DGSE COMPANIES INC
Form 10-Q
October 31, 2012

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, DC. 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, 2012

or

o 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 incorporation or organization)	(I.R.S. Employer Identification No.)

11311 Reeder Road

Dallas, Texas 75229

(972) 484-3662

(Address, including zip code, and telephone

number, including area code, of registrant's

principal executive offices)

NONE

(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 o

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). o Yes þ 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. (Check one):

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

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

YES o NO þ

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of October 29, 2012:

Class	Outstanding
Common stock, $.01 par value per share	12,175,584

EXPLANATORY NOTES

Unless the context indicates otherwise, references to "we," "us," "our," "the Company" and "DGSE" refer to the consolidat business operations of DGSE Companies, Inc. (the parent) and all of its direct and indirect subsidiaries.

We previously issued our Annual Report on Form 10-K for the fiscal year ended December 31, 2010 on April 15, 2011. We subsequently issued our Quarterly Reports on Form 10-Q for the fiscal quarters ended March 31, 2011, June 30, 2011 and September 30, 2011 on May 6, 2011, August 11, 2011 and November 14, 2011, respectively. We were obligated to file our Annual Report on Form 10-K for the fiscal year ended December 31, 2011 (such fiscal year, "Fiscal 2011" and such Annual Report on Form 10-K, the "Fiscal 2011 10-K") by March 30, 2012. On March 30, 2012, we filed a Form 12b-25 with the Securities and Exchange Commission (the "SEC") stating that we were unable to file the Fiscal 2011 10-K by the prescribed filing date. On April 16, 2012 we filed a Current Report on Form 8-K disclosing that our Board of Directors had determined the existence of certain accounting irregularities beginning approximately during the second calendar quarter of 2007 and continuing in periods subsequent thereto (the "Accounting Irregularities"), which could affect financial information reported since that time. We also announced that we had engaged forensic accountants to analyze the Accounting Irregularities, and that financial statements and information reported since the inception of the Accounting Irregularities, believed to be the second calendar quarter of 2007, should not be relied upon.

On April 17, 2012, we filed a Current Report on Form 8-K in which we announced that we had received a written notice (the "Notice") from the NYSE MKT LLC (then known as the NYSE Amex, LLC) (the "Exchange") indicating that we were not in compliance with the Exchange's continued listing criteria set forth in Sections 134 and 1101 of the Exchange's Company Guide because we did not timely file our Fiscal 2011 10-K. On May 1, 2012, in connection with the listing qualification notification received from the Exchange, we announced that we had submitted to the Exchange our plan to regain compliance with the listing standards of Sections 134 and 1101 of the Exchange's Company Guide. On May 31, 2012, we received notice from the Exchange advising us that the plan of compliance we had previously submitted to the Exchange had been approved with an extended compliance date of October 31, 2012.

This Quarterly Report on Form 10-Q for the quarter ended March 31, 2012 (this "Form 10-Q") is being filed concurrently with the Fiscal 2011 10-K, in which we (i) are restating our Consolidated Financial Statements for the fiscal year ended December 31, 2010 ("Fiscal 2010") and (ii) are presenting our Consolidated Financial Statements for Fiscal 2011. Due to the lack of audited financial statements for Fiscal 2011, we were previously unable to file our Forms 10-Q for the quarterly periods ended March 30, 2012, and June 30, 2012. In addition to this Form 10-Q for the quarter ended March 31, 2012, we are concurrently filing our (i) the Fiscal 2011 10-K and (ii) the Quarterly Report on Form 10-Q for the quarter ended June 30, 2012.

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PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements.

DGSE COMPANIES, INC AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	March 31, 2012 (Unaudited)	December 31, 2011
ASSETS		
Current Assets:		
Cash and cash equivalents	$3,354,378	$5,976,928
Trade receivables	576,256	1,578,892
Inventories	11,458,174	10,717,291
Prepaid expenses	111,250	84,971
Current assets related to continuing operations	15,500,058	18,358,082
Assets related to discontinued operations	1,030,368	1,311,929
Total current assets	16,530,426	19,670,011
Marketable securities-available for sale	113,112	-
Property and equipment, net	4,611,976	4,420,704
Intangible assets, net	3,340,485	3,397,367
Other assets	145,310	160,491
Total assets	$24,741,309	$27,648,573
LIABILITIES		
Current Liabilities:		
Line of credit	$2,999,887	$2,999,887
Current maturities of long-term debt	444,171	451,674
Current maturities of capital leases	25,349	21,184
Accounts payable-trade	996,361	1,497,492
Accrued expenses	833,236	3,017,394
Customer deposits and other liabilities	1,001,879	1,836,748
Current liabilities related to continuing operations	6,300,883	9,824,379
Liabilities related to discontinued operations	175,810	54,454

Total current liabilities	6,476,693	9,878,833
Long-term debt, less current maturities	2,369,395	2,447,336
Capital leases, less current maturities	21,174	30,914
Total liabilities	8,867,262	12,357,083
Commitments and contingencies		
STOCKHOLDERS' EQUITY		
Common stock	121,755	121,639
Additional paid-in capital	34,027,769	33,942,579
Accumulated deficit	(18,275,477)	(18,772,728)
Total stockholders' equity	15,874,047	15,291,490
Total liabilities and stockholders' equity	$24,741,309	$27,648,573

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)

	Three Months Ended March 31,	
	2012	2011 (As Restated)
Revenue:		
Sales	$32,814,664	$22,970,462
Costs and expenses:		
Cost of goods sold	26,087,151	20,423,414
Selling, general and administrative expenses	5,609,294	2,042,757
Depreciation and amortization	152,427	87,691
	31,848,872	22,553,862
Operating income	965,792	416,600
Other expense (income):		
Other expense (income), net	(83,925)	(2,245)
Interest expense	90,714	98,606
	6,789	96,361
Income from continuing operations before income taxes	959,003	320,239
Income tax expense	-	-
Income from continuing operations	959,003	320,239
Discontinued operations:		
Loss from discontinued operations, net of taxes of $0	(461,752)	(124,933)
Net income	$497,251	$195,306
Basic net income per common share:		
Income from continuing operations	$0.08	$0.03
Loss from discontinued operations	(0.04)	(0.01)
Net income per share	$0.04	$0.02
Diluted net income per common share:		
Income from continuing operations	$0.08	$0.03
Loss from discontinued operations	(0.04)	(0.01)
Net income per share	$0.04	$0.02

Weighted-average number of common shares		
Basic	12,174,689	10,379,119
Diluted	12,544,143	11,222,041

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)

	Three Months Ended March 31, 2012	2011 As Restated
Cash Flows From Operating Activities:		
Net income	$497,251	$195,306
Loss from discontinued operations	461,752	124,933
Income from continuing operations	959,003	320,239
Adjustments to reconcile net income to net cash (used in) provided by operating activities of continuing operations:		
Depreciation and amortization	152,427	87,691
Gain on marketable securities	(18,112)	-
Stock based compensation	8,942	8,942
Stock issued as compensation for consulting services	76,365	-
Changes in operating assets and liabilities:		
Trade receivables	1,002,636	417,500
Inventories	(740,883)	588,148
Prepaid expenses	(26,279)	(52,738)
Other assets	(219)	(7,167)
Accounts payable and accrued expenses	(2,685,292)	(808,900)
Customer deposits and other liabilities	(834,869)	1,313,315
Net cash (used in) provided by operating activities of continuing operations	(2,106,281)	1,867,030
Cash Flows From Investing Activities:		
Payments for property and equipment	(209,970)	290,795
Purchase of available-for-sale investments	(95,000)	-
Net cash (used in) provided by used in investing activities of continuing operations	(304,970)	290,795
Cash Flows From Financing Activities:		
Repayment of debt	(109,334)	(190,511)
Payments on capital lease obligations	(5,575)	-
Net cash used in financing activities of continuing operations	(114,909)	(190,511)
Cash Flows From Discontinued Operations:		

Net cash used in operating activities of discontinued operations	(96,390)	(1,265,391)
Net change in cash	(2,622,550)	701,923
Cash, beginning of period	5,976,928	732,449
Cash, end of period	$3,354,378	$1,434,372
Supplemental Disclosures:		
Cash paid during the period for:		
Interest	$91,645	$88,799
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 accompanying unaudited condensed consolidated financial statements of DGSE Companies, Inc. and Subsidiaries (the “Company”) include the financial statements of DGSE Companies, Inc. and its wholly-owned subsidiaries, DGSE Corporation, Charleston Gold and Diamond Exchange, Inc., Superior Gold and Diamond Exchange, Inc., Superior Precious Metals, Inc., American Gold and Diamond Exchange, Inc. and SBT, Inc. (“SBT”).

The 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. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America 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, 2011 (such fiscal year, “Fiscal 2011” and such Annual Report on Form 10-K, the “Fiscal 2011 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) Restatement of previously issued financial statements

The Company previously issued its Annual Report on Form 10-K for the fiscal year ended December 31, 2010 on April 15, 2011. The Company was obligated to file its Fiscal 2011 10-K by March 30, 2012. On March 30, 2012, the Company filed a Form 12b-25 with the Securities and Exchange Commission (the “SEC”) stating that the Company was unable to file the Fiscal 2011 10-K by the prescribed filing date. On April 16, 2012, the Company filed a Current Report on Form 8-K disclosing that its Board of Directors had determined the existence of certain accounting irregularities beginning approximately during the second calendar quarter of 2007 and continuing in periods subsequent thereto (the “Accounting Irregularities”), which could affect financial information reported since that time. The Company also announced that it had engaged forensic accountants to analyze the Accounting Irregularities, and that financial statements and information reported since the inception of the Accounting Irregularities, believed to be the second calendar quarter of 2007, should not be relied upon.

As part of the forensic accounting review and the restatement process resulting from the Accounting Irregularities, the Company restated its Fiscal 2010 consolidated financial statements, and made adjustments to its previously unaudited

Fiscal 2011 consolidated financial statements, which are presented in the Fiscal 2011 10-K being filed concurrently with this Form 10-Q. Also as a result of the restatement, numerous changes were made to the Company's previously filed unaudited quarterly financial statements for Fiscal 2011 as follows:

The Company decreased inventory and increased cost of goods sold by $485,432. Adjustments were also made to correct various other expenses including rent, salaries, property taxes, consulting fees, advertising expense, miscellaneous expense, depreciation, amortization and interest. The result of these adjustments was an overall decrease in selling, general and administrative expense of $247,098, an increase in depreciation and amortization of $19,910, an increase in interest expense of $9,827, and a decrease in income tax expense of $160,766, compared to previous reported quarterly results. These changes resulted in a net decrease of $107,305 in net income, compared to previously reported amounts.

Additionally, for the quarter ended March 31, 2011 unaudited consolidated financial statements included in this Form 10-Q, the Company has reclassified the operations of its Superior Galleries subsidiary as discontinued operations (see Note 12). This reclassification includes $1,787,781 of revenue and $124,933 of net loss, as well as the assets and liabilities of the Company's Superior Galleries subsidiary.

(3) Critical Accounting Policies and Estimates

Income Taxes

The Company accounts for its position in tax uncertainties in accordance with 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, 2012 and 2011, 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.*

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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. Marketable securities are classified as Level 1 investments.

Earnings Per Share

Basic earnings per common share is computed by dividing net earnings available to common stockholders 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, 2012	December 31, 2011
Jewelry	$ 4,816,349	$ 4,357,724
Rare coins and collectibles	1,841,402	2,656,959
Bullion	1,879,781	1,521,550
Scrap	2,920,642	2,181,058
Total	$ 11,458,174	$ 10,717,291

The inventory amounts in the chart above exclude discontinued operations.

(5) Earnings per share.

A reconciliation of the earnings and number of shares of the basic earnings per common share and diluted earnings per common share for the three months ended March 31, 2012 and 2011 is as follows:

	2012 Three months ended March 31, Net Earnings	Shares	Per share	2011 Three months ended March 31, Net Earnings	Shares	Per share
Basic earnings per common share	$497,251	12,174,689	$ 0.04	$195,306	10,379,119	$ 0.02
Effect of dilutive stock options	-	369,454	-	-	842,922	-
Diluted earnings per common share	$497,251	12,544,143	$ 0.04	$195,306	11,222,041	$ 0.02

For the three months ended March 31, 2012 and 2011, options to purchase 5,000,000 and 18,000 shares of the common stock of the Company, respectively, were not added to the denominator because inclusion of such shares would be antidilutive.

As of March 31, 2012 and March 31, 2011, options to purchase 5,547,500 and 1,493,134 shares of the common stock of the Company, respectively, were outstanding.

(6) Long-Term Debt

Outstanding Balance