GSE SYSTEMS INC
Form 10-Q
November 14, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

[X] Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Quarterly Period Ended September 30, 2012.

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 No.)

1332 Londontown Blvd., Suite 200, Sykesville, MD 21784
(Address of principal executive office and 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.

Accelerated filer [ ] Non-accelerated filer [ ]

Large accelerated filer [ ]		Smaller reporting company [X]
	(Do not check if a 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 18,348,336 shares of common stock, with a par value of $.01 per share outstanding as of November 12, 2012.

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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 data)

	Unaudited September 30, 2012	December 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 21,304	$ 20,326
Restricted cash	3,761	3,505
Contract receivables, net	19,441	20,356
Prepaid expenses and other current assets	3,314	3,733
Total current assets	47,820	47,920
Equipment and leasehold improvements	6,683	5,206
Accumulated depreciation	(4,604)	(4,105)
Equipment and leasehold improvements, net	2,079	1,101
Software development costs, net	2,193	1,815
Goodwill	4,502	4,462
Intangible assets, net	990	1,207
Long-term restricted cash	1,177	897
Other assets	1,987	1,413
Total assets	$ 60,748	$ 58,815
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 4,886	$ 4,077
Accrued expenses	1,779	1,581
Accrued compensation and payroll taxes	2,350	2,754
Billings in excess of revenue earned	4,954	5,261
Accrued warranty	2,157	2,300
Other current liabilities	2,302	1,707
Total current liabilities	18,428	17,680
Other liabilities	1,213	2,352
Total liabilities	19,641	20,032
Commitments and contingencies	-	-
Stockholders' equity:		
Preferred stock $.01 par value, 2,000,000 shares authorized, shares issued and outstanding none in 2012 and 2011	-	-
Common stock $.01 par value, 30,000,000 shares authorized, shares issued 19,421,892 in 2012 and 19,254,681 in 2011	194	193

Additional paid-in capital		71,117			70,167	
Accumulated deficit		(27,559	)		(29,063	)
Accumulated other comprehensive loss		(574	)		(865	)
Treasury stock at cost, 1,047,461 shares in 2012, 824,374 in 2011		(2,071	)		(1,649	)
Total stockholders' equity		41,107			38,783	
Total liabilities and stockholders' equity	$	60,748		$	58,815	

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

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

	Three Months ended September 30, 2012	Three Months ended September 30, 2011	Nine Months ended September 30, 2012	Nine Months ended September 30, 2011
Contract revenue	$ 13,009	$ 12,549	$ 39,581	$ 36,128
Cost of revenue	7,960	7,931	26,143	24,278
Gross profit	5,049	4,618	13,438	11,850
Operating expenses:				
Selling, general and administrative	3,483	3,302	10,663	9,920
Depreciation	131	137	406	365
Amortization of definite-lived intangible assets	79	204	235	629
Total operating expenses	3,693	3,643	11,304	10,914
Operating income	1,356	975	2,134	936
Interest income, net	36	29	121	91
Gain (loss) on derivative instruments, net	20	(129)	36	49
Other income (expense), net	(97)	31	82	70
Income before income taxes	1,315	906	2,373	1,146
Provision (benefit) for income taxes	499	48	869	(481)
Net income	$ 816	$ 858	$ 1,504	$ 1,627
Basic income per common share	$ 0.04	$ 0.05	$ 0.08	$ 0.09
Diluted income per common share	$ 0.04	$ 0.05	$ 0.08	$ 0.08

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

GSE SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)
(Unaudited)

	Three Months ended September 30,		Nine Months ended September 30,	
	2012	2011	2012	2011
Net income	$816	$858	$1,504	$1,627
Foreign currency translation adjustment	442	(378)	291	(62)
Comprehensive income	$1,258	$480	$1,795	$1,565

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

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

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Treasury Stock Shares	Treasury Stock Amount	Total
Balance, December 31, 2011	19,255	$ 193	$ 70,167	$ (29,063)	$ (865)	(824)	$ (1,649)	$ 38,783
Stock-based compensation expense	-	-	678	-	-	-	-	678
Common stock issued for options exercised	167	1	272	-	-	-	-	273
Foreign currency translation adjustment	-	-	-	-	291	-	-	291
Treasury stock at cost	-	-	-	-	-	(223)	(422)	(422)
Net income	-	-	-	1,504	-	-	-	1,504
Balance, September 30, 2012	19,422	$ 194	$ 71,117	$ (27,559)	$ (574)	(1,047)	$ (2,071)	$ 41,107

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, 2012	Nine Months ended September 30, 2011
Cash flows from operating activities:		
Net income	$ 1,504	$ 1,627
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	406	365
Amortization of definite-lived intangible assets	235	629
Capitalized software amortization	536	612
Amortization of deferred financing costs	9	-
Change in fair value of contingent consideration	245	331
Stock-based compensation expense	678	569
Equity (gain) loss on investment in GSE-UNIS Simulation Technology Co. Ltd.	(27)	22
Gain on derivative instruments	(36)	(49)
Changes in assets and liabilities:		
Contract receivables	884	(2,980)
Prepaid expenses and other assets	262	(1,359)
Accounts payable, accrued compensation and accrued expenses	609	(1,597)
Billings in excess of revenue earned	(225)	656
Accrued warranty reserves	(143)	401
Other liabilities	97	(844)
Net cash provided by (used in) operating activities	5,034	(1,617)
Cash flows from investing activities:		
Capital expenditures	(1,404)	(370)
Capitalized software development costs	(914)	(572)
Investment in GSE-UNIS Simulation Technology Co. Ltd.	(469)	(456)
Acquisitions, net of cash acquired	-	(830)
Restrictions of cash as collateral under letters of credit	(1,734)	(5,171)
Releases of cash as collateral under letters of credit	1,197	1,178
Drawdown of cash collateral on Emirates Simulation Academy, LLC line of credit	-	(79)
Net cash used in investing activities	(3,324)	(6,300)
Cash flows from financing activities:		
Proceeds from issuance of common stock	273	119
Payments of the liability-classified contingent consideration arrangements	(845)	-
Treasury stock purchases	(422)	(1,127)
Net cash used in financing activities	(994)	(1,008)

Effect of exchange rate changes on cash		262		6
Net increase (decrease) in cash and cash equivalents		978		(8,919)
Cash and cash equivalents at beginning of year		20,326		26,577
Cash and cash equivalents at end of period	$	21,304	$	17,658

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

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GSE SYSTEMS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the Three and Nine Months ended September 30, 2012 and 2011
(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 period ended December 31, 2011 filed with the Securities and Exchange Commission on March 8, 2012.

The Company has only one reportable segment. The Company has a wide range of knowledge of simulation systems and the processes those systems are intended to control and model. The Company's knowledge is concentrated heavily in simulation technology and model development. The Company is primarily engaged in simulation for the power generation industry and the process industries. Contracts typically range from twelve months to three years.

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, capitalization of software development costs, valuation of 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.

Revenue Recognition

The majority of the Company's revenue is derived through the sale of uniquely designed systems containing hardware, software and other materials under fixed-price contracts. Revenue under these fixed-price contracts is accounted for on 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 for 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 experience and projected claims. 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 must normally 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.

Revenue from certain consulting or training contracts is recognized on a time-and-material basis. For time-and-material type contracts, revenue is recognized based on hours incurred at a contracted labor rate plus expenses.

The following customers have provided more than 10% of the Company's consolidated revenue for the indicated periods:

	Three Months ended September 30,		Nine Months ended September 30,	
	2012	2011	2012	2011
BP Products North America	15.6%	0.1%	6.2%	0.1%
Slovenské elektrárne, a.s.	2.3%	12.5%	4.8%	12.3%

2. Recently Adopted Accounting Pronouncements

In September 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2011-08, Intangibles — Goodwill and Other (Topic 350) — Testing Goodwill for Impairment ("ASU 2011-08"), to allow entities to use a qualitative approach to test goodwill for impairment. ASU 2011-08 permits an entity to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If it is concluded this is the case, it is necessary to perform the currently prescribed two-step goodwill impairment test. Otherwise, the two-step goodwill impairment test is not required. ASU 2011-08 is effective for the Company for interim and annual periods ending during 2012, with earlier application permitted. The adoption of this guidance had no impact on the Company's consolidated financial statements.

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (Topic 820) — Fair Value Measurement ("ASU 2011-04"), to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. generally accepted accounting principles and International Financial Reporting Standards. ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements particularly for Level 3 fair value measurements. ASU 2011-04 is effective for the Company for interim and annual periods ending during 2012 and will be applied prospectively. The adoption of this guidance had no impact on the Company's consolidated financial statements.

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3. Basic and Diluted Income Per Common Share

Basic income per share is based on the weighted average number of outstanding common shares for the period. Diluted income per share adjusts the weighted average shares outstanding for the potential dilution that could occur if stock options or warrants were exercised into common stock. The number of common shares and common share equivalents used in the determination of basic and diluted income per share were as follows:

(in thousands, except for share amounts)	Three Months ended September 30, 2012	Three Months ended September 30, 2011	Nine Months ended September 30, 2012	Nine Months ended September 30, 2011
Numerator:				
Net income	$ 816	$858	$1,504	$1,627
Denominator:				
Weighted-average shares outstanding for basic earnings per share	18,390,034	18,879,757	18,370,907	19,101,284
Effect of dilutive securities:				
Employee stock options	69,900	112,841	112,235	202,913
Adjusted weighted-average shares outstanding and assumed conversions for diluted earnings per share	18,459,934	18,992,598	18,483,142	19,304,197
Shares related to dilutive securities excluded because inclusion would be anti-dilutive	2,847,203	1,573,896	2,799,268	1,544,504

4. 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, 2012	December 31, 2011
Billed receivables	$ 7,858	$ 8,258
Recoverable costs and accrued profit not billed	11,719	12,234
Allowance for doubtful accounts	(136)	(136)
Total contract receivables, net	$ 19,441	$ 20,356

Recoverable costs and accrued profit not billed totaled $11.7 million and $12.2 million as of September 30, 2012 and December 31, 2011, respectively. During October 2012, the Company invoiced $1.8 million of the unbilled amounts.

The following customers account for more than 10% of the Company's consolidated contract receivables for the indicated periods:

	September 30,2012	December 31, 2011
Slovenské elektrárne, a.s.	15.7%	24.2%
Shandong Nuclear Power Co. Ltd.	15.3%	5.0%
Kraftwerkesschule E.V.	12.4%	7.9%

In May 2012, Slovenské elektrárne, a.s. ("SE") notified the Company of its decision to suspend work under the contract due to changes in the Slovakian regulation requiring SE to redesign certain aspects of the plant. The Company and SE are currently discussing amendments to the existing contract addressing (i) substantial additional scope of work for the Company, (ii) costs related to suspension of the contract and its restart, (iii) the Company's continued support of the project during the suspension period and (iv) withdrawal of SE outstanding claims. At September 30, 2012, the Company had a $188,000 outstanding invoice included in accounts receivable, $2.9 million of recoverable costs and accrued profit not billed, and a $2.9 million performance bond in place to secure completion of the contract.

5. 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.

Software development costs capitalized were $306,000 and $914,000 for the three and nine months ended September 30, 2012, respectively, and $186,000 and $572,000 for the three and nine months ended September 30, 2011, respectively. Total amortization expense was $168,000 and $536,000 for the three and nine months ended September 30, 2012, respectively, and $218,000 and $612,000 for the three and nine months ended September 30, 2011, respectively.

6. Fair Value of Financial Instruments

Accounting Standards Codification ("ASC") 820, Fair Value Measurements and Disclosures, 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 cash, accounts receivable and accounts payable, to approximate the fair value of the respective assets and liabilities at September 30, 2012 and December 31, 2011 based upon the short-term nature of the assets and liabilities.

The following table presents assets and liabilities measured at fair value at September 30, 2012:

(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 fund	$ 15,429	$ -	$ -	$ 15,429
Certificates of deposit	3,942	-	-	3,942
Foreign exchange contracts	-	507	-	507
Total assets	$ 19,371	$ 507	$ -	$ 19,878
Foreign exchange contracts	$ -	$ (370)	$ -	$ (370)
Total liabilities	$ -	$ (370)	$ -	$ (370)

The following table presents assets and liabilities measured at fair value at December 31, 2011:

(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 fund	$ 8,163	$ -	$ -	$ 8,163
Certificates of deposit	5,976	-	-	5,976
Foreign exchange contracts	-	483	-	483
Total assets	$ 14,139	$ 483	$ -	$ 14,622
Foreign exchange contracts	$ -	$ (314)	$ -	$ (314)
Total liabilities	$ -	$ (314)	$ -	$ (314)

7. 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, 2012, the Company had foreign exchange contracts outstanding of approximately 1.0 million Pounds Sterling, 13.3 million Euro, and 70.8 million Japanese Yen at fixed rates. The contracts expire on various dates through May 2016. At December 31, 2011, the Company had contracts outstanding of approximately 3.1 million Pounds Sterling, 12.0 million Euro, and 383.5 million Japanese Yen 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, 2012	December 31, 2011
Asset derivatives		
Prepaid expenses and other current assets	$ 481	$ 393
Other assets	26	90
	507	483
Liability derivatives		
Other current liabilities	(203)	(258)
Other liabilities	(167)	(56)
	(370)	(314)
Net fair value	$ 137	$ 169

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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, 2012 and 2011, the Company recognized a net gain (loss) on its derivative instruments as outlined below:

	Three Months ended September 30,		Nine Months ended September 30,	
(in thousands)	2012	2011	2012	2011
Foreign exchange contracts- change in fair value	$(134)	$(143)	$(42)	$(298)
Remeasurement of related contract receivables, billings in excess of revenue earned, and subcontractor accruals	154	14	78	347
Gain (loss) on derivative instruments, net	$20	$(129)	$36	$49

8. 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 $231,000 and $183,000 of stock-based compensation expense for the three months ended September 30, 2012 and 2011, respectively, under the fair value method and recognized $678,000 and $569,000 of stock-based compensation expense for the nine months ended September 30, 2012 and 2011, respectively. The Company granted 0 and 152,870 stock options for the three and nine months ended September 30, 2012, respectively. The fair value of the granted options at the grant date was $145,000. The Company granted 60,000 and 102,000 stock options for the three and nine months ended September 30, 2011, respectively. The fair value of the options granted for the three and nine months ended September 30, 2011 was $75,000 and $135,000, respectively.

9.Long-Term Debt

At September 30, 2012 and December 31, 2011, the Company had no long-term debt outstnading.

Line of Credit

The Company has a Master Loan and Security Agreement and Revolving Credit Note with Susquehanna Bank ("Susquehanna"). The Company and its subsidiaries, GSE Power Systems, Inc., and GSE EnVision LLC, are 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 ½%. The two-year agreement is to expire on November 1, 2013.

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, inventory, proceeds and products, intangibles, trademarks, patents, intellectual property, machinery and equipment.

Issuances of stand-by letters of credit and advances of working capital (collectively referred to as the "Advances") require that the Company maintain a minimum cash balance of $3.0 million at all times (the "Cash Balance Requirement"). The Cash Balance Requirement will remain at the minimum amount as long as the Company's quarterly net income (exclusive of gains and losses on derivative instruments and stock option expense) as defined ("Net Income") remains positive and the Company is in compliance with the covenants. If the Company's quarterly consolidated Net Income is negative or the Company is not in compliance with the covenants, the Cash Balance Requirement will revert to the amount of the Advances, until the Company attains positive Net Income for two consecutive quarters. The credit agreements contain certain restrictive covenants regarding future acquisitions, and incurrence of debt. In addition, the credit agreements contain financial covenants with respect to the Company's cash flow coverage ratio, minimum tangible capital base, quick ratio, and tangible capital base ratio. At September 30, 2012, the Company had not made any borrowings for over one year. As such, the cash flow coverage ratio is not applicable at September 30, 2012.

	Covenant	As of September 30, 2012
Minimum tangible capital base	Must Exceed $26.0 million	$33.4 million
Quick ratio	Must Exceed 2.00 : 1.00	2.59 : 1.00
Tangible capital base ratio	Not to Exceed .75 : 1.00	.59 : 1.00

As the Company's Net Income for the nine months ended September 30, 2012 was positive and the Company is in compliance with its covenants, the Company is currently required to maintain the minimum cash balance of $3.0 million with Susquehanna. At September 30, 2012, the Company had $328,000 in Advances, all of which consisted of outstanding stand-by letters of credit.

As of September 30, 2012, the Company was contingently liable for eleven standby letters of credit and five surety bonds totaling $6.3 million which represent performance and bid bonds on eleven contracts. The Company has deposited the full value of eight standby letters of credit in certificates of deposit and escrow accounts ($4.8 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, 2012 as restricted cash.

10. 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, 2011	$	2,300
Warranty provision		727
Warranty claims		(897)
Currency adjustment		27
Balance at September 30, 2012	$	2,157

11. 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 2005 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, through its acquisition of EnVision Systems Inc. ("EnVision") on January 4, 2011, recognized deferred tax liabilities of $1.0 million. As a result of this acquisition, in accordance with ASC-805 Business Combinations, the Company reduced the valuation allowance on its U.S. net deferred tax assets and recognized the change in the valuation allowance ($1.0 million) through the income tax provision in the three months ended March 31, 2011.

The Company, through its acquisition of EnVision on January 4, 2011, also recorded $320,000 of unrecognized tax benefits as well as a receivable from the EnVision shareholders for the same amount as indemnity for this tax position. During 2011, the Company also recorded $126,000 of unrecognized tax benefits in 2011 for certain foreign tax contingencies. During the nine months ended September 30, 2012, the Company recorded $29,000 of unrecognized tax benefits for certain foreign tax contingencies. The Company records interest and penalties associated with uncertain tax positions as a component of income tax expense. The Company does not expect any material changes to its uncertain tax positions in the next twelve months.

The Company expects to pay income taxes in Sweden, India, and China in 2012. In 2011, the Company paid income taxes to Sweden, India, China, and the United Kingdom. In addition, the Company will pay foreign income tax withholding on several non-U.S. contracts in 2012, which is consistent with the foreign income tax withholdings in 2011. The Company has a full valuation allowance on its U.S. net deferred tax assets at September 30, 2012.

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12. 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. Upon approval of both an independent committee of the Board of Directors and the Board of Directors, the Rights Plan can be extended for up to three years. The Rights will initially trade with and be inseparable from the Common Stock and will not be 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.

13. Share Repurchase Plan

On March 21, 2011, the Board of Directors authorized the purchase of up to $3.0 million of the Company’s common stock in accordance with the safe harbor provisions of Rule 10b-18 of the Securities Exchange Act of 1934. During the three and nine months ended September 30, 2012 the Company repurchased 60,700 and 223,087 shares at an aggregate cost of $119,000 and $422,000, respectively. During the three and nine months ended September 30, 2011 the Company repurchased 370,519 and 521,400 shares at an aggregate cost of $792,000 and $1.1 million, respectively.

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:

- 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;
- TAS Engineering Consultants Ltd., an English limited liability company;
- GSE EnVision, LLC, a New Jersey limited-liability company; and
- EnVision Systems (India) Pvt. Ltd., an Indian limited liability company.

The Company has a 49% minority interest in GSE-UNIS Simulation Technology Co., Ltd., a Chinese limited liability company, and has a 10% minority interest in Emirates Simulation Academy, LLC, a United Arab Emirates limited liability company. The Company has only one reportable segment.

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. Bec 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 2011 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

It has been over 18 months since a 9.0 magnitude earthquake and subsequent tsunami occurred along the northeast coast of Japan which damaged the Fukushima Daiichi I Nuclear Power Plant, which is maintained by the Tokyo Electric Power Company (TEPCO).

Most countries with nuclear programs reacted to the Fukushima disaster by announcing the delay of new nuclear plants while they conducted reviews of their programs. On March 9, 2012, the U.S. Nuclear Regulatory Commission (NRC) approved the first three new regulatory requirements to deal with safety issues based on eight changes identified by the NRC's Fukushima task force, with implementation required by the end of 2016. The three orders require safety enhancements of operating reactors, construction permit holders, and combined license holders. These orders require nuclear power plants to implement safety enhancements related to (1) mitigation strategies to respond to extreme natural events resulting in the loss of power at plants, (2) ensuring reliable hardened containment vents, and (3) enhancing spent fuel pool instrumentation. In addition, the NRC requested each reactor reevaluate the seismic and flooding hazards at their site using present-day methods and information.

On May 31, 2012, the State Council, China's Cabinet, approved a nuclear safety plan for 2011-2015 following a nine month safety inspection of China's 41 nuclear power plants, which are either operating or under construction. The inspection reportedly showed that most of China's nuclear power stations meet both Chinese and International Atomic Energy Agency standards. According to the Council's statements, the main issues have been for some nuclear power plants to meet new standards on flood protection and for some research reactors to meet new earthquake requirements. Some power plants must also develop better procedures for severe accident prevention and mitigation. Although the Chinese government has not made a decision on when to start approving new nuclear plant projects, there are signs that the decision may come soon. China National Nuclear Power, the biggest nuclear power developer in the country, announced plans to raise money for projects worth more than $27 billion through what could be one of the biggest initial public offerings (IPO) in China and the first for a nuclear power company. The Ministry of Environmental Protection has approved the IPO plan, which must still be submitted to the China Securities Regulatory Commission for approval.

In Japan, all of the country's 54 commercial nuclear reactors had gone offline since the Fukushima disaster. The Japanese government has asked the plant operators to conduct stress tests: computer simulations designed to show how the reactors would hold up during a large natural disaster. In April, 2012, the Japanese nuclear regulators issued a list of 30 lessons from the Fukushima disaster. Although the Japanese Prime Minister, Yoshihiko Noda, has called for restarting the plants as soon as possible, he has said that the reactors will not restart without the approval of local community leaders. Many such local leaders have stated that the stress tests are not enough and want additional guidelines issued before the nuclear reactors are restarted. However, on July 1, 2012, Japan restarted the reactor No. 3 at Ohi nuclear power plant.

Previous nuclear accidents have resulted in new regulations requiring additional operator training, higher fidelity models and new testing scenarios. Accordingly, as evidenced by the new safety rules that the NRC has recently issued, the Chinese State Council's Safety Plan, and the debate in Japan as to the need for new regulatory guidelines, it is likely that there will be additional governmental regulations requiring plant modifications and new testing scenarios that will result in the need for higher simulator fidelity, such as that designed and supplied by GSE.

GSE has developed PSA-HD™, an engineering-grade nuclear simulation solution that allows operations personnel to train for and develop responses to severe accident scenarios based on the operations of their specific facility. PSA-HD utilizes MAAP 5.0 as the calculation engine, with GSE's real-time executive and graphical interface to provide a dynamic, real-time solution for severe accident analysis. MAAP 5.0 is an Electric Power Research Institute (EPRI) software program that performs severe accident analysis for nuclear power plants including assessments of core damage and radiological transport. A valid license to MAAP 5.0 from EPRI is required to use MAAP 5.0 with PSA-HD. PSA-HD's real-time code can be integrated with a nuclear plant's existing full-scope training simulator and is applicable to all current nuclear plant designs. PSA-HD can be used to validate the utility's severe accident management guidelines (SAMGs), demonstrate the safety of current plant designs to regulators and stakeholders, and identify potential issues with existing plant design that may require modification. PSA-HD includes high-fidelity models of the plant's reactor core, containment structures and spent fuel pool. The models simulate severe accident conditions which mirror those that occurred at the Fukushima facility, such as the release of radioactive materials due to overheating of the core, exposure of the fuel rods in the spent fuel pool, and hydrogen build up in the containment building.

In order to meet the world's growing energy needs, the growth of all forms of energy is critical. Per the ExxonMobil 2012 the Outlook for Energy: A View to 2040, "By 2040 electricity generation will account for more than 40% of global energy consumption. Oil will remain the most widely used fuel, but natural gas will grow fast enough to overtake coal for the number-two position. For both oil and natural gas, an increasing share of global supply will come from unconventional sources, such as those from shale formations. Demand for natural gas will rise by more than 60% through 2040." For more than three decades, GSE has leveraged the simulation capability that we initially developed for nuclear power for non-nuclear projects. Globally we have delivered 121 fossil power plant simulators and 96 process industry simulators. Our EnVision™ products include interactive multi-media tutorials and simulation models primarily for the petrochemical and oil & gas refining industries. These products provide a foundation in process fundamentals, as well as plant operations and interaction. GSE now has a tiered offering when it comes to simulation, as well as a large library of training content in multiple languages.

According to the U.S. Energy Information Administration, world energy consumption is forecasted to increase by 52% from 505 quadrillion BTU in 2008 to 770 quadrillion BTU in 2035. New consumption means new production, which means new plants, new workers, and an enormous amount of training to provide a skilled workforce. GSE recognized this growing need for energy industry training several years ago and began developing various training solutions leveraging the use of our simulation technology. GSE created a 163 module, five-simulator training course that was sold to the Emirates Simulation Academy LLC, in the UAE, a training academy that was created by GSE and two other partners in 2007. The Company worked with the University of Strathclyde in Glasgow, Scotland to incorporate GSE's simulation into the University's degreed and industrial education programs. GSE developed a 20-week "Nuclear Operator Jump Start Training Program" for Southern Nuclear Company in Augusta, GA utilizing the Company's VPanel™ interactive visual training simulator. The advantage of the VPanel simulator is its scalability and ease of configuration for both team and individual training, plant specific or cross training. The VPanel allows customers to utilize their existing simulator load while bringing many full scope simulator capabilities directly into the classroom for a fraction of the cost. The "Operator Jump Start" program helps customers screen and train new operator candidates. This training program is designed to provide essential knowledge and skills to potential nuclear plant operators and to determine if candidates have the ability to successfully complete the customer's own operator licensing programs. The program includes instruction on fundamental sciences (including Generic Fundamentals Examinations "GFES"), plant components, systems, and operations.

A compounding problem is facing the energy industry. While experiencing rapid growth requiring new plants and new workers, the incumbent industry workforce is aging and facing dramatic turnover. Per the Nuclear Energy Institute, as of 2008 nearly 38% of the U.S. nuclear power industry would be eligible to retire by 2013. According to the Center for Energy Workforce Development, an estimated 46% of the current energy industry workforce may need to be replaced by 2015 due to attrition and retirement. While the data is readily available in the nuclear industry because it is so heavily regulated, similar demographics exist in the fossil, oil & gas, chemical and petrochemical industries. The impact of this pending workforce turnover has been somewhat delayed due to the recent global economic downturn which has forced many employees to postpone their retirements. Accordingly, the Company anticipates that in the near future, a larger number of employees are likely to retire within a shorter time span and the need to find qualified employees to replace them will become an acute issue.

Except for some insightful early adopters, many companies tend to put off spending on training until their training needs become acute. Often it is viewed as a cost rather than an investment, and is often one of the first expenditures to be reduced during economic downturns. However, the statistics associated with new plant builds and the aging workforce are undeniable, and training will be required to supply the skilled employees that will be needed to staff the new plants and replace the retirees. Therefore, when the energy industry recognizes the need to train, they will want training that is faster and better than what is traditionally available. Additionally, they will have to consider the nature of the next generation workforce who has grown up with a computer and vast amounts of interactive multimedia. Standard classroom training will not provide the efficacy that will be needed nor satisfy the interest level of the new workforce.

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In fact, according to the NTL Institute's statistics on adult learner retention only 5% of information is retained from lecture, and only 10% from reading. However, 75% retention is accomplished when learners practice by doing. These statistics support GSE's success with the Nuclear Operator Jump Start Training Program at Southern Nuclear Company, as our design combines traditional instructor-led classroom training with structured simulator exercises supporting the concepts learned. This model is transportable globally to anywhere a new energy workforce is needed.

Case studies demonstrate that the inclusion of "serious gaming" technology such as immersive 3D environments can reduce training time and improve learning significantly. In fact, the Royal Canadian Army was able to reduce the cost of training and increase the pass rate of students by incorporating gaming into the curriculum. Due to the advancement of computer processing power and graphics technology, immersive commercially viable off-the-shelf 3D game engines are readily available. Additionally, this style of learning also lends itself to the next generation workforce, and as such GSE is investing significantly in 3D visualization training products. This investment comes in the form of strategic hires, investment in technology, and software product development. Through development efforts already undertaken, GSE's engineers have discovered how to link our industry-leading, high fidelity models to commercially off-the-shelf game engines. This enables us to make the invisible visible, for example seeing the inside of an operating reactor, steam generator, or turbine generator. Blending the learning strategy by incorporating 3D visualization interfacing high fidelity real time simulation models will allow GSE to provide the energy industry with better, faster, less costly training ideally suited for the next generation workforce, which we have branded as ACTIV-3Di. In September 2012, the Company introduced the Virtual Flow Loop TrainerTM. It can cost approximately $1.0 million to construct a brick and mortar flow loop facility for training plant operating and maintenance staff. The Virtual Flow Loop Trainer is a practical and cost-effective alternative that operates on personal computers across a company's existing IT infrastructure. The Virtual Flow Loop Trainer provides the same level of training in a convenient, flexible environment. The Virtual Flow Loop Trainer is applicable across all industries and learning organizations that need to train their staff and students on both the fundamental and practical operations of a wide variety of pumps, valves, controllers, and instrumentation. We received our first 3D visualization orders in 2011 and will recognize modest revenue from 3D visualization training products in 2012.

Besides new employees, the dramatic increase in energy demand world-wide over the next 30 years will require new plants of all sources, too. Obviously, these new plants will need to be engineered and designed prior to construction, and GSE's modeling tools are being used more and more to verify and validate control system design and overall plant designs. Finding design errors during engineering rather than construction allows plant startup to occur sooner saving countless dollars and allowing revenue generation sooner. GSE is developing new design solutions leveraging our high fidelity simulation models to improve and streamline the plant engineering process.

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,			
	2012	%	2011	%	2012	%	2011	%
Contract revenue	$ 13,009	100.0 %	$ 12,549	100.0 %	$ 39,581	100.0 %	$ 36,128	100.0 %
Cost of revenue	7,960	61.2 %	7,931	63.2 %	26,143	66.0 %	24,278	67.2 %
Gross profit	5,049	38.8 %	4,618	36.8 %	13,438	34.0 %	11,850	32.8 %
Operating expenses:								
Selling, general and administrative	3,483	26.8 %	3,302	26.3 %	10,663	27.0 %	9,920	27.5 %
Depreciation	131	1.0 %	137	1.1 %	406	1.0 %	365	1.0 %
Amortization of definite-lived intangible assets	79	0.6 %	204	1.6 %	235	0.6 %	629	1.7 %
Total operating expenses	3,693	28.4 %	3,643	29.0 %	11,304	28.6 %	10,914	30.2 %
Operating income	1,356	10.4 %	975	7.8 %	2,134	5.4 %	936	2.6 %
Interest income, net	36	0.3 %	29	0.2 %	121	0.3 %	91	0.3 %
Gain (loss) on derivative instruments, net	20	0.2 %	(129)	(1.0)%	36	0.1 %	49	0.1 %
Other income (expense), net	(97)	(0.8)%	31	0.2 %	82	0.2 %	70	0.2 %
Income before income taxes	1,315	10.1 %	906	7.2 %	2,373	6.0 %	1,146	3.2 %
Provision (benefit) for income taxes	499	3.8 %	48	0.4 %	869	2.2 %	(481)	(1.3)%
Net income	$ 816	6.3 %	$ 858	6.8 %	$ 1,504	3.8 %	$ 1,627	4.5 %

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, 2011 is included in Note 2 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2011. 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 intangible assets acquired, 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 2011 Annual Report on Form 10-K for the fiscal year ended December 31, 2011.

Results of Operations - Three and Nine months ended September 30, 2012 versus Three and Nine months ended September 30, 2011

Contract Revenue. Total contract revenue for the three months ended September 30, 2012 totaled $13.0 million, which was 3.7% greater than the $12.5 million total revenue for the three months ended September 30, 2011. For the nine months ended September 30, 2012, contract revenue totaled $39.6 million, a $3.5 million increase from the $36.1 million for the nine months ended September 30 2011. The Company recorded total orders of $34.9 million in the nine months ended September 30, 2012 compared to $28.4 million for the nine months ended September 30, 2011. During the second quarter of 2012, GSE's wholly-owned subsidiary, GSE EnVision LLC ("EnVision"), received a multi-year contract to provide simulation and computer-based learning modules to the subsidiary of a global energy services company. Revenue from such contract for the three and nine months ended September 30, 2012 was $2.0 million and $2.4 million, respectively. Revenue related to the $26.9 million full scope simulator and digital control system order from Slovenské elektrárne, a.s. ("SE") was $293,000 (2.3% of revenue) and $1.6 million (12.5% of revenue) for the three months ended September 30, 2012 and 2011, respectively. For the nine months ended September 30, 2012 and 2011, revenue from SE was $1.9 million (4.8% of revenue) and $4.5 million (12.3% of revenue), respectively. At September 30, 2012, the Company's backlog was $47.2 million, of which $4.1 million is related to the SE contract. At December 31, 2011 the Company's backlog totaled $51.5 million.

Gross Profit. Gross profit totaled $5.0 million for the three months ended September 30, 2012 compared to $4.6 million for the same period in 2011. As a percentage of revenue, gross profit increased from 36.8% for the three months ended September 30, 2011 to 38.8% for the three months ended September 30, 2012. For the nine months ended September 30, 2012, gross profit increased from $11.9 million during the same period in 2011 to $13.4 million and as a percentage of revenue, gross profit increased from 32.8% to 34.0%, respectively. The increase in revenue from EnVision which has an overall gross profit significantly higher than the Company's normal gross profits, and the decrease in revenue on the Slovakia contract, which has an overall gross profit lower than the Company's normal gross profits, have contributed to the increase in gross profit for the three and nine months ended September 30, 2012. In addition, during the three months ended September 30, 2011, the Company received a $3.0 million change order related to the SE project which increased the overall gross margin on the project and generated an additional $679,000 in gross profit on the project for both the three and nine months ended September 30, 2011.

Selling, General and Administrative Expenses. Selling, general and administrative ("SG&A") expenses totaled $3.5 million in the three months ended September 30, 2012, a 5.5% increase from the $3.3 million for the same period in 2011. For the nine months ended September 30, 2012 and 2011, SG&A expenses totaled $10.7 million and $9.9 million, respectively. The increase reflects the following spending variances:

♦ Business development and marketing costs increased from $1.3 million to $1.7 million for the three months ended September 30, 2011 and 2012, respectively, and increased from $4.1 million to $5.0 million for the nine months ended September 30, 2011 and 2012, respectively. The Company hired three business development resources in the United States and hired two additional business development resources in Europe as compared to the prior year. Included in business development and marketing costs are bidding and proposal costs, which are the costs of operations personnel assisting with the preparation of contract proposals. Bidding and proposal costs increased by $128,000 and $301,000 during the three and nine months ended September 30, 2012 to $463,000 and $1.4 million, respectively, as compared to the three and nine months ended September 30, 2011.

♦ The Company's general and administrative expenses ("G&A") decreased from $1.7 million to $1.5 million for the three months ended September 30, 2011 and 2012, respectively and decreased from $5.2 million to $4.7 million for the nine months ended September 30, 2011 and 2012, respectively. The fluctuations were primarily attributable to the following:

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The Company incurred $0 and $206,000 of acquisition related expenses, primarily composed of legal, audit, and due diligence expenses for the three and nine months ended September 30, 2011, respectively. The Company did not incur any acquisition related expenses during the three and nine months ended September 30, 2012.

- The change in the fair value of contingent consideration (accretion expense) related to the TAS and EnVision acquisitions totaled $102,000 and $245,000 for the three and nine months ended September 30, 2012, respectively, versus $47,000 and $331,000 for the three and nine months ended September 30, 2011, respectively.

♦ Gross spending on software product development ("development") expenses for the three and nine months ended September 30, 2012 totaled $587,000 and $1.9 million, respectively, as compared to $454,000 and $1.2 million for the three and nine months ended September 30, 2011, respectively. The Company capitalized $306,000 and $914,000 of product development expenses for the three and nine months ended September 30, 2012, respectively, and $186,000 and $572,000 for the same periods in 2011, respectively. Net development spending increased from $268,000 for the three months ended September 30, 2011 to $281,000 for the three months ended September 30, 2012 and from $628,000 for the nine months ended September 30, 2011 to $950,000 for the nine months ended September 30, 2012.

o The Company created a 3D visualization team in January 2011 to develop 3D technology to add to our training programs. The Company incurred $70,000 and $306,000 of costs related to this effort in the three and nine months ended September 30, 2012, respectively, as compared to $104,000 and $231,000 for the same periods in 2011.

o Spending on other software product development totaled $517,000 and $1.6 million for the three and nine months ended September 30, 2012, respectively. For the three and nine months ended September 30, 2011, development expense totaled $350,000 and $969,000, respectively. The Company's development expenses were mainly related to three projects, an enhanced graphical user interface for our JADE™ modeling toolset, secondly, advancements were made to our configuration management system, ISIS™, which is a central data warehouse that supports various forms of data on a simulator, and thirdly, development work was performed on our new product, PSA-HD, which is used to train operators and power plant personnel on the sequence of events during severe accident conditions.

Depreciation. Depreciation expense totaled $131,000 and $137,000 during the three months ended September 30, 2012 and 2011, respectively. For the nine months ended September 30, 2012 and 2011, depreciation expense totaled $406,000 and $365,000, respectively.

Amortization of definite-lived intangible assets. Amortization expense related to definite-lived intangible assets totaled $79,000 and $204,000 for the three months ended September 30, 2012 and 2011, respectively. For the nine months ended September 30, 2012 and 2011, amortization expense related to definite-lived intangible assets totaled $235,000 and $629,000, respectively. The Company recorded intangible assets of $1.5 million in conjunction with the EnVision acquisition which included the following:

♦ Contractual customer relationships acquired totaled $438,000 and are being amortized in proportion to the projected revenue streams of the related contracts over three years.
♦ Non-contractual customer relationships acquired totaled $433,000 and are being amortized in proportion to the projected revenue streams of the related relationships over eight years.
♦ Developed technology acquired totaled $471,000 and is being amortized on a straight line method over an eight year period.
♦ In process research and development acquired totaled $152,000 and is being amortized over eight years in proportion to the projected revenue streams of the related in-process research and development.
♦ Domain names and other marketing related intangibles acquired totaled $15,000 and are being amortized on a straight line method over an estimated useful life of three years.

Operating Income. The Company had operating income of $1.4 million (10.4% of revenue) during the three months ended September 30, 2012, as compared with operating income of $975,000 (7.8% of revenue) for the same period in 2011. For the nine months ended September 30, 2012 and 2011, the Company had operating income of $2.1 million (5.4% of revenue) and operating income of 936,000 (2.6% of revenue), respectively. The variances were due to the factors outlined above.

Interest Income, Net. Net interest income totaled $36,000 and $29,000 for the three months ended September 30, 2012 and 2011, respectively. For the nine months ended September 30, 2012 and 2011, net interest income totaled $121,000 and $91,000, 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, 2012, the Company had foreign exchange contracts outstanding of approximately 1.0 million Pounds Sterling, 13.3 million Euro, and 70.8 million Japanese Yen at fixed rates. The contracts expire on various dates through May 2016. The Company has not designated the contracts as hedges and has recognized losses on the change in the estimated fair value of the contracts of ($134,000) and ($42,000) for the three and nine months ended September 30, 2012, respectively.

At September 30, 2011, the Company had foreign exchange contracts of approximately 2.3 million Pounds Sterling, 17.0 million Euro and 682.9 million Japanese Yen at fixed rates. The contracts expire on various dates through February 2014. The Company had not designated the contracts as hedges and had recognized losses on the change in the estimated fair value of the contracts of ($143,000) and ($298,000) for the three and nine months ended September 30, 2011, 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, 2012, the Company recognized gains of $154,000 and $78,000, respectively, from the remeasurement of such contract receivables, billings in excess of revenue earned and subcontractor accruals. For the same periods in 2011, the Company recognized gains of $14,000 and $347,000, respectively.

Other Income (Expense), net. For the three and nine months ended September 30, 2012, other income, net was ($97,000) and $82,000, respectively. For the three and nine months ended September 30, 2011, other income (expense), net was $31,000 and $70,000, respectively. The major components of other income (expense), net included the following items:

- For the three and nine months ended September 30, 2012, the Company recognized a gain(loss) of ($107,000) and $27,000, respectively, relating to its pro rata share of operating results from GSE-UNIS Simulation Technology Co., Ltd. For the three and nine months ended September 30, 2011, the Company recognized a gain of $3,000 and a loss of $22,000, respectively, relating to its pro rata share of operating results from GSE-UNIS Simulation Technology Co., Ltd.
- The Company had other miscellaneous income for the three and nine months ended September 30, 2012 of $10,000 and $55,000, respectively. For the three and nine months ended September 30, 2011, other miscellaneous income amounted to $28,000 and $92,000, respectively.

Provision 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 2005 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.

During the nine months ended September 30, 2012, the Company recorded $29,000 of unrecognized tax benefits for certain foreign tax contingencies. The Company, through its acquisition of EnVision on January 4, 2011, recorded $320,000 of unrecognized tax benefits as well as a receivable from the EnVision shareholders for the same amount as indemnity for this tax position. The Company does not expect any material changes to its uncertain tax positions in the next twelve months.

The Company, through its acquisition of EnVision on January 4, 2011, recognized deferred tax liabilities of $1.0 million. As a result of this acquisition, in accordance with ASC-805 Business Combinations, the Company reduced the valuation allowance on its U.S. net deferred tax assets and recognized the change in the valuation allowance ($1.0 million) through the income tax provision in the nine months ended September 30, 2011.

The Company expects to pay income taxes in Sweden, India, and China in 2012. In 2011, the Company paid income taxes to Sweden, India, China, and the United Kingdom. In addition, the Company will pay foreign income tax withholding on several non-U.S. contracts in 2012, which is consistent with the foreign income tax withholdings in 2011. The Company has a full valuation allowance on its U.S. net deferred tax assets at September 30, 2012.

Liquidity and Capital Resources

As of September 30, 2012, the Company's cash and cash equivalents totaled $21.3 million compared to $20.3 million at December 31, 2011.

Cash provided by (used in) operating activities. For the nine months ended September 30, 2012, net cash provided by operations totaled $5.0 million. Significant changes in the Company's assets and liabilities in the nine months ended September 30, 2012 included:

- ♦ An $884,000 decrease in the Company's contract receivables. The Company's trade receivables, net of the allowance for doubtful accounts, decreased from $8.1 million at December 31, 2011 to $7.7 million at September 30, 2012. At September 30, 2012, trade receivables outstanding for more than 90 days, net of the bad debt reserve, totaled approximately $1.4 million versus $278,000 at December 31, 2011. The Company's unbilled receivables decreased by approximately $500,000 to $11.7 million at September 30, 2012. The decrease in the unbilled receivables is due to the timing of contracted billing milestones of the Company's current projects. In October 2012, the Company invoiced $1.8 million of the unbilled amounts; the balance is expected to be invoiced and collected within one year.
- ♦ A $609,000 increase in accounts payable, accrued compensation and accrued expenses. The increase is due to the timing of payments made by the Company to vendors and subcontractors.

Net cash used in operations for the nine months ended September 30, 2011, totaled $1.6 million. Significant changes in the Company's assets and liabilities in the nine months ended September 30, 2011 included:

- ♦ A $3.0 million increase in the Company's contract receivables. The Company's trade receivables, net of the allowance for doubtful accounts, increased from $5.7 million at December 31, 2010 to $9.0 million at September 30, 2011. At September 30, 2011, trade receivables outstanding for more than 90 days, net of the bad debt reserve, totaled approximately $491,000 versus $318,000 at December 31, 2010. The Company's unbilled receivables increased by approximately $1.3 million to $12.8 million at September 30, 2011. The increase in the unbilled receivables was due to the timing of contracted billing milestones of the Company's current projects. In October 2011, the Company invoiced over $4.2 million of the unbilled amounts.
    - ♦ A $1.6 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 $3.3 million for the nine months ended September 30, 2012. During the nine months ended September 30, 2012 the Company was required to cash collateralize $1.7 million of stand-by letters of credit with certain foreign customers. Cash provided by the release of cash as collateral under letters of credit totaled $1.2 million for the nine months ended September 30, 2012.

Capital expenditures totaled $1.4 million. The majority of the capital expenditures are related to the Company's new Enterprise Resource Planning (ERP) software that is being implemented across our global operations. The Company has spent approximately $1.1 million on the new ERP software during the nine months ended September 30, 2012. Capitalized software development costs totaled $914,000 for the nine months ended September 30, 2012.

During the nine months ended September 30, 2012, the Company made its final equity contribution of $469,000 to GSE-UNIS Simulation Technology Co., Ltd. ("GSE-UNIS"). GSE-UNIS is 51% owned by Beijing UNIS Investment Co., Ltd. and 49% owned by GSE.

Net cash used was investing activities totaled $6.3 million for the nine months ended September 30, 2011. The increase was primarily the result of Bank of America's amendments to the Company's then existing revolving credit agreements effective March 14, 2011, which required the Company to cash collateralize all existing and future letters of credit. At September 30, 2011 the Company had cash collateralized $4.3 million of standby letters of credit. This balance represented a $4.1 million increase from December 31, 2010.

The Company acquired EnVision Systems Inc. on January 4, 2011. The present value of the purchase price totaled $4.0 million with $1.2 million paid in cash at closing. The balance is payable on the first, second and third anniversaries of the closing date based upon the attainment of various revenue and cash targets. In the second quarter of 2011, the Company made payments of $74,000 to EnVision's shareholders related to billed receivables included on the Closing Date balance sheet. An additional payment of $109,000 to the EnVision shareholders was made during the second quarter of 2011 related to the working capital true-up provisions of the purchase agreement. GSE acquired approximately $550,000 in cash through the acquisition of EnVision.

During the nine months ended September 30, 2011, the Company made an additional equity contribution totaling $456,000 to GSE-UNIS.

As of September 30, 2011 capital expenditures totaled $370,000 and capitalized software development costs totaled $572,000. GSE had $79,000 of cash on deposit with Union National Bank ("UNB") as a partial guarantee against the Emirates Simulation Academy, LLC ("ESA") line of credit, was withdrawn by UNB during the nine months ended September 30, 2011. As of September 30, 2011, GSE had a full reserve for the amount in the restricted cash account.

Cash used in financing activities. Net cash used in financing activities totaled $994,000 for the nine months ended September 30, 2012. During the nine months ended September 30, 2012, the Company made payments of $73,000 and $772,000, in relation to the liability classified contingent-consideration associated with the acquisitions of TAS and EnVision, respectively. The Company repurchased 223,087 shares of the Company's common stock at an aggregate cost of $422,000 for the nine months ended September 30, 2012. Proceeds from the issuance of common stock for the nine months ended September 30, 2012 totaled $273,000.

For the nine months ended September 30, 2011, net cash used in financing activities totaled $1.0 million. The Company repurchased 521,400 shares of the Company's common stock at an aggregate cost of $1.1 million for the nine months ended September 30, 2011. Proceeds from the issuance of common stock for the nine months ended September 30, 2011 totaled $119,000.

At September 30, 2012, the Company had cash and cash equivalents of $21.3 million. Based on the Company's forecasted expenditures and cash flow, the Company believes that it will generate sufficient cash through its normal operations to meet its liquidity and working capital needs for the next twelve months.

Credit Facilities

The Company has a Master Loan and Security Agreement and Revolving Credit Note with Susquehanna. The Company and its subsidiaries, GSE Power Systems, Inc., and GSE EnVision LLC, are 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 ½%. The two-year agreement is to expire on November 1, 2013.

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, inventory, proceeds and products, intangibles, trademarks, patents, intellectual property, machinery and equipment.

Issuances of stand-by letters of credit and advances of working capital (collectively referred to as the “Advances”) require that the Company maintain a minimum cash balance of $3.0 million at all times (the “Cash Balance Requirement”). The Cash Balance Requirement will remain at the minimum amount as long as the Company’s quarterly consolidated net income (exclusive of gains and losses on derivative instruments and stock option expense) as defined (“Net Income”), remains positive and the Company is in compliance with the covenants. If the Company’s quarterly Net Income is negative or the Company is not in compliance with the covenants, the Cash Balance Requirement will revert to the amount of the Advances, until the Company attains positive Net Income for two consecutive quarters. The credit agreements contained certain restrictive covenants regarding future acquisitions, and incurrence of debt. In addition, the credit agreements contained financial covenants with respect to the Company’s cash flow coverage ratio, minimum tangible capital base, quick ratio, and tangible capital base ratio. At September 30, 2012, the Company had not paid any interest or principal payments related to any borrowings for over one year. As such the cash flow coverage ratio is not applicable at September 30, 2012.

	Covenant	As of September 30, 2012
Minimum tangible capital base	Must Exceed $26.0 million	$33.4 million
Quick ratio	Must Exceed 2.00 : 1.00	2.59 : 1.00
Tangible capital base ratio	Not to Exceed .75 : 1.00	.59 : 1.00

As the Company’s Net Income for the three months ended September 30, 2012 is positive and the Company is in compliance with its covenants, the Company is currently required to maintain the minimum cash balance of $3.0 million with Susquehanna. At September 30, 2012, the Company had $328,000 in Advances, all of which consisted of outstanding stand-by letters of credit.

As of September 30, 2012, the Company was contingently liable for eleven standby letters of credit and five surety bonds totaling $6.3 million which represent performance and bid bonds on eleven contracts. The Company has deposited the full value of eight standby letters of credit in certificates of deposit and escrow accounts ($4.8 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, 2012 as restricted cash.

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, 2012, the Company had foreign exchange contracts outstanding of approximately 1.0 million Pounds Sterling, 13.3 million Euro, and 70.8 million Japanese Yen at fixed rates. The contracts expire on various dates through May 2016. The Company had not designated the contracts as hedges and has recognized a losses on the change in the estimated fair value of the contracts of ($134,000) and ($42,000) for the three and nine months ended September 30, 2012, respectively. A 10% fluctuation in the foreign currency exchange rates up or down as of September 30, 2012 would have increased/decreased the change in the estimated fair value of the contracts by $14,000.

As of September 30, 2011, the Company had foreign exchange contracts of approximately 2.3 million Pounds Sterling, 17.0 million Euro and 682.9 million Japanese Yen at fixed rates. The contracts expire on various dates through February 2014. The Company had not designated the contracts as hedges and recognized losses on the change in the estimated fair value of the contracts of ($143,000) and ($298,000) for the three and nine months ended September 30, 2011, respectively.

Item 4. Controls and Procedures

(a) Evaluation of disclosure controls and procedures. The Company maintains adequate internal disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the “Exchange Act”), as amended) as of the end of the period covered by this quarterly report on Form 10-Q pursuant to Rule 13a-15(b) under the Exchange Act that are designed to ensure that information required to be disclosed by it in its reports filed or submitted pursuant to the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the 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.

The Company’s CEO and CFO are responsible for establishing and maintaining adequate internal control over the Company’s financial reporting. They have reviewed and evaluated the effectiveness of the Company’s disclosure controls and procedures pursuant to Exchange Act Rule 13a-14 as of September 30, 2012 in order to ensure the reporting of material information required to be included in the Company’s periodic filings with the Commission comply with the Commission’s requirements for certification of this Form 10-Q. Based on that evaluation, the Company’s CEO and CFO have concluded that as of September 30, 2012 the Company’s disclosure controls and procedures were effective.

(b) Changes in internal control. In the ordinary course of business, the Company reviews its system of internal control over financial reporting to evaluate whether to implement any changes to its systems and processes to improve such controls and increase efficiency, while ensuring that we maintain an effective internal control environment. During the three months ended September 30, 2012, the Company implemented a new system for financial reporting and accumulation of financial data. The new financial system is a significant component of the Company’s internal control over financial reporting, but was not made in response to any deficiency in our internal controls.

Other than the implementation of the new financial system described above, no changes in the Company’s internal control over financial reporting (as defined in Exchange Act Rule 13a-15) occurred during the quarter ended September 30, 2012 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

Limitation of Effectiveness of Controls

It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system will be met. The design of any control system is based, in part, upon the benefits of the control system relative to its costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision making can be faulty, and that controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of control. In addition, over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events. Because of inherent limitation in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. The Company’s controls and procedures are designed to provide a reasonable level of assurance of achieving their objectives.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 1A. Risk Factors

The risk factors set forth in the Annual Report on Form 10-K for the period ended December 31, 2011 are hereby updated as follows:

Risks related to contract with Slovenské elektrárne, a.s.

In 2009, the Company entered into a contract with Slovenské elektrárne, a.s. (“SE”) to provide a full scope simulator for a two unit reactor plant in Slovakia. The Company has subsequently received several change orders which have increased the contract value to $26.9 million, including a $3.0 million change order of which $2.1 million related to compensation provided by SE to the Company for a nine and half month delay caused by SE. To date, the Company has recognized $22.9 million of revenue on the contract.

In November and December 2011 and January 2012, SE notified the Company of various alleged breaches of the contract. In the notification, SE claimed a contractual penalty for delay in the amount of $1.0 million related to the Company’s failure to complete Factory Acceptance Testing (“FAT”) for the simulator and unspecified potential damages for other alleged breaches of the contract.

Based upon the schedule for the completion of FAT contained in the contract, which currently does not take into account the acknowledged nine and a half month delay caused by SE, the Company does not believe that it is responsible for the delay in FAT completion. After engaging in discussions with SE, the Company formally responded to all of the claims in January 2012. In March 2012, the Company completed a modified FAT.

In May 2012, SE notified the Company of its decision to suspend work under the contract due to changes in the Slovakian regulation requiring SE to redesign certain aspects of the plant. Since May 2012, at the request of SE, the Company has provided a two person project team, who are providing support services during the project suspension currently expected to continue until May 2013. In addition, the Company has provided a proposal to SE covering the cost of (i) demobilization and mobilization of GSE’s project team and the monthly suspension costs and (ii) reduction of GSE’s project team and the costs related thereto during suspension period.

In September 2012, the Company received a $3.7 million payment from SE with respect to an outstanding $5.6 million receivable and SE agreed to pay the remaining $1.9 million upon completion of the Site Acceptance Test, which is currently expected to take place in November 2013. In October 2012, SE paid the Company $188,000 within thirty days from the date of invoice for the services provided by the Company’s two person project team referred to above.

The Company and SE are currently discussing amendments to the existing contract addressing (i) substantial additional scope of work for the Company, (ii) costs related to suspension of the contract and its restart, (iii) the Company’s continued support of the project during the suspension period and (iv) withdrawal of SE outstanding claims. At September 30, 2012, the Company had a $188,000 outstanding invoice included in accounts receivable, $2.9 million of recoverable costs and accrued profit not billed, and a $2.9 million performance bond in place to secure completion of the contract.

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

Issuer Purchases of Equity Securities

The following table provides information about the Company’s share repurchase activity for the nine months ended September 30, 2012:

Month	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced program	Approximate dollar value of shares that may yet be purchased under the program
January 1 - January 31	68,684	$ 1.87	893,058	$ 1,222,521
February 1 - February 29	59,878	$ 1.89	952,936	$ 1,109,569
March 1 - March 31	33,825	$ 1.81	986,761	$ 1,048,231
April 1- April 30	-	$ -	986,761	$ 1,048,231
May 1 - May 31	-	$ -	986,761	$ 1,048,231
June 1 - June 30	-	$ -	986,761	$ 1,048,231
July 1 - July 31	-	$ -	986,761	$ 1,048,231
August 1 - August 31	33,200	$ 1.98	1,019,961	$ 982,565
September 1 - September 30	27,500	$ 1.95	1,047,461	$ 928,905

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None

Item 6. Exhibits

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

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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 14, 2012
GSE SYSTEMS, INC.

/S/ JAMES A. EBERLE
James A. Eberle
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)