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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

SLP $32.69 — (NasdaqCM)

January 15, 2020

	2017 A	2018 A	2019 A	*2020 E*	*2021 E*
Net sales (in millions)	$24.1	$29.7	$34.0	***$39.5***	***$45.9***
Earnings per share	$0.33	$0.42*	$0.46*	***$0.54***	***$0.68***

52-Week range	$41.95 – $18.21	Fiscal year ends:	August
Shares outstanding a/o 01/09/20	17.6 million	Revenue/shares (ttm)	$1.98
Approximate float	12.5 million	Price/Sales (ttm)	16.5X
Market Capitalization	$577 million	Price/Sales (2021) E	13.0X
Tangible Book value/shr	$1.18	Price/Earnings (ttm)	65.4X
Price/Tangible Book	27.7X	Price/Earnings (2021) E	48.1X
Annual Dividend	$0.24	Dividend Yield	0.7%

**Excludes an $0.08 per share tax benefit due to the 2017 tax reform act in 2018 and approximately $0.02 per share related to corporate tax deductions from exercise of stock incentive options.*
Simulations Plus, Inc., based in Lancaster, CA, develops drug discovery/development software, and provides preclinical/clinical consulting for regulatory submissions.

Key Investment Considerations:

Maintaining Speculative Buy rating and 12-month price target of $39.00 per share.

Long-term growth should be driven by the increased use of software tools and consulting analytics for drug discovery. SLP estimates it has penetrated approximately 20% of the pharmaceutical, biotechnology, and generic companies that would be potential users of its software and/or consulting services. Future penetration should be supported by continual upgrades to SLP's existing software, consulting services, and scientific staff.

In December 2019, SLP entered into a new collaboration agreement with Bayer AG to advance its ADMET Predictor machine learning software for use within integrated drug discovery workflows.

In 2019, the FDA renewed its multi-seat license for SLP's quantitative systems toxicology modeling software (DILIsym) and a 15-user license for SLP's ADMET Predictor software. The renewal will give access to FDA employees across its divisions and support research projects aimed at informing regulatory decision making.

1Q20 EPS (reported 01/09/20) was $0.11 on sales growth of 24.7% to $9.4 million. Sales growth reflects accelerated project delivery requests from two clients. We projected sales of $8.4 million and EPS of $0.10. In 1Q19, EPS was $0.09 on sales of $7.5 million.

In FY20, we project EPS of $0.54 (unchanged) on sales growth of 16.2% to $39.5 million (prior was $39.1 million). The increase in our sales forecast reflects 1Q20 results stemming from accelerated project delivery requests from two clients in the company's DILIsym subsidiary.

In FY21, we project EPS of $0.68 on sales growth of 16.4% to $45.9 million (prior was $45.3 million). We anticipate SLP achieving operating leverage as SG&A margin improves to 31.8% from 33.4% in FY20.

Please view our Disclosures pages on 15 – 17.

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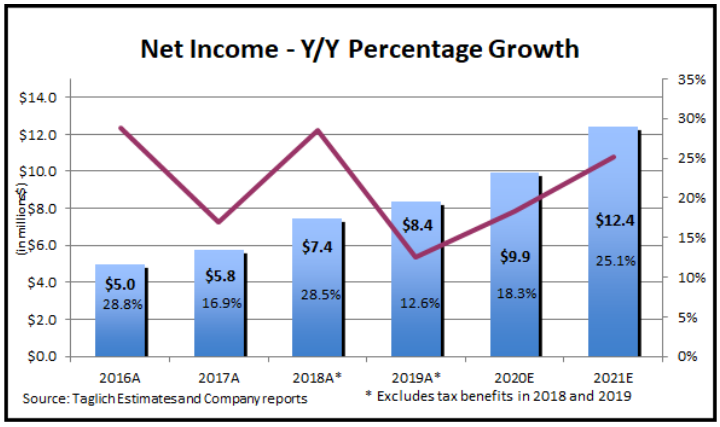
Investment Recommendation

Maintaining our Speculative Buy rating. Our rating reflects projected earnings growth in FY21 (see table below) due primarily to the build out of company's sales and contract services infrastructure through the increased hiring of its scientific staff. The company's scientific staff should have the ability to handle an increased number of consulting and analytical study projects. Long-term growth should also be supported by the collaboration between scientists at SLP's subsidiaries located in CA, NY, and NC resulting in new and innovative solutions for clients' research and development programs. In FY19, the company closed on a large contract with a pharmaceutical client that included both software products and consulting services sourced across all three of SLP's divisions.



We are maintaining our 12-month price target of $39.00 per share based on our FY21 EPS growth forecast valuation model – price/earnings/growth (P/E/G). This valuation model reflects SLP's relative EPS growth outperformance compared to its peers (see table on the right). Our valuation model includes four comparative companies profiled in the chart on the right. We believe these companies align with SLP's software offerings and analytical and consulting services. The four comparative companies have an average forward P/E/G multiple of 2.4X (prior was 2.2X) on 14.6% earnings growth compared to a forward P/E/G multiple of 1.9X on 25.8% EPS growth for SLP.

Name	Symbol	Price 01-14-20	Market Cap in $Mil	P/E - TTM	Forward EPS Growth Rate	P/E 2021 E	Forward P/E/G
Contract Research Organizations							
Charles River Laboratories	CRL	159.61	7695	25.7	13.1%	18.9	1.6
IQVIA Haoldings Inc.	IQV	158.93	31389	25.8	13.8%	19.0	1.6
Software and Service Providers							
Veeva Systems Inc.	VEEV	147.78	18617	70.4	15.7%	48.9	3.8
Dassault Systemes SE	DASTY	171.23	44282	42.8	15.7%	33.2	2.4
Combined Average				**41.2**	**14.6%**	**30.0**	**2.3**
Company							
Simulations Plus Inc.	SLP	32.69	577	65.4	25.0%	48.1	1.9

Source: Taglich Brothers estimates and Thompson Reuters

We anticipate investors are likely to accord a P/E/G multiple close to that of its four larger comparative (peer) companies due primarily to SLP's higher FY21 EPS growth rate, no debt on its balance sheet, and a growing cash balance. The company also has the flexibility to make strategic accretive (no debt) acquisitions. Additionally, SLP's ability to obtain user licenses for its software from the US Food & Drug Administration should drive sales to commercial companies that need to submit data to the FDA. Applying a P/E/G multiple of 2.2X provides a year-head price target of approximately $39.00 per share, implying a total (including a 0.7% dividend yield) return of approximately 20%.

Simulations Plus shares are best suited for investors seeking exposure to a software and company offering consulting services that are targeting research scientists in the pharmaceutical, biotechnology, and drug development sectors.

Overview

The company's simulation software (see description on page 4) assists pharmaceutical scientists in rapidly predicting certain key potential drug dynamics and compound properties, thereby reducing the risk of multi-million dollar clinical trial failures, and reducing the time to market of effective new medications. Pharmaceutical software and consulting services sales growth is driven by the company's technical and research and development staff, which increased to 78 at August 31, 2019, up from 69 at August 31, 2018 and six in FY06.

Simulations Plus, Inc., based in Lancaster, California, at the end of FY19 employed 52 Ph.Ds. in their respective science or engineering disciplines, and 24 employees hold one or more Master's degrees. In FY19, net sales consisted of annual site license revenue and consulting services from the company's portfolio of pharmaceutical software offerings.

The Cognigen subsidiary (based in Buffalo, NY) offers pharmacokinetic (the study of the bodily absorption, distribution, metabolism, and excretion of drugs) and pharmacodynamic (the study of the action or effects of drugs on living organisms) modeling simulation services to the clinical pharmacology sector. This division generates revenue from services provided to customers during Phase I through IV of clinical drug development. Over the last five years, approximately 45% of its projects have resulted in direct regulatory interaction.

Cognigen offerings include a private cloud-based validated platform (KIWI) to efficiently and consistently organize, process, visualize, evaluate, and communicate modeling and simulation results. The goal of the company's KIWI offering is to provide the functionality to meet the scientist's need for extensive documentation of the analysis of results, management's need for summaries of modeling and simulation highlights, and the regulatory agencies' needs for transparency and reproducibility.

The DILIsym Services, Inc. subsidiary (based in North Carolina) provides Drug Induced Liver Injury modeling and simulations software and contract research services. DILIsym's software also provides analysis of potential drug-induced liver injury, as well as a simulation program for analyzing nonalcoholic fatty liver disease called NAFLDsym. The difference between DILIsym and NAFLDsym is the former estimates the potential for a particular drug molecule to induce liver injury, while the latter estimates the likelihood of new molecules to treat nonalcoholic fatty liver disease, and is unique to the mechanisms involved in such treatment.

In 2011, the initial partnerships consisted of 17 pharmaceutical companies to develop DILIsym. Approximately $7 million has been invested to produce the software. Partnership members provide compounds, data, and conduct experiments to support the development effort. The partnerships are in the third stage of their software lifecycle with contract renewals from pharmaceutical companies' occurring through 2020. In 2019, updates were released to incorporate drug-induced injury to bile duct cells, as well as enabling users to evaluate key pathophysiologic areas of evaluation in non-alcoholic steatohepatitis drug development, such as how drug candidates affect steatosis, lipotoxicity, inflammation, and fibrosis. Future releases should include adaptive immune components, new simulated populations, and integration with SLP's GastroPlus software.

DILIsym Services received an NIH small business grant funding the development of RENAsym (predicting drug-induced kidney injury) and also has a two-year agreement with a large pharmaceutical company for the development of IPFsym, a quantitative systems pharmacology modeling application that should have the ability to predict the efficacy of drugs being developed to treat idiopathic pulmonary fibrosis.

In October 2019, DILIsym announced it will lead the development of RADAsym™ a drug development program for lifesaving countermeasures to acute radiation syndrome. This is a funded multiyear project with a global pharmaceutical company. Once the project is completed, the RADAsym platform will be available for licensing and consulting service through the company's DILIsym subsidiary.

Offerings	Description
ADMET* Predictor™/ ADMET Modeler™ **absorption, distribution, metabolism, elimination, and toxicity*	The predictor component (molecular property prediction program) enables pharmaceutical researchers to rapidly estimate a number of ADMET properties of new chemical entities. The modeler component allows researchers to build artificial neural network ensembles or support vector machine ensemble models from their own data to rapidly calculate quantum level descriptors. Prediction of sites of metabolism, new atomic level descriptors, adds skin permeability, transporter, and toxicity models that includes air/water partition coefficient and an improved mutagenicity models in toxicity module, and integrates with its MedChem Designer program. The MedChem Studio module enables the mining of data to design new drug-like molecules. Additional updates include new toxicity models, rapid compound library screening in virtual humans and rates, as well as synthetic feasibility assessments for virtual molecules, and an HTPK Simulation Module. In 2019, Version 9.5 was released to provide novel approaches to calculate uncertainty estimates on all regression models, new machine learning models for metabolism and transporter endpoints and for a primary toxicity endpoint required during risk assessment, as well as a structure sensitivity analysis visualization tool.
DDDPlus™	DDDPlus (dose disintegration & dissolution) enables formulation scientists to predict how changes in formulation or experimental setup affect dissolution rate in laboratory experiments. DDDPlus integrates with ADMET Predictor and provides dosage form options for immediate and controlled release formulations. Customers in the US use DDDPlus with multiple licenses used at FDA, and in Europe, and Japan. Includes parameter sensitivity analysis, a virtual trial capability, immediate release capsule dosage form, and new input/output functions. Released in 2019, Version 6 provides long-acting injectable model developed from an FDA grant and precipitation assay and biphasic dissolution models.
GastroPlus™	GastroPlus simulates absorption, pharmacokinetics (the process by which a drug is absorbed, distributed, metabolized, and eliminated by the body), and pharmacodynamics (the combination of therapeutic and adverse effects on the body) for orally dosed and injected drugs. For drug development it aids researchers in dosage formulation by allowing the adjustment of formulation variables (solubility, particle density, dose, and radius) versus time, in order to achieve a target plasma concentration. GastroPlus is also capable of providing drug interactions for ocular, nasal, dermal, and pulmonary drug delivery, and drug interactions with transporter and induction capabilities, as well as precipitation models, infant PBPK physiologies model, built-in enzyme expression levels, and biologics from large molecules. GastroPlus has added an intramuscular dosing model and antibody-drug conjugate model for biologics, and new physiology models, including Chinese and hepatic impairment populations, as well as revamped workflows for building in-vitro in-vivo correlations and reporting capabilities, making it easier for companies wishing to submit results to regulatory agencies. In 2018, Version 9.6 provided customers with new special population physiology models and improvements to all mechanistic absorption models. In 2019, Version 9.7 was released to include improvements to population simulations, dissolution, absorption, PBPK models, drug-drug interactions, dermal absorption, and immune response was added to the intramuscular injection models. **Working on various collaborations to add additional modules.**
MembranePlus™	MembranePlus, launched in 4Q14, simulates laboratory experiments for measuring permeability of drug-like molecules through various membranes, including several different cell cultures, as well as artificially formulated membranes. MembranePlus will integrate with GastroPlus. Clinical research departments should be the primary customers of this offering. The September 2017 release of version 2.0 added new models to analyze data collected from hepatocyte (liver cells).
PKPlus™	PKPlus, launched in 4Q16, provides a complete level of functionality needed by pharmaceutical industry scientists to generate the analyses and output needed to satisfy regulatory agency requirements for both noncompartmental and compartmental pharmacokinetics analysis. While version 2.0 (released in February 2018) fix items reported to the company by initial customers, version 2.5 (released in July 2019) provided enhancement such as the simplification of pharmockinetic data analyses, as well as automating and streamlining key routines.
	Source: company reports and presentations **Future Updates are in Bold**

R&D Budget Pressures – Simulation Tools to the Rescue

A strategic shift in drug development should drive the use of simulation software tools. In the 2019 global life sciences outlook published by consulting firm Deloitte, global R&D spending within the pharmaceutical industry is projected to reach $177 billion in 2019, up from $171 billion in 2018. To enhance productivity in drug development, technologies employed by scientists and engineers in laboratories are expected to continuously evolve over the next several years, especially with the increasing use of big data predictive analytics.

Biosimulation (use of computer aided simulation of biological processes and systems) market growth reflects the cost and time spent on drug discovery and development programs and the failures of drug candidates. Regulatory agencies in the US and Europe are using and promoting the use of predictive technologies in order to streamline the drug approval process, reduce R&D costs, and potentially eliminate late stage drug failures. In April 2019, Zion Market Research published a report that indicates the global biosimulation technology market to grow

annually by 15.7%, reaching $4.6 billion by 2025, up from an estimated $1.7 billion in 2018. Biosimulation market growth is segmented into software and services with the software segment holding the largest share of the market. Driving market growth is the adoption of biosimulation software by pharmaceutical and research organizations and the increasing R&D investment for pharmaceutical research.

Analysis by the Industrial Research Institute and the biosimulation market forecast suggest sales gains by SLP's simulation software tools such as GastroPlus, ADMET Predictor/Modeler, DDDPlus, and ClassPharmer. In the very early stage of drug development, these tools can help determine whether or not to proceed with continued development of a potential drug candidate. SLP software tools that enable clinicians to meet clinical trial endpoints could potentially save millions of dollars, especially if a simulation software tool detects a failure prior to Phase III testing.

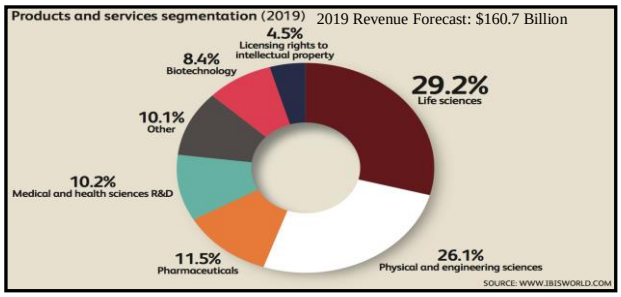
Pharmaceutical and biotechnology companies continue to seek innovative alternatives to lower the cost of drug development and submission processes to regulatory agencies. Simulation software should be increasingly important in reducing costs and increasing productivity as R&D budgets shrink. Simulations Plus software can increase productivity and reduce the risk of failure in late stage clinical trials as the prediction and data mining models can provide the researcher with a better understanding of drug reactions in the human body, enabling a more informed go/no-go decision.

Since 2015, the company's consulting services and results from its software tools have been part of at least 50 submissions to regulatory agencies around the world. The agencies include the US Food and Drug Administration (FDA), the European Medicines Agency in Europe, the Medicines and Healthcare products Regulatory Agency in England, as well as other FDA equivalent agencies in other countries primarily in Asia.

Strong Growth Prospects

We project sales and net income growth through FY20 due primarily to the acquisitions of Cognigen and DILIsym Services, new software offerings such as PKPlus, funded collaborations (with the FDA, National Institute of Health, and large pharmaceutical companies), and KIWI contracts, as well as an increasing number of consulting contracts and the increasing usage of simulation tools by global regulatory agencies.

SLP anticipates revenue will be enhanced though the collaboration between its DILIsym, SLP, and Cognigen divisions. In October 2019, the company obtained a partnership with a global pharmaceutical company to create a new platform for acute radiation syndrome (RADAsym) with DILIsym services taking the lead and its Cognigen and Lancaster divisions supporting the effort. Cross selling between the company's three subsidiaries, a growing client base, and user licenses purchased by US and foreign regulators for software products and analytical consulting services should underlie accelerated net income growth through FY21.



Industry Dynamics

IBISWorld projects total US Scientific R&D spending through 2025 to grow 1.1% annually reaching $217.2 billion, up from an estimated $160.7 billion in 2019. Based on IBISWorld's January 2020 forecast for the Scientific R&D Development industry, if the percentages for biotechnology, pharmaceutical, and other segments hold (30% total – see chart on the right), 2025 spending on those three categories should approximate $65.2 billion, up from $48.2 billion forecast for 2019. Growth should be driven by the increased outsourcing to companies with specialized skill sets.

Fundamentals

SLP's sales growth is driven primarily by participation of its life science and market teams in large and small conferences around the world. Making in excess of 25 presentations at global conferences resulted in the company's database of over 2,000 potential customers, which should grow annually by approximately 20%. We project annual customer additions could reach approximately 130 in FY21, up from 118 in FY19. Along with

customer additions, we anticipate more complex, higher value consulting projects due to the collaborative efforts between the SLP, Cognigen, and DILIsym science teams. In FY21, we anticipate analytical consulting services to account for 46.6% of total sales, up from approximately 45.4% in FY20, and 42.1% in FY19. We anticipate by 2H20, the company will have developed methods and practices that will improve margins on its consulting services offerings.

Customers evaluate software and then obtain approvals from multiple decision makers prior to making a purchase, a process that can take up to six months. Company data suggest that once a customer purchases a license, the annual account renewal rate approximates 85% with a revenue renewal rate at least 95%.

Entering 2Q20, the company's Cognigen subsidiary had 18 outstanding proposals with 11 companies and a $6.5 million project backlog. Its DILIsym subsidiary is working on 19 consulting projects (including two projects from its NAFLDsym software along with 7 active consortium contracts). DILIsym also has a funded collaboration with a large pharmaceutical company (funding could reach $2.9 million over the next two years).

Operations

For FY20, we project 16.2% sales growth to $39.5 million ($39.1 million), reflecting a 30.5% increase in DILIsym sales to $6.6 million stemming from accelerated consulting working for two existing clients, a 14.1% increase in the company's Lancaster, CA. division sales to $22.4 million reflecting the addition of approximately 118 new customers due primarily to consulting customer conversions and license renewals from regulatory agencies, and a 12.7% increase at its Cognigen division to $10.5 million due to a growing customer base. We anticipate analytical consulting services increasing 25.2% to $17.9 million or 45.4% of total sales, up from $14.3 million or 42.1% of total sales in FY19. Consulting services growth should reflect an increasing number of consulting projects for new and existing customers at the company's Cognigen division and enhanced analytical capabilities as DILIsym's unique software algorithms are merged into SLP's current services offering at its divisions in California and North Carolina.

For FY21, we project 16.4% sales growth to $45.9 million (prior was $45.3 million), reflecting a 17.8% increase in DILIsym sales to $7.8 million, a 16.5% increase in the company's Lancaster, CA. division sales to $26 million reflecting the addition of approximately 130 new customers due primarily to consulting customer conversions and license renewals from regulatory agencies, and a 15.4% increase at its Cognigen division to $12.1 million due to a growing customer base and revenue recognized from its KIWI offering. We anticipate analytical consulting services increasing 19.7% to $21.4 million or 46.6% of total sales, up from an estimated $17.9 million or 45.4% of total sales in FY20. Consulting services growth should reflect an increasing number of consulting projects for new and existing customers at the company's Cognigen division and enhanced analytical capabilities as DILIsym's unique software algorithms are merged into SLP's current services offering at its divisions in California and North Carolina.

The table below outlines the cost structure we anticipate for fiscal years 2020 and 2019 vs. 2018 and 2017 results.

Cost Structure

Margin Analysis	FY18A	FY19A	**FY20E**	**FY20E**	**FY21E**	**FY21E**
	Actual	Actual	**Prior**	**Current**	**Prior**	**Current**
Gross Profit	73.1%	73.4%	73.0%	73.0%	73.3%	73.3%
SG&A expenses	32.3%	32.9%	32.8%	33.4%	31.7%	31.8%
R&D expenses	6.0%	7.4%	7.5%	6.8%	6.3%	6.2%
Operating income	34.7%	31.3%	32.7%	32.9%	35.4%	35.5%
Tax rate	11.9%*	18.7%	23.0%	24.0%	23.0%	24.0%

Source: Taglich Brothers estimates and company reports *Includes a $1.5 million tax benefit in 2Q18.

Our gross margin projection reflects FY20 and FY21 Cognigen margins of 50.4%, and 51.1%, respectively, vs. 84.4% and 84.7%, respectively for each period in the Lancaster, CA division. We estimate the DILIsym division should have gross margin of 70.4% and 69.6% in FY20 and FY21. We forecast consolidated gross margin to remain at or just above 73% for FY20 and FY21, which is relatively flat with 73.4% in FY19. Our gross margin forecast reflects the hiring of additional scientific staff in FY19 in order to fulfill the increase in consulting and

analytical study contracts from new and existing customers during the upcoming two fiscal years. We anticipate the costs associated with the new personnel should gain additional leverage due to increased productivity as the staff is able to handle more consulting and analytical study contracts.

For the next two fiscal years, we project SG&A margins of 33.4% and 31.8%, respectively, and R&D margins of 6.8% to 6.2%, respectively (see table on prior page). Our operating expense forecasts reflect nearly a 17% increase in the company's scientific staff in FY19 and additional staff hiring at least 10%, partly offset by operational efficiencies created from marketing initiatives at its three divisions in order to obtain and support new customers and expand the functionality of SLP's software programs. Overall expenses will include support for workshops and training sessions in Germany, Korea, India, New Jersey, and at customer sites, as well as global participation in scientific meetings, conferences, and poster presentations.

In FY20, operating expenses should increase 10.8% to $15.8 million reflecting an 11.6% increase in SG&A expense to $13.2 million and R&D expense increase of 7% to $2.7 million. The increase in SG&A expense reflects spending to support growth initiatives at its three operating divisions in CA, NY, and NC. The $2.7 million in spending on R&D reflects the development and enhancement of new and existing software offerings. We project flat operating expense margin of 40.1% in FY20 compared to FY19 due primarily to higher sales offset by increased spending and a decrease in gross margin to 73% compared to 73.4% in FY19. We project 21.9% operating income growth to $13 million with operating margin of 32.9%.

In FY20, we project other income of $50,000 compared to an expense of $92,000 in FY19. The swing to income from an expense reflects no recognition of imputed-interest in FY20 compared to $109,000 in FY19 (the latter offset by interest income of approximately $33,000). Our net income projection is $9.9 million or $0.54 per share. We previously forecasted net income of $9.8 million or $0.54 per share.

In FY21, operating expenses should increase 10.2% to $17.5 million reflecting an 11% increase in SG&A expense to $14.6 million and a $163,000 increase in R&D expense to over $2.8 million. The increase in SG&A expense should support sales growth of the company's software offerings and consulting/analytical services. We project operating expense margin decreasing to 38% from our forecast of 40.1% in FY20 due to higher sales and the acceleration of scientists' productivity across the company's software and analytical consulting services platforms. We project 25% operating income growth to $16.2 million with operating margin of 35.3%.

In FY21, we project other income of $80,000 compared to $50,000 in FY20, reflecting the increase in the company's cash balances. Our FY21 net income projection is $12.4 million or $0.68 per share, unchanged from our prior forecast. The growth we forecast reflects increased productivity from the prior years' build out of company's sales and contract services infrastructure.

Finances

For FY20, we project cash earnings of $13.8 million and an increase in working capital of $3.2 million due primarily to increases in receivables and revenue in excess of billings and a decrease in deferred tax accruals. Cash from operations of $10.6 million should cover software development costs, contingent and contract payments, and common stock dividends, increasing cash by nearly $2.5 million to $14 million at the end of FY20.

For FY21, we project cash earnings of $16.5 million and an increase in working capital of $3.3 million due primarily to increases in receivables and revenue in excess of billings and a decrease in deferred tax accruals. Cash from operations of $13.2 million should cover software development costs and common stock dividends, increasing cash by $5.1 million to $19.1 million at the end of FY21.

1Q20 Results

1Q20

Sales increased 24.7% to $9.4 million due primarily to an 88.7% sales increase at its North Carolina DILISym subsidiary to nearly $2.1 million stemming from accelerated project delivery requests from two clients in support of critical development and regulatory strategies. The company's Buffalo subsidiary (Cognigen) increased sales

by 15.6% to nearly $2.4 million due primarily to working on 33 contracts and initiating 15 new projects. Sales at the Lancaster, CA division increased 12.9% to $4.9 million stemming from 16 new commercial customers and 22 new non-profit customers, as well as retaining approximately 98% of fees from existing customers. Total sales included a $1.3 million increase (or 38.6%) in all consulting and analytical study revenues from its three subsidiaries.

Gross profit increased 26.7% to $6.8 million due to sales growth and gross margin improvement to 71.9% from 70.8% in the year-ago period. Gross margin for the software and services division was 84.9% versus 81.1% and the DILIsym subsidiary had gross margin of 69.9% compared to 63.5% in 1Q19. Gross margin at the Cognigen subsidiary contracted to 46.8% from 53.1% in the year-ago period. Gross margin improvement was due primarily to accelerated sales growth that was restrained by a $399,000 increase in labor costs, as well as increases in direct contract expenses paid for testing at DILIsym of $81,000.

Operating expense margin was essentially flat at 43% compared to 43.1% in 1Q19. Operating expenses increased 24.3% to $4 million compared to 24.8% sales growth. SG&A expense increased 29.2% to $3.5 million and R&D was flat at $526,000. The increase in SG&A expense includes higher software license costs ($29,000 increase), insurance ($72,000 increase), payroll taxes ($23,000 increase), commission expenses ($22,000 increase), and salaries and wages and 401K expenses ($403,000) reflecting increased stock compensation, costs associated with a new CEO, and annual salary increases and increased head count in Lancaster and Buffalo. Expenses also increased due to increases in director fees professional service fees of $71,000 and $60,000, respectively, compared to 1Q19.

Operating income increased 30.3% to $2.7 million from $2.1 million in the year-ago period due primarily to sales growth and gross margin improvement. Other income was $15,000 (comprised of $11,000 in interest income and $4,000 of currency exchange gain) compared to an expense of $65,000 in the year-ago period. The other expense in the year-ago period stems from currency exchange losses of $31,000 and net interest expense of $35,000 that consisted of contingent consideration (imputed interest) offset in part by interest income of $3,700.

Net income was $2.1 million or $0.11 per share compared to $1.5 million or $0.09 per share. The company recorded an income tax expense of $675,000 (24.7% tax-rate) compared to an expense of $486,000 (24% tax-rate) in the year-ago period. We projected net income of $1.8 million or $0.10 per share on sales of $8.4 million.

Finances

In 1Q20, cash earnings of $3.1 million and an increase in working capital of $462,000 resulted in cash from operations of $2.6 million. The increase in working capital resulted primarily from an increase in receivables, partly offset by a decrease in deferred tax and refund and accrued income taxes. Cash from operations covered capital expenditures and common stock dividends, increasing cash by $1.2 million to $12.6 million at November 30, 2019.

Strategy

SLP aims to increase its visibility and customer leads by having their life science team members attend conferences and scientific meetings worldwide. The company attends approximately 50 scientific conferences annually, while also presenting posters and oral podium presentations globally. SLP also hosts webinars on modeling and simulation applications and holding global workshops demonstrating the utility of its offerings.

The company aims to expand its contract research, consulting, and workshop services offered to the industry. In FY19, SLP's Lancaster division engaged with 40 new commercial clients, increased its consulting revenue by 28% to $2.3 million, and increased its professional staff by approximately 17% to 111. Of the increased staff, four were place in Europe to support the company's increasing physical presence in that market. While the new staff is an initial expense, operating leverage should emerge in FY20. The consulting offering is a marketing tool since it demonstrates the capabilities of the company's life sciences team and simulation tools, which often lead to site licenses for its software offerings.

SLP is engaged in the practice of seeking funded research consulting agreements with government agencies and commercial pharmaceutical companies. The company's Lancaster division ended FY19 with two FDA funded collaborations and two unfunded collaborations (with future funding potential). In 1Q20, the Lancaster division obtained three funded collaborations with a clinical stage biotechnology company and two large pharmaceutical companies to enhance the Gastroplus offering. The DILISym subsidiary is actively working on one NIH funded collaboration and two funded collaborations with large pharmaceutical companies. The potential future value of the DILISym collaborations is approximately $4.4 million.

Competitive Landscape

Pharmaceutical companies conduct drug discovery and development efforts through internal development staffs and outsourcing some of this work. Smaller companies need to outsource a greater percentage of this research. SLP also competes with in-house development teams at some pharmaceutical companies.

Drug makers have turned to innovative drug treatments that serve an unmet need in order to get regulatory approval. In 2015, the FDA approved 45 novel drugs, four more than in 2014 and the most since the all-time record of 53 set in 1996. In 2016, FDA approvals fell to 22, the lowest number since 2010. In 2017, FDA approvals rebounded to 46 and accelerated in 2018 to 59, but decreased to 48 in 2019.

The company's pharmaceutical software and services business competes against companies that provide more extensive and higher cost screening, testing, and research services, and products that are not based on simulation software. There are also software companies whose products do not compete directly, but are related. We were unable to find other companies that might pose a competitive threat to GastroPlus, DDDPlus, and/or MembranePlus. Those simulated software offerings appear to be unique. ADMET Predictor/ADMET Modeler operates in a more competitive environment; however, independently published product comparisons have been very favorable, with ADMET Predictor consistently ranked first in predictive accuracy.

Risks

Technology
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 products.

Shareholder Control
Walter Woltosz, co-founder and chairman of the board, and Virginia Woltosz, co-founder, own approximately 27.8% of the outstanding voting stock (based on SEC filing in December 2019). Walter and Virginia Woltosz might greatly influence the outcome on all matters requiring stockholder approval in ways that may not be in the best interests of other shareholders.

Intellectual Property Rights
Third parties may infringe on or misappropriate IP 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.

Cyber Security
SLP operates large and complex computer systems that contain significant amounts of client data. Unauthorized third parties could attempt to gain entry to its computer systems for the purpose of stealing data or disrupting the systems. The company believes appropriate measures are in place to protect client data from intrusion, and will constantly work to improve and enhance its computer systems. However, if its systems prove not to be secure, the company could suffer significant harm since client contracts typically contain provisions that require their data to remain confidential.

Foreign Exchange
While nearly all of SLP's transactions are denominated in US dollars, approximately 18% and 18% of sales were to Asian and European customers, respectively, in FY19. In Japan and China, the company receives payment in

Yen and Yuan, respectively. If foreign currency transactions increase significantly, the company may engage in hedging in order to mitigate risk. So far exchange rate exposure has had no material impact.

Miscellaneous Risk

The company's financial results are subject to other risks and uncertainties including 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 2018 was 63,700 shares a day. In 2019, average daily volume increased to 97,300, and over the last three months (ending January 14, 2020) was 121,600. SLP has 17.6 million shares outstanding and a float of approximately 12.5 million. Investors should by aware that a thinly traded equity could experience price volatility.

Simulations Plus, Inc.
Consolidated Balance Sheets
FY2017 –FY2021E
(in thousands)

	FY17A	FY18A	FY19A	1Q20A	**FY20E**	**FY20E**
ASSETS						
Current assets:						
Cash	$ 6,216	$ 9,401	$ 11,436	$ 12,610	**$ 13,979**	**$ 19,083**
Accounts receivable, net	4,049	5,515	5,027	6,353	**6,578**	**7,147**
Revenue in excess of billings	1,481	1,986	3,234	3,481	**4,500**	**6,000**
Prepaid income taxes	462	313	765	87	**525**	**800**
Prepaid expense and other current assets	460	610	704	561	**726**	**781**
Total current assets	12,668	17,824	21,165	23,093	**26,308**	**33,811**
Capitalized computer software development costs, net	4,308	5,153	4,960	5,153	**5,750**	**7,000**
Property and equipment, net	291	335	341	335	**350**	**355**
Operating lease right of use asset	-	-	-	771	**771**	**771**
Customer relationships, intellectual property, goodwill, intangibl	21,212	19,930	18,693	18,374	**17,585**	**16,880**
Other assets	34	37	37	37	**37**	**37**
Total assets	$ 38,512	$ 43,279	$ 45,197	$ 47,763	**$ 50,801**	**$ 58,854**
LIABILITIES AND STOCKHOLDERS' EQUITY						
Current liabilities:						
Accounts payable	241	352	204	585	**213**	**110**
Accrued payroll and other expenses	983	1,152	1,639	1,598	**1,676**	**1,887**
Operating lease liability	-	-	-	528	**528**	**528**
Contract payable	247	2,557	1,761	1,761	**-**	**-**
Billings in excess of revenues	217	385	799	890	**850**	**800**
Current portion of deferred revenue	354	382	381	272	**400**	**400**
Total current liabilities	2,042	4,827	4,783	5,633	**3,667**	**3,726**
Deferred income tax accruals	4,927	3,195	2,732	2,704	**2,269**	**1,000**
Payments due under contract payable	5,738	3,334	-	-	**-**	**-**
Operating lease liability	-	-	-	240	**240**	**115**
Stockholders' equity:						
Common stock, no par value; authorized 20,000,000 shares;	7	7	8	8	**8**	**8**
Additional paid-in capital	12,109	13,454	15,319	15,822	**16,655**	**18,055**
Retained earnings (accumulated deficit)	13,688	18,462	22,354	23,356	**27,962**	**35,950**
Total stockholders' equity	25,805	31,923	37,681	39,186	**44,625**	**54,013**
Total liabilities and stockholders' equity	$ 38,512	$ 43,279	$ 45,197	$ 47,763	**$ 50,801**	**$ 58,853**
SHARES OUT	17,278	17,416	17,592	17,623	**17,630**	**17,640**

Source: Company reports and Taglich Brothers estimates

Simulations Plus, Inc.
Annual Income Statement Model
FY2017 – 2021E
(in thousands)

	FY17 A	FY18 A	FY19 A	**FY20 E**	**FY21 E**
Simulations Plus - Pharmaceutical software/consulting	$ 15,600	$ 17,553	$ 19,585	**$ 22,352**	**$ 26,030**
DILIsym - North Carolina	1,238	4,257	5,065	**6,607**	**7,785**
Cognigen division - Consulting services	7,300	7,857	9,321	**10,507**	**12,130**
Total Net sales	$ 24,138	$ 29,667	$ 33,970	**$ 39,466**	**$ 45,945**
Cost of sales - Simulations Plus Division	2,643	3,049	3,277	**3,479**	**3,975**
Cost of sales - DILIsym	555	1,718	1,382	**1,953**	**2,365**
Cost of sales - Cognigen Division	3,110	3,227	4,367	**5,216**	**5,935**
Total Cost of sales	6,308	7,994	9,026	**10,648**	**12,275**
Gross Profit	17,830	21,672	24,945	**28,818**	**33,670**
Operating Expenses:					
Selling, general, and administrative	8,198	9,584	11,796	**13,163**	**14,613**
Research and development	1,368	1,791	2,500	**2,676**	**2,839**
Total Operating Expenses	9,566	11,375	14,296	**15,840**	**17,452**
Operating Income (loss)	8,264	10,298	10,649	**12,978**	**16,218**
Other income (expense)					
Interest income (expense)	(22)	(126)	(76)	**50**	**80**
Gain (Loss) on exhange of currency	(2)	(33)	(17)	**4**	**-**
Total Other Income (expense)	(24)	(159)	(92)	**54**	**80**
Pre-Tax Income (loss)	8,240	10,139	10,556	**13,032**	**16,298**
Income Tax Expense (Benefit)	2,453	1,204	1,973	**3,125**	**3,910**
Net income (loss)	5,788	8,935	8,583	**9,907**	**12,388**
Earning (loss) per share	$ 0.33	$ 0.50	$ 0.48	**$ 0.54**	**$ 0.68**
Avg Shares Outstanding	17,515	17,860	18,039	**18,317**	**18,336**
Dividends per Share	$ 0.20	$ 0.24	$ 0.24	**$ 0.24**	$ 0.24
Margin Analysis					
Gross margin - Simulations Plus Division	83.1%	82.6%	83.3%	**84.4%**	**84.7%**
DILIsym - North Carolina	55.2%	59.6%	72.7%	**70.4%**	**69.6%**
Gross margin - Cognigen Division	57.4%	58.9%	53.1%	**50.4%**	**51.1%**
Total gross margin	73.9%	73.1%	73.4%	**73.0%**	**73.3%**
Selling, general, and administrative	34.0%	32.3%	32.9%	**33.4%**	**31.8%**
Research and development	5.7%	6.0%	7.4%	**6.8%**	**6.2%**
Operating margin	34.2%	34.7%	31.3%	**32.9%**	**35.3%**
Pre-tax margin	34.1%	34.2%	31.1%	**33.0%**	**35.5%**
Tax rate	29.8%	11.9%	18.7%	**24.0%**	**24.0%**
YEAR / YEAR GROWTH					
Total Revenues	20.9%	22.9%	14.5%	**16.2%**	**16.4%**

Source: Company reports and Taglich Brothers estimates

Simulations Plus, Inc.
Quarterly Income Statement Model
FY2019 to 2021E
(in thousands)

	Q1 19 A	Q2 19 A	Q3 19 A	Q4 19 A	FY19 A	Q1 20 A	Q2 20 E	Q3 20 E	Q4 20 E	**FY20 E**	Q1 21 E	Q2 21 E	Q3 21 E	Q4 21 E	**FY21 E**
Simulations Plus - Pharmaceutical software/consulting	$ 4,365	$ 5,008	$ 6,025	$ 4,187	$ 19,585	$ 4,927	$ 5,855	$ 6,895	$ 4,675	**$ 22,352**	$ 5,455	$ 7,125	$ 8,050	$ 5,400	**$ 26,030**
DILIsym - North Carolina	1,106	1,172	1,374	1,413	5,065	2,087	1,295	1,600	1,625	**6,607**	1,925	1,950	1,975	1,935	**7,785**
Cognigen division - Consulting services	2,065	2,292	2,538	2,426	9,321	2,387	2,525	2,995	2,600	**10,507**	2,800	2,950	3,400	2,980	**12,130**
Total Net sales	$ 7,536	$ 8,472	$ 9,937	$ 8,026	$ 33,970	$ 9,401	$ 9,675	$ 11,490	$ 8,900	**$ 39,466**	$ 10,180	$ 12,025	$ 13,425	$ 10,315	**$ 45,945**
Cost of sales - Simulations Plus Division	827	840	806	805	3,277	744	880	965	890	**3,479**	925	1,000	1,085	965	**3,975**
Cost of sales - DILIsym	404	314	314	350	1,382	628	390	465	470	**1,953**	605	585	565	610	**2,365**
Cost of sales - Cognigen Division	969	1,054	1,205	1,139	4,367	1,271	1,275	1,455	1,215	**5,216**	1,400	1,430	1,615	1,490	**5,935**
Total Cost of sales	2,200	2,208	2,324	2,293	9,026	2,643	2,545	2,885	2,575	**10,648**	2,930	3,015	3,265	3,065	**12,275**
Gross Profit	5,336	6,264	7,613	5,733	24,945	6,758	7,130	8,605	6,325	**28,818**	7,250	9,010	10,160	7,250	**33,670**
Operating Expenses:															
Selling, general, and administrative	2,719	2,810	3,087	3,180	11,796	3,513	3,100	3,450	3,100	**13,163**	3,585	3,650	3,735	3,643	**14,613**
Research and development	530	724	643	603	2,500	526	700	800	650	**2,676**	575	750	850	664	**2,839**
Total Operating Expenses	3,249	3,534	3,731	3,783	14,296	4,040	3,800	4,250	3,750	**15,840**	4,160	4,400	4,585	4,307	**17,452**
Operating Income (loss)	2,087	2,730	3,882	1,950	10,649	2,718	3,330	4,355	2,575	**12,978**	3,090	4,610	5,575	2,943	**16,218**
Other income (expense)															
Interest income (expense)	(35)	(33)	(22)	13	(76)	11	12	13	14	**50**	20	20	20	20	**80**
Gain (Loss) on exhange of currency	(31)	(2)	(8)	24	(17)	4	-	-	-	**4**	-	-	-	-	-
Total Other Income (expense)	(65)	(35)	(30)	37	(92)	15	12	13	14	**54**	20	20	20	20	**80**
Pre-Tax Income (loss)	2,022	2,696	3,852	1,987	10,556	2,733	3,342	4,368	2,589	**13,032**	3,110	4,630	5,595	2,963	**16,298**
Income Tax Expense (Benefit)	486	596	964	(72)	1,973	675	800	1,035	615	**3,125**	745	1,110	1,345	710	**3,910**
Net income (loss)	1,536	2,099	2,889	2,059	8,583	2,058	2,542	3,333	1,974	**9,907**	2,365	3,520	4,250	2,253	**12,388**
Earning (loss) per share	$ 0.09	$ 0.12	$ 0.16	$ 0.11	$ 0.48	$ 0.11	$ 0.14	$ 0.18	$ 0.11	**$ 0.54**	$ 0.13	$ 0.19	$ 0.23	$ 0.12	**$ 0.68**
Avg Shares Outstanding	17,998	18,003	18,096	18,057	18,039	18,307	18,315	18,320	18,325	**18,317**	18,325	18,335	18,340	18,345	**18,336**
Dividends per Share	$ 0.06	$ 0.06	$ 0.06	$ 0.06	$ 0.24	$ 0.06	$ 0.06	$ 0.06	$ 0.06	**$ 0.24**	$ 0.06	$ 0.06	$ 0.06	$ 0.06	$ 0.24
Margin Analysis															
Gross margin - Simulations Plus Division	81.1%	83.2%	86.6%	80.8%	83.3%	84.9%	85.0%	86.0%	81.0%	**84.4%**	83.0%	86.0%	86.5%	82.1%	**84.7%**
DILIsym - North Carolina	63.5%	73.2%	77.1%	75.3%	72.7%	69.9%	69.9%	70.9%	71.1%	**70.4%**	68.6%	70.0%	71.4%	68.5%	**69.6%**
Gross margin - Cognigen Division	53.1%	54.0%	52.5%	53.1%	53.1%	46.8%	49.5%	51.4%	53.3%	**50.4%**	50.0%	51.5%	52.5%	50.0%	**51.1%**
Total gross margin	70.8%	73.9%	76.6%	71.4%	73.4%	71.9%	73.7%	74.9%	71.1%	**73.0%**	71.2%	74.9%	75.7%	70.3%	**73.3%**
Selling, general, and administrative	36.1%	33.2%	31.1%	39.6%	32.9%	37.4%	32.0%	30.0%	34.8%	**33.4%**	35.2%	30.4%	27.8%	35.3%	**31.8%**
Research and development	7.0%	8.5%	6.5%	7.5%	7.4%	5.6%	7.2%	7.0%	7.3%	**6.8%**	5.6%	6.2%	6.3%	6.4%	**6.2%**
Operating margin	27.7%	32.2%	39.1%	24.3%	31.3%	28.9%	34.4%	37.9%	28.9%	**32.9%**	30.4%	38.3%	41.5%	28.5%	**35.3%**
Pre-tax margin	26.8%	31.8%	38.8%	24.8%	31.1%	29.1%	34.5%	38.0%	29.1%	**33.0%**	30.6%	38.5%	41.7%	28.7%	**35.5%**
Tax rate	24.0%	22.1%	25.0%	(3.6%)	18.7%	24.7%	23.9%	23.7%	23.8%	**24.0%**	24.0%	24.0%	24.0%	24.0%	**24.0%**
YEAR / YEAR GROWTH															
Total Revenues	6.6%	15.2%	16.2%	20.0%	14.5%	24.7%	14.2%	15.6%	10.9%	**16.2%**	8.3%	24.3%	16.8%	15.9%	**16.4%**

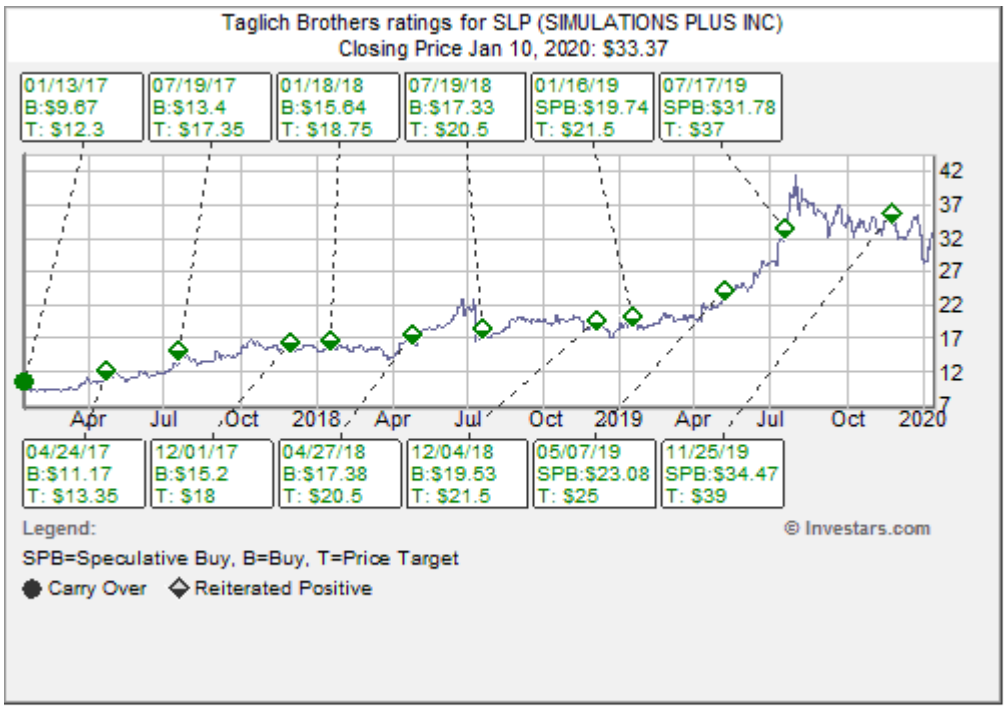
Source: Company reports and Taglich Brothers estimates

Simulations Plus, Inc.
Cash Flow Statement
FY2017 – FY2021E
(in thousands)

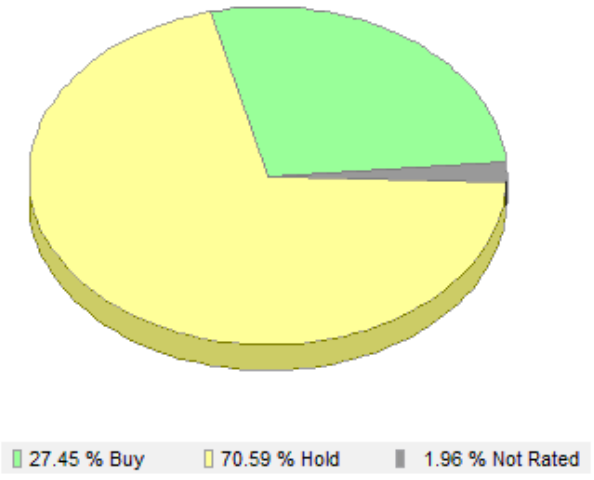
	FY2017A	FY2018A	FY2019A	1Q20A	**FY2020E**	**FY2021E**
Cash Flows from Operating Activities						
Net Income (loss)	$ 5,788	$ 8,935	$ 8,583	$ 2,058	**$ 9,907**	**$ 12,388**
Depreciation and amortization	1,248	2,721	2,750	671	**2,700**	**2,750**
Amortization of intellectual property	887	-	-	-	**-**	**-**
Stock-based compensation, net	622	709	1,078	367	**1,200**	**1,400**
Loss (gain) on sale of assets and change in value of contigent considera	38	153	109	-	**-**	**-**
Cash earnings (burn)	8,583	12,518	12,520	3,096	**13,807**	**16,538**
Changes In:						
Accounts receivable	(876)	(1,466)	488	(1,327)	**(1,551)**	**(569)**
Revenues in excess of billings	(634)	(505)	(1,248)	(247)	**(1,266)**	**(1,500)**
Deferred tax and refund and accured income taxes	(239)	(1,582)	(752)	650	**(463)**	**(1,269)**
Pre-paids and other assets	41	(154)	(94)	143	**(22)**	**(54)**
Accounts payable	99	111	(148)	381	**9**	**(102)**
Accrued payroll and other expenses	284	169	487	(44)	**37**	**211**
Income taxes	-	-	-	-	**-**	**-**
Billings in excess of revenues	(118)	168	414	91	**51**	**(50)**
Other and accrued income taxes	(8)	-	-	-	**(3)**	**-**
Deferred revenue	(253)	28	(30)	(109)	**19**	**-**
(Increase)/decrease in Working Capital	(1,705)	(3,231)	(882)	(462)	**(3,189)**	**(3,334)**
Net cash Provided by Operations	6,878	9,287	11,638	2,634	**10,619**	**13,204**
Cash Flows from Investing Activities						
Purchase of property and equipment	(176)	(183)	(138)	(31)	**(150)**	**(200)**
Cash used/received to purchase Cognigen Corporation and DILIsym	(2,796)	-	-	-	**-**	**-**
Purchases of intellectual property	-	-	(50)	-	**-**	**-**
Earn-out payments	-	-	-	-	**-**	**-**
Capitalized computer software development costs	(1,384)	(2,145)	(1,768)	(507)	**(2,000)**	**(3,500)**
Cash Flows from Investing Activities	(4,355)	(2,329)	(1,956)	(538)	**(2,150)**	**(3,700)**
Cash Flows from Financing Activities						
Payments on contracts payable	(1,000)	(247)	(4,239)	(1,056)	**(1,761)**	**-**
Common stock dividends	(3,448)	(4,162)	(4,197)	-	**(4,300)**	**(4,400)**
Proceeds from the exercise of stock options and excess benefits	111	636	788	136	**136**	**-**
Net cash provided by Financing	(4,337)	(3,773)	(7,648)	(921)	**(5,925)**	**(4,400)**
Net change in Cash	(1,815)	3,185	2,035	1,175	**2,544**	**5,104**
Cash Beginning of Period	8,030	6,216	9,401	11,436	**11,436**	**13,979**
Cash End of Period	$ 6,216	$ 9,401	$ 11,436	$ 12,610	**$ 13,979**	**$ 19,083**

Source: Company reports and Taglich Brothers estimates

Price Chart



Taglich Brothers Current Ratings Distribution



Investment Banking Services for Companies Covered in the Past 12 Months

Rating	#	%
Buy	1	5
Hold		
Sell		
Not Rated	1	50

Important Disclosures

As of the date of this report, we, our affiliates, any officer, director or stockholder, or any member of their families do not have a position in the stock of the company mentioned in this report. Taglich Brothers, Inc. does not currently have an Investment Banking relationship with the company mentioned in this report and was not a manager or co-manager of any offering for the company within the last three years.

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Analyst Certification

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.

Public Companies mentioned in this report:

None

Meaning of Ratings

Buy – The growth prospects, degree of investment risk, and valuation make the stock attractive relative to the general market or comparable stocks.

Speculative Buy – Long-term prospects of the company are promising but investment risk is significantly higher than it is in our BUY-rated stocks. Risk-reward considerations justify purchase mainly by high risk-tolerant accounts. In the short run, the stock may be subject to high volatility and could continue to trade at a discount to its market.

Neutral – Based on our outlook the stock is adequately valued. If investment risks are within acceptable parameters, this equity could remain a holding if already owned.

Sell – Based on our outlook the stock is significantly overvalued. A weak company or sector outlook and a high degree of investment risk make it likely that the stock will underperform relative to the general market.

Discontinued – Research coverage discontinued due to the acquisition of the company, termination of research services (includes non-payment for such services), diminished investor interest, or departure of the analyst.

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.

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.