and development, 7 in production, and 1 in information technology/repairs. Ten employees have Ph.D.s and one is a Ph.D. candidate. In addition, four have one or more Master's degrees. SLP continues to seek additional scientists to expand its Life Sciences team.

SLP's net sales are derived from two distinct operations:

- Simulations Plus, Inc., develops and licenses software for pharmaceutical research and development, and performs contract studies for pharmaceutical and biotechnology companies. The Company's software offerings are in two major areas: simulation and cheminformatics (the use of computer and informational techniques, applied to a range of problems in the field of chemistry). The offerings focus on ADMET (absorption, distribution, metabolism, elimination, and toxicity) and on tools for discovery chemistry in the pharmaceutical and biotechnology industries. The Company's software assists pharmaceutical scientists to predict certain key potential drug dynamics and compound properties rapidly, thereby increasing the likelihood of eliminating multi-million dollar clinical trial failures and speeding up the time to market of effective new medications. SLP provides the following software offerings:
  - **ADMET Predictor™/ADMET Modeler™** - the predictor component is an advanced property prediction program that enables pharmaceutical researchers to rapidly estimate a number of ADMET properties of new chemical entities from their molecular structure. The modeler component allows researchers to build artificial neural network ensemble or support vector machine (svm) ensemble models from their own data. On July 24, 2007, the Company announced the release of Version 2.3, which adds both more accurate predictive models, as well as a list of new features inspired by user feedback and SLP's own internal use of the program. Included in the new release is a unique new predictive capability that will help pharmaceutical chemists predict drug-caused DNA mutations. The models were developed based on the proprietary database of salmonella mutagenicity measurements acquired as part of the assets of Bioreason, Inc. Unlike previous models for salmonella mutagenicity that lump together strains of the bacteria, this unique database provides individual mutagenicity data for each of ten individual strains. According to the Company's Chief Scientist, one FDA-required test for any new drug is the potential to cause mutations in the DNA of various strains of salmonella;
  - **ClassPharmer™** - enhances the hits-to-lead-to-clinic process which aids in find drug leads with novel and unpatented structural motifs, reduces screening costs with more efficient follow-up screening strategies, and improves productivity with software that thinks like a medicinal chemist. On October 17, 2007, the Company released of Version 4.4. The upgrade includes features requested by users, as well as extensions to the molecule design capability;
  - **DDDPlus™** - is a relatively new and unique tool for formulation scientists, which enables them to predict how changes in formulation or changes in experimental setup are likely to affect dissolution rate in laboratory experiments.; and
  - **GastroPlus™** - simulates absorption, pharmacokinetics (PK) (the process by which a drug is absorbed, distributed, metabolized, and eliminated by the body), and pharmacodynamics (PD) (the combination of therapeutic and adverse effects on the body) for orally dosed and injected drugs. In the drug development phase, GastroPlus is designed to aid researchers in dosage formulation, the effects of various controlled release profiles, and evaluation of heterogeneous variations in physiology and transit times. On October 4, 2007, the Company released Version 5.3, which includes the ability to call ADMET Predictor™ software directly from within GastroPlus. Additionally, the upgrade includes a new numerical integrator that speeds up simulations, improved

virtual trials for simulating effects in large populations, handling enteric coated or delayed release tables and capsules, particle shape for dissolving particles, a redesigned units converter for the Metabolism and Transporter Module, as well as a monkey physiology model for physiologically based pharmacokinetics.

- The Words+ Inc., subsidiary, which was founded in 1981, produces computer software and specialized hardware for use by people with severe disabilities, as well as a personal productivity software program called Abbreviate! for the retail market.

### ***Recent Developments***

#### **During August 2007, the Company announced the following:**

- Received a purchase order from the U.S. Food and Drug Administration for additional licenses for its GastroPlus™ simulation software offering, as well as new licenses for its DDDPlus™ offering. In the press release, Management stated that they are excited that FDA scientists will have both GastroPlus and DDDPlus to assist in their simulation and modeling activities; and
- Received a purchase order from the U.S. National Institutes of Health for its ClassPharmer™ offering.

#### **During September 2007, Simulations Plus announced the following:**

- Signed a collaboration agreement with Enslein Research, Inc. The agreement provides Simulations Plus with exclusive access to a database of metabolism measurements for an important group of Cytochrome P450 enzymes that are involved in the metabolism of a large number of drug-like molecules. An important group of enzymes will be added to the Company's ADMET Predictor™ offering. Management publicly stated that the resulting models from this exclusive agreement will be embodied in an extra-cost 'Enslein Metabolism Module' within ADMET Predictor™. The agreement calls for revenues received from licenses for this module to be shared with Enslein Research;
- Appointed Dr. John Crison as the Company's Director, Life Sciences. Dr. Crison replaces Dr. Michael Bolger, who served in that position for over eleven years and will continue to serve as the Company's Chief Scientist. Dr. John Crison served as Corporate Vice President, Research and Development at Therapeutic Systems Research Laboratories. He also served as Vice President of Pharmaceutical Products at MediVas. Dr. Crison has seventeen years of Research and Development experience and eight years as a registered pharmacist. His experience includes simulation and modeling of gastrointestinal absorption, dissolution, and controlled release dosage from design, as well as ocular delivery.

#### **During November 2007, the Company announced the following:**

- F. Hoffmann-LaRoche issued a purchase order to renew their global software license for another year. Investors should note that last year's order was in Q2'07 and this year the order will occur in Q1'08. This means a revenue shift will occur from the second quarter into the first quarter of fiscal 2008. The reason for the shift is to allow F. Hoffmann-LaRoche's scientists to use the software on December 1, 2008 (start of the second quarter) without delay, in order to prevent a disruption of scientific activities (investors should be aware that this was done at the customer's request).

### ***Financial Results*** (All per share figures reflect the 2-1 stock split effective October 2, 2007)

For the twelve-month period ended August 31, 2007, versus the twelve-months ended August 31, 2006:

- Net sales increased to \$8.858 million versus \$5.855 million. Taglich Brothers' estimate called for net sales of \$8.891 million;
- Gross margins increased to 76.49% versus 72.90%;

Simulations Plus, Inc.

- SG&A expenses increased to \$3.458 million versus \$2.972 million. However, as a percentage of net sales SG&A expenses declined to 39.04% versus 50.76%;
- Research and development expenses increased to \$0.815 million versus \$0.445 million. Investors should note that the Company capitalized R&D costs in the amount of \$0.583 million versus \$0.725 million in the same period last year;
- Operating income nearly tripled to \$2.624 million versus \$0.889 million; and
- Net income improved to \$1.466 million or \$0.08 per diluted share versus net income of \$0.676 million or \$0.04 per diluted share. Taglich Brothers' estimate called for net income of \$2.041 million or \$0.11 per diluted share.

Management attributed the 51.3% growth in year-over-year net sales to an 80.7% (or \$2.570 million) increase from pharmaceutical software and services. The growth was primarily attributable to increased licenses from new customers, as well as for new modules to existing customers, expansion of additional licenses to renewal customers, and increased use of the Company's contract consulting services.

Also contributing to growth in net sales was an increase of 16.2% (or \$0.433 million) from the Company's Words+ subsidiary. The increase was primarily due to higher sales of Say-it-SAM! and Freedom products, which more than offset lower sales of TuffTalker and TuffTalker Plus products.

Investors should be aware that the Company's sales cycle for its pharmaceutical software products tends to average about six months. The long sales cycle is because customers frequently need to evaluate software and then obtain approvals from multiple decision makers prior to the purchase order being placed. Also, of note, when multi-year licenses are sold, they are only unlocked (allowed to be used) for each year of the term with the subsequent years of the license being placed in deferred revenue until they are unlocked at the same time the following fiscal year.

Gross margins increased by 389 basis points primarily due to the growth in sales of its higher margin pharmaceutical and educational software, as well as contract consulting service studies. Gross margin for pharmaceutical and educational software was 87.7% compared to 44.4% for Words+. Gross margin for Words+ was negatively impacted by one large order due to a volume discount, as well as increased costs of computers. This year, the Company was unable to obtain discounts from volume purchases of computers.

The overall \$0.486 million increase in SG&A expenses versus fiscal 2006 was the result of commissions, bonuses to the Company's President, Walter Woltosz, and Corporate Secretary, Virginia Woltosz, a bad debt from receivables that were part of the purchased assets of Bioreason Inc., in addition to increased estimates for doubtful accounts, and salaries and payroll-related expenses (i.e., health insurance, 401K, and payroll taxes), which outweighed decreases in expenses for travel, professional fees, and recruitment. Travel expenses were reduced by using more Web conferences and by the CEO's use of his personal airplane at his own expense in lieu of airline transportation. Investors should note that as a percentage of net sales, SG&A expenses for the current period declined to 39.04% versus 50.76% in fiscal 2006.

For fiscal 2007, the Company experienced a \$0.370 million increase in research and development spending. The increase was primarily attributable to increases in salaries resulting from staff additions in the Life Sciences department, as well as salary increases for existing staff.

It is important for investors to note that based on the Company's reconciliation of the expected income tax, it recorded a provision of \$1.158 million for income taxes in fiscal 2007, compared to \$0.213 million in fiscal 2006. The tax rates recorded for fiscal 2007 and 2006 were 44.14% and 23.96%, respectively.

Balance Sheet Snapshot as of August 31, 2007

The Company had cash of \$4.538 million versus \$1.685 million as of its fiscal year ended August 31, 2006. Working capital was \$6.187 million versus \$3.050 million as of August 31, 2006. Total assets, which stood at \$8.895 million, are primarily comprised of cash, inventory, accounts receivable (that totaled \$2.060 million) and a deferred tax asset of \$0.240 million.

Also, the Company had total liabilities of \$1.231 million, retained earnings of \$1.856 million, and total shareholders' equity of \$7.665 million. At the end of fiscal 2006, the Company had total liabilities of \$0.845 million with an accumulated deficit of \$0.390 million, and total shareholders' equity of \$5.669 million.

Management believes that existing capital and anticipated funds from operations will be sufficient to meet cash needs for working capital and capital expenditures for the foreseeable future.

### **Outlook**

We believe the Company's primary simulation software products (GastroPlus™, ADMET Predictor/Modeler™, DDDPlus™, and ClassPharmer™) need to gain exposure to a wider audience within the community of researchers in the Pharmaceutical, Biotechnology, and Drug Discovery Industries of the Healthcare Sector.

This should be accomplished through continued exposure at large conferences around the world and an increase in the Company's sales personnel. According to the Company's SEC filings, members of its staff have been speakers or presenters at over 40 prestigious scientific meeting worldwide over the past three years. The following are recent examples:

- During October 2007, the Company's Chairman and CEO was co-chair of a scientific session and gave a presentation to a large group of scientists from around the world at the International Society for the Study of Xenobiotics conference in Sendai, Japan. According to SLP's public statements, a number of requests for copies of the presentation slides were made, as well as excellent responses from giving additional presentations at pharmaceutical sides in Japan.
- During November 2007, the Company attended the American Association of Pharmaceutical Scientists annual meeting. At the meeting there were more than ten posters and podium presentations that referenced Simulations Plus software, including one entire session wherein every presenter showed results obtained from GastroPlus analyses. According to Management, the number of leads generated at that one meeting far exceeds what had been seen in the past.

In addition, Management has publicly stated that it will add to its scientific staff. According to the Company's 10-K filing, the number of Ph.D.'s on its staff is 10, with one Ph.D. candidate. The increase in its professional staff is important since they all have the potential to bring in new customers due to their knowledge and interaction with scientists.

Additionally, as a result of the established relationships with large pharmaceutical companies, other researchers within those companies are likely to be exposed to Simulations Plus product offerings. This could lead to increased activity related to its ADMET Partners global licensing program for large pharmaceutical companies.

Management has publicly stated that:

- The Company's customer base, which continues to grow, should build the base for future license renewals;
- Since fiscal 2006, the Company has been booking multi-year licenses on an annual basis. Management believes this should eliminate the extreme lumpiness in reported top and bottom line results the Company experienced in the past;
- It is actively interviewing candidates to expand its Life Sciences team. In September 2005, work on MembranePlus™ was put on hold as a result of the scientist responsible for that project being reassigned to take over GastroPlus™. MembranePlus™ is a computer program that simulates in-vitro experiments that measure the permeability of new drug-like molecules through a layer of living cells or through an artificial membrane. A new product such as MembranePlus™ would not only expand the product portfolio but would have the potential to grow revenue from existing customers, as well as obtain a wider customer base;

- On January 9, 2007, the Company received a purchase order from the U.S. Food and Drug Administration (FDA) to license its GastroPlus™ simulation software. During August 2007, SLP received additional licenses orders for GastroPlus™, as well as new licenses for its DDDPlus software from the FDA;
- On August 30, 2007, the U.S. National Institutes of Health ordered the Company's ClassPharmer™ product offering. Management believes this can serve as trend-setting and as examples to companies who work in pharmaceutical research and development;
- On November 29, 2007, F. Hoffmann-LaRoche issued a purchase order to renew their global software license for another year. Based on prior SEC filings, revenue from the Company's global licenses from this customer were approximately \$1.5 million (over a three year term) or approximately \$0.500 million per year;
- Demand for consulting services increased due to a shortage of expertise in simulation and modeling personnel within pharmaceutical and biotechnology companies. The evidence of internal growth in this area is that in fiscal 2005, 2006, and 2007, the Company had undertaken 2, 3, and most likely in excess of 15 contract studies, respectively. Also, on October 4, 2007, the Company publicly stated that they have been approached by a number of new companies for consulting studies that use GastroPlus™. On the earnings conference call, Management publicly stated that the Company is usually working on at least two or three consulting contracts at any given point in time. This not only brings in revenue, but is leveraged by the Company as a marketing tool, since doing consulting services has the potential to lead to software license revenue;
- They are seeking accretive acquisitions to enhance and expand the product portfolio. This point was reiterated during the Company's full year earnings conference call. Management is seeking acquisitions for both the pharmaceutical software side and Words+ side of the business. Also, they stated that negotiations are ongoing, but it is taking much longer than anticipated; however, it is Management's belief that something will be concluded in the near future. The intent is to increase revenues and earnings by acquiring products and technologies that complement what Simulations Plus and Words+ do; and
- A second \$0.100 million six-month Phase I Small Business Innovation Research proposal to the National Institutes of Health was submitted, and on June 18, 2007, its first proposal submitted in December 2006 was awarded and funded. The Company has applied for a Phase II follow-on grant of \$0.750 million over two years. Investors should note that SBIR grant funds provide the ability to expand staff and grow the product line without adversely affecting earnings, because the expenses associated with the efforts in the studies are funded largely, if not completely, through the grants.

We believe that the Words+ subsidiary will be profitable in fiscal 2008. During fiscal 2007, the Company's Words+ subsidiary developed a new design for its PDA-based Say-it! SAM augmentative communication device, including a completely new PDA and a custom injection-molded case available in multiple colors. This new device includes a new audio amplifier and speaker system. This offering was demonstrated at the Closing the Gap conference in Minneapolis during October 2007 and received strong interest from those in attendance. According to Management, those units began shipping during November 2007. Also, the addition of a new California sales representative and a marketing effort being conducted by the national sales consultant should benefit results in future periods.

### ***Projections***

We are adjusting our fiscal 2008 forecasts based on results for fiscal 2007, current licensing trends and renewals, potential for new customers, and growth of contract consulting services. Our net sales forecast calls for sales to \$11.540 million versus our prior estimate of \$11.100 million. Our upward adjustment also incorporates:

- Management’s sense that the pharmaceutical industry surpassed the aerospace industry in terms of research and development spending; as well as
- The urgency to change how business is done in the pharmaceutical industry is at the highest level Management has seen since Simulations Plus was founded, because of an unsustainable path of higher and higher spending with fewer and few new drugs to show for it.

Our revised forecast (which does not include the potential for accretive acquisitions) would be a 30.28% increase versus fiscal 2007 results. We anticipate net sales growth for simulations software products in fiscal 2008 of approximately 43.5% to \$8.258 million. Our net sales expectation for the Words+ subsidiary for fiscal 2008 is \$3.282 million, which is approximately a 3.0% increase versus fiscal 2007.

The table below illustrates the cost structure we anticipate for fiscal and 2008, versus actual results achieved in 2006 and 2007.

**Cost Structure**

	<b>2006A</b>	<b>2007A</b>	<b>2008E</b>	
	<b>Actual</b>	<b>Actual</b>	<b>Prior</b>	<b>Revised</b>
<b>Gross Margin</b>	72.60%	76.49%	77.57%	77.73%
<b>SG&amp;A expenses (as a Percent of Net Sales)</b>	50.76%	39.04%	36.17%	36.70%
<b>Research and Development (as a Percent of Net Sales)</b>	7.60%	9.20%	7.60%	7.28%
<b>Operating Margin</b>	14.23%	28.26%	33.74%	33.75%
<b>Pre-tax Margin</b>	15.18%	29.63%	35.18%	35.31%

Source: Company filings and Taglich Brothers estimates

Based on our net sales and cost structure estimates, EBITDA should approach \$4.415 million in fiscal 2008, versus EBITDA of \$3.032 million in fiscal 2007. Our revised net income forecast for fiscal 2008 is \$2.275 million or \$0.12 per diluted share. Our prior forecast called for net income of \$2.975 million or \$0.16 per diluted share. Our EPS forecasts are based on average fully diluted shares of 18.480 million. The change in our bottom line forecast is due to the fact that Management stated on the earnings conference call that income taxes will be in the 44% area for fiscal 2008, the amount recorded in fiscal 2007.

The Company has federal net operating loss (NOL) carryforwards of approximately \$0.117 million, which expire through 2024. **Investors should note that since we are forecasting increased profitability, that during fiscal 2008, the NOL’s will expire in early fiscal 2008.**

**Risks**

Growth Management

Investors need to be aware that as the Company becomes increasingly successful, it must meet the challenges associated with growth. If the Company is not successful in meeting these challenges, its business will be adversely impacted. Additionally, Management believes that future success will depend on the ability to attract, hire, and retain qualified personnel in order to expand the Company’s overall intellectual knowledge base.

Sales Cycle

Investors should be aware that the Company’s sales cycle for its pharmaceutical software products tends to average about six months. The long sales cycle is because customers frequently need to evaluate software and then obtain approvals from multiple decision makers prior to the purchase order being placed.

Technology

The Company’s strongest area of growth is its software products for pharmaceutical research. In general the software industry is highly competitive and changes rapidly. The Company’s operating results could be significantly affected by its ability to maintain and increase acceptance of its current and future products by researchers in the industry.

### Customer Concentration

International sales accounted for 37.0% and 35.0% of net sales for fiscal 2007 and 2006, respectively. For simulation software sales, two customers accounted for 27.0% of net sales for fiscal 2007 compared to one customer accounting for 24% of net sales in fiscal 2006. Two customers represented approximately 44.0% of the net accounts receivable in fiscal 2007, while four customers accounted for 62% of the net accounts receivable in fiscal 2006. For the Words+ subsidiary, one government agency accounted for 25.0% of net sales during fiscal 2007, and one customer represented approximately 29.0% of the net accounts receivable. In fiscal 2006, one government agency accounted for 18.0% of net sales and one customer represented approximately 21.0% of the net accounts receivable.

### Revenue Recognition

Simulation Plus accounts for the licensing of software in accordance with American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 97-2 (Software Revenue Recognition). The application of SOP 97-2 requires judgment, including whether a software arrangement includes multiple elements, and if so, whether vendor-specific objective evidence (VSOE) of fair value exists for those elements.

The end users receive certain elements of its products over a period of time. These elements include free post-delivery telephone and e-mail support and the right to receive unspecified upgrades/enhancements. In accordance with SOP 97-2, Management has evaluated these agreements and recognized the entire license fee on the date the software is delivered to and accepted by the customer. In order to recognize the fee in this manner, the Company must meet all the criteria required, including: 1) the post contract customer support (PCS) fee is included in the initial licensing fee; 2) the PCS included with the license is for one year or less; 3) the estimated cost of providing the PCS during the arrangement is insignificant; and 4) unspecified upgrades/enhancements during the PCS arrangements have been and are expected to continue to be minimal and infrequent.

Changes to the elements in a software arrangement, the ability to identify VSOE for those elements, the fair value of the respective elements, the costs associated with providing PCS, and changes to a product's estimated life cycle could materially impact the amount of earned and unearned revenue. Going forward, Management has stated that multi-year software licenses will be unlocked and invoiced at the beginning of each license year, which will require recognizing revenues one year at a time.

### Shareholder Control

We estimate that Walter Woltosz, the Company's Co-founder, Chairman of the Board, President, and CEO, and Virginia Woltosz, the Company's Co-founder, Corporate Secretary, and Treasurer own approximately 46% of the outstanding voting stock. Therefore, Mr. Walter and Virginia Woltosz should be able to control the outcome, or greatly influence the outcome, on all matters requiring stockholder approval, including the election of directors, amendment of certificate of incorporation, and any merger, consolidation or sale of all or substantially all of the Company's assets or other transactions resulting in a change of control.

### Seasonality

Historically, the third and fourth fiscal quarters have generated higher revenues and bottom line results compared to the first and second fiscal quarters of the year (the Company's fiscal year ends August 31). Management believes that sales of its Words+ products to schools are slightly seasonal, with greater sales to schools during the March to May and June to August periods.

Management believes that sales of pharmaceutical products exhibit minimal seasonal fluctuation. However, the tendency is for the first fiscal quarter to almost always be below the average for all quarters. According to the Company's fiscal 2007 10-K filing, this trend has continued for nine out of the last ten years.

### Intellectual Property Rights

Despite the Company's best efforts to protect its intellectual property rights, third parties may infringe or misappropriate those rights, or otherwise independently develop substantially equivalent products and/or services. The loss of intellectual property protection or the inability to secure or enforce intellectual property protection could harm its business and/or ability to compete.



### Government Regulation

The Company's pharmaceutical software products are tools used in research and development and do not need to obtain approval by the Food and Drug Administration or other government agency. Approximately 17.0% of the Company's products for the disabled are funded by Medicare or Medicaid programs. However, changes in government regulations regarding the use of augmentative communication aids and other assistive technology under such funding could affect the Company's operations of its Words+ subsidiary. On January 1, 2001, Medicare began funding augmentative communication devices for the first time and over the Company's 22-year history, the trend has been toward increasing funding from government agencies. There can be no assurance that government funding for such devices will continue, or if it does continue, that the Company's products will continue to meet the requirements imposed for funding of such devices.

### Vendor(s)

The Company's subsidiary purchases most of the notebook computers for its disability related computer products from a single vendor. In addition, it uses a number of pictographic symbols that are used in its software products which are licensed from a third party. The inability of the Company to obtain computers used in its products or to renew its licensing agreement to use pictographic symbols could negatively impact its financial position, results of operations, and cash flows.

### Legal Issues

While the Company may from time to time be involved in various claims, lawsuits or disputes with third parties, the Company is not a party to any significant litigation and is not aware of any significant pending or threatened litigation against the Company.

On April 6, 2006, the Company received notice from a liquidator for the former French subsidiary of Bioreason (Bioreason SARL), saying that the liquidator had initiated legal action against SLP in the French courts with respect to ClassPharmer distribution rights to European customers, and is claiming commissions and legal fees with respect to European customers. Management has been working through the Company's U.S. attorneys and a law firm in Paris. SLP filed a counterclaim for its rights and lost sales against Bioreason SARL's assets by sending a debt recovery declaration to the liquidator on June 15, 2006.

On May 23, 2007, the Company through its French Lawyer received a proposal for an amicable settlement, in which SLP would give up claims if Bioreason SARL would agree to waive any claims against Simulations Plus. This proposal was accepted by phone by the lawyer of Bioreason SARL, and the parties signed an agreement which was submitted to the French court. On July 13, 2007, SLP received another e-mail from its French Lawyer that the agent in charge of the liquidation of Bioreason SARL requested the hearing to be postponed until October 11, 2007, and her request was accepted by the French supervisory judge. However, on October 31, the French Lawyer informed SLP that the hearing had been again postponed until November 2007.

### Foreign Exchange Risks

Even though most of the Company's transactions are in U.S. dollars, revenues are generated from overseas customers. Specifically, the Company is compensated in Japanese yen by most Japanese customers. During the fiscal 2007, the Company experienced a very small gain from currency exchange. If foreign currency transactions increase significantly, then SLP 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.

### Miscellaneous Risk

The Company's financial results and equity values are subject to other risks and uncertainties known and unknown, including but not limited to competition, operations, financial markets, regulatory risk, and/or other events. These risks may cause actual results to differ from expected results.

### Trading Volume

Liquidity is a potential concern. Based on our calculations, the average daily-volume during calendar 2004 increased to approximately 8,340 shares from 7,685 shares in calendar 2003. During calendar 2005 average daily-volume decreased to 4,424 shares a day. During calendar 2006, average daily-volume increased to 21,398 shares a day. During the first eleven months of 2007 average daily volume increased to 207,122 shares traded a day. Investors need to be aware that by nature a thinly traded equity can have significant price volatility.

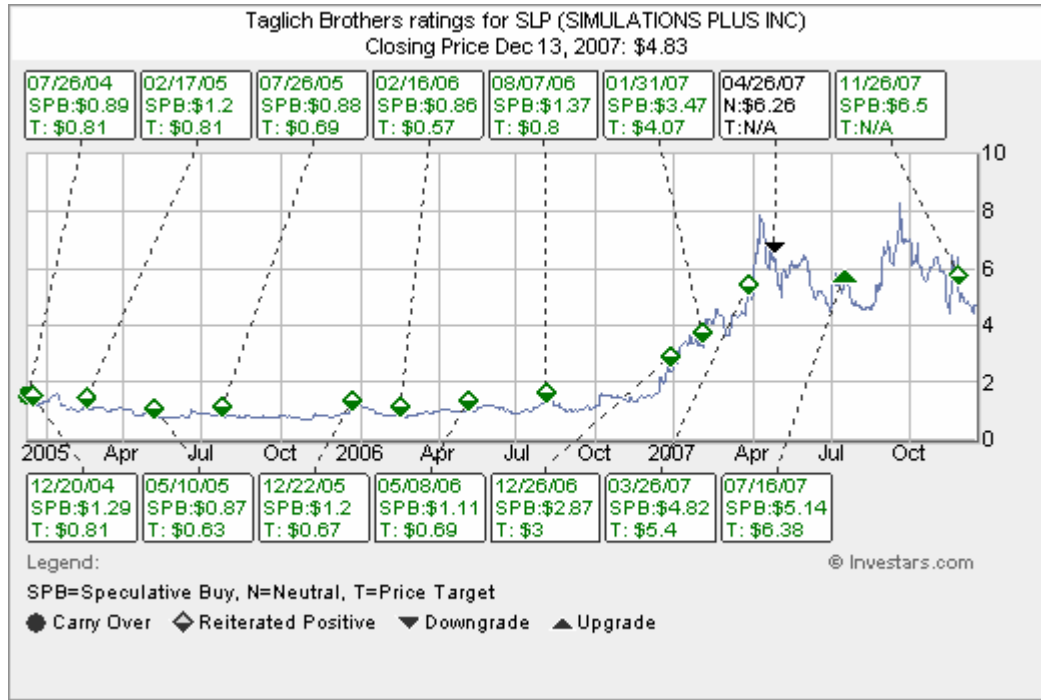
### **Valuation**

**We reiterate our Speculative Buy rating on shares of Simulations Plus, Inc. (AMEX: SLP), as we continue to forecast positive growth trends for fiscal 2008.**

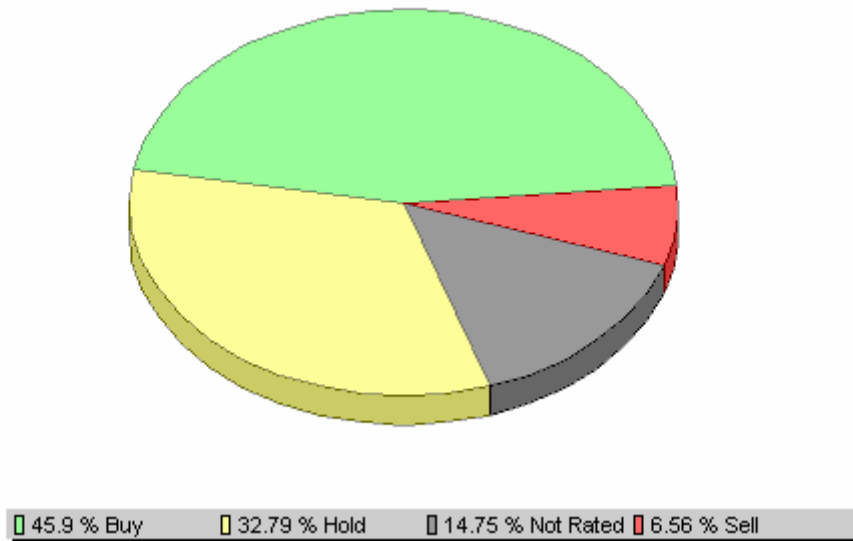
We are adjusting our twelve-month price target to \$6.40 per share (prior was \$6.38 per share – split adjusted) based on our sales and EBITDA forecasts for fiscal 2008.

Our price target is based on the following valuation models discounted by 25% to account for microcap risk along with Company specific risks discussed earlier:

- A 9.85X price-to-sales multiple, which is the Company's current trailing-twelve month multiple, applied to our net sales estimate of \$0.62 per share for fiscal 2008; and
- A 45.6X price-to-EBITDA multiple, which is our anticipated EBITDA growth for fiscal 2008 versus fiscal 2007, applied to our EBITDA estimate of \$0.24 per share for fiscal 2008.



Taglich Brothers Current Ratings Distribution



<b>Investment Banking Services for Companies Covered in the Past 12 Months</b>		
Rating	#	%
Buy	0	0
Hold	2	11.11%
Sell	0	0
Not Rated	0	0

### Meaning of Ratings

#### Buy

We believe the Company is undervalued relative to its market and peers. We believe its risk reward ratio strongly advocates purchase of the stock relative to other stocks in the marketplace. Remember, with all equities there is always downside risk.

#### Speculative Buy

We believe that the long run prospects of the Company are positive. We believe its risk reward ratio advocates purchase of the stock. We feel the investment risk is higher than our typical “buy” recommendation. In the short run, the stock may be subject to high volatility and continue to trade at a discount to its market.

#### Neutral

We will remain neutral pending certain developments.

#### Underperform

We believe that the Company may be fairly valued based on its current status. Upside potential is limited relative to investment risk.

#### Sell

We believe that the Company is significantly overvalued based on its current status. The future of the Company's operations may be questionable and there is an extreme level of investment risk relative to reward.

### **Some notable Risks within the Microcap Market**

**Stocks in the Microcap segment of the market have many risks that are not as prevalent in Large-cap, Blue Chips or even Small-cap stocks. Often it is these risks that cause Microcap stocks to trade at discounts to their peers. The most common of these risks is liquidity risk, which is typically caused by small trading floats and very low trading volume which can lead to large spreads and high volatility in stock price. In addition, Microcaps tend to have significant company-specific risks that contribute to lower valuations. Investors need to be aware of the higher probability of financial default and higher degree of financial distress inherent in the microcap segment of the market.**

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From time to time our analysts may choose to withhold or suspend a rating on a company. We continue to publish informational reports on such companies; however, they have no ratings or price targets. In general, we will not rate any company that has too much business or financial uncertainty for our analysts to form an investment conclusion, or that is currently in the process of being acquired.

**Public Companies mentioned in this report:**

Abbott Laboratories	(NYSE: ABT)
Eli Lilly	(NYSE: LLY)
GlaxoSmithKline PLC	(NYSE: GSK)
Pfizer Inc.	(NYSE: PFE)

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All research issued by Taglich Brothers, Inc. is based on public information. The company paid for the first year of distribution a fee of \$21,000 (USD) on May 2004, and since August 2005 pays a monthly monetary fee of \$1,750 (USD) to Taglich Brothers, Inc. for the creation and dissemination of research reports.

**I, Howard Halpern, the research analyst of this report, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities and issuers; and that no part of my compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in this report.**

Simulations Plus, Inc.  
Consolidated Balance Sheets  
(in thousands)

	August 2005 Fiscal Year End	August 2006 Fiscal Year End	August 2007 Fiscal Year End
<b>ASSETS</b>			
Current assets:			
Cash	\$ 1,754	\$ 1,685	\$ 4,538
Accounts receivable, net	1,098	1,589	2,060
Contracts receivable, net	-	194	47
Inventory	281	237	231
Deferred tax	60	109	241
Prepaid expense and other current assets	<u>81</u>	<u>81</u>	<u>74</u>
<b>Total current assets</b>	<b>3,274</b>	<b>3,895</b>	<b>7,191</b>
Long term receivables, net of present value discount	-	-	-
Capitalized computer software development costs, net	937	1,374	1,528
Property and Equipment, net	87	96	90
Contracts receivable	-	37	-
Customer relationships	-	100	69
Deferred tax	1,252	991	-
Other assets	<u>11</u>	<u>18</u>	<u>18</u>
<b>Total assets</b>	<b><u>\$ 5,561</u></b>	<b><u>\$ 6,513</u></b>	<b><u>\$ 8,895</u></b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>			
Current liabilities:			
Accounts payable	91	215	201
Accrued payroll and other expenses	399	364	492
Accrued bonuses to officers	39	99	201
Accrued income taxes	2	2	71
Accrued warranty and service costs	28	35	38
Current portion of deferred revenue	132	129	-
Other current liabilities	<u>-</u>	<u>0</u>	<u>-</u>
<b>Total current liabilities</b>	<b>690</b>	<b>845</b>	<b>1,004</b>
Deferred Revenue	9	-	-
<b>Stockholders' equity:</b>			
Common stock, no par value; authorized 20,000,000 shares;	4	4	4
Additional paid-in capital	5,144	5,274	5,804
Accumulated deficit	(285)	390	1,857
<b>Total stockholders' equity</b>	<b><u>4,862</u></b>	<b><u>5,669</u></b>	<b><u>7,665</u></b>
<b>Total liabilities and stockholders' equity</b>	<b><u>\$ 5,561</u></b>	<b><u>\$ 6,513</u></b>	<b><u>\$ 8,895</u></b>
SHARES OUT	14,595	14,883	15,761

Simulations Plus, Inc.  
Annual Income Statement Model  
For the Years Ended August 31,  
(in thousands)

	<u>FY2005A</u>	<u>FY2006A</u>	<u>FY2007A</u>	<u>FY2008E</u>
Net sales	4,753	5,855	8,858	<b>11,540</b>
Cost of sales	<u>1,508</u>	<u>1,605</u>	<u>2,082</u>	<u><b>2,570</b></u>
<b>Gross Profit</b>	<u>3,244</u>	<u>4,250</u>	<u>6,776</u>	<u><b>8,970</b></u>
<i>Gross Margins</i>	68.27%	72.60%	76.49%	<b>77.73%</b>
<b>Operating Expenses:</b>				
Selling, general, and administrative	2,424	2,972	3,458	<b>4,235</b>
Research and development	525	445	815	<b>840</b>
Total Operating Expenses	<u>2,948</u>	<u>3,417</u>	<u>4,273</u>	<u><b>5,075</b></u>
EBITDA	503	1,196	3,032	<b>4,415</b>
<b>Operating Income (loss)</b>	296	833	2,503	<b>3,895</b>
<i>Operating Margin</i>	6.23%	14.23%	28.26%	<b>33.75%</b>
Other income (expense)				
Interest income	43	21	114	<b>180</b>
Interest expense	(1)	(0)	(0)	-
Gain (Loss) on exchange of currency	(7)	23	2	-
Loss on sale of assets	<u>15</u>	<u>11</u>	<u>5</u>	<u>-</u>
Total Other Income (expense)	<u>52</u>	<u>56</u>	<u>122</u>	<u><b>180</b></u>
<b>Pre-Tax Income (loss)</b>	348	889	2,624	<b>4,075</b>
<i>Pre-Tax Margins</i>	7.32%	15.18%	29.63%	<b>35.31%</b>
Income Tax Expense (Benefit)	86	213	1,158	<b>1,800</b>
Release of valuation allowance	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<i>Tax Rate</i>	24.66%	23.96%	44.14%	<b>44.18%</b>
Net income (loss)	\$ 262	\$ 676	\$ 1,466	\$ <b>2,275</b>
<b>Earnings per share -- Diluted</b>	<u>\$ 0.02</u>	<u>\$ 0.04</u>	<u>\$ 0.08</u>	<u><b>\$ 0.12</b></u>
Avg Shares Outstanding	15,922	15,953	17,957	<b>18,480</b>
Percent of Revenue				
Selling, general, and administrative	51.00%	50.76%	39.04%	36.70%
Research and development	11.04%	7.60%	9.20%	7.28%
YEAR / YEAR GROWTH				
Total Revenues	-8.72%	23.19%	51.29%	30.28%
Earnings per share	-69.33%	152.01%	92.72%	50.76%

Simulations Plus, Inc.  
Income Statement Model  
For the Year Ended August 31, 2006  
(in thousands)

	<u>Q1(11/05)A</u>	<u>Q2 (02/06)A</u>	<u>Q3 (05/06)A</u>	<u>Q4 (08/06)A</u>	<u>FY2006A</u>
Net sales	819	1,482	1,788	1,766	<b>5,855</b>
Cost of sales	<u>332</u>	<u>387</u>	<u>433</u>	<u>452</u>	<u><b>1,605</b></u>
<b>Gross Profit</b>	<u>487</u>	<u>1,095</u>	<u>1,355</u>	<u>1,314</u>	<u><b>4,250</b></u>
<i>Gross Margins</i>	59.50%	73.88%	75.76%	74.39%	<b>72.60%</b>
<b>Operating Expenses:</b>					
Selling, general, and administrative	629	688	796	860	<b>2,972</b>
Research and development	97	120	119	110	<b>445</b>
Total Operating Expenses	<u>726</u>	<u>807</u>	<u>914</u>	<u>970</u>	<u><b>3,417</b></u>
EBITDA	(181)	380	544	452	<b>1,196</b>
<b>Operating Income (loss)</b>	(239)	287	441	344	<b>833</b>
<i>Operating Margin</i>	-29.16%	19.39%	24.64%	19.48%	<b>14.23%</b>
Other income (expense)					
Interest income	3	6	4	8	<b>21</b>
Gain (Loss) on exchange of currency	(5)	4	10	14	<b>23</b>
Loss on sale of assets	<u>0</u>	<u>3</u>	<u>5</u>	<u>3</u>	<u><b>11</b></u>
Total Other Income (expense)	<u>(2)</u>	<u>13</u>	<u>19</u>	<u>26</u>	<u><b>56</b></u>
<b>Pre-Tax Income (loss)</b>	(241)	300	460	370	<b>889</b>
<i>Pre-Tax Margins</i>	-29.38%	20.24%	25.71%	20.93%	<b>15.18%</b>
Income Tax Expense (Benefit)	(42)	52	74	130	<b>213</b>
Release of valuation allowance	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u><b>-</b></u>
<i>Tax Rate</i>	17.46%	17.17%	16.00%	35.13%	<b>23.96%</b>
Net income (loss)	\$ (199)	\$ 248	\$ 386	\$ 240	\$ <b>676</b>
<b>Earnings per share -- Diluted</b>	<u>\$ (0.01)</u>	<u>\$ 0.02</u>	<u>\$ 0.02</u>	<u>\$ 0.01</u>	<u>\$ 0.04</u>
Avg Shares Outstanding	14,597	16,361	16,452	16,400	<b>15,953</b>
Percent of Revenue					
Selling, general, and administrative	76.79%	46.41%	44.48%	48.70%	50.76%
Research and development	11.87%	8.08%	6.64%	6.80%	7.60%
<b>YEAR / YEAR GROWTH</b>					
Total Revenues	-23.22%	43.62%	25.54%	43.58%	23.19%



Simulations Plus, Inc.  
Income Statement Model  
For the Year Ended August 31, 2007  
(in thousands)

	<u>Q1(11/06)A</u>	<u>Q2 (02/07)A</u>	<u>Q3 (05/07)A</u>	<u>Q4 (08/07)E</u>	<u>FY2007A</u>
Net sales	1,456	2,534	2,631	2,236	<b>8,858</b>
Cost of sales	<u>441</u>	<u>557</u>	<u>551</u>	<u>533</u>	<b>2,082</b>
<b>Gross Profit</b>	<u>1,015</u>	<u>1,977</u>	<u>2,080</u>	<u>1,703</u>	<b>6,776</b>
<i>Gross Margins</i>	69.69%	78.01%	79.07%	76.17%	<b>76.49%</b>
<b>Operating Expenses:</b>					
Selling, general, and administrative	757	936	885	880	<b>3,458</b>
Research and development	184	216	227	188	<b>815</b>
Total Operating Expenses	<u>940</u>	<u>1,153</u>	<u>1,112</u>	<u>1,068</u>	<b>4,273</b>
EBITDA	194	979	1,094	766	<b>3,032</b>
<b>Operating Income (loss)</b>	75	824	968	636	<b>2,503</b>
<i>Operating Margin</i>	5.12%	32.53%	36.80%	28.43%	<b>28.26%</b>
Other income (expense)					
Interest income	16	25	35	38	<b>114</b>
Gain (Loss) on exchange of currency	3	4	(1)	(4)	<b>2</b>
Loss on sale of assets	<u>0</u>	<u>3</u>	<u>0</u>	<u>2</u>	<b>5</b>
Total Other Income (expense)	<u>19</u>	<u>32</u>	<u>35</u>	<u>36</u>	<b>122</b>
<b>Pre-Tax Income (loss)</b>	94	856	1,003	671	<b>2,624</b>
<i>Pre-Tax Margins</i>	6.44%	33.79%	38.12%	30.03%	<b>29.63%</b>
Income Tax Expense (Benefit)	21	188	221	729	<b>1,158</b>
Release of valuation allowance	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<b>-</b>
<i>Tax Rate</i>	22.00%	22.00%	22.00%	108.53%	<b>44.14%</b>
Net income (loss)	\$ 73	\$ 668	\$ 782	\$ (57)	<b>\$ 1,466</b>
<b>Earnings per share -- Diluted</b>	<u>\$ 0.00</u>	<u>\$ 0.04</u>	<u>\$ 0.04</u>	<u>\$ (0.00)</u>	<u>\$ 0.08</u>
Avg Shares Outstanding	17,097	18,030	18,361	18,340	<b>17,957</b>
Percent of Revenue					
Selling, general, and administrative	51.96%	36.94%	33.65%	39.33%	39.04%
Research and development	12.61%	8.54%	8.62%	8.41%	9.20%
YEAR / YEAR GROWTH					
Total Revenues	77.87%	71.00%	47.14%	26.63%	51.29%
Earnings per share	NMF	143.92%	81.51%	-121.37%	92.72%

Simulations Plus, Inc.  
Income Statement Model  
For the Year Ended August 31, 2008  
(in thousands)

	<u>Q1(11/07)E</u>	<u>Q2 (02/08)E</u>	<u>Q3 (05/08)E</u>	<u>Q4 (08/08)E</u>	<u>FY2008E</u>
Net sales	2,350	2,715	3,480	2,995	<b>11,540</b>
Cost of sales	<u>550</u>	<u>630</u>	<u>715</u>	<u>675</u>	<u><b>2,570</b></u>
<b>Gross Profit</b>	<u>1,800</u>	<u>2,085</u>	<u>2,765</u>	<u>2,320</u>	<u><b>8,970</b></u>
<i>Gross Margins</i>	76.60%	76.80%	79.45%	77.45%	<b>77.73%</b>
<b>Operating Expenses:</b>					
Selling, general, and administrative	965	1,045	1,175	1,050	<b>4,235</b>
Research and development	210	200	225	205	<b>840</b>
Total Operating Expenses	<u>1,175</u>	<u>1,245</u>	<u>1,400</u>	<u>1,255</u>	<u><b>5,075</b></u>
EBITDA	755	970	1,495	1,195	<b>4,415</b>
<b>Operating Income (loss)</b>	625	840	1,365	1,065	<b>3,895</b>
<i>Operating Margin</i>	26.61%	30.94%	39.22%	35.55%	<b>33.75%</b>
Other income (expense)					
Interest income	<u>45</u>	<u>45</u>	<u>45</u>	<u>45</u>	<u><b>180</b></u>
Total Other Income (expense)	<u>45</u>	<u>45</u>	<u>45</u>	<u>45</u>	<u><b>180</b></u>
<b>Pre-Tax Income (loss)</b>	670	885	1,410	1,110	<b>4,075</b>
<i>Pre-Tax Margins</i>	28.52%	32.59%	40.51%	37.05%	<b>35.31%</b>
Income Tax Expense (Benefit)	295	390	625	490	<b>1,800</b>
Release of valuation allowance	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<i>Tax Rate</i>	44.01%	44.07%	44.33%	44.16%	<b>44.18%</b>
Net income (loss)	\$ 375	\$ 495	\$ 785	\$ 620	\$ <b>2,275</b>
<b>Earnings per share -- Diluted</b>	<u>\$ 0.02</u>	<u>\$ 0.03</u>	<u>\$ 0.04</u>	<u>\$ 0.03</u>	<u>\$ 0.12</u>
Avg Shares Outstanding	18,460	18,470	18,480	18,510	<b>18,480</b>
<b>Percent of Revenue</b>					
Selling, general, and administrative	41.05%	38.50%	33.77%	35.06%	36.70%
Research and development	8.94%	7.37%	6.47%	6.85%	7.28%
<b>YEAR / YEAR GROWTH</b>					
Total Revenues	61.35%	7.15%	32.26%	33.92%	30.28%
Earnings per share	374.68%	-27.65%	-0.33%	-1171.81%	50.76%

Simulations Plus, Inc.  
Cash Flow Statement  
(in thousands)

	<u>FY2005A</u>	<u>FY2006A</u>	<u>FY2007A</u>
<i>Cash Flows from Operating Activities</i>			
Net Income (loss)	\$ 262	\$ 676	\$ 1,466
Depreciation and amortization of property and equipment	43	48	51
Amortization of capitalized software development	164	287	430
Amortization of customer relationships	-	28	32
Bad debt expense	-	-	63
Stock-based compensation	-	-	17
Contribution of equipment at book value	-	-	1
Loss on sale of assets	<u>(15)</u>	<u>(11)</u>	<u>(4)</u>
	454	1,028	2,055
<i>Changes In:</i>			
Accounts receivable	608	(275)	(351)
Inventory	77	44	6
Deferred tax	84	211	1,087
Other assets	35	(8)	8
Accounts payable	(62)	124	(14)
Accrued payroll and other expenses	177	(34)	127
Accrued bonuses to officers	(39)	60	103
Income taxes	-	-	70
Accrued warranty and service costs	(5)	7	3
Deferred revenue	110	(12)	(129)
Net Changes in Working Capital	<u>985</u>	<u>119</u>	<u>909</u>
<b>Net cash Provided by Operations</b>	<u><u>1,438</u></u>	<u><u>1,148</u></u>	<u><u>2,964</u></u>
<i>Cash Flows from Investing Activities</i>			
Purchase of property and equipment	(71)	(62)	(48)
Purchases of Bioreason's assets	-	(826)	-
Capitalized computer software development costs	(475)	(480)	(583)
Proceeds from sale of assets	<u>23</u>	<u>21</u>	<u>7</u>
<b>Cash Flows from Investing Activities</b>	<u><u>(522)</u></u>	<u><u>(1,347)</u></u>	<u><u>(624)</u></u>
<i>Cash Flows from Financing Activities</i>			
Proceeds from the exercise of stock options	<u>104</u>	<u>131</u>	<u>513</u>
<b>Net cash provided by Financing</b>	<u><u>104</u></u>	<u><u>131</u></u>	<u><u>513</u></u>
Net change in Cash	1,020	(69)	2,853
Cash Beginning of Period	<u>734</u>	<u>1,754</u>	<u>1,685</u>
Cash End of Period	<u><u>\$ 1,754</u></u>	<u><u>\$ 1,685</u></u>	<u><u>\$ 4,538</u></u>