

GSE SYSTEMS INC
Form 10-Q
November 12, 2015
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934
for the Quarterly Period Ended September 30, 2015

or

Transition Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934
for the transition period from ____ to ____

Commission File Number 001-14785

GSE Systems, Inc.
(Exact name of registrant as specified in its charter)

Delaware 52-1868008
(State of incorporation) (I.R.S. Employer Identification Number)

1332 Londontown Blvd., Suite 200, Sykesville MD 21784
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (410) 970-7800

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X]
No []

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

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

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

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

There were 17,897,859 shares of common stock, with a par value of \$.01 per share outstanding as of November 11, 2015.

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GSE SYSTEMS, INC.
 QUARTERLY REPORT ON FORM 10-Q
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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

GSE SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share data)

	Unaudited September 30, 2015	December 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 12,832	\$ 13,583
Restricted cash	223	613
Contract receivables, net	12,240	15,830
Prepaid expenses and other current assets	2,380	1,703
Total current assets	27,675	31,729
Equipment, software and leasehold improvements	7,039	7,055
Accumulated depreciation	(5,387)	(5,229)
Equipment, software and leasehold improvements, net	1,652	1,826
Software development costs, net	996	1,414
Goodwill	5,612	5,612
Intangible assets, net	903	1,279
Long-term restricted cash	3,305	3,591
Other assets	78	548
Total assets	\$ 40,221	\$ 45,999
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Line of credit	\$ -	\$ 339
Accounts payable	2,015	2,330
Accrued expenses	1,944	1,554
Accrued compensation and payroll taxes	3,707	2,595
Billings in excess of revenue earned	7,062	8,684
Accrued warranty	1,614	1,456
Current contingent consideration	2,601	2,842
Other current liabilities	444	473
Total current liabilities	19,387	20,273
Contingent consideration	2,221	1,948
Other liabilities	238	38
Total liabilities	21,846	22,259
Stockholders' equity:		
Preferred stock \$.01 par value, 2,000,000 shares authorized, shares issued and outstanding none in 2015 and 2014	-	-
Common stock \$.01 par value, 30,000,000 shares authorized, 19,496,770 shares issued and 17,897,859 shares outstanding in 2015, 19,486,770 shares	195	195

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issued and 17,887,859 shares outstanding in 2014

Additional paid-in capital	73,324		72,917	
Accumulated deficit	(50,708))	(45,142))
Accumulated other comprehensive loss	(1,437))	(1,231))
Treasury stock at cost, 1,598,911 shares in 2015 and 2014	(2,999))	(2,999))
Total stockholders' equity	18,375		23,740	
Total liabilities and stockholders' equity	\$ 40,221		\$ 45,999	

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

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GSE SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)
(Unaudited)

	Three Months ended September 30,		Nine Months ended September 30,	
	2015	2014	2015	2014
Contract revenue	\$ 14,961	\$ 7,823	\$ 42,589	\$ 24,823
Cost of revenue	11,158	5,368	32,649	17,497
Write-down of capitalized software development costs	1,538	-	1,538	-
Gross profit	2,265	2,455	8,402	7,326
Operating expenses:				
Selling, general and administrative	3,811	3,954	11,031	11,939
Restructuring charges	1,600	272	1,746	883
Depreciation	119	140	383	413
Amortization of definite-lived intangible assets	123	36	370	108
Total operating expenses	5,653	4,402	13,530	13,343
Operating loss	(3,388)	(1,947)	(5,128)	(6,017)
Interest income, net	19	44	67	103
Gain (loss) on derivative instruments, net	20	69	(59)	178
Other expense, net	(156)	-	(235)	(7)
Loss before income taxes	(3,505)	(1,834)	(5,355)	(5,743)
Provision for income taxes	50	61	211	162
Net loss	\$(3,555)	\$(1,895)	\$(5,566)	\$(5,905)
Basic loss per common share	\$(0.20)	\$(0.11)	\$(0.31)	\$(0.33)
Diluted loss per common share	\$(0.20)	\$(0.11)	\$(0.31)	\$(0.33)

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

GSE SYSTEMS, INC. AND SUBSIDIARIES
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(in thousands)
 (Unaudited)

	Three Months ended September 30,		Nine Months ended September 30,	
	2015	2014	2015	2014
Net loss	\$ (3,555)	\$ (1,895)	\$ (5,566)	\$ (5,905)
Foreign currency translation adjustment, net of tax	(76)	(261)	(206)	(362)
Comprehensive loss	\$ (3,631)	\$ (2,156)	\$ (5,772)	\$ (6,267)

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

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GSE SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
(in thousands)
(Unaudited)

	Common Stock Shares	Amount	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Treasury Stock Shares	Amount	Total
Balance, December 31, 2014	19,487	\$ 195	\$ 72,917	\$ (45,142)	\$ (1,231)	(1,599)	\$(2,999)	\$23,740
Stock-based compensation expense	-	-	392	-	-	-	-	392
Common stock issued for services provided	10	-	15	-	-	-	-	15
Foreign currency translation adjustment	-	-	-	-	(206)	-	-	(206)
Net loss	-	-	-	(5,566)	-	-	-	(5,566)
Balance, September 30, 2015	19,497	\$ 195	\$ 73,324	\$ (50,708)	\$ (1,437)	(1,599)	\$(2,999)	\$18,375

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

GSE SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	Nine Months ended September 30,	
	2015	2014
Cash flows from operating activities:		
Net loss	\$(5,566)	\$(5,905)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Write-down of capitalized software development costs	1,538	-
Depreciation	383	413
Amortization of definite-lived intangible assets	370	108
Capitalized software amortization	291	173
Change in fair value of contingent consideration	739	69
Stock-based compensation expense	407	514
Equity loss on investments	233	38
(Gain) loss on derivative instruments	59	(178)
Changes in assets and liabilities:		
Contract receivables	3,580	11,928
Prepaid expenses and other assets	(409)	419
Accounts payable, accrued compensation and accrued expenses	1,262	(2,292)
Billings in excess of revenue earned	(1,618)	792
Accrued warranty reserves	158	(349)
Other liabilities	(120)	(575)
Net cash provided by operating activities	1,307	5,155
Cash flows from investing activities:		
Capital expenditures	(217)	(240)
Capitalized software development costs	(1,411)	(590)
Restrictions of cash as collateral under letters of credit	(1,148)	(3,159)
Releases of cash as collateral under letters of credit	1,824	34
Net cash used in investing activities	(952)	(3,955)
Cash flows from financing activities:		
Payments on line of credit	(339)	-
Payments of the liability-classified contingent consideration arrangements	(500)	(500)
Net cash used in financing activities	(839)	(500)
Effect of exchange rate changes on cash	(267)	(315)
Net increase (decrease) in cash and cash equivalents	(751)	385
Cash and cash equivalents at beginning of year	13,583	15,643
Cash and cash equivalents at end of period	\$ 12,832	\$ 16,028

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

GSE SYSTEMS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the Three and Nine Months ended September 30, 2015 and 2014
(Unaudited)

1. Basis of Presentation and Revenue Recognition

Basis of Presentation

The consolidated interim financial statements included herein have been prepared by GSE Systems, Inc. (the "Company" or "GSE") without independent audit. In the opinion of the Company's management, all adjustments and reclassifications of a normal and recurring nature necessary to present fairly the financial position, results of operations and cash flows for the periods presented have been made. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles ("GAAP") have been condensed or omitted. The results of operations for interim periods are not necessarily an indication of the results for the full year. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014 filed with the Securities and Exchange Commission on March 19, 2015. Certain reclassifications have been made to prior period amounts to conform to the current presentation.

The Company has two reportable segments as follows:

·Performance Improvement Solutions

Our Performance Improvement Solutions business segment encompasses all of the solution-oriented technologies and services traditionally associated with GSE which focus on both our client's people and their plants and operations. This segment includes various simulation, training and engineering products and services delivered across the breadth of industries we serve. Our simulation solutions include platforms ranging from (1) the non-specific plant systems of our EnVision product line used to teach fundamental processes to newly hired employees, to (2) custom plant-specific simulators used to train plant operators, to (3) engineering-grade simulation solutions used to help clients verify and validate control systems prior to new plant construction or modification of existing plants, to (4) engineering-grade simulation solutions used for human factors engineering. Training applications include turnkey and custom training services to make training more effective. Our engineering services include plant design, automation and control systems design, functional safety and compliance analysis, and engineering consultations.

·Nuclear Industry Training and Consulting (formerly our "Staff Augmentation" segment)

Nuclear Industry Training and Consulting services provide specialized workforce solutions primarily to the nuclear industry. These employees work at our clients' facilities under client direction. Examples of these highly skilled positions are primarily senior reactor operations instructors, procedure writers, work management specialists, planners and training material developers. This business is managed through our Hyperspring, LLC subsidiary. Hyperspring has been providing these services since 2005.

Financial information about the two business segments is provided in Note 15 of the accompanying Consolidated Financial Statements.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements as well as reported amounts of revenues and expenses during the reporting period. The Company's most significant estimates relate to revenue recognition on long-term contracts, product warranties, capitalization of software development costs, valuation of goodwill and intangible assets acquired, valuation of contingent consideration issued in business acquisitions, and the recoverability of deferred tax assets. Actual results could differ from these estimates and those differences could be material.

Revenue Recognition on Long-Term Contracts

The Company recognizes revenue through (1) fixed price contracts on the sale of uniquely designed systems containing hardware, software and other material and (2) time and material contracts primarily for Nuclear Industry Training and Consulting support and service agreements.

In accordance with ASC 605-35, Construction-Type and Production-Type Contracts, our Performance Improvement Solutions segment accounts for revenue under fixed-price contracts using the percentage-of-completion method. This methodology recognizes revenue and earnings as work progresses on the contract and is based on an estimate of the revenue and earnings earned to date, less amounts recognized in prior periods. The Company bases its estimate of the degree of completion of the contract by reviewing the relationship of costs incurred to date to the expected total costs that will be incurred on the project. Estimated contract earnings are reviewed and revised periodically as the work progresses, and the cumulative effect of any change in estimate is recognized in the period in which the change is identified. Estimated losses are charged against earnings in the period such losses are identified. The Company recognizes revenue arising from contract claims either as income or as an offset against a potential loss only when the amount of the claim can be estimated reliably and realization is probable and there is a legal basis of the claim. Uncertainties inherent in the performance of contracts include labor availability and productivity, material costs, change order scope and pricing, software modification and customer acceptance issues. The reliability of these cost estimates is critical to the Company's revenue recognition as a significant change in the estimates can cause the Company's revenue and related margins to change significantly from the amounts estimated in the early stages of the project.

As the Company recognizes revenue under the percentage-of-completion method, it provides an accrual for estimated future warranty costs based on historical and projected claims experience. The Company's long-term contracts generally provide for a one-year warranty on parts, labor and any bug fixes as it relates to software embedded in the systems.

The Company's system design contracts do not normally provide for "post customer support service" (PCS) in terms of software upgrades, software enhancements or telephone support. In order to obtain PCS, the customers normally must purchase a separate contract. Such PCS arrangements are generally for a one-year period renewable annually and include customer support, unspecified software upgrades, and maintenance releases. The Company recognizes revenue from these contracts ratably over the life of the agreements.

Revenue from the sale of software licenses which do not require significant modifications or customization for the Company's modeling tools are recognized when the license agreement is signed, the license fee is fixed and determinable, delivery has occurred, and collection is considered probable.

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We evaluate our contracts for multiple deliverables under ASC 605-25 Revenue Recognition-Multiple Element Arrangements, and when appropriate, separate the contracts into separate units of accounting for revenue recognition. Contracts with multiple element arrangements typically include, but are not limited to, components such as training, licenses, and PCS, as described above, embedded in the agreement. When a contract contains multiple deliverables, the Company allocates revenue to each deliverable based on its relative selling price which is determined based on its vendor specific objective evidence ("VSOE") if available, third party evidence ("TPE") if VSOE is not available, or estimated selling price if neither VSOE nor TPE is available. Amounts allocated to training and support services are based on VSOE and revenue is deferred until the services have been performed. Amounts allocated to software licenses are also based on VSOE. Revenue related to software licenses is recognized once the license has been delivered.

The Company recognizes revenue under time and materials contracts primarily from Nuclear Industry Training and Consulting and certain consulting agreements. Revenue on time and materials contracts is recognized as services are rendered and performed. Under a typical time-and-materials billing arrangement, customers are billed on a regularly scheduled basis, such as biweekly or monthly. At the end of each accounting period, revenue is estimated and accrued for services performed since the last billing cycle. These unbilled amounts are billed the following month.

For the three and nine months ended September 30, 2015 and 2014, the following customers provided more than 10% of the Company's consolidated revenue:

	Three Months ended		Nine Months ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Tennessee Valley Authority	14.3 %	0.0 %	17.9 %	0.0 %
Public Service Enterprise Group Inc.	11.3 %	0.6 %	10.6 %	0.6 %

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2. Recent Accounting Pronouncements Not Yet Adopted

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, Revenue from Contracts with Customers, which provides guidance for revenue recognition. The standard's core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In doing so, companies will need to use more judgment and make more estimates than under today's guidance. These may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. This guidance will be effective for the Company in the first quarter of its fiscal year ending December 31, 2018, and interim periods therein, using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or (ii) a retrospective approach with the cumulative effect of initially adopting ASU 2014-09 recognized at the date of adoption (which includes additional footnote disclosures). The Company is currently in the process of evaluating the impact of its pending adoption of this ASU on the Company's consolidated financial statements and has not yet determined the method by which it will adopt the standard in 2018.

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3. Basic and Diluted Loss per Common Share

Basic loss per share is based on the weighted average number of outstanding common shares for the period. Diluted loss per share adjusts the weighted average shares outstanding for the potential dilution that could occur if stock options were exercised into common stock.

The number of common shares and common share equivalents used in the determination of basic and diluted loss per share were as follows:

(in thousands, except for share amounts)	Three Months ended September 30,		Nine Months ended September 30,	
	2015	2014	2015	2014
Numerator:				
Net loss	\$(3,555) \$(1,895) \$(5,566) \$(5,905
Denominator:				
Weighted-average shares outstanding for basic earnings per share	17,894,272	17,887,859	17,890,020	17,887,859
Effect of dilutive securities:				
Employee stock options	-	-	-	-
Adjusted weighted-average shares outstanding and assumed conversions for diluted earnings per share	17,894,272	17,887,859	17,890,020	17,887,859
Shares related to dilutive securities excluded because inclusion would be anti-dilutive	2,513,321	2,736,703	2,548,401	2,730,558

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4. Acquisition

Hyperspring, LLC

On November 14, 2014, (the "Closing Date") the Company, through its operating subsidiary, GSE Power Systems, Inc. (now GSE Performance Solutions, Inc. "GSE Performance"), acquired Hyperspring, LLC ("Hyperspring") pursuant to a Membership Interests Purchase Agreement ("Purchase Agreement") with the sellers of Hyperspring ("Sellers"). Hyperspring, headquartered in Huntsville, Alabama, specializes in training and development, plant operations support services, and Nuclear Industry Training and Consulting, primarily in the United States nuclear industry. Hyperspring operates as a wholly-owned subsidiary of GSE Performance Solutions, Inc. The purchase price allocation included customer relationship intangible assets valued at \$779,000 which are being amortized over seven years.

GSE Performance paid the Sellers an aggregate of \$3.0 million in cash at the closing date. Per the Purchase Agreement, a \$1.2 million payment was due to the former Hyperspring members if Hyperspring were successful in renewing its contract with the Tennessee Valley Authority ("TVA") for a two year period for substantially the same scope as was currently being provided and with substantially the same economics. On September 24, 2015, TVA executed a three-year renewal contract with Hyperspring; accordingly the Company paid the \$1.2 million payment to the former Hyperspring members in October 2015.

In addition, GSE may be required, pursuant to the terms of the Purchase Agreement, to pay the Sellers up to an additional \$7.2 million if Hyperspring attains certain EBITDA (earnings before interest, taxes, depreciation and amortization) targets for the three-year period ending November 13, 2017. Accordingly, the total cash paid to the former Hyperspring members may total \$11.4 million.

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The following table summarizes the purchase price and purchase price allocation for the acquisition of Hyperspring, LLC, acquired on November 14, 2014.

(in thousands)

Cash purchase price	\$3,000
Fair value of contingent consideration	3,953
Total purchase price	\$6,953
Purchase price allocation:	
Cash	\$152
Contract receivables	1,719
Prepaid expenses and other current assets	23
Property and equipment, net	12
Intangible assets	779
Goodwill	5,612
Total assets	8,297
Line of credit	749
Accounts payable, accrued expenses, and other liabilities	586
Billings in excess of revenue earned	9
Total liabilities	1,344
Net assets acquired	\$6,953

Pro forma results. Our consolidated financial statements include the operating results of Hyperspring as of the date of acquisition. For the nine months ended September 30, 2015 and 2014, the unaudited pro forma financial information below assumes that our material business acquisition of Hyperspring occurred on January 1, 2014.

(in thousands except per share data)	(unaudited)			
	Three Months ended		Nine Months ended	
	September 30,		September 30,	
Pro forma financial information including the acquisition of Hyperspring	2015	2014	2015	2014
Revenue	\$14,961	\$12,307	\$42,589	\$37,930
Operating loss	(3,195)	(1,785)	(4,701)	(5,848)
Net loss	(3,363)	(1,697)	(5,140)	(5,749)
Loss per common share — basic	\$(0.19)	\$(0.09)	\$(0.29)	\$(0.32)
Loss per common share — diluted	\$(0.19)	\$(0.09)	\$(0.29)	\$(0.32)

IntelliQlik LLC

In conjunction with the Hyperspring acquisition, GSE Performance invested \$250,000 for a 50% interest in IntelliQlik, LLC ("IntelliQlik"). IntelliQlik is developing a software platform for online learning and learning management for the energy market and is jointly owned by GSE Performance and a former Hyperspring member. GSE Performance was obligated to contribute an additional \$250,000 should IntelliQlik attain certain development milestones by September 30, 2015. Based on a review of the software platform as of September 30, 2015, GSE concluded that the required development milestones had not been met and did not contribute the additional \$250,000 investment. The Company wrote-off the remaining \$126,000 balance of its IntelliQlik investment in the third quarter 2015. The loss was recorded under other expense, net.

Contingent Consideration

Accounting Standards Codification 805, Business Combinations ("ASC 805") requires that contingent consideration be recognized at fair value on the acquisition date and be re-measured each reporting period with subsequent adjustments recognized in the consolidated statement of operations. We estimate the fair value of contingent consideration liabilities based on financial projections of the acquired companies and estimated probabilities of achievement and discount the liabilities to present value using a weighted-average cost of capital. Contingent consideration is valued using significant inputs that are not observable in the market which are defined as Level 3 inputs pursuant to fair value measurement accounting. We believe our estimates and assumptions are reasonable, however, there is significant judgment involved. At each reporting date, the contingent consideration obligation is revalued to estimated fair value, and changes in fair value subsequent to the acquisitions are reflected in income or expense in the consolidated statements of operations, and could cause a material impact to, and volatility in, our operating results. Changes in the fair value of contingent consideration obligations may result from changes in discount periods, changes in the timing and amount of revenue and/or earnings estimates and changes in probability assumptions with respect to the likelihood of achieving the various earn-out criteria.

As of September 30, 2015 and December 31, 2014, current contingent consideration totaled \$2.6 million and \$2.8 million, respectively. As of September 30, 2015 and December 31, 2014, we also had accrued contingent consideration totaling \$2.2 million and \$1.9 million, respectively, which represents the portion of contingent consideration estimated to be payable greater than twelve months from the balance sheet date.

During the three and nine months ended September 30, 2015 the Company made payments of \$182,000 and \$500,000, respectively, to the former EnVision shareholders in accordance with the purchase agreements. For the nine months ended September 30, 2015, the Company did not make any payments to the former owners of Hyperspring. Refer to the Subsequent Event footnote in regards to the \$1.2 million payout to the former Hyperspring members in October 2015.

(in thousands)

	September 30, 2015	December 31, 2014
Hyperspring, LLC	\$2,601	\$ 2,152
IntelliQlik, LLC	-	213
EnVision Systems, Inc.	-	477
Current contingent consideration	\$2,601	\$ 2,842
Hyperspring, LLC	\$2,221	\$ 1,948
Contingent consideration	\$2,221	\$ 1,948

5. Contract Receivables

Contract receivables represent balances due from a broad base of both domestic and international customers. All contract receivables are considered to be collectible within twelve months. Recoverable costs and accrued profit not billed represent costs incurred and associated profit accrued on contracts that will become billable upon future milestones or completion of contracts.

The components of contract receivables are as follows:

(in thousands)	September 30, 2015	December 31, 2014
Billed receivables	\$ 7,473	\$ 10,792
Recoverable costs and accrued profit not billed	4,769	5,060
Allowance for doubtful accounts	(2) (22
Total contract receivables, net	\$ 12,240	\$ 15,830

Recoverable costs and accrued profit not billed totaled \$4.8 million and \$5.1 million as of September 30, 2015 and December 31, 2014, respectively. During October 2015, the Company invoiced \$1.9 million of the unbilled amounts.

The following customers accounted for more than 10% of the Company's consolidated contract receivables as of September 30, 2015 and December 31, 2014, respectively:

	September 30, 2015	December 31, 2014
China Nuclear Power Engineering Company	14.7 %	3.9 %
State Nuclear Power Automation System Engineering Co.	0.4 %	10.2 %

6. Software Development Costs

Certain computer software development costs are capitalized in the accompanying consolidated balance sheets. Capitalization of computer software development costs begins upon the establishment of technological feasibility. Capitalization ceases and amortization of capitalized costs begins when the software product is commercially available for general release to customers. Amortization of capitalized computer software development costs is included in cost of revenue and is determined using the straight-line method over the remaining estimated economic life of the product, typically three years. On an annual basis, and more frequently as conditions indicate, the Company assesses the recovery of the unamortized software development costs by estimating the net undiscounted cash flows expected to be generated by the sale of the product. If the undiscounted cash flows are not sufficient to recover the unamortized software costs the Company will write-down the investment to its estimated fair value based on future undiscounted cash flows. The excess of any unamortized software development costs over the related net realizable value is written down and charged to cost of revenue.

During the third quarter of 2015, the Company's new CEO conducted a review of the Company's organizational and cost structure and software development plans. Based upon this review, GSE decided to terminate the Enterprise Data Management ("EDM") development program. As a result, GSE believes that the full value of the capitalized software development costs relating to EDM are no longer recoverable. As of September 30, 2015, GSE recorded a \$1.5 million write-down of software development costs which was the full capitalized balance of its EDM development projects.

Software development costs capitalized were \$473,000 and \$1.4 million for the three and nine months ended September 30, 2015, respectively, and \$241,000 and \$590,000 for the three and nine months ended September 30, 2014, respectively. Total amortization expense was \$96,000 and \$291,000 for the three and nine months ended September 30, 2015, respectively, and \$78,000 and \$173,000 for the three and nine months ended September 30, 2014, respectively.

7. Goodwill and Intangible Assets

Goodwill

We review goodwill for impairment annually as of November 30 and whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. We test goodwill at the reporting unit level. A reporting unit is an operating segment, or one level below an operating segment, as defined by U.S. generally accepted accounting principles. After the acquisition of Hyperspring, LLC ("Hyperspring") on November 14, 2014, our reporting units are: (i) Performance Improvement Solutions and (ii) Nuclear Industry Training and Consulting. At September 30, 2015 and December 31, 2014, the \$5.6 million of goodwill balance was related to the Hyperspring acquisition and is assigned to our Nuclear Industry Training and Consulting segment.

Accounting Standards Update ("ASU") 2011-08, Testing Goodwill for Impairment ("ASU 2011-08") permits an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. Under ASU 2011-08, an entity is not required to perform step one of the goodwill impairment test for a reporting unit if it is more likely than not that its fair value is greater than its carrying amount. As of September 30, 2015, no impairment has been recognized on goodwill.

Intangible Assets Subject to Amortization

The Company's intangible assets include amounts recognized in connection with business acquisitions, including customer relationships, contract backlog and technology. Intangible assets are initially valued at fair market value using generally accepted valuation methods appropriate for the type of intangible asset. Amortization is recognized on a straight-line basis over the estimated useful life of the intangible assets, except for contract backlog and contractual customer relationships which are recognized in proportion to the related projected revenue streams. The Company reviews specific definite-lived intangibles for impairment when events occur that may impact their value in accordance with the respective accounting guidance for long-lived assets.

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8. Fair Value of Financial Instruments

ASC 820, Fair Value Measurements and Disclosures ("ASC 820"), defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The levels of the fair value hierarchy established by ASC 820 are:

Level 1: inputs are quoted prices, unadjusted, in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2: inputs are other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. A Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3: inputs are unobservable and reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability.

The Company considers the recorded value of certain of its financial assets and liabilities, which consist primarily of accounts receivable and accounts payable, to approximate the fair value of the respective assets and liabilities at September 30, 2015 and December 31, 2014 based upon the short-term nature of the assets and liabilities.

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The following table presents assets and liabilities measured at fair value at September 30, 2015:

(in thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Money market funds	\$ 12,129	\$ -	\$ -	\$12,129
Foreign exchange contracts	-	124	-	124
Total assets	\$ 12,129	\$ 124	\$ -	\$12,253
Foreign exchange contracts	\$ -	\$ (107)	\$ -	\$(107)
Total liabilities	\$ -	\$ (107)	\$ -	\$(107)

The following table presents assets and liabilities measured at fair value at December 31, 2014:

(in thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Money market funds	\$ 11,661	\$ -	\$ -	\$11,661
Foreign exchange contracts	-	92	-	92
Total assets	\$ 11,661	\$ 92	\$ -	\$11,753
Foreign exchange contracts	\$ -	\$ (24)	\$ -	\$(24)
Total liabilities	\$ -	\$ (24)	\$ -	\$(24)

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9. Derivative Instruments

The Company utilizes forward foreign currency exchange contracts to manage market risks associated with the fluctuations in foreign currency exchange rates. It is the Company's policy to use such derivative financial instruments to protect against market risk arising in the normal course of business in order to reduce the impact of these exposures. The Company minimizes credit exposure by limiting counterparties to nationally recognized financial institutions.

As of September 30, 2015, the Company had foreign exchange contracts outstanding of approximately 2.6 million Euro, 0.6 million Pounds Sterling, 0.5 million Australian Dollars, and 12.5 million Japanese Yen at fixed rates. The contracts expire on various dates through December 2016. At December 31, 2014, the Company had contracts outstanding of approximately 1.4 million Euro, 0.3 million Pounds Sterling, 0.8 million Australian Dollars, and 0.5 million Malaysian Ringgits at fixed rates.

The Company has not designated any of the foreign exchange contracts outstanding as hedges and has recorded the estimated fair value of the contracts in the consolidated balance sheets as follows:

(in thousands)	September 30, 2015	December 31, 2014
Asset derivatives		
Prepaid expenses and other current assets	\$ 121	\$ 71
Other assets	3	21
	124	92
Liability derivatives		
Other current liabilities	(15)	(23)
Other liabilities	(92)	(1)
	(107)	(24)
Net fair value	\$ 17	\$ 68

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The changes in the fair value of the foreign exchange contracts are included in net gain (loss) on derivative instruments in the consolidated statements of operations.

The foreign currency denominated contract receivables, billings in excess of revenue earned and subcontractor accruals that are related to the outstanding foreign exchange contracts are remeasured at the end of each period into the functional currency using the current exchange rate at the end of the period. The gain or loss resulting from such remeasurement is also included in net gain (loss) on derivative instruments in the consolidated statements of operations.

For the three and nine months ended September 30, 2015 and 2014, the Company recognized a net gain (loss) on its derivative instruments as outlined below:

(in thousands)	Three Months ended		Nine Months ended	
	September 30, 2015	2014	September 30, 2015	2014
Foreign exchange contracts- change in fair value	\$ 34	\$ 58	\$ (53)	\$ 312
Remeasurement of related contract receivables, billings in excess of revenue earned, and subcontractor accruals	(14)	11	(6)	(134)
Gain (loss) on derivative instruments, net	\$ 20	\$ 69	\$ (59)	\$ 178

10. Stock-Based Compensation

The Company recognizes compensation expense for all equity-based compensation awards issued to employees, directors and non-employees that are expected to vest. Compensation cost is based on the fair value of awards as of the grant date. The Company recognized \$136,000 and \$175,000 of stock-based compensation expense for the three months ended September 30, 2015 and 2014, respectively, under the fair value method and recognized \$407,000 and \$514,000 of stock-based compensation expense for the nine months ended September 30, 2015 and 2014, respectively.

In the third quarter 2015, the Company granted 975,000 Restricted Stock Unit's with an aggregate fair value of \$673,500. The RSUs vest upon the achievement of specific performance measures. The fair value of the RSUs is expensed ratably over the requisite service period, which ranges between one and five years.

The Company granted 10,000 and 60,000 stock options for the three and nine months ended September 30, 2015, respectively. The fair value of the options granted for the three and nine months ended September 30, 2015 was \$8,000 and \$48,000, respectively. The Company granted 0 and 60,000 stock options for the three and nine months ended September 30, 2014, respectively. The fair value of the granted options at the grant date was \$56,000.

11. Long-Term Debt

At September 30, 2015 and December 31, 2014, the Company had no long-term debt.

Lines of Credit

Susquehanna Bank

At September 30, 2015, the Company had a Master Loan and Security Agreement and Revolving Credit Note with Susquehanna Bank ("Susquehanna"). The Company and its subsidiary, GSE Performance Solutions, Inc., were jointly and severally liable as co-borrowers. The Loan Agreement provides a \$7.5 million revolving line of credit for the purpose of (i) issuing stand-by letters of credit and (ii) providing working capital. Working capital advances bear interest at a rate equal to the Wall Street Journal Prime Rate of Interest, floating with a floor of 4 1/2%. The agreement expires on June 30, 2016.

As collateral for the Company's obligations, the Company granted a first lien and security interest in all of the assets of the Company, including but not limited to, accounts receivable, proceeds and products, intangibles, trademarks, patents, intellectual property, machinery and equipment.

On September 9, 2014, the Company signed a Third Comprehensive Amendment to the Master Loan and Security Agreement. According to the Third Amendment, the Company is to maintain a segregated cash collateral account at Susquehanna Bank equal to the greater of (i) \$3.0 million or (ii) the aggregate principal amounts of all Loans outstanding under the Revolving Credit Facility (including any issued and outstanding letters of credit, working capital advances, and negative foreign exchange positions) as security for the Company's obligations. Under this Amendment, Susquehanna Bank shall have complete and unconditional control over the cash collateral account. On September 30, 2014, Susquehanna Bank collateralized the outstanding letters of credit issued under the line of credit. At September 30, 2015 and December 31, 2014, the cash collateral account totaled \$3.6 million and \$4.2 million, respectively. The balances were classified as restricted cash on the balance sheet.

The credit agreements contain certain restrictive covenants regarding future acquisitions and incurrence of debt. On July 31, 2015, the Company signed a Fifth Comprehensive Amendment to the Master Loan and Security Agreement in which the Company's financial covenants were reduced from four to two, and the covenant targets were adjusted.

Covenant	As of September 30, 2015
Minimum tangible capital base	Must Exceed \$10.5 million \$10.9 million
Quick ratio	Must Exceed 1.00 : 1.00 1.43 : 1.00

As of September 30, 2015, the Company was in compliance with its financial covenants as defined above.

IberiaBank

At September 30, 2015, Hyperspring, LLC has a \$1.0 million working capital line of credit with IberiaBank for a one year period. Under the executed promissory note, interest is payable monthly at the rate of 1.00 percentage points over the prime rate of interest as published in the money rate section of the Wall Street Journal resulting in an effective interest rate of 4.25%. The line is secured by all accounts of Hyperspring and guaranteed by GSE Systems, Inc. The line of credit expires on July 6, 2016. At September 30, 2015, the Company had no outstanding amounts under the line of credit.

Letters of Credit and Bonds

As of September 30, 2015, the Company has thirteen standby letters of credit and one surety bond totaling \$3.6 million which represent advance payment and performance bonds on twelve contracts. The Company has deposited the full value of thirteen standby letters of credit in escrow accounts, amounting to \$3.6 million, which have been restricted in that the Company does not have access to these funds until the related letters of credit have expired. The cash has been recorded on the Company's balance sheet at September 30, 2015 as restricted cash.

12. Product Warranty

As the Company recognizes revenue under the percentage-of-completion method, it provides an accrual for estimated future warranty costs based on historical experience and projected claims. The activity in the warranty account is as follows:

(in thousands)

Balance at December 31, 2014	\$ 1,456
Warranty provision	514
Warranty claims	(312)
Currency adjustment	(44)
Balance at September 30, 2015	\$ 1,614

13. Income Taxes

The Company files in the United States federal jurisdiction and in several state and foreign jurisdictions. Because of the net operating loss carryforwards, the Company is subject to U.S. federal and state income tax examinations from years 1997 forward and is subject to foreign tax examinations by tax authorities for years 2007 and forward. Open tax years related to state and foreign jurisdictions remain subject to examination but are not considered material to our financial position, results of operations or cash flows.

An uncertain tax position taken or expected to be taken in a tax return is recognized in the financial statements when it is more likely than not (i.e., a likelihood of more than 50%) that the position would be sustained upon examination by tax authorities that have full knowledge of all relevant information. A recognized tax position is then measured at the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement. Interest and penalties related to income taxes are accounted for as income tax expense. The Company has appropriately accounted for its uncertain tax positions.

In 2014, the Company paid income taxes in the UK and India and expects to do so again in 2015. The Company has a full valuation allowance on its U.S., Swedish, and Chinese net deferred tax assets at September 30, 2015.

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14. Preferred Stock Rights

On March 21, 2011, the Board of Directors of the Company declared a dividend, payable to holders of record as of the close of business on April 1, 2011, of one preferred stock purchase right (a "Right") for each outstanding share of common stock, par value \$0.01 per share, of the Company (the "Common Stock"). In addition, the Company will issue one Right with each new share of Common Stock issued. In connection therewith, on March 21, 2011, the Company entered into a Stockholder Protection Rights Agreement (as amended from time to time, the Rights Agreement) with Continental Stock Transfer & Trust Company, as Rights Agent, which has a term of three years, unless amended by the Board of Directors in accordance with the terms of the Rights Agreement. On March 21, 2014, the Rights Agreement was amended to extend the term an additional two years. The Rights Agreement will now expire on March 21, 2016. The Rights trade with and are inseparable from the Common Stock and are not evidenced by separate certificates unless they become exercisable. Each Right entitles its holder to purchase from the Company one-hundredth of a share of participating preferred stock having economic and voting terms similar to the Common Stock at an exercise price of \$8.00 per Right, subject to adjustment in accordance with the terms of the Rights Agreement, once the Rights become exercisable. Under the Rights Agreement, the Rights become exercisable if any person or group acquires 20% or more of the Common Stock or, in the case of any person or group that owned 20% or more of the Common Stock as of March 21, 2011, upon the acquisition of any additional shares by such person or group. The Company, its subsidiaries, employee benefit plans of the Company or any of its subsidiaries and any entity holding Common Stock for or pursuant to the terms of any such plan are accepted. Upon exercise of the Right in accordance with the Rights Agreement, the holder would be able to purchase a number of shares of Common Stock from the Company having an aggregate market price (as defined in the Rights Agreement) equal to twice the then-current exercise price for an amount in cash equal to the then-current exercise price. In addition, the Company may, in certain circumstances and pursuant to the terms of the Rights Agreement, exchange the Rights for one share of Common Stock or an equivalent security for each Right or, alternatively, redeem the Rights for \$0.001 per Right. The Rights will not prevent a takeover of our Company, but may cause substantial dilution to a person that acquires 20% or more of the Company's Common Stock.

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15. Segment Information

The Company has two reportable business segments. The Performance Improvement Solutions business segment provides simulation, training and engineering products and services delivered across the breadth of industries we serve. Solutions include simulation for both training and engineering applications. Example training applications include turnkey and custom training services, while engineering services include plant design verification and validation. We provide these services across all our market segments. Contracts typically range from ten months to three years.

The Nuclear Industry Training and Consulting services segment provides specialized workforce solutions primarily to the U.S. nuclear industry, working at our clients' facilities. This business is managed through our Hyperspring, LLC subsidiary. Hyperspring has been providing these services since 2005.

The following table sets forth the revenue and operating results attributable to each reportable segment and includes a reconciliation of segment revenue to consolidated revenue and operating results to consolidated loss before income tax expense:

(in thousands)	Three Months ended		Nine Months ended	
	September 30, 2015	2014	September 30, 2015	2014
Contract revenue:				
Performance Improvement Solutions	\$ 9,903	\$ 7,823	\$ 26,911	\$ 24,823
Nuclear Industry Training and Consulting	5,058	-	15,678	-
	\$ 14,961	\$ 7,823	\$ 42,589	\$ 24,823
Operating income (loss):				
Performance Improvement Solutions	\$ (3,604)	\$ (1,905)	\$ (5,493)	\$ (5,948)
Nuclear Industry Training and Consulting	442	-	1,104	-
Loss on change in fair value of contingent consideration, net	(226)	(42)	(739)	(69)
Operating loss	\$ (3,388)	\$ (1,947)	\$ (5,128)	\$ (6,017)
Interest income, net	19	44	67	103
Gain (loss) on derivative instruments, net	20	69	(59)	178
Other expense, net	(156)	-	(235)	(7)
Loss before income taxes	\$ (3,505)	\$ (1,834)	\$ (5,355)	\$ (5,743)

16. Subsequent Events

Per the Hyperspring LLC Purchase Agreement, a \$1.2 million payment was due to the former Hyperspring members if Hyperspring were successful in renewing its contract with the Tennessee Valley Authority ("TVA") for at least a two year period for substantially the same scope as was being provided at the acquisition date and with substantially the same economics. On September 24, 2015, TVA executed a three-year renewal contract with Hyperspring; accordingly, the Company paid the \$1.2 million payment to the former Hyperspring members in October 2015.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

GSE Systems, Inc. ("GSE Systems", "GSE" or the "Company") is a world leader in real-time high fidelity simulation. The Company provides simulation and educational solutions and services to the nuclear and fossil electric utility industry, and the chemical and petrochemical industries. GSE is the parent company of the following entities:

- GSE Performance Solutions, Inc. (formerly GSE Power Systems, Inc.), a Delaware corporation;
- GSE Power Systems, AB, a Swedish corporation;
- GSE Engineering Systems (Beijing) Co. Ltd., a Chinese limited liability company;
- GSE Systems, Ltd., a Scottish limited liability company;
- EnVision Systems (India) Pvt. Ltd., an Indian limited liability company; and
- Hyperspring, LLC, an Alabama limited liability company.

The Company has a 50% interest in IntelliQlik, LLC, a Delaware limited liability company and a 50% interest in General Simulation Engineering RUS LLC, a Russian closed joint-stock company.

The Company has two reportable business segments: Performance Improvement Solutions which provides simulation, engineering, and training solutions and services to the nuclear and fossil fuel power industry and to the chemical and petrochemical industries and Nuclear Industry Training and Consulting (formerly our "Staff Augmentation" segment) which provides personnel to fulfill staff positions on a short-term basis to energy industry customers.

Cautionary Statement Regarding Forward-Looking Statements

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward looking statements. Forward-looking statements are not statements of historical facts, but rather reflect our current expectations concerning future events and results. We use words such as "expects", "intends", "believes", "may", "will" and "anticipates" to indicate forward-looking statements. Because these forward-looking statements involve risks and uncertainties, there are important factors that could cause actual results to differ materially from those expressed or implied by these forward-looking statements, including, but not limited to, those factors set forth under Item 1A - Risk Factors of the Company's 2014 Annual Report on Form 10-K and those other risks and uncertainties detailed in the Company's periodic reports and registration statements filed with the Securities and Exchange Commission. We caution that these risk factors may not be exhaustive. We operate in a continually changing business environment, and new risk factors emerge from time to time. We cannot predict these new risk factors, nor can we assess the effect, if any, of the new risk factors on our business or the extent to which any factor or combination of factors may cause actual results to differ from those expressed or implied by these forward-looking statements.

If any one or more of these expectations and assumptions proves incorrect, actual results will likely differ materially from those contemplated by the forward-looking statements. Even if all of the foregoing assumptions and expectations prove correct, actual results may still differ materially from those expressed in the forward-looking statements as a result of factors we may not anticipate or that may be beyond our control. While we cannot assess the future impact that any of these differences could have on our business, financial condition, results of operations and cash flows or the market price of shares of our common stock, the differences could be significant. We do not undertake to update any forward-looking statements made by us, whether as a result of new information, future events or otherwise. You are cautioned not to unduly rely on such forward-looking statements when evaluating the information presented in this report.

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General Business Environment

We operate through two reportable business segments: Performance Improvement Solutions and Nuclear Industry Training and Consulting. Each segment focuses on delivering solutions to certain classes of customers or within targeted markets. Marketing and communications, accounting, finance, legal, human resources, information systems and other administrative services are organized at the corporate level. Business development and sales resources are generally aligned with each segment to support existing customer accounts and new customer development. Our two business segments are:

Performance Improvement Solutions

Our Performance Improvement Solutions business segment primarily encompasses our next-generation power plant and process simulation solutions, as well as engineering solutions. This segment includes various simulation products, engineering services, and operation training systems delivered across the industries we serve: primarily nuclear and fossil power generation, and the petroleum industry. Our simulation solutions include the following: (1) simulation tools and services, including operator training systems, for the nuclear power industry, (2) simulation tools and services, including operator training systems, for the fossil power industry, (3) simulation tools and services for the petroleum industry used to teach fundamental industry processes and control systems to newly hired employees.

Nuclear Industry Training and Consulting

Nuclear Industry Training and Consulting provides highly specialized and skilled nuclear operations instructors and other consultants to the nuclear power industry. These employees work at our clients' facilities under client direction. Examples of these highly skilled positions are primarily senior reactor operations instructors, procedure writers, work management specialists, planners and training material developers. This business is managed through our Hyperspring LLC subsidiary. The business model, management focus, margins and other factors clearly separate this business line from the rest of the GSE product and service portfolio. Hyperspring has been providing these services since 2005.

Industry Trends

We believe the most serious future challenge facing the industries we serve is access to and continued development of a trained and efficient workforce. This challenge manifests itself in the increasing pace of the knowledge lost as a large percentage of the experienced workforce reaches retirement age over the next ten years. The replacement of these experienced workers by a new generation who have different learning styles and work expectations is a critical challenge that the power and process industries must address. Globally, as more people increase their standard of living so too will global power demand increase, which will require the on-going construction of power plants. Developing a skilled labor force to operate these plants and keep their skills honed and evergreen is another key challenge facing the global power industry. Additionally, there seems to be an emerging enlightenment that nuclear energy is an increasingly desirable form of energy production as there are no greenhouse gas emissions associated with nuclear power generation. We believe that GSE is well positioned to take advantage of these trends as they emerge.

Growing Global Power Demand

At the same time that experienced nuclear workforce is retiring, new nuclear capacity will be coming into operation. According to the International Energy Agency's, World Energy Outlook 2014, global energy demand is projected to rise 37% by 2040. Similarly the BP Energy Outlook 2035 projects a 41% rise in global energy consumption between 2012 and 2035. While a diverse mix of power generation technologies will be used to satisfy the increasing demand, nuclear energy will continue to play a significant role. Nuclear energy output is expected to rise at around 1.9% per year until 2035. There are currently 67 nuclear plants under construction in 15 countries, including 24 in China, 9 in Russia, 6 in India and 4 in the United Arab Emirates according to the Nuclear Energy Institute. Other countries with multiple reactors under construction include Slovakia, Korea, Pakistan, Belarus and Japan.

Five reactors are currently under construction in the US including two for Southern Nuclear at the Vogtle Site; two at SCANA's VC Summer site and one at the Tennessee Valley Authority's Watts Bar generating facility. The UK recently announced collaboration with Chinese nuclear entities that will help finance new reactors at the Hinkley Point site and set the stage for additional reactor projects in the UK in the future.

According to the World Nuclear Association, there are 165 reactors in 27 countries in specific phases of planning that will be operating by 2030.

Growing awareness of strategic environmental advantages of nuclear energy

The growth in nuclear energy is aided by its increasing recognition as a critical technology for reaching the CO2 emission reduction targets recommended by the scientific community. According to the UN's Intergovernmental Panel on Climate Change and research from the National Renewable Energy Laboratory, greenhouse gas emissions across the entire lifecycle of nuclear energy from uranium mining to decommissioning, are comparable with those of wind power.

Workforce Trends

Power Engineering Magazine article: Who will Replace Power Aging Workforce? cites the Nuclear Energy Institute estimates that 39% of the nuclear workforce will be eligible to retire by 2018 resulting in the need for 20,000 new workers to replace them. The article goes on to discuss the US Department of Labor estimates as much as 50% of the nation's utility workforce will be retiring in the next 5-10 years.

Exacerbating this workforce trend is the continuing domestic and global population increases which will continue to increase the overall demand for energy. As the U.S.' current educational system is not able to provide the needed trained workers in adequate numbers, the onus is on the energy industry itself to address its training needs at both entry levels and more senior levels. A complete lifecycle of training, from a worker's entry into the energy industry through to the achievement of expert knowledge and skills, is now required for the energy industry more than ever.

Power Magazine article Manpower Report: Power Industry Faces Talent Shortage, (May 2014) cites a survey by Manpower which say 58% of executives struggle finding the talent they need. Students are consistently underperforming in science, technology, engineering and math and, on average, only 45% of applicants are passing basic skilled-trade aptitude tests.

Business leaders are recognizing the problem and the challenge ahead. A study published in Harvard Business Review (May 28, 2013) revealed that Boards of Directors identified Talent Management as their number one concern. Those same executives rated their companies very poorly on key elements of talent management including attracting, hiring, assessing and developing top talent.

As companies are always under pressure to improve productivity, reduce costs and improve operating margins, energy industry companies have been working to create leaner, more competent organizations that can rapidly respond to a changing environment. Increasing pressures to improve profitability have resulted in flatter organizational structures within companies with less middle management to exercise control. According to the International Atomic Energy Agency (IAEA) article, A Systematic Approach to Human Performance Improvement in Nuclear Power Plants: Training Solutions, companies understand and value the potential contribution that every employee can make to their overall success. As a result, companies have been emphasizing the quality of their human performance processes and the building of excellent educational processes for their employees.

Our Solutions

Our two overarching solution sets, Entry2Expert (E2E) and Design2Decom (D2D) bring together the collection of skills GSE has amassed over more than 40 years from its traditional roots in custom simulation to the recent acquisition of the specialized engineering and training capabilities.

Entry2Expert Performance Cycle

To assist our clients in creating world-class internal training and performance improvement programs, we are building the E2E Performance Solution, a set of integrated and scalable products and services which provide a structured program from employee selection and onboarding through continuous skills improvement for experienced employees. GSE can now provide the right training solution for the right step in each employee's career.

The goal of our E2E performance lifecycle offering is to help improve our customer's bottom line through superior human achievement in screening and selecting the right workforce, shortening the learning process, reducing human errors, improving worker agility and mitigating the effects of retirements and turnover.

Design2Decom Performance Cycle

Just like the E2E process helps improve the performance of our customers' people, D2D encompasses a range of services and technologies aimed at improving plant performance. From getting a client's system on-line faster, to operating safety, and support from experienced staff throughout the lifecycle, services include: engineering and specialized plant support services, virtual commissioning of plants and plant changes, safety and compliance services and assistance in decommissioning.

Results of Operations

The following table sets forth the results of operations for the periods presented expressed in thousands of dollars and as a percentage of revenue:

(in thousands)	Three Months ended September 30,				Nine Months ended September 30,			
	2015	%	2014	%	2015	%	2014	%
Contract revenue	\$14,961	100.0%	\$7,823	100.0%	\$42,589	100.0%	\$24,823	100.0%
Cost of revenue	11,158	74.6 %	5,368	68.6 %	32,649	76.7 %	17,497	70.5 %
Write-down of capitalized software development costs	1,538	10.3 %	-	0.0 %	1,538	3.6 %	-	0.0 %
Gross profit	2,265	15.1 %	2,455	31.4 %	8,402	19.7 %	7,326	29.5 %
Operating expenses:								
Selling, general and administrative	3,811	25.5 %	3,954	50.5 %	11,031	25.9 %	11,939	48.0 %
Restructuring charges	1,600	10.7 %	272	3.5 %	1,746	4.1 %	883	3.6 %
Depreciation	119	0.8 %	140	1.8 %	383	0.9 %	413	1.7 %
Amortization of definite-lived intangible assets	123	0.8 %	36	0.5 %	370	0.9 %	108	0.4 %
Total operating expenses	5,653	37.8 %	4,402	56.3 %	13,530	31.8 %	13,343	53.7 %
Operating loss	(3,388)	(22.7)%	(1,947)	(24.9)%	(5,128)	(12.1)%	(6,017)	(24.2)%
Interest income, net	19	0.1 %	44	0.6 %	67	0.2 %	103	0.4 %
Gain (loss) on derivative instruments, net	20	0.1 %	69	0.9 %	(59)	(0.1)%	178	0.7 %
Other expense, net	(156)	(0.9)%	-	0.0 %	(235)	(0.6)%	(7)	0.0 %
Loss before income taxes	(3,505)	(23.4)%	(1,834)	(23.4)%	(5,355)	(12.6)%	(5,743)	(23.1)%
Provision for income taxes	50	0.4 %	61	0.8 %	211	0.5 %	162	0.7 %
Net loss	\$(3,555)	(23.8)%	\$(1,895)	(24.2)%	\$(5,566)	(13.1)%	\$(5,905)	(23.8)%

Critical Accounting Policies and Estimates

The preparation of financial statements in accordance with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Our estimates, judgments and assumptions are continually evaluated based on available information and experience. Because of the use of estimates inherent in the financial reporting process, actual results could differ from those estimates.

A summary of the Company's significant accounting policies as of December 31, 2014 is included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2014. Certain of our accounting policies require higher degrees of judgment than others in their application. These include revenue recognition on long-term contracts, capitalization of computer software development costs, valuation of contingent consideration issued in business acquisitions, and the recoverability of deferred tax assets. These critical accounting policies and estimates are discussed in the Management's Discussion and Analysis of Financial Condition and Results of Operations section in the 2014 Annual Report on Form 10-K for the fiscal year ended December 31, 2014.

Results of Operations - Three and Nine Months ended September 30, 2015 versus Three and Nine Months ended September 30, 2014

Contract Revenue. Total contract revenue for the three months ended September 30, 2015 totaled \$15.0 million, which was 91.2% more than the \$7.8 million total revenue for the quarter ended September 30, 2014. For the nine months ended September 30, 2015, contract revenue totaled \$42.6 million, which was 71.6% greater than the \$24.8 million of revenue for the nine months ended September 30, 2014. The increase in revenue was primarily driven by the acquisition of Hyperspring, represented by our Nuclear Industry Training and Consulting segment, described below.

(in thousands)	Three Months ended September 30,		Nine Months ended September 30,	
	2015	2014	2015	2014
Contract Revenue:				
Performance Improvement Solutions	\$ 9,903	\$ 7,823	\$ 26,911	\$ 24,823
Nuclear Industry Training and Consulting	5,058	-	15,678	-
Total Contract Revenue	\$ 14,961	\$ 7,823	\$ 42,589	\$ 24,823

Performance Improvement Solutions revenue increased 26.6% from \$7.8 million for the three months ended September 30, 2014 to \$9.9 million for the three months ended September 30, 2015. The main driver of this increase was a \$1.0 million increase in Fossil project revenue. In addition, Performance Improvement Solutions saw increases in revenue from a mix of other industries between those periods, including Nuclear and Process. We recorded total Performance Improvement Solutions orders of \$3.8 million in the three months ended September 30, 2015 as compared to \$17.6 million in the three months ended September 30, 2014. For the nine months ended September 30, 2015 Performance Improvement Solutions revenue was \$26.9 million compared to \$24.8 million for the nine months ended September 30, 2014. Again, the main driver of this increase was Fossil project revenue which increased \$3.4 million in the third quarter 2015 as compared to the third quarter 2014. The increase in Fossil project revenue for the nine months ended September 30, 2015 compared to the nine months ended September 30, 2014 was partially offset by decreases in project revenue in a mix of other industries. We recorded total Performance Improvement Solutions orders of \$27.6 million in the nine months ended September 30, 2015 as compared to \$33.5 million in the nine months ended September 30, 2014.

As discussed earlier, our Nuclear Industry Training and Consulting business segment was created due to the acquisition of Hyperspring, LLC on November 14, 2014. Revenue for the three months ended September 30, 2015 totaled \$5.1 million. Nuclear Industry Training and Consulting orders totaled \$1.5 million during the same period. Revenue for the nine months ended September 30, 2015 totaled \$15.7 million and orders totaled \$14.6 million during the same period.

At September 30, 2015, backlog was \$47.5 million: \$42.1 million for the Performance Improvement Solutions business segment and \$5.4 million for Nuclear Industry Training and Consulting. At December 31, 2014, the Company's backlog was \$48.4 million: \$41.7 million for the Performance Improvement Solutions business segment and \$6.7 million for Nuclear Industry Training and Consulting.

Write-down of capitalized software development costs. The Company makes ongoing evaluations of the recoverability of its capitalized software projects. During the third quarter of 2015, the Company's new CEO conducted a review of the Company's organizational and cost structures and software development plans. As a result of this review, the Company has terminated further development of its Enterprise Data Management ("EDM") system and has concluded that the capitalized software development costs relating to EDM were no longer recoverable. Accordingly, in the three months ended September 30, 2015, GSE recorded a \$1.5 million write-down of software development costs which was the full capitalized balance of the EDM configuration management system.

Gross Profit. Excluding the \$1.5 million write-down of software development costs, gross profit was \$3.8 million for the three months ended September 30, 2015 compared to \$2.5 million for the same period in 2014. As a percentage of revenue, gross profit decreased from 31.4% for the three months ended September 30, 2014 to 25.4% for the three months ended September 30, 2015. Excluding the \$1.5 million write-down of software development costs, for the nine months ended September 30, 2015, gross profit was \$9.9 million compared to \$7.3 million for the same period in 2014. As a percentage of revenue, gross profit decreased from 29.5% for the nine months ended September 30, 2014 to 23.3% for the nine months ended September 30, 2015. The reduction in gross profit in 2015 reflects the Company's acquisition of Hyperspring LLC in November 2014. Hyperspring, which comprises our Nuclear Industry Training and Consulting segment, has an overall gross profit which is significantly lower than the historical gross profit of our Performance Improvement Solution segment.

(in thousands)	Three Months ended September 30,				Nine Months ended September 30,			
	2015	%	2014	%	2015	%	2014	%
Gross Profit:								
Performance Improvement Solutions	\$3,127	31.6%	\$2,455	31.4%	\$8,158	30.3%	\$7,326	29.5%
Nuclear Industry Training and Consulting	676	13.4%	-	0.0%	1,782	11.4%	-	0.0%
Consolidated Gross Profit Excluding Write-down	3,803	25.4%	2,455	31.4%	9,940	23.3%	7,326	29.5%
Write-down of capitalized software development costs	(1,538)	10.3%	-	0.0%	(1,538)	3.6%	-	0.0%
Consolidated Gross Profit	\$2,265	15.1%	\$2,455	31.4%	\$8,402	19.7%	\$7,326	29.5%

Excluding the \$1.5 million write-down of software development costs, Performance Improvement Solutions had gross profit of \$3.1 million or 31.6% of segment revenue for the three months ended September 30, 2015 compared to \$2.5 million or 31.4% of segment revenue for the quarter ended September 30, 2014.

Excluding the \$1.5 million write-down of software development costs, Performance Improvement Solutions had gross profit of \$8.2 million or 30.3% of segment revenue for the nine months ended September 30, 2015 compared to gross profit of \$7.3 million or 29.5% of segment revenue for the nine months ended September 30, 2014. The increase in gross margin percent for Performance Improvement Solutions for the nine months ended September 30, 2015 as compared to the same period in 2014 is mainly due to:

- The restructuring of our Swedish operations in 2014 which has reduced their operations overhead costs and facility expenses in 2015,
- The completion in 2014 of a process simulation project that had a 14% gross margin, and
- Higher margined engineering consulting projects in 2015 for our UK subsidiary.

Selling, General and Administrative Expenses. Selling, general and administrative ("SG&A") expenses totaled \$3.8 million in the three months ended September 30, 2015, a 3.6% decrease from the \$4.0 million for the same period in 2014. For the nine months ended September 30, 2015 and 2014, SG&A expenses totaled \$11.0 million and \$11.9 million, respectively. The decreases reflect the following spending variances:

Business development and marketing costs decreased from \$1.5 million for the three months ended September 30, 2014 to \$1.2 million for the three months ended September 30, 2015, and decreased from \$4.5 million for the nine months ended September 30, 2014 to \$4.0 million for the nine months ended September 30, 2015.

Bidding and proposal costs, a component of business development costs which are the costs of operations personnel assisting with the preparation of contract proposals, were \$180,000 and \$420,000 for the three months ended September 30, 2015 and 2014, respectively, and \$679,000 and \$1.2 million for the nine months ended September 30, 2015 and 2014, respectively.

The Company's general and administrative expenses ("G&A") increased to \$2.2 million from \$1.7 million for the three months ended September 30, 2015 and 2014, respectively, and increased to \$5.9 million from \$5.2 million for the nine months ended September 30, 2015 and 2014, respectively. Some components of G&A are as follows:

For the three months ended September 30, 2015 and 2014, contingent consideration accretion expense was \$306,000 and \$22,000, respectively. For the nine months ended September 30, 2015 and 2014, contingent consideration accretion expense was \$739,000 and \$69,000, respectively. The increase in contingent consideration is a result of the Hyperspring acquisition on November 14, 2014 and is associated with the deferred contingent consideration due to the former Hyperspring members if certain EBITDA targets are met.

In 2014, the Company's Board of Directors agreed to waive their fees for 2014. These fees were reinstated in 2015 and totaled \$51,000 and \$149,000 in the three and nine months ended September 30, 2015.

For the three and nine months ended September 30, 2014, the Company incurred acquisition expenses of \$35,000 and \$108,000, respectively, related to the acquisition of Hyperspring. No acquisition expenses were incurred in 2015.

Gross spending on software product development ("development") expenses for the three and nine months ended September 30, 2015 totaled \$866,000 and \$2.6 million, respectively, as compared to \$1.0 million and \$2.8 million for the three and nine months ended September 30, 2014, respectively. The Company capitalized \$473,000 and \$1.4 million of product development expenses for the three and nine months ended September 30, 2015, respectively, and \$241,000 and \$590,000 for the same periods in 2014, respectively. Net development spending decreased from \$795,000 for the three months ended September 30, 2014 to \$393,000 for the three months ended September 30, 2015 and decreased from \$2.2 million for the nine months ended September 30, 2014 to \$1.2 million for the nine months ended September 30, 2015.

Spending on simulator software development and modeling tools totaled \$518,000 and \$1.7 million for the three and nine months ended September 30, 2015, respectively. Spending on software product development totaled \$760,000 and \$2.2 million for the three and nine months ended September 30, 2014, respectively. The Company's development expenses were mainly related to a new configuration management system and the enhancement of JADE™ and SimExec® applications. However, the Company wrote off the capitalized costs related to the new configuration management system in the third quarter 2015. See Write-down of capitalized software development costs, above.

During the three months ended September 30, 2015 the Company completed its new Propane Refrigeration Process and Feed Gas Conditioning Process computer based tutorial and simulation training tools. Development expense related to the EnVision product line totaled \$276,000 and \$233,000 for the three months ended September 30, 2015 and 2014, respectively. For the nine months ended September 30, 2015 and 2014, EnVision incurred \$775,000 and \$455,000 of development expense, respectively.

The Company's 3D visualization team, which develops 3D technology to add to our training programs, incurred \$72,000 and \$108,000 of costs related to this effort during the three and nine months ended September 30, 2015, respectively, as compared to \$43,000 and \$178,000 for the same periods in 2014, respectively. The Company's 3D development activities have been curtailed as a part of the third quarter 2015 restructuring.

Restructuring Charges. In July 2015, GSE entered into a separation and release agreement with James Eberle, the former Chief Executive Officer of the company. Effective July 31, 2015, Mr. Eberle resigned his position as Chief Executive Officer and as a director on GSE's board of directors. The Company incurred a \$380,000 charge in the third quarter 2015 in severance expense related to the termination of Mr. Eberle.

In the third quarter 2015, the Board of Directors of the Company approved restructuring actions for the Company's worldwide operations. For the three and nine months ended September 30, 2015, the Company incurred \$1.2 million and \$1.3 million, respectively, of restructuring charges including severance expense, facility closing costs, and other restructuring costs. The restructuring actions were designed to deliver cost reductions and operating efficiencies throughout the Company and reduce both operations overheads and selling, general, and administrative expenses. During the three and nine months ended September 30, 2014, the Company incurred severance costs of \$193,000 and \$474,000, respectively, associated with the downsizing of our Swedish operations. We also incurred severance costs of \$272,000 for terminations in the U.S. in the third quarter 2014. In addition, we recorded a \$137,000 charge in the second quarter of 2014 related to the renegotiation of our Swedish office lease to reduce the size of the office.

Depreciation. Depreciation expense totaled \$119,000 and \$140,000 for the three months ended September 30, 2015 and 2014, respectively. For the nine months ended September 30, 2015 and 2014, depreciation expense totaled \$383,000 and \$413,000, respectively.

Amortization of Definite-lived Intangible Assets. Amortization expense related to definite-lived intangible assets totaled \$123,000 and \$36,000 for the three months ended September 30, 2015 and 2014, respectively. For the nine months ended September 30, 2015 and 2014, amortization expense related to definite-lived intangible assets totaled \$370,000 and \$108,000, respectively.

In conjunction with the Hyperspring acquisition on November 14, 2014, we recorded \$779,000 of customer-related intangible assets which is being amortized on a waterfall basis over seven years. We recognized \$91,000 and \$274,000 of amortization expense for the Hyperspring intangibles for the three and nine months ended September 30, 2015, respectively.

The balance of the intangible asset amortization relates to the amortization of EnVision and TAS intangible assets which is recognized on a straight-line basis over the estimated useful life of the intangible assets, except for contractual customer relationships and contract backlog which are recognized in proportion to the related projected revenue streams.

Operating Loss. The Company had an operating loss of \$3.4 million (22.7% of revenue) during the three months ended September 30, 2015, as compared with an operating loss of \$1.9 million (24.9% of revenue) for the same period in 2014. For the nine months ended September 30, 2015 and 2014, the Company had an operating loss of \$5.1 million (12.1% of revenue) and an operating loss of \$6.0 million (24.2% of revenue), respectively. The variances were due to the factors outlined above. Excluding the impact of the \$1.5 million capitalized software write-down from the three and nine months ended September 30, 2015 and the \$1.6 million and \$1.7 million restructuring charges for the three and nine months ended September 30, 2015, respectively, the Company generated an operating loss of \$250,000 (1.7% of revenue) during the three months ended September 30, 2015, and an operating loss of \$1.8 million (4.3% of revenue) during the nine months ended September 30, 2015.

Interest Income, Net. Net interest income totaled \$19,000 and \$44,000 for the three months ended September 30, 2015 and 2014, respectively. For the nine months ended September 30, 2015 and 2014, net interest income totaled \$67,000 and \$103,000, respectively.

Gain (Loss) on Derivative Instruments, Net. The Company periodically enters into forward foreign exchange contracts to manage market risks associated with the fluctuations in foreign currency exchange rates on foreign-denominated trade receivables. As of September 30, 2015, the Company had foreign exchange contracts outstanding of approximately 2.6 million Euro, 0.6 Pounds Sterling, 0.5 million Australian Dollars and 12.5 million Japanese Yen at fixed rates. The contracts expire on various dates through December 2016. The Company has not designated the contracts as hedges and has recognized a gain on the change in the estimated fair value of the contracts of \$34,000 for both the three months ended September 30, 2015 and a loss \$53,000 for the nine months ended September 30, 2015.

As of September 30, 2014, the Company had foreign exchange contracts outstanding of approximately 1.5 million Euro, 0.1 million Pounds Sterling and 33,000 Canadian Dollars at fixed rates. The contracts expire on various dates through June 2016. The Company had not designated the contracts as hedges and had recognized gains of on the change in the estimated fair value of the contracts of \$58,000 and \$312,000 for the three and nine months ended September 30, 2014, respectively.

The foreign currency denominated contract receivables, billings in excess of revenue earned, and subcontractor accruals that are related to the outstanding foreign exchange contracts were remeasured into the functional currency using the current exchange rate at the end of the period. For the three and nine months ended September 30, 2015, the Company recognized losses of \$14,000 and \$6,000, respectively, from the remeasurement of such contract receivables, billings in excess of revenue earned and subcontractor accruals. For the same periods in 2014, the Company recognized a gain of \$11,000 and a loss of \$134,000, respectively.

Other Expense, Net. For the three and nine months ended September 30, 2015, the Company recognized other expense, net of \$156,000 and \$235,000, respectively. For the three and nine months ended September 30, 2014, the Company recognized other expense, net of \$0 and \$7,000, respectively. The major components of other expense, net included the following items:

On November 14, 2014, in conjunction with the Hyperspring acquisition, the Company invested \$250,000 for a 50% interest in IntelliQlik, LLC ("IntelliQlik"). For the three and nine months ended September 30, 2015, the Company recognized equity losses of \$28,000 and \$107,000, respectively, on its investment in IntelliQlik. IntelliQlik is developing a software platform for online learning and learning management for the energy market. The Company was obligated to contribute an additional \$250,000 should IntelliQlik attain certain development milestones by September 30, 2015. Based on a review of the software platform as of September 30, 2015, GSE concluded that the required development milestones had not been met and did not contribute the additional \$250,000 investment. The Company wrote-off the remaining \$126,000 balance of its IntelliQlik investment in Q3 2015.

On May 22, 2013, the Company and Electrobalt Holding, a Russian Federation closed joint-stock company, created a 50/50 joint venture called General Simulation Engineering RUS Limited Liability Company ("GSE RUS"). For the nine months ended September 30, 2014, the Company recognized a loss of \$38,000 relating to its pro rata share of operating results from GSE-RUS. Although the company's entire investment in GSE-RUS was written off by the end of December 2014, we have not received a request for additional funding from the joint venture and, due to the political issues with Russia regarding the conflict in Ukraine, we do not intend to contribute additional equity in the foreseeable future.

The Company had other miscellaneous losses of \$2,000 for the three and nine months ended September 30, 2015, respectively. For the nine months ended September 30, 2014, the Company had other miscellaneous income of \$31,000.

Provision (Benefit) for Income Taxes

The Company files in the United States federal jurisdiction and in several state and foreign jurisdictions. Because of the net operating loss carryforwards, the Company is subject to U.S. federal and state income tax examinations from years 1997 and forward and is subject to foreign tax examinations by tax authorities for years 2007 and forward. Open tax years related to state and foreign jurisdictions remain subject to examination but are not considered material to our financial position, results of operations or cash flows.

An uncertain tax position taken or expected to be taken in a tax return is recognized in the financial statements when it is more likely than not (i.e., a likelihood of more than fifty percent) that the position would be sustained upon examination by tax authorities that have full knowledge of all relevant information. A recognized tax position is then measured at the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. Interest and penalties related to income taxes are accounted for as income tax expense. The Company has appropriately accounted for its uncertain tax positions.

In 2014, the Company paid income taxes in the UK and India and expects to do so again in 2015. The Company has a full valuation allowance on its U.S., Swedish, and Chinese net deferred tax assets at September 30, 2015.

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Liquidity and Capital Resources

As of September 30, 2015, the Company's cash and cash equivalents totaled \$12.8 million compared to \$13.6 million at December 31, 2014.

Cash provided by operating activities. For the nine months ended September 30, 2015, net cash provided by operations totaled \$1.3 million. Significant changes in the Company's assets and liabilities in the nine months ended September 30, 2015 included:

A \$3.6 million decrease in the Company's contract receivables. The Company's trade receivables, net of the allowance for doubtful accounts, decreased from \$10.8 million at December 31, 2014 to \$7.5 million at September 30, 2015. At September 30, 2015, trade receivables outstanding for more than 90 days, net of the bad debt reserve, totaled approximately \$1.1 million as compared to \$369,000 at December 31, 2014. The Company believes the entire 90-day balance at September 30, 2015 will be received. The Company's unbilled receivables decreased by approximately \$291,000 to \$4.8 million at September 30, 2015 as compared to December 31, 2014. The decrease in the unbilled receivables is due to the timing of contracted billing milestones of the Company's current projects. In October 2015, the Company invoiced \$1.9 million of the unbilled amounts; the balance is expected to be invoiced and collected within one year.

A \$1.6 million decrease in billings in excess of revenue earned. The decrease is due to the timing of contracted billing milestones of the Company's current projects.

A \$1.3 million increase in accounts payable, accrued compensation and accrued expenses. The increase was due to the timing of payments made by the Company to vendors and subcontractors.

For the nine months ended September 30, 2014, net cash provided by operations totaled \$5.2 million. Significant changes in the Company's assets and liabilities in the nine months ended September 30, 2014 included:

An \$11.9 million decrease in the Company's contract receivables. The Company's trade receivables, net of the allowance for doubtful accounts, decreased from \$19.0 million at December 31, 2013 to \$6.2 million at September 30, 2014. At September 30, 2014, trade receivables outstanding for more than 90 days, net of the bad debt reserve, totaled approximately \$549,000 as compared to \$623,000 at December 31, 2013. The Company's unbilled receivables increased by approximately \$760,000 to \$6.3 million at September 30, 2014 as compared to December 31, 2013. The increase in the unbilled receivables was due to the timing of contracted billing milestones of the Company's current projects.

A \$2.3 million decrease in accounts payable, accrued compensation, and accrued expenses. The decrease was due to the timing of payments made by the Company to vendors and subcontractors.

Cash used in investing activities. Net cash used in investing activities totaled \$1.0 million for the nine months ended September 30, 2015. Capital expenditures totaled \$217,000 and capitalized software development costs totaled \$1.4 million for the nine months ended September 30, 2015. Restrictions of cash used as collateral for outstanding letters of credit decreased by \$676,000 for the nine months ended September 30, 2015.

Net cash used in investing activities totaled \$4.0 million for the nine months ended September 30, 2014. Capital expenditures totaled \$240,000 and capitalized software development costs totaled \$590,000 for the nine months ended September 30, 2014. On September 30, 2014 Susquehanna Bank collateralized the Company's outstanding letters of credit and segregated \$3.2 million into a restricted cash account. Releases of restricted cash as collateral under letters of credit totaled \$34,000 for the nine months ended September 30, 2014.

Cash used in financing activities. Cash used in financing activities totaled \$839,000 for the nine months ended September 30, 2015. The Company has a working capital line of credit with IberiaBank for its Hyperspring subsidiary. In the first quarter 2015, the Company paid down the outstanding balance of the line of credit, \$339,000, and at September 30, 2015, the Company had no outstanding borrowings. During the nine months ended September 30, 2015, the Company made payments of \$500,000 to the former EnVision Systems, Inc. members in accordance with the 2011 purchase agreement due to the achievement of certain revenue targets in 2014.

Net cash used in financing activities totaled \$500,000 for the nine months ended September 30, 2014. During the nine months ended September 30, 2014, the Company made payments of \$500,000 in accordance with the 2011 purchase agreement due to the achievement of certain revenue targets in 2013.

At September 30, 2015, the Company had cash and cash equivalents of \$12.8 million. The Company believes that its (i) cash and cash equivalents and (ii) cash generated from normal operations will be sufficient to fund its working capital and other requirements for at least the next twelve months. However, notwithstanding the foregoing, the Company may be required to look for additional capital to fund its operations if the Company is unable to operate profitably and generate sufficient cash from operations. There can be no assurance that the Company would be successful in raising such additional funds.

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Credit Facilities

Susquehanna Bank

At September 30, 2015, the Company had a Master Loan and Security Agreement and Revolving Credit Note with Susquehanna Bank ("Susquehanna"). The Company and its subsidiary, GSE Performance Solutions, Inc., were jointly and severally liable as co-borrowers. The Loan Agreement provides a \$7.5 million revolving line of credit for the purpose of (i) issuing stand-by letters of credit and (ii) providing working capital. Working capital advances bear interest at a rate equal to the Wall Street Journal Prime Rate of Interest, floating with a floor of 4 1/2%. The agreement expires on June 30, 2016.

As collateral for the Company's obligations, the Company granted a first lien and security interest in all of the assets of the Company, including but not limited to, accounts receivable, proceeds and products, intangibles, trademarks, patents, intellectual property, machinery and equipment.

On September 9, 2014, the Company signed a Third Comprehensive Amendment to the Master Loan and Security Agreement. According to the Third Amendment, the Company is to maintain a segregated cash collateral account at Susquehanna Bank equal to the greater of (i) \$3.0 million or (ii) the aggregate principal amounts of all Loans outstanding under the Revolving Credit Facility (including any issued and outstanding letters of credit, working capital advances, and negative foreign exchange positions) as security for the Company's obligations. Under this Amendment, Susquehanna Bank shall have complete and unconditional control over the cash collateral account. On September 30, 2014, Susquehanna Bank collateralized the outstanding letters of credit issued under the line of credit. At September 30, 2015 and December 31, 2014, the cash collateral account totaled \$3.6 million and \$4.2 million, respectively. The balances were classified as restricted cash on the balance sheet.

The credit agreements contain certain restrictive covenants regarding future acquisitions and incurrence of debt. On July 31, 2015, the Company signed a Fifth Comprehensive Amendment to the Master Loan and Security Agreement in which the Company's financial covenants were reduced from four to two, and the covenant targets were adjusted.

	Covenant	As of September 30, 2015
Minimum tangible capital base	Must Exceed \$10.5 million	\$10.9 million
Quick ratio	Must Exceed 1.00 : 1.00	1.43 : 1.00

As of September 30, 2015, the Company was in compliance with its covenants as defined above.

IberiaBank

At September 30, 2015, Hyperspring, LLC had a \$1.0 million working capital line of credit with IberiaBank. Under the executed promissory note, interest is payable monthly at the rate of 1.00 percentage points over the prime rate of interest as published in the money rate section of the Wall Street Journal resulting in an effective interest rate of 4.25%. The line is secured by all accounts of Hyperspring and guaranteed by GSE Systems, Inc. The line of credit expires on July 6, 2016. At September 30, 2015, the Company had no outstanding amounts under the line of credit.

Letters of Credit and Bonds

As of September 30, 2015, the Company had thirteen standby letters of credit and one surety bond totaling \$3.6 million which represent advance payment and performance bonds on twelve contracts. The Company has deposited the full value of thirteen standby letters of credit in escrow accounts, amounting to \$3.6 million, which have been restricted in that the Company does not have access to these funds until the related letters of credit have expired. The cash has been recorded on the Company's balance sheet at September 30, 2015 as restricted cash.

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Item 3. Quantitative and Qualitative Disclosure about Market Risk

The Company's market risk is principally confined to changes in foreign currency exchange rates. The Company's exposure to foreign exchange rate fluctuations arises in part from customer contracts that are denominated in currencies other than the Company's functional currency as well as from inter-company accounts in which costs incurred in one entity are charged to other entities in different foreign jurisdictions. The Company is also exposed to foreign exchange rate fluctuations as the financial results of all foreign subsidiaries are translated into U.S. dollars in consolidation. As exchange rates vary, those results when translated may vary from expectations and adversely impact overall expected profitability.

The Company utilizes forward foreign currency exchange contracts to manage market risks associated with the fluctuations in foreign currency exchange rates. The principal currencies for which such forward exchange contracts are entered into are the Pound Sterling, the Euro and the Japanese Yen. It is the Company's policy to use such derivative financial instruments to protect against market risk arising in the normal course of business in order to reduce the impact of these exposures. The Company minimizes credit exposure by limiting counterparties to nationally recognized financial institutions.

As of September 30, 2015, the Company had foreign exchange contracts outstanding of approximately 2.6 million Euro, 0.6 million Pounds Sterling, 0.5 million Australian Dollars and 12.5 million Japanese Yen at fixed rates. The contracts expire on various dates through December 2016. The Company had not designated the contracts as hedges and had recognized a gain of \$34,000 and a loss of \$53,000 in the estimated fair value of the contracts for the three and nine months ended September 30, 2015, respectively. A 10% fluctuation in the foreign currency exchange rates up or down as of September 30, 2015 would have increased/decreased the change in the estimated fair value of the contracts by \$1,700.

As of September 30, 2014, the Company had foreign exchange contracts outstanding of approximately 1.5 million Euro, 0.1 million Pounds Sterling, and 34,000 Canadian Dollars at fixed rates. The contracts expire on various dates through June 2016. The Company had not designated the contracts as hedges and had recognized gains on the change in the estimated fair value of the contracts of \$58,000 and \$312,000 for the three and nine months ended September 30, 2014, respectively. A 10% fluctuation in the foreign currency exchange rates up or down as of September 30, 2014 would have increased/decreased the change in the estimated fair value of the contracts by \$1,400.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed by it in its reports filed or submitted pursuant to the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that information required to be disclosed by the Company in its Exchange Act reports is accumulated and communicated to management, including the Company's Chief Executive Officer ("CEO"), who is its principal executive officer, and Chief Financial Officer ("CFO"), who is its principal financial officer, to allow timely decisions regarding required disclosure. At the end of the period covered by this report, an evaluation was performed under the supervision and with the participation of our management including our CEO and our CFO, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13-15(e) of the Exchange Act. Based on the evaluation of our disclosure controls and procedures as of September 30, 2015, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective.

(b) Changes in internal control over financial reporting

There were no changes in the Company's internal control over financial reporting that occurred during the most recent fiscal quarter that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

(c) Limitation of Effectiveness of Controls

Internal control over financial reporting has inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements will not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate this risk.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 1A. Risk Factors

The Company has no material changes to the disclosure on this matter made in its Annual Report on Form 10-K for the fiscal year ended December 31, 2014.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not applicable.

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Item 5. Other Information

None

Item 6. Exhibits

- 10.1 Form of Restricted Stock Unit Agreement Under the GSE Systems, Inc. 1995 Long-Term Incentive Plan, as amended and restated effective March 6, 2014, filed herewith.
- 31.1 Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes- Oxley Act of 2002, filed herewith.
- 31.2 Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith.
- 32.1 Certification of the Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.
- 101.INS* XBRL Instance Document
- 101.SCH* XBRL Taxonomy Extension Schema
- 101.CAL* XBRL Taxonomy Extension Calculation Linkbase
- 101.DEF* XBRL Taxonomy Extension Definition Linkbase
- 101.LAB* XBRL Taxonomy Extension Label Linkbase
- 101.PRE* XBRL Taxonomy Extension Presentation Linkbase

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: November 12, 2015
SYSTEMS, INC.

GSE

/S/ KYLE J. LOUDERMILK

Kyle J. Loudermilk
Chief Executive Officer
(Principal Executive Officer)

/S/ JEFFERY G. HOUGH

Jeffery G. Hough
Senior Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)