DGSE COMPANIES INC
Form 10-Q
May 14, 2013

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2013

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 1-11048

DGSE Companies, Inc.

(*Exact name of registrant as specified in its charter*)

Nevada	**88-0097334**
(State or other jurisdiction of	*(I.R.S. Employer*

incorporation or organization) Identification No.)

15850 Dallas Parkway, Suite 140

Dallas, Texas 75248

(972) 587-4049

(Address, including zip code, and telephone

number, including area code, of registrant's

principal executive offices)

11311 Reeder Road

Dallas, Texas 75229

(Former name, former address and former

fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 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 þ 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o

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. (Check one):

Large accelerated filer ¨ Accelerated filer ¨

Non-accelerated filer ¨ Smaller reporting company þ

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES ¨ NO þ

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of May 13, 2013:

Class	Outstanding
Common stock, $0.01 par value per share	12,175,584

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PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements.

DGSE COMPANIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	March 31, 2013 (Unaudited)	December 31, 2012
ASSETS		
Current Assets:		
Cash and cash equivalents	$3,563,500	$4,911,087
Trade receivables, net of allowances	756,298	718,501
Inventories	13,266,637	11,932,729
Prepaid expenses	300,975	321,709
Total current assets	17,887,410	17,884,026
Property and equipment, net	4,898,022	4,849,937
Intangible assets, net	3,112,958	3,169,840
Other assets	223,805	211,069
Total assets	$26,122,195	$26,114,872
LIABILITIES		
Current Liabilities:		
Current maturities of long-term debt	$122,750	$146,949
Current maturities of capital leases	21,663	28,285
Accounts payable-trade	3,939,635	3,561,794
Accrued expenses	867,809	1,250,319
Customer deposits and other liabilities	2,389,864	2,617,592
Total current liabilities	7,341,721	7,604,939
Line of credit, related party	3,583,358	3,583,358
Long-term debt, less current maturities	1,813,191	1,843,062
Total liabilities	12,738,270	13,031,359
Commitments and contingencies		
STOCKHOLDERS' EQUITY		

Common stock, $0.01 par value; 30,000,000 shares authorized; 12,175,584 shares issued and outstanding	121,755	121,755
Additional paid-in capital	34,045,654	34,045,654
Accumulated deficit	(20,783,484)	(21,083,896)
Total stockholders' equity	13,383,925	13,083,513
Total liabilities and stockholders' equity	$26,122,195	$26,114,872

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

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DGSE COMPANIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	For the Three Months Ended March 31, 2013	2012
Revenue:		
Sales	$30,541,146	$32,814,664
Cost of goods sold	24,927,194	26,087,151
Gross margin	5,613,952	6,727,513
Expenses:		
Selling, general and administrative expenses	5,023,499	5,582,691
Depreciation and amortization	192,884	152,427
	5,216,383	5,735,118
Operating income	397,569	992,395
Other expense (income) :		
Other income, net	(12,147)	(22,341)
Interest expense	51,704	90,714
	39,557	68,373
Income from continuing operations before income taxes	358,012	924,022
Income tax expense	57,600	26,603
Income from continuing operations	300,412	897,419
Discontinued operations:		
Loss from discontinued operations, net of taxes of $0	-	(400,168)
Net income	$300,412	$497,251
Basic net income per common share:		
Income from continuing operations	$0.02	$0.07
Loss from discontinued operations	-	(0.03)
Net income per share	$0.02	$0.04
Diluted net income per common share:		
Income from continuing operations	$0.02	$0.07

Loss from discontinued operations	-	(0.03)
Net income per share	$0.02	$0.04
Weighted-average number of common shares		
Basic	12,175,584	12,174,689
Diluted	12,313,048	12,544,143

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

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DGSE COMPANIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	For the Three Months Ended March 31, 2013	2012
Cash Flows From Operating Activities:		
Net income	$300,412	$497,251
Loss from discontinued operations	-	400,168
Income from continuing operations	300,412	897,419
Adjustments to reconcile income from continuing operations to net cash used in operating activities of continuing operations:		
Depreciation and amortization	192,884	152,427
Gain on marketable securities	-	(18,112)
Stock based compensation	-	8,942
Stock issued as compensation for consulting services	-	76,365
Changes in operating assets and liabilities:		
Trade receivables, net	(37,797)	1,002,636
Inventories	(1,333,907)	(740,883)
Prepaid expenses	20,734	(26,279)
Other assets	(19,755)	(219)
Accounts payable and accrued expenses	(4,670)	(2,685,292)
Customer deposits and other liabilities	(227,728)	(834,869)
Net cash used in operating activities of continuing operations	(1,109,827)	(2,167,865)
Cash Flows From Investing Activities:		
Payments for property and equipment	(177,069)	(209,970)
Purchase of available-for-sale investments	-	(95,000)
Net cash used in investing activities of continuing operations	(177,069)	(304,970)
Cash Flows From Financing Activities:		
Repayment of debt	(54,069)	(109,334)
Payments on capital lease obligations	(6,622)	(5,575)
Net cash used in financing activities of continuing operations	(60,691)	(114,909)
Cash Flows From Discontinued Operations:		
Net cash used in operating activities of discontinued operations	-	(96,390)
Net change in cash	(1,347,587)	(2,684,134)

Cash, beginning of period	4,911,087	5,976,928
Cash, end of period	$3,563,500	$3,292,794
Supplemental Disclosures:		
Cash paid during the period for:		
Interest	$40,390	$91,645
Income taxes	-	-

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) Basis of Presentation

The consolidated interim financial statements of DGSE Companies, Inc. included herein have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) have been condensed or omitted pursuant to the Commission’s rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading. The Company suggests that these financial statements be read in conjunction with the financial statements and notes included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2012 (such fiscal year, “Fiscal 2012” and such annual Report on Form 10-K, the “Fiscal 2012 10-K”). In the opinion of the management of the Company, the accompanying unaudited interim financial statements contain all adjustments, consisting only of those of a normal recurring nature, necessary to present fairly its results of operations and cash flows for the periods presented. The results of operations for the periods presented are not necessarily indicative of the results to be expected for the full year. Certain reclassifications were made to the prior year's consolidated financial statements to conform to the current year presentation.

(2) Principles of Consolidation and Nature of Operations

DGSE Companies, Inc., a Nevada corporation, and its subsidiaries (the “Company” or “DGSE”), buy and sell jewelry and bullion products to both retail and wholesale customers throughout the United States through its facilities in Alabama, Florida, Georgia, Illinois, South Carolina, North Carolina, Tennessee, and Texas, and through its various internet sites.

The interim consolidated financial statements have been prepared in accordance with U.S. GAAP and include the accounts of the Company and its subsidiaries. All material intercompany transactions and balances have been eliminated.

(3) Critical Accounting Policies and Estimates

Income Taxes

The Company accounts for its position in tax uncertainties in accordance with Accounting Standards Codification (“ASC”) 740, *Income Taxes*. The guidance establishes standards for accounting for uncertainty in income taxes. The guidance provides several clarifications related to uncertain tax positions. Most notably, a "more likely-than-not" standard for initial recognition of tax positions, a presumption of audit detection and a measurement of recognized tax benefits based on the largest amount that has a greater than 50 percent likelihood of realization. The guidance applies a two-step process to determine the amount of tax benefit to be recognized in the financial statements. First, the Company must determine whether any amount of the tax benefit may be recognized. Second, the Company determines how much of the tax benefit should be recognized (this would only apply to tax positions that qualify for recognition). The Company has not taken a tax position that, if challenged, would have a material effect on the financial statements or the effective tax rate during the periods ended March 31, 2013 and 2012, respectively.

Fair Value Measures

The Company follows the Financial Accounting Standards Board issued ASC 820, *Fair Value Measurements and Disclosure*. ASC 820 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair values. These tiers include:

Level 1 —	Quoted prices for *identical* instruments in active markets;
Level 2 —	Quoted prices for *similar* instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose significant inputs are observable; and
Level 3 —	Instruments whose significant inputs are *unobservable.*

The Company utilizes fair value techniques to evaluate the need for potential impairment losses related to goodwill and intangible assets not subject to amortization pursuant to ASC 350, *Intangible—Goodwill and Other* and long-lived assets pursuant to ASC 360, *Property, Plant and Equipment*. The Company calculates estimated fair value using Level 3 inputs, including the present value of future cash flows expected to be generated using weighted average cost of capital, terminal values and updated financial projections. The weighted average cost of capital is estimated using information from comparable companies and management's judgment related to risks associated with the operations of each reporting unit.

Financial Instruments

The carrying amounts reported in the consolidated balance sheets for cash equivalents, accounts receivable, accounts payable and accrued expenses approximate fair value because of the immediate or short-term maturity of these financial instruments. The line of credit, related party does not bear a market rate of interest. Management believes that, based on the Company's situation at the time the line was negotiated, it could not have obtained comparable financing, and as such cannot estimate the fair value of the line of credit, related party. The carrying amounts reported for the Company's long-term debt, and capital lease approximate fair value because substantially all of the underlying instruments have variable interest rates, which adjust frequently, or the interest rates approximate current market rates. None of these instruments are held for trading purposes.

Earnings Per Share

Basic earnings per common share is computed by dividing net earnings available to holders of the Company's common stock by the weighted average number of common shares outstanding for the reporting period. Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. For the calculation of diluted earnings per share, the basic weighted average number of shares is increased by the dilutive effect of stock options and warrants outstanding determined using the treasury stock method.

(4) Inventories

A summary of inventories is as follows:

	March 31, 2013	December 31, 2012
Jewelry	$7,334,451	$6,979,144
Scrap	1,785,862	2,354,338
Bullion	2,876,322	1,558,414
Rare coins	1,270,002	1,040,833
	$13,266,637	$11,932,729

(5) Basic and Diluted Average Shares

A reconciliation of basic and diluted average common shares for the three months ended March 31, 2013 and 2012 is as follows:

	For the Three Months Ended March 31, 2013	2012
Basic weighted average shares	12,175,584	12,174,689
Effect of potential dilutive securities:		
Stock options	137,464	369,454
Diluted weighted average shares	12,313,048	12,544,143

For the three months ended March 31, 2013 and 2012, approximately 5,030,000 and 5,000,000 common stock options, respectively, were not added to the diluted average shares because inclusion of such shares would be antidilutive.

(6) Long-Term Debt

	Outstanding Balance March 31, 2013	December 31, 2012	Current Interest Rate	Maturity
NTR line of credit (1)	$3,583,358	$ 3,583,358	2.0%	August 1, 2014
Mortgage payable	1,929,738	1,957,678	6.7%	August 1, 2016
Settlement payment (2)	-	23,890	8.0%	February 15, 2013
Notes payable	6,203	8,443	Various	Various
Capital leases (3)	21,663	28,285	17.4%	December 2013
Sub-Total	5,540,962	5,601,654		
Less: Capital leases	21,663	28,285		
Less: Current maturities	122,750	146,949		
Long-term debt	5,396,549	5,426,420		
Less: Line of credit (1)	3,583,358	3,583,358		
Long term debt, less current maturities	$1,813,191	$ 1,843,062		

(1) On July 19, 2012, DGSE entered into a loan agreement with NTR Metals, LLC, DGSE's majority stockholder ("NTR"), pursuant to which NTR, agreed to provide the Company a guidance line of revolving credit in an amount up to $7,500,000 (the "Loan Agreement"). The Loan Agreement will terminate–and all amounts outstanding thereunder will be due and payable (such amounts, the "Obligations")–upon the earlier of: (i) August 1, 2014; (ii) the date that is twelve months after the Company receives notice from NTR demanding the repayment of the Obligations; (iii) the date the Obligations are accelerated in accordance with the terms of the Loan Agreement; or (iv) the date on which the commitment terminates under the Loan Agreement. In connection with the Loan Agreement, the Company granted a security interest in the respective personal property of each of its subsidiaries. The loan carries an interest rate of two percent (2%) per annum for all funds borrowed pursuant to the Loan Agreement. Proceeds received by the Company pursuant to the terms of the Loan Agreement were used for repayment of all outstanding financial obligations incurred in connection with that certain Loan Agreement, dated as of December 22, 2005, between the Company and Texas Capital Bank, and additional proceeds are expected to be used as working capital in the ordinary course of business. The Company incurred debt issuance costs associated with the Loan Agreement totaling $56,150. The debt issuance costs are included in other assets in the accompanying consolidated balance sheet and will be amortized to interest expense on a straight-line basis over two years.

(2) On February 26, 2010, Superior Galleries entered into a settlement agreement for a lawsuit filed by its previous landlord, DBKK, LLC for $385,000 to be paid over three years bearing interest at 8%. The lawsuit resulted from a lease transaction entered into by certain officers of Superior Galleries. The final payment under the settlement agreement was made in February of 2013.

(3) On November 23, 2010, DGSE entered into a capital lease for $78,450 with Direct Capital Corporation for a radio-frequency identification ("RFID") inventory management solution. The non-cancelable lease agreement

required an advanced payment of $5,169 and monthly payments of $2,584 for 36 months at an interest rate of 11.5% beginning in January 2011. At the end of the lease in December 2013, the equipment can be purchased for $1.

(7) Stock-based Compensation

The Company accounts for