GSE SYSTEMS INC
Form 10-Q
May 14, 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 March 31, 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 (Do not check if a smaller reporting company)	Smaller reporting company

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 17,887,859 shares of common stock, with a par value of $.01 per share outstanding as of May 13, 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 March 31, 2015	December 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$ 11,590	$ 13,583
Restricted cash	775	613
Contract receivables, net	15,191	15,830
Prepaid expenses and other current assets	1,698	1,703
Total current assets	29,254	31,729
Equipment, software and leasehold improvements	6,957	7,055
Accumulated depreciation	(5,171)	(5,229)
Equipment, software and leasehold improvements, net	1,786	1,826
Software development costs, net	1,830	1,414
Goodwill	5,612	5,612
Intangible assets, net	1,145	1,279
Long-term restricted cash	3,465	3,591
Other assets	485	548
Total assets	$ 43,577	$ 45,999
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Line of credit	$ -	$ 339
Accounts payable	1,967	2,330
Accrued expenses	1,631	1,554
Accrued compensation and payroll taxes	2,516	2,595
Billings in excess of revenue earned	7,885	8,684
Accrued warranty	1,507	1,456
Current contingent consideration	1,900	2,842
Other current liabilities	499	473
Total current liabilities	17,905	20,273
Contingent consideration	2,492	1,948
Other liabilities	86	38
Total liabilities	20,483	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, shares issued 19,486,770 and 17,887,859 shares outstanding in both 2015 and 2014	195	195

Additional paid-in capital	73,051	72,917
Accumulated deficit	(45,686)	(45,142)
Accumulated other comprehensive loss	(1,467)	(1,231)
Treasury stock at cost, 1,598,911 shares in 2015 and 2014	(2,999)	(2,999)
Total stockholders' equity	23,094	23,740
Total liabilities and stockholders' equity	$ 43,577	$ 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 March 31, 2015	2014
Contract revenue	$ 13,996	$ 8,724
Cost of revenue	10,774	6,500
Gross profit	3,222	2,224
Operating expenses:		
Selling, general and administrative	3,366	4,144
Depreciation	129	139
Amortization of definite-lived intangible assets	123	36
Total operating expenses	3,618	4,319
Operating loss	(396)	(2,095)
Interest income, net	27	31
Gain (loss) on derivative instruments, net	(48)	104
Other expense, net	(39)	(10)
Loss before income taxes	(456)	(1,970)
Provision for income taxes	88	54
Net loss	$ (544)	$ (2,024)
Basic loss per common share	$ (0.03)	$ (0.11)
Diluted loss per common share	$ (0.03)	$ (0.11)

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 March 31,	
	2015	2014
Net loss	$ (544)	$ (2,024)
Foreign currency translation adjustment, net of tax	(236)	5
Comprehensive loss	$ (780)	$ (2,019)

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	-	-	134	-	-	-	-	134
Foreign currency translation adjustment	-		-	-	(236)	-	-	(236)
Net loss	-	-	-	(544)	-	-	-	(544)
Balance, March 31, 2015	19,487	$ 195	$ 73,051	$ (45,686)	$ (1,467)	(1,599)	$ (2,999)	$ 23,094

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)

	Three Months ended March 31,	
	2015	2014
Cash flows from operating activities:		
Net loss	$ (544)	$ (2,024)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation	129	139
Amortization of definite-lived intangible assets	123	36
Capitalized software amortization	90	32
Change in fair value of contingent consideration	(80)	27
Stock-based compensation expense	134	178
Equity loss on investments	39	27
(Gain) loss on derivative instruments	48	(104)
Changes in assets and liabilities:		
Contract receivables	583	9,875
Prepaid expenses and other assets	86	126
Accounts payable, accrued compensation and accrued expenses	(358)	(2,210)
Billings in excess of revenue earned	(791)	173
Accrued warranty reserves	51	(61)
Other liabilities	18	(388)
Net cash provided by (used in) operating activities	(472)	5,826
Cash flows from investing activities:		
Capital expenditures	(104)	(80)
Capitalized software development costs	(506)	(155)
Restrictions of cash as collateral under letters of credit	(216)	-
Releases of cash as collateral under letters of credit	180	34
Net cash used in investing activities	(646)	(201)
Cash flows from financing activities:		
Payments on line of credit	(339)	-
Payments of the liability-classified contingent consideration arrangements	(318)	(500)
Net cash used in financing activities	(657)	(500)
Effect of exchange rate changes on cash	(218)	(12)
Net increase (decrease) in cash and cash equivalents	(1,993)	5,113
Cash and cash equivalents at beginning of year	13,583	15,643
Cash and cash equivalents at end of period	$ 11,590	$ 20,756

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 Months ended March 31, 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 and 3D visualization training products to make training more effective. Our engineering services include plant design, automation and control systems design, functional safety and compliance analysis, and engineering consultations.

· Staff Augmentation
Staff Augmentation services provide specialized workforce solutions primarily to the nuclear industry. These employees work at our clients' facilities under client direction. Examples of staff augmentation positions include instructors, procedure writers, work management specialists, planners, outage execution specialists, corrective action and self-assessment specialists, 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.
Financial information about the two business segments are 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, product warranties, capitalization of software development costs, valuation of goodwill and intangible assets acquired, 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.
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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 materials as well as (2) time and material contracts primarily through staff augmentation support and service agreements.
In accordance with U.S. generally accepted accounting principles ("GAAP"), 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.
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 staff augmentation and certain consulting agreements. Revenue on time and material 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 months ended March 31, 2015 the following customer provided more than 10% of the Company's consolidated revenue:

	Three Months ended March 31,	
	2015	2014
Tennessee Valley Authority	21.0 %	0.0 %

Tennessee Valley Authority ("TVA") is a customer of Hyperspring, LLC, which was acquired on November 14, 2014.

2. Recently Adopted 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.

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 March 31,	
	2015	2014
Numerator:		
Net loss	$(544)	$(2,024)
Denominator:		
Weighted-average shares outstanding for basic earnings per share	17,887,859	17,887,859
Effect of dilutive securities:		
Employee stock options	-	-
Adjusted weighted-average shares outstanding and assumed conversions for diluted earnings per share	17,887,859	17,887,859
Shares related to dilutive securities excluded because inclusion would be anti-dilutive	2,565,067	2,897,319

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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 staff augmentation, primarily in the United States nuclear industry. Hyperspring operates as a wholly-owned subsidiary of GSE Performance. 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. In addition, GSE may be required, pursuant to the terms of the Purchase Agreement, to pay the Sellers up to an additional $8.4 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. Included in this $11.4 million was a $1.2 million payment to the Hyperspring members if Hyperspring was successful in renewing its contract with the Tennessee Valley Authority ("TVA") on or before May 15, 2015 for a two year period for substantially the same scope as was currently being provided and with substantially the same economics. However, TVA did not issue their request for bid until late April 2015 and the award date is now scheduled for November 2015. Although TVA did grant Hyperspring a six month extension of their contract from May to November 2015, since this did not meet the two-year extension requirement per the Purchase Agreement, the $1.2 million TVA payment is divided into three increments of $400,000 each and are added to the annual payments which will be made to the former Hyperspring members if they achieved certain EBITDA (earnings before interest, taxes, depreciation and amortization) targets for the three-year period ending November 13, 2017. However, refer to Note 16 Subsequent Events regarding an amendment to the Purchase Agreement affecting the $1.2 million TVA payment.
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. GSE Performance is obligated to contribute an additional $250,000 should IntelliQlik attain certain development milestones by September 30, 2015. IntelliQlik is jointly owned by GSE Performance and a former member of Hyperspring.
To assist our clients in creating world-class internal training and performance improvement programs, GSE is building an E2E (Entry2Expert) Performance Solution. The Performance Solution includes a set of integrated and scalable products and services that provide a structured training program, from employee selection and onboarding through continuous skills improvement for experienced employees. The Hyperspring acquisition, through its staff of instructors, engineers and specialists, and the IntelliQlik training platform, once completed, will increase the breadth of solutions that GSE can offer within the E2E Performance Solution program.

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 three months ended March 31, 2015 and 2014, the unaudited pro forma financial information below assumes that our material business acquisition of Hyperspring occurred on January 1, 2014. This pro forma information does not purport to represent what the Company's actual results would have been if the acquisition had occurred as of the date indicated or what results would be for any future periods.

(in thousands except per share data)	(unaudited) Three Months ended March 31,	
Pro forma financial information including the acquisition of Hyperspring	2015	2014
Revenue	$ 13,996	$ 13,208
Operating loss	(446)	(2,101)
Net loss	(592)	(2,031)
Loss per common share — basic	$ (0.03)	$ (0.11)
Loss per common share — diluted	$ (0.03)	$ (0.11)

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 March 31, 2015 and December 31, 2014, contingent consideration included in the other current liabilities on the consolidated balance sheet totaled $1.9 million and $2.8 million, respectively. As of March 31, 2015 and December 31, 2014, we also had accrued contingent consideration totaling $2.5 million and $1.9 million, respectively, which is included in other long-term liabilities on the consolidated balance sheet and represents the portion of contingent consideration estimated to be payable greater than twelve months from the balance sheet date.

(in thousands)	March 31, 2015	December 31, 2014
Hyperspring, LLC	$ 1,516	$ 2,152
IntelliQlik, LLC	213	213
EnVision Systems, Inc.	171	477
Current contingent consideration	$ 1,900	$ 2,842
Hyperspring, LLC	$ 2,492	$ 1,948

Contingent consideration	$2,492	$ 1,948

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5. Contracts 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)	March 31, 2015	December 31, 2014
Billed receivables	$ 8,427	$ 10,792
Recoverable costs and accrued profit not billed	6,766	5,060
Allowance for doubtful accounts	(2)	(22)
Total contract receivables, net	$ 15,191	$ 15,830

Recoverable costs and accrued profit not billed totaled $6.8 million and $5.1 million as of March 31, 2015 and December 31, 2014, respectively. During April 2015, the Company invoiced $2.3 million of the unbilled amounts.

The following customer accounted for more than 10% of the Company's consolidated contract receivables as of December 31, 2014:

	March 31, 2015	December 31, 2014
State Nuclear Power Automation System Engineering Co.	7.0 %	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.

Software development costs capitalized were $506,000 and $155,000 for the three months ended March 31, 2015 and 2014, respectively. Total amortization expense was $90,000 for the three months ended March 31, 2015 and $32,000 for the three months ended March 31, 2014.

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) Staff Augmentation. At March 31, 2015 and December 31, 2014, the $5.6 million of goodwill balance was related to the Hyperspring acquisition and is assigned to our Staff Augmentation 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.

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.

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 March 31, 2015 and December 31, 2014 based upon the short-term nature of the assets and liabilities.

The following table presents assets and liabilities measured at fair value at March 31, 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	$ 10,557	$ -	$ -	$10,557
Foreign exchange contracts	-	149	-	149
Total assets	$ 10,557	$ 149	$ -	$10,706
Foreign exchange contracts	$ -	$ (78)	$ -	$(78)
Total liabilities	$ -	$ (78)	$ -	$(78)

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 March 31, 2015, the Company had foreign exchange contracts outstanding of approximately 0.3 million Pounds Sterling, 0.7 million Australian Dollars and 2.2 million Euro at fixed rates. The contracts expire on various dates through December 2016. At December 31, 2014, the Company had contracts outstanding of approximately 0.3 million Pounds Sterling, 1.4 million Euro, 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)	March 31, 2015	December 31, 2014
Asset derivatives		
Prepaid expenses and other current assets	$ 109	$ 71
Other assets	40	21
	149	92
Liability derivatives		
Other current liabilities	(24)	(23)
Other liabilities	(54)	(1)
	(78)	(24)
Net fair value	$ 71	$ 68

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 months ended March 31, 2015 and 2014, the Company recognized a net gain (loss) on its derivative instruments as outlined below:

(in thousands)	Three Months ended March 31, 2015	2014
Foreign exchange contracts- change in fair value	$ -	$ 243
Remeasurement of related contract receivables, billings in excess of revenue earned, and subcontractor accruals	(48)	(139)

Gain (loss) on derivative instruments, net	$ (48)	$ 104

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 $134,000 and $178,000 of stock-based compensation expense for the three months ended March 31, 2015 and 2014, respectively, under the fair value method. The Company granted 50,000 stock options for the three months ended March 31, 2015. The fair value of the options granted for the three months ended March 31, 2015 was $40,000. The Company granted 60,000 stock options for the three months ended March 31, 2014. The fair value of the granted options at the grant date was $56,000.

11. Long-Term Debt

At March 31, 2015 and December 31, 2014, the Company had no long-term debt.
Lines of Credit
Susquehanna Bank
At March 31, 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, 2015.
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 both March 31, 2015 and December 31, 2014, the cash collateral account totaled $4.2 million and was classified as restricted cash on the balance sheet.

The credit agreement contains certain restrictive covenants regarding future acquisitions and incurrence of debt. In addition, the credit agreement contains financial covenants with respect to the Company's cash flow coverage ratio, minimum tangible capital base, quick ratio, and tangible capital base ratio.

	Covenant	As of March 31, 2015
Cash flow coverage ratio	Must Exceed 1.20 : 1.00	-4.41 : 1.00
Minimum tangible capital base	Must Exceed $26.0 million	$14.5 million
Quick ratio	Must Exceed 2.00 : 1.00	1.63 : 1.00
Tangible capital base ratio	Not to Exceed .75 : 1.00	1.41 : 1.00

As of March 31, 2015, the Company was not in compliance with any of its covenants as defined above, however, the Company has received a written waiver from Susquehanna Bank for noncompliance.

<u>IberiaBank</u>

On November 14, 2014, the acquisition date, Hyperspring, LLC had a $1.0 million working capital line of credit with IberiaBank. Interest was payable monthly at a rate of the prime rate of interest as published in the money rate section of the Wall Street Journal plus 2.50%. The effective rate at November 14, 2014 was 5.750%. The line was secured by all accounts and was guaranteed by the members of Hyperspring, LLC.

On December 7, 2014, the working capital line of credit matured while the Company was renegotiating the new terms with IberiaBank subsequent to the acquisition of Hyperspring. On January 22, 2015, a promissory note was executed between Hyperspring, LLC and IberiaBank to extend the $1.0 million line of credit until June 30, 2015. Under the new terms, interest is payable monthly at a rate of the prime rate of interest as published in the money rate section of the Wall Street Journal plus 1.00 %. The effective rate at the date of the promissory note was 4.25 %. The line is secured by all accounts of Hyperspring and guaranteed by GSE Systems, Inc.

At December 31, 2014 the outstanding balance on the line of credit was $339,000. At March 31, 2015, no balance was outstanding on the line of credit.

The Company draws on the IberiaBank line of credit as needed mainly to provide for payroll funding for Hyperspring. The line is replenished through collection of receivables obtained in the following weeks.

Contingent Liabilities

As of March 31, 2015, the Company was contingently liable for fourteen standby letters of credit and one surety bond totaling $4.3 million which represent advance payment and performance bonds on twelve contracts. The Company has deposited the full value of fourteen standby letters of credit in escrow accounts, amounting to $4.2 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 March 31, 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	171
Warranty claims	(109)
Currency adjustment	(11)
Balance at March 31, 2015	$1,507

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.

The Company expects to pay income taxes in India and the UK in 2015. In 2014, the Company paid income taxes in the UK and India. The Company has a full valuation allowance on its U.S., Swedish, and Chinese net deferred tax assets at March 31, 2015.

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.

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 Staff Augmentation 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. 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.

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

(in thousands)	Three Months ended March 31,	
	2015	2014
Contract revenue:		
Performance Improvement Solutions	$ 8,816	$ 8,724

Staff Augmentation	5,180	-
	13,996	8,724
Operating income (loss):		
Performance Improvement Solutions	(776)	(2,068)
Staff Augmentation	300	-
Gain (Loss) on change in fair value of contingent consideration, net	80	(27)
Operating loss	(396)	(2,095)
Interest income, net	27	31
Gain (loss) on derivative instruments, net	(48)	104
Other expense, net	(39)	(10)
Loss before income taxes	$ (456)	$ (1,970)

16. Subsequent Events

On May 13, 2015, GSE Performance Solutions, Inc. (previously known as GSE Power Systems, Inc.) and the former owners (the "Sellers") of Hyperspring, LLC agreed to an amendment (the "Amendment") to the Membership Interest Purchase Agreement. Under the terms of the Amendment, the date to attain a renewal of the TVA contract was extended from May 15, 2015 to December 31, 2015 (the "Extension Date"). If, prior to the Extension Date, the TVA contract is renewed until at least May 15, 2016, the Sellers will receive a lump sum payment in the amount of $600,000 and if the TVA contract is renewed until at least May 15, 2017, the Sellers will receive a lump sum payment in the amount of $1.2 million. If Hyperspring does not achieve a new, multi-year contract with TVA, then the $1.2 million earnout payment will remain divided into three increments of $400,000 and be added to the annual payments which will be made to the former Hyperspring members if they achieve EBITDA targets for the three year period following the Acquisition Date.

Due to the amendment of the Purchase Agreement, the Company will recognize a $262,000 accretion expense charge in the second quarter 2015 to reflect the change in the current value of the contingent consideration based on the revised payment terms.

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.

For years we have described ourselves as a simulation company, providing mainly simulation solutions to improve designs, de-risk projects and train operators. Our acquisition of Hyperspring, LLC and investment in IntelliQlik, LLC in November 2014 are helping to accelerate our transformation into a Performance Improvement Company. We improve plant performance with a combination of simulation, engineering and plant services that help clients improve their plant's profitability, productivity and safety, and assist in decommissioning the plants at the end of their life cycle. We improve human performance by providing technologies and services that systematically help clients in recruiting and selecting the right person for the job and training that individual throughout their career from entry-level to expert.

GSE is the parent company of:

- 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: Staff Augmentation which provides personnel to fulfill staff positions on a short-term basis to energy industry customers and 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.

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.

General Business Environment

GSE Systems, Inc. ("GSE Systems", "GSE", the "Company", "we", "us" or "our"), a NYSE MKT company trading under symbol GVP, is a team of dedicated people that help customers meet their performance improvement goals and reduce their risk. We do this by combining expertise in simulation, visualization, engineering, equipment operations, and training to improve both plant and human performance.

We execute projects globally with over 354 employees operating from offices in the U.S., China, India, Sweden and the United Kingdom. While the majority of revenue comes from the nuclear and fossil power generation markets, we also serve the oil and gas, refining, chemicals, petrochemicals, industrial gas, manufacturing, transportation and plant utilities markets.

GSE Systems was formed on March 30, 1994 to consolidate the simulation and related businesses of S3 Technologies, General Physics International Engineering & Simulation and EuroSim, each separately owned and operated by ManTech International Corporation, GP Strategies Corporation and Vattenfall AB, respectively.

On April 26, 2010, we completed the acquisition of TAS Holdings Ltd ("TAS") and subsequently merged TAS into our UK subsidiary, GSE Systems Ltd. Our UK operations, located in Stockton-on-Tees, England provides engineering consulting, specifically in electrical system design, instrumentation and controls engineering and automation engineering. The majority of our UK customers are in the petroleum refining, oil and gas, chemical and petrochemical industries.

On January 4, 2011, we acquired EnVision Systems, Inc. ("EnVision"). The EnVision product line consists of interactive computer-based tutorials and related simulation models primarily for the petrochemical and oil & gas refining industries. The EnVision products provide a foundation in process fundamentals and plant operations and interaction. We have more than 750 installations of EnVision products in over 28 countries, and our approximately 130 clients include Shell Oil Company, BP Products North America ("BP"), Total and Chevron.

On November 14, 2014, we acquired Hyperspring, LLC, an Alabama limited liability company. Hyperspring is a staff augmentation company that hires personnel to fulfill staff positions on a short-term basis for energy industry customers, primarily nuclear power customers. Hyperspring personnel provide training, operations and maintenance support including: generic fundamentals exams (GFES), accreditation training visit (ATV) preparation, senior reactor operator (SRO) certification, procedure development, work management, tagging/labeling, outage execution, planning/scheduling, corrective action, self-assessments and equipment reliability. Customers include TVA, Entergy, PSEG Nuclear LLC and NRG Energy Inc.

In conjunction with the Hyperspring acquisition, the Company acquired a 50% ownership stake in IntelliQlik, LLC, a Delaware limited liability company. IntelliQlik is developing a software platform for online learning and learning management for the energy market. A former Member of Hyperspring also has a 50% ownership stake in IntelliQlik.

On December 31, 2014 the Company merged EnVision with GSE Power Systems, Inc. and changed the name of GSE Power Systems, Inc. to GSE Performance Solutions, Inc. The change reflects our growing focus on providing solutions to improve Human and Plant Performance Lifecycles.

Operating Segments

With the acquisition of Hyperspring, we now operate through two reportable business segments. We are organized by operating groups primarily based upon the services performed by each group. Each operating group consists of business units which are focused on providing specific products and services 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 aligned with operating groups to support existing customer accounts and new customer development. Our two business segments are:

· Performance Improvement Solutions

As evidenced through the change in the company name of our U.S. operating company to GSE Performance Solutions, Inc., 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 and 3D visualization training products to make training more effective. Our engineering services include plant design, automation and control systems design, functional safety and compliance analysis, and engineering consultations.

· Staff Augmentation

Staff Augmentation services provide specialized workforce solutions primarily to the nuclear industry. These employees work at our clients' facilities under client direction. Examples of staff augmentation positions include instructors, procedure writers, work management specialists, planners, outage execution specialists, corrective action and self-assessment specialists, 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.
Financial information about our business segments and geographic operations and revenue are provided in Note 15 of the accompanying Consolidated Financial Statements.

Products, Services, Strategy

We believe the most serious future challenge facing the industries we serve is not their access to technology, their access to markets, nor their access to operating capital. Instead the challenge will be their access to a trained and efficient workforce. This challenge manifests itself due to both the knowledge that will be lost as a large percentage of the experienced workforce reaches retirement age in the next ten years and the replacement of these experienced workers by a new generation who have different learning styles and work expectations.
This belief is supported by the following trends as reported in the U.S. Department of Energy's National Energy Technology Laboratory 2013 report entitled Emerging Workforce Trends in the U.S. Energy and Mining Industries: A Call to Action.

- About 1/3 of the U.S. energy industry workforce is comprised of "baby boomers" (those born between 1946 and 1964), and they are poised to retire in great numbers by the end of this decade,
- There are too few younger workers in the pipeline to replace them, and many of the younger workers lack the necessary science, technology, engineering and math skills needed for many energy jobs,
- There is a critical need to capture the knowledge of experienced employees before they leave.

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.
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.

Entry2Expert Performance Cycle

To assist our clients in creating world-class internal training and performance improvement programs, we are building the E2E (Entry2Expert) 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 major elements of the E2E Performance Solution include:

- Employee Screening and Selection: Leveraging the use of simulation and providing experts in employee assessments, we help clients ensure their candidates for employment possess both technical aptitude as well as personality traits suited for the specific job functions.
- Training Needs Assessments: We help clients define their specific training needs by analyzing the job functions and processes specific to their plant. This is the first step in creating a structured training program that will provide consistent and predictable results.
- Training Program Development: Following the ADDIE (Analyze, Design, Develop, Implement, and Evaluate) model for training program management, we can structure the entire training program for the client, including training media and modes, such as self-paced e-Learning, instructor-led classroom, in-depth simulation, and serious gaming.
- Self-Paced Training Tutorials: We have a full complement of e-Learning material. The products include basic equipment and component fundamentals that are applicable across a variety of industries, as well as comprehensive training for the oil and gas and refining markets. Using a blended learning approach, students learn the overall purpose of plant systems, the major equipment, how the equipment is operated and controlled. This methodology ensures the students know the basics before entering a plant-specific training program. We have delivered over 500 such tutorial programs in multiple languages worldwide.
- Instructor-Led Training: We provide classroom and simulator instructors as adjunct staff or to teach turnkey training programs using training materials that either we or the client have developed. Turnkey courses include ANSI Fundamentals (math and sciences), Generic Fundamentals (nuclear plant components, systems, and reactor theory), Senior Reactor Operator (SRO) Certification, and Engineering Systems Program courses.

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- Universal Training Simulators: These products complement the Self-Paced Training Tutorials by reinforcing what the student learned in the tutorial by putting it into practice on the Universal Simulator. The simulation models are high fidelity and engineering correct, but represent a typical plant or typical process, versus the exact replication of a client's plant. We have delivered over 250 such simulation models to clients consisting of major oil companies and educational institutions.
- Part-Task Training Simulators: Like the Universal Simulators, we provide other unique training solutions such as a generic nuclear plant simulator, VPanel displays which replicate control room hardware and simulator solutions specific to industry need, such as Severe Accident models to train on and aid in the understanding of events such as the Fukushima Daiichi accident.
- 3D Visualization: Being able to visualize complex processes, or detailed maintenance tasks significantly improves understanding and retention while reducing the learning process. We provide 3D visualization solutions to help customers "see" and understand the internal workings complex systems such as nuclear reactors, or how to maintain complicated pieces of equipment. Blending the learning strategy of incorporating 3D visualization with high-fidelity, real-time simulation models enables us to provide the energy industry with better, faster, and less costly training in an immersive environment that is ideally suited for the next generation workforce.
- Plant-Specific Operator Training Simulators: These simulators provide an exact replication of the plant control room and plant operations. They provide the highest level of realism and training and allow users to practice their own plant-specific procedures. Clients can safely practice startup, shutdown, normal operations, as well as response to abnormal events we all hope they never have to experience in real life. We have delivered nearly 450 plant-specific simulators to clients in the nuclear power, fossil power and process industries worldwide.

The goal of our E2E performance lifecycle offering is to ensure superior human achievement in the dimensions of:
- Recruiting, screening, and selecting the right workforce
- Shortening the learning process
- Reduce human errors
- Mitigate effects of retirement and turnover
- Improve workforce agility
- Achieve and maintain certifications and compliance
- All of which improve our customers' bottom lines

The dramatic increase in energy demand world-wide over the next 30 years will require significant amounts of training for new employees and also require new plants using energy of all sources.   Obviously, these new plants will need to be engineered and designed prior to construction, and due to their high-fidelity our modeling tools are being increasingly used to verify and validate control system and overall plant designs.

Design2Decom Performance Cycle

Just like the Entry2Expert (E2E) process helps improve the performance of our customers' people, Design2Decom (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 Consultancy, Project Execution and Project Management: Whether in the feasibility, concept or detail design stages of a plant or for plant modifications, we help clients design and implement engineering projects across several disciplines:
  - Instrumentation Engineering
  - Control Systems Engineering
  - Automation Design Engineering
  - Electrical Design Engineering
- Virtual commissioning of plants. Our high-fidelity, simulation-based engineering solutions test design assumptions and provide feedback throughout the design process for:
  - Integrated systems design validation
  - Control strategy design validation
  - Human factors engineering support
  - Operating procedure validation
  - Control system validation
- Safety and Compliance: Our engineering expert de-risk operations through engineering assessments and remediation services to ensure safety and legislative compliance in the following areas:
  - Functional Safety
  - Electrical Safety
  - Hazardous Areas Safety
  - Arc Flash Safety
  - Alarm Management

- Specialized Plant Support: As our customers' experienced staffs retire, access to experts that can help with specialized plant projects is critical. Through the acquisition of Hyperspring, we also provide expert support either through staff augmentation or turnkey projects for the following:
  - Procedure Development
  - Training Material Upgrade and Development
  - Work Management
  - Outage Execution
  - Planning and Scheduling
  - Corrective Actions
  - Self-Assessments
  - Equipment Reliability
- Decommissioning: As plants reach the end of their useful life, decommissioning and deconstruction is a critical service, particularly in the nuclear industry where contaminated material must be handled in safe and precise manners. Our engineering, simulation and visualization capabilities enable clients to plan for, train for, and execute decommissioning while minimizing exposure to hazardous materials and saving money.

The goal of Design2Decom (D2D) is to help clients optimize plant performance and compliance in terms of the following:

- Finding design errors during engineering rather than construction allowing plant startup to occur sooner saving countless man-hours and dollars while simultaneously allowing revenue generation sooner.
- Ensuring plants are safely operated within the regulatory requirements.
- Providing expert support for specialized projects and to augment an aging workforce.
- Limiting cost and hazards exposure through intelligent decommissioning 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 acquisition of the specialized engineering capabilities of TAS Holding, entry and intermediate level training solutions via our EnVision acquisition, and now extensive training and plant support capabilities by acquiring Hyperspring.

Competitive Advantages

While there is competition in various industry niches, there are few companies in our space that can combine the engineering, simulation and training expertise we now have through the execution of our acquisition strategy. None of our traditional competitors serve the broader performance improvement market.

- Unique Combination of Talent. Nobody in our market space brings together the sophistication of simulation technology with the engineering expertise, training expertise and visualization expertise to provide the holistic people and plant performance improvement solutions.
- Reputation for Customer Satisfaction. As part of its ISO-9000 Quality Program Certification, GSE measures customer satisfaction across numerous factors such as On-Time Delivery, Problem Solving, and Customer Communication. In each category measured we routinely exceed customer expectations.
- Industry Expertise. GSE is a leading innovator and developer of real-time software with more than 40 years of experience producing high-fidelity, real-time simulators. As a result, the Company has acquired substantial applications expertise in the energy and industrial process industries. The Company employs a highly educated and experienced multinational workforce of over 300 employees, including approximately 180 engineers and scientists. Of the almost 180 engineers, approximately 49% of these engineers and scientists have advanced science and technical degrees in fields such as chemical, mechanical and electrical engineering, applied mathematics and computer sciences, while an additional 33% have master degrees, and another 12% have doctorate degrees in the aforementioned fields.
- Proprietary Software Tools. GSE has developed a library of proprietary software tools including auto-code generators and system models that substantially facilitate and expedite the design, production and integration, testing and modification of software and systems. These tools are used to automatically generate the computer code and systems models required for specific functions commonly used in simulation applications, thereby enabling it or its customers to develop high-fidelity, real-time software quickly, accurately and at lower costs. The Company has a substantial library of Process-Specific Simulation models and eLearning Modules aimed at the oil and gas, refining and specialty chemicals market.
- Training Curricula.   The Company has developed hundreds of detailed courses and simulator exercise material or specific industrial applications including oil and gas refining, gas-oil production, nuclear and combined cycle gas turbine power plant and desalination.
- In the area of training and training related products, Hyperspring can now include: state of the art 3D graphics and simulation to enhance our offerings and differentiate us from our competitors. The area of staff augmentation is mostly focused on training and operations support. The senior management of Hyperspring has strong active ties to the industries we serve which allows us to interface with our customers directly in the course of doing business versus having to periodically call on customers. Our proximity allows us a significant competitive advantage in that we can immediately offer solutions and therefore bypass lengthy bid processes.

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 March 31,			
	2015	%	2014	%
Contract revenue	$13,996	100.0%	$8,724	100.0%
Cost of revenue	10,774	77.0 %	6,500	74.5 %
Gross profit	3,222	23.0 %	2,224	25.5 %
Operating expenses:				
Selling, general and administrative	3,366	24.0 %	4,144	47.5 %
Depreciation	129	0.9 %	139	1.6 %
Amortization of definite-lived intangible assets	123	0.9 %	36	0.4 %
Total operating expenses	3,618	25.8 %	4,319	49.5 %
Operating loss	(396)	(2.8)%	(2,095)	(24.0)%
Interest income, net	27	0.2 %	31	0.4 %
Gain (loss) on derivative instruments, net	(48)	(0.4)%	104	1.2 %
Other expense, net	(39)	(0.3)%	(10)	(0.2)%
Loss before income taxes	(456)	(3.3)%	(1,970)	(22.6)%
Provision for income taxes	88	0.6 %	54	0.6 %
Net loss	$(544)	(3.9)%	$(2,024)	(23.2)%

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, 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 Months ended March 31, 2015 versus Three Months ended March 31, 2014

Contract Revenue. Contract revenue for the three months ended March 31, 2015 totaled $14.0 million, which was 60.4% greater than the $8.7 million of revenue for the three months ended March 31, 2014. The increase in revenue was driven by the acquisition of Hyperspring, represented by our Staff Augmentation segment, depicted below.

(in thousands)	Three Months ended March 31,	
	2015	2014
Contract Revenue:		
Performance Improvement Solutions	$ 8,816	$ 8,724
Staff Augmentation	5,180	-
Total Contract Revenue	$ 13,996	$ 8,724

Performance Improvement Solutions revenue increased 1.1% from $8.7 million for the three months ended March 31, 2014 to $8.8 million for the March 31, 2015. We recorded total Performance Improvement Solutions orders of $11.1 million in the three months ended March 31, 2015 as compared to $6.3 million in the three months ended March 31, 2014.

As discussed earlier, our Staff Augmentation business segment was created due to the acquisition of Hyperspring, LLC on November 14, 2014. Revenue for the three months ended March 31, 2015 totaled $5.2 million. Staff Augmentation orders totaled $7.0 million during the same period.

At March 31, 2015, backlog was $52.4 million: $44.0 million for the Performance Improvement Solutions business segment and $8.4 million for Staff Augmentation. 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 Staff Augmentation.

Gross Profit. Gross profit totaled $3.2 million for the three months ended March 31, 2015 compared to $2.2 million for the same period in 2014. As a percentage of revenue, gross profit decreased from 25.5% for the three months ended March 31, 2014 to 23.0% for the three months ended March 31, 2015. The addition of the Staff Augmentation segment, which has an overall gross profit lower than the Company's historical Performance Improvement Solution segment gross profits, has contributed to the decrease in gross profit percentage for the three months ended March 31, 2015.

($ in thousands) Three Months ended