

DGSE COMPANIES INC  
Form 10-Q  
May 07, 2007

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

\_\_\_\_\_  
**FORM 10-Q**  
\_\_\_\_\_

(Mark One)

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

For the Quarterly Period ended March 31, 2007

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**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**88-0097334**  
(IRS Employer  
Identification No.)

**2817 Forest Lane  
Dallas, Texas 75234  
(972) 848-3662**

(Address, Including Zip Code, and Telephone Number,  
Including Area Code, of Registrant's Principal Executive Offices)

**None**

(Former name, former address and former

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fiscal year, if changed since last report)

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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  No

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

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of May 4, 2007:

| <b>Class</b>                            | <b>Outstanding</b> |
|---|--------------------|
| Common stock, \$.01 par value per share | 4,913,290          |

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## DGSE COMPANIES, INC. AND SUBSIDIARIES

## PART I. FINANCIAL INFORMATION

## Item 1. Consolidated Financial Statements.

## CONSOLIDATED BALANCE SHEETS

|   | March 31,<br>2007<br>unaudited | December 31,<br>2006 |
|---|--------------------------------|----------------------|
| <b>ASSETS</b>   |                                |                      |
| Current Assets:   |                                |                      |
| Cash and cash equivalents   | \$ 123,499                     | \$ 1,210,282         |
| Trade receivables   | 983,817                        | 1,053,454            |
| Inventories   | 8,113,746                      | 7,796,028            |
| Prepaid expenses  | 236,385                        | 192,379              |
| Prepaid federal income tax  | 40,192                         | 97,472               |
| Total current assets  | 9,497,639                      | 10,349,615           |
| Marketable securities available for sale  | 57,879                         | 57,879               |
| Property and equipment, net   | 1,048,221                      | 1,024,405            |
| Deferred income taxes   | 18,031                         | 7,152                |
| Goodwill  | 837,117                        | 837,117              |
| Other assets  | 976,719                        | 869,398              |
|   | \$ 12,435,606                  | \$ 13,145,566        |
| <b>LIABILITIES</b>  |                                |                      |
| Current Liabilities:  |                                |                      |
| Notes payable   | \$ 183,708                     | \$ 183,708           |
| Current maturities of long-term debt  | 4,104,326                      | 259,273              |
| Accounts payable trade  | 390,965                        | 828,323              |
| Accrued expenses  | 235,680                        | 721,305              |
| Customer deposits   | 270,544                        | 171,912              |
| Total current liabilities   | 5,185,223                      | 2,164,521            |
| Long-term debt, less current maturities   | 390,608                        | 4,303,685            |
|   | 5,575,831                      | 6,468,206            |
| <b>Stockholders Equity</b>  |                                |                      |
| Common stock, \$.01 par value; 10,000,000 shares authorized;<br>4,913,290 shares issued and outstanding at the end of each period in<br>2007 and 2006 | 49,133                         | 49,133               |
| Additional paid-in capital  | 5,708,760                      | 5,708,760            |
| Accumulated other comprehensive loss  | (132,245 )                     | (132,245 )           |

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|                   |               |               |
|-------------------|---------------|---------------|
| Retained earnings | 1,234,127     | 1,051,712     |
|                   | 6,859,775     | 6,677,360     |
|                   | \$ 12,435,606 | \$ 13,145,566 |

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

## DGSE COMPANIES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS

|  | <b>Three Months<br/>Ended March 31,</b> |              |
|--|---|--------------|
|  | <b>2007</b>                             | <b>2006</b>  |
|  | unaudited                               |              |
| Revenue                                      |   |              |
| Sales  | \$ 9,976,378                            | \$ 9,628,653 |
| Consumer loan service charges                | 113,425                                 | 92,344       |
| Management fees                              | 150,000                                 |              |
|  | 10,239,803                              | 9,720,997    |
| Costs and expenses                           |   |              |
| Cost of goods sold                           | 8,405,391                               | 8,168,080    |
| Selling, general and administrative expenses | 1,401,005                               | 1,212,041    |
| Depreciation and amortization                | 49,780                                  | 39,300       |
|  | 9,856,176                               | 9,419,421    |
| Operating income                             | 383,627                                 | 301,576      |
| Other expense                                |   |              |
| Interest expense                             | 107,240                                 | 76,606       |
| Earnings before income taxes                 | 276,387                                 | 224,970      |
| Income tax expense                           | 93,972                                  | 76,490       |
| Net earnings                                 | \$ 182,415                              | \$ 148,480   |
| Earnings per common share basic and diluted  | \$ 0.04                                 | \$ 0.03      |
| Weighted average number of common shares:    |   |              |
| Basic  | 4,913,290                               | 4,913,290    |
| Diluted                                      | 5,020,436                               | 4,913,290    |

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

## DGSE COMPANIES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

|  | <b>Three Months<br/>Ended March 31,</b> |                   |
|--|---|-------------------|
|  | <b>2007</b>                             | <b>2006</b>       |
|  | unaudited                               |                   |
| <b>Cash flows from operating activities</b>  |   |                   |
| Net earnings   | \$ 182,415                              | \$ 148,480        |
| Adjustments to reconcile net earnings to net cash provided by operating activities |   |                   |
| Depreciation and amortization  | 49,780                                  | 39,300            |
| (Increase) decrease in operating assets and liabilities                            |   |                   |
| Trade receivables  | 97,256                                  | (113,091 )        |
| Inventories  | (317,718 )                              | (241,046 )        |
| Prepaid expenses and other current assets  | (44,006 )                               | (33,469 )         |
| Accounts payable and accrued expenses  | (939,845 )                              | (636,787 )        |
| Customer deposits  | 98,632                                  | 76,942            |
| Federal income taxes payable   | 57,280                                  | 76,490            |
| Other assets   | (22,357 )                               | (9,002 )          |
| Net cash used in operating activities  | (838,563 )                              | (692,183 )        |
| <b>Cash flows from investing activities</b>  |   |                   |
| Pawn loans made  | (77,851 )                               | (124,500 )        |
| Pawn loans repaid  | 46,988                                  | 108,699           |
| Recovery of pawn loan principal through sale of forfeited collateral               | 20,396                                  | 21,515            |
| Pay day loans made   | (73,866 )                               | (58,583 )         |
| Pay day loans repaid   | 63,123                                  | 40,279            |
| Purchase of property and equipment   | (74,022 )                               | (2,361 )          |
| Merger costs paid  | (84,964 )                               |                   |
| Net cash used in investing activities  | (180,196 )                              | (14,951 )         |
| <b>Cash flows from financing activities</b>  |   |                   |
| Proceeds from notes issued   |   | 350,000           |
| Repayments of notes payable  | (68,024 )                               | (422,678 )        |
| Net cash used in financing activities  | (68,024 )                               | (72,678 )         |
| <b>Net Decrease in Cash and Cash Equivalents</b>                                   | <b>(1,086,783 )</b>                     | <b>(779,812 )</b> |
| Cash and cash equivalents at beginning of period                                   | 1,210,282                               | 1,042,834         |
| Cash and cash equivalents at end of period   | \$ 123,499                              | \$ 263,022        |

**Supplemental disclosures:**

Interest paid for the three months ended March 31, 2007 and 2006 was \$99,019 and \$79,940, respectively.

Income taxes paid for the three months ended March 31, 2007 and 2006 was \$50,000 and \$0, respectively.

Pawn loans forfeited and transferred to inventory amounted to \$20,396 and \$66,818, respectively, for the three months ended March 31, 2007 and 2006.

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



## DGSE COMPANIES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**1 Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements of DGSE Companies, Inc. and Subsidiaries include the financial statements of DGSE Companies, Inc. and its wholly-owned subsidiaries, DGSE Corporation, National Jewelry Exchange, Inc., Charleston Gold and Diamond Exchange, Inc. and American Pay Day Centers, Inc. In the opinion of management, all adjustments consisting of normal recurring accruals considered necessary for a fair presentation have been included.

The interim financial statements of DGSE Companies, Inc. included herein have been prepared by us 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 we believe that the disclosures are adequate to make the information presented not misleading. We suggest that these financial statements be read in conjunction with the financial statements and notes included in our Annual Report on Form 10-K for the year ended December 31, 2006. In our opinion, 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 Trade Receivables**

Pawn loans receivable in the amount of \$112,260 and \$105,787 as of March 31, 2007 and 2006, respectively, are included in the Consolidated Balance Sheets caption trade receivables as of these respective dates. The related pawn service charges receivable in the amount of \$37,371 and \$31,075 as of March 31, 2007 and 2006, respectively, are also included in the Consolidated Balance Sheets caption trade receivables as of these respective dates. Pay day loans receivable in the amount of \$80,979 as of March 31, 2007 and \$53,026 as of March 31, 2006, respectively, are also included in the Consolidated Balance Sheets caption trade receivables as of these respective dates.

**3 Earnings per Share**

A reconciliation of the income and shares of the basic earnings per common share and diluted earnings per common share for the periods ended March 31, 2007 and 2006 is as follows:

|                                   | 2007                         |           |         | 2006                         |           |         |
|-----------------------------------|------------------------------|-----------|---------|------------------------------|-----------|---------|
|                                   | Three Months Ended March 31, |           | Per     | Three Months Ended March 31, |           | Per     |
|                                   | Net                          | Shares    | share   | Net                          | Shares    | share   |
|                                   | Earnings                     |           |         | Earnings                     |           |         |
| Basic earnings per common share   | \$ 182,415                   | 4,913,290 | \$ 0.04 | 148,480                      | 4,913,290 | \$ 0.03 |
| Effect of dilutive stock options  |                              | 107,146   |         |                              |           |         |
| Diluted earnings per common share | \$ 182,415                   | 5,020,436 | \$ 0.04 | 148,480                      | 4,913,290 | \$ 0.03 |



## DGSE COMPANIES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**4 Business Segment Information**

Management identifies reportable segments by product or service offered. Each segment is managed separately. Corporate and other includes certain general and administrative expenses not allocated to segments and pawn operations. Our operations by segment for the three months ended March 31 were as follows:

|                                  | <b>Retail<br/>Jewelry</b> | <b>Wholesale<br/>Jewelry</b> | <b>Bullion</b> | <b>Rare<br/>Coins</b> | <b>Corporate<br/>and<br/>Other</b> | <b>Consolidated</b> |
|----------------------------------|---------------------------|------------------------------|----------------|-----------------------|------------------------------------|---------------------|
|                                  | (in thousands)            |                              |                |                       |                                    |                     |
| Revenues                         |                           |                              |                |                       |                                    |                     |
| 2007                             | \$ 3,951                  | \$ 1,336                     | \$ 3,343       | \$ 1,286              | \$ 324                             | \$ 10,240           |
| 2006                             | 3,228                     | 1,121                        | 3,880          | 1,334                 | 158                                | 9,721               |
| Net income (loss)                |                           |                              |                |                       |                                    |                     |
| 2007                             | 62                        | 43                           | 53             | 9                     | 15                                 | 182                 |
| 2006                             | 40                        | 24                           | 62             | 68                    | (46 )                              | 148                 |
| Identifiable assets              |                           |                              |                |                       |                                    |                     |
| 2007                             | 9,094                     | 1,907                        | 259            | 237                   | 938                                | 12,435              |
| 2006                             | 8,408                     | 1,894                        | 325            | 145                   | 658                                | 11,430              |
| Capital Expenditures             |                           |                              |                |                       |                                    |                     |
| 2007                             | 71                        |                              |                |                       | 3                                  | 74                  |
| 2006                             | 3                         |                              |                |                       | (1 )                               | 2                   |
| Depreciation and<br>amortization |                           |                              |                |                       |                                    |                     |
| 2007                             | 24                        |                              |                |                       | 26                                 | 50                  |
| 2006                             | 24                        |                              |                |                       | 15                                 | 39                  |

**5 Stock-based Compensation**

Effective January 1, 2006, we adopted the fair value recognition provisions of SFAS No. 123(R) for all share based payment awards to employees and directors including employee stock options granted under our employee stock option plan. As all options outstanding have vested prior to December 31, 2005, no stock based compensation expense has been recorded as of March 31, 2007.

**6 New Accounting Pronouncements**

In September 2006, the FASB issued SFAS No. 157, Fair Value Measures ( SFAS No. 157 ). SFAS No. 157 defines fair value, establishes a framework for measuring fair value and enhances disclosures about fair value measures required under other accounting pronouncements, but does not change existing guidance as to whether or not an

instrument is carried at fair value. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. We are currently evaluating the impact of adopting SFAS 157 on our financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS No. 159). SFAS No. 159 permits entities to choose to measure many financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. We are currently evaluating the impact of SFAS No. 159 on our consolidated financial position and results of operations.

In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, and disclosure. We adopted FIN 48 as of January 1, 2007. The adoption of FIN 48 had no impact on our financial statements for the quarter ended March 31, 2007.

**DGSE COMPANIES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**7 Recent Developments**

On January 6, 2007, we entered into an Amended and Restated Agreement and Plan of Merger and Reorganization, which we refer to as the merger agreement, with Superior Galleries, Inc., a Delaware corporation, DGSE Merger Corp., a wholly-owned subsidiary of our company which we refer to as our merger subsidiary, and Stanford International Bank Ltd., which we refer to as SIBL and which is Superior's largest stockholder and principal lender, as stockholder agent. The merger agreement materially amends the original Agreement and Plan of Merger and Reorganization the parties entered into on July 12, 2006. Pursuant to the terms and subject to the conditions of the merger agreement, we will acquire Superior through the merger of Superior with our merger subsidiary. At the effective time of the merger, we will issue approximately 3.6 million shares of DGSE common stock to the holders of Superior common stock, using an exchange ratio of 0.2731 shares of DGSE common stock for each outstanding share of Superior common stock, subject to a limited escrow, and Superior will become our wholly-owned subsidiary. We will also assume a number of options (including options granted to Superior employees, officers and directors pursuant to Superior's stock option plans) disclosed by Superior in connection with the merger. Each outstanding share of our common stock will remain unchanged in the merger.

One condition to the closing of the merger is SIBL's conversion of approximately \$8.4 million in Superior debt into approximately 5 million shares of Superior common stock, at a conversion ratio of \$1.70 per share. In consideration of this exchange of debt and an \$11.5 million increase in the SIBL credit facility, which will be available to Superior and in part to our company, at the closing of the merger, we will issue seven-year warrants to SIBL and its designees entitling the holders thereof to purchase 845,634 shares of our common stock at an exercise price of \$1.89 per share, and 863,000 shares of our common stock at an exercise price of their par value of \$0.01 per share.

We and Superior have made customary representations, warranties and covenants in the merger agreement, including, among others, covenants (i) not to (A) solicit proposals relating to alternative business combination transactions or (B) subject to certain exceptions, enter into discussions concerning or provide information in connection with alternative business combination transactions, (ii) to cause stockholder meetings to be held to consider approval of the merger agreement, and (iii) subject to certain exceptions, for our and Superior's board of directors to recommend adoption of the merger agreement to their respective stockholders.

Consummation of the merger is subject to numerous closing conditions, including stockholder approval of the merger agreement by our and Superior's stockholders; approval by our stockholders of an increase in the number of authorized shares of our common stock; absence of governmental restraints; effectiveness of our registration statement on Form S-4, File No. 333-140890, which we filed with the SEC on April 20, 2007, registering the shares of our common stock to be issued to Superior stockholders; the exchange by SIBL of approximately \$8.4 million in debt for shares of Superior common stock; the effectiveness of a corporate governance agreement relating to the nomination of our directors after the merger; and the provision by SIBL or one of its affiliates of a new secured credit facility of \$11.5 million to Superior. The merger agreement allows us or Superior to terminate the merger agreement upon the occurrence (or non-occurrence) of certain events.

In connection with the closing, SIBL and Dr. Smith, our chairman and chief executive officer, are expected to enter into a corporate governance agreement with us. Pursuant to this agreement, for so long as SIBL and its affiliates beneficially own at least 15% of our outstanding common shares, SIBL will have the right to nominate two independent directors to our board; for so long as Dr. Smith and his affiliates and immediate family beneficially own at least 10% of our outstanding common shares, Dr. Smith will have the right to nominate two independent directors to our board; for so long as Dr. Smith is our executive officer, he will have the right to be nominated to our board; and for so long as William H. Oyster is our executive officer, he will have the right to be nominated to our board. The

DGSE board will consist of seven members.

Upon consummation of the merger, SIBL will own approximately 29 percent of the outstanding shares of DGSE (and will beneficially own approximately 28 percent on a fully diluted basis); all pre-merger Superior stockholders will own approximately 43 percent of the outstanding shares of DGSE (and will beneficially own approximately 39 percent on a fully diluted basis); and Dr. L.S. Smith, our chairman and chief executive officer, will own approximately 26 percent of the outstanding shares of DGSE (and will beneficially own approximately 26 percent on a fully-diluted basis).

**DGSE COMPANIES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**7 Recent Developments (continued)**

In connection with the parties entering into the merger agreement, our merger subsidiary entered into a management agreement with Superior. Pursuant to this agreement, our merger subsidiary has been providing the senior management to Superior since January 6, 2007, and will continue to provide these services until the consummation of the merger or the earlier termination of the merger agreement. In particular, Mr. Oyster has been appointed a director interim chief executive officer of Superior, Mr. Williamson has been appointed a director and interim chief operating officer of Superior, and Mr. Benson has been appointed a director and vice president, finance and interim chief financial officer of Superior. All three officers manage Superior on a part-time basis pursuant to the management agreement, while continuing to provide services to us as part of our senior management. Superior is paying us a monthly fee of \$50,000, plus our expenses, for these services.

In connection with the merger agreement, Dr. L.S. Smith, our chairman and chief executive officer and our largest stockholder, entered into a support agreement with us and Superior, pursuant to which Dr. Smith agreed to vote all of his shares of our common stock in favor of the merger and related transactions, and against any proposal or action that could reasonably be expected to delay, impede or interfere with the approval of the merger or any related transaction. Dr. Smith has the power to vote approximately 52% of our outstanding shares, which represents sufficient shares to approve the acquisition and related stockholder matters. SIBL and Superior have entered into a corresponding support agreement with us, pursuant to which SIBL and some individual stockholders of Superior have agreed to vote all of their shares of Superior common stock in favor of the merger and related transactions, and against any proposal or action that could reasonably be expected to delay, impede or interfere with the approval of the merger or any related transaction. These stockholders own approximately 76% of Superior's outstanding shares, which represents sufficient shares to approve the merger and related stockholder matters.

We expect the acquisition to close in the second quarter of our fiscal year 2007, subject to the satisfaction or waiver of the various closing conditions in the merger agreement.

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

### Forward-Looking Statements

The statements, other than statements of historical facts, included in this report are forward-looking statements. Forward-looking statements generally can be identified by the use of forward-looking terminology such as "may," "will," "would," "expect," "intend," "could," "estimate," "should," "anticipate" or "believe." We believe that the expectations reflected in such forward-looking statements are accurate. However, we cannot assure you that these expectations will occur. Our actual future performance could differ materially from such statements. Factors that could cause or contribute to these differences include, but are not limited to:

- uncertainties regarding price fluctuations in the price of gold and other precious metals;
- our ability to manage inventory fluctuations and sales;
- changes in governmental rules and regulations applicable to the specialty financial services industry;
- the results of any unfavorable litigation;
- interest rates;
- economic pressures affecting the disposable income available to our customers;
- our ability to maintain an effective system of internal controls;
- the other risks detailed from time to time in our SEC reports.

Additional important factors that could cause our actual results to differ materially from our expectations are discussed under "Risk Factors" in our Annual Report on Form 10-K for our fiscal year ended December 31, 2006. You should not unduly rely on these forward-looking statements, which speak only as of the date of this report. Except as required by law, we are not obligated to publicly release any revisions to these forward-looking statements to reflect events or circumstances occurring after the date of this report or to reflect the occurrence of unanticipated events.

### Our Business



We sell jewelry, bullion products and rare coins to both retail and wholesale customers throughout the United States and makes collateralized loans to individuals. Our products are marketed through our facilities in Dallas, Texas and Mt. Pleasant, South Carolina and through our internet web sites.

We operate three internet sites on the World Wide Web. Through dgse.com we operate a virtual store and a real-time auction of our jewelry products. We and our customers buy and sell items of jewelry and are free to set their own prices in an interactive market. We also offer customers the key unlimited trading power to buy and sell precious metal assets. Customers have access to our competitive two-way markets in all of the most popularly traded precious metal products as well as current quotations for precious metals prices on our internet site USBullionExchange.com. FairchildWatches.com provides wholesale customers a virtual catalog of our fine watch inventory. Over 7,500 items are available for sale on our internet sites including \$2,000,000 in diamonds.

Our wholly-owned subsidiary, National Pawn, formerly Jewelry Exchange, Inc., operates a pawn shop in Dallas, Texas. We have focused the operations of the pawn location on sales and pawn loans of jewelry products.

In January 2005 we began offering unsecured payday loans through our wholly owned subsidiary American Pay Day Centers, Inc. which operates three locations in New Mexico.

### **Recent Developments**

On January 6, 2007, we entered into an Amended and Restated Agreement and Plan of Merger and Reorganization, which we refer to as the merger agreement, with Superior Galleries, Inc., a Delaware corporation which we refer to as Superior, DGSE Merger Corp., a wholly-owned subsidiary of our company which we refer to as our merger subsidiary, and Stanford International Bank Ltd., the largest Superior stockholder which we refer to as SIBL, as stockholder agent. Subject to terms and conditions of the merger agreement, our company will issue approximately 3.6 million shares of our common stock to the Superior stockholders and Superior will become a

wholly-owned subsidiary of DGSE. In addition, our company will assume a number of options (including options granted to Superior employees, officers and directors pursuant to Superior's stock option plans) disclosed by Superior in connection with the merger. The consummation of the acquisition is subject to a number of conditions.

Superior's principal line of business is the sale of rare coins on a retail, wholesale, and auction basis. Superior's retail and wholesale operations are conducted in virtually every state in the United States. Superior also provides auction services for customers seeking to sell their own coins. Superior markets its services nationwide through broadcasting and print media and independent sales agents, as well as on the Internet through third party websites such as eBay, Overstock.com and Amazon.com and through its own website at SGBH.com. Superior's principal offices are located in Beverly Hills, California.

In connection with the parties entering into the merger agreement, our merger subsidiary entered into a management agreement with Superior. Pursuant to this agreement, our merger subsidiary has been providing senior management to Superior on a part-time basis since January 6, 2007, and will continue to provide these services until the consummation of the merger or the earlier termination of the merger agreement. Pursuant to the management agreement, William H. Oyster, our chief operating officer, has been appointed interim chief executive officer of Superior; Scott Williamson, our executive vice president, has been appointed interim chief operating officer of Superior; and John Benson, our chief financial officer, has been appointed vice president, finance and interim chief financial officer of Superior. All three officers manage Superior part-time pursuant to the management agreement, while continuing to provide us services as part of our senior management. Superior is paying us a monthly fee of \$50,000, plus our expenses, for these services. All three individuals also currently serve on the Superior board of directors.

We expect the acquisition of Superior to close in the second quarter of our 2007 fiscal year. For additional information about the planned acquisition, please see our current report on Form 8-K filed with the SEC on January 9, 2007 and our related registration statement on Form S-4/A, File No. 333-140890, filed with the SEC on April 20, 2007.

### **Significant Accounting Policies**

*Inventory.* Jewelry and other inventory is valued at lower-of-cost-or-market (specific identification). Bullion inventory is valued at lower-of-cost-or-market (average cost).

*Accounts Receivable.* We record trade receivables when revenue is recognized. No product has been consigned to customers. Our allowance for doubtful accounts is primarily determined by review of specific trade receivables. Those accounts that are doubtful of collection are included in the allowance. These provisions are reviewed to determine the adequacy of the allowance for doubtful accounts. Trade receivables are charged off when there is certainty as to their being uncollectible. Trade receivables are considered delinquent when payment has not been made within contract terms.

*Revenue Recognition.* Sales revenue consists of direct sales to customers for jewelry, rare coins and bullion. Sales are recognized when title and risk of loss have passed to the customer, which is generally at the point-of-sale. Provisions for discounts and rebates to customers and returns, bad debts, and other adjustments are provided in the period the related sales are recorded.

Pawn loans (loans) are made with the collateral of tangible personal property for one month with an automatic 60-day extension period. Pawn service charges are recorded at the time of redemption at the greater of \$15 or the actual interest accrued to date. If the loan is not repaid, the principal amount loaned plus accrued interest (or the fair value of the collateral, if lower) becomes the carrying value of the forfeited collateral (inventories) which is recovered through sales to customers.

### **Results of Operations**

***Three Months Ended March 31, 2007 compared to Three Months Ended March 31, 2006***

Sales increased by \$347,725 or 3.6%, during the three months ended March 31, 2007 as compared to 2006. This increase was primarily the result of a \$723,000, or 22.4%, increase in retail jewelry sales, a \$215,000, or 19.2%, increase in wholesale jewelry sales offset by a \$537,000, or 13.8%, decrease in bullion sales and a \$48,000, or 3.6%, decrease in the sale of rare coin products. The increase in both retail and wholesale jewelry sales were due to higher

gold prices and improved activity from our customers. The decrease in rare coin and bullion sales were the result of less volatile gold prices during the first quarter of 2007 as compared to 2006. Consumer loan service fees increased \$21,081, or 22.8%, in 2007 due to an increase in pay day loans outstanding during the period. Cost of goods as a percentage of sales decreased from 84.8% in 2006 to 84.3 % in 2007. This slight decrease was due to the decrease in rare coin and bullion revenue as a percentage of total sales.

Selling, general and administrative expenses increased by \$188,964, or 15.6%, during the three months ended March 31, 2007 as compared to 2006. This increase was primarily due to an increase in staff and payroll related cost of \$131,340 and higher advertising cost of \$27,942. The increase in staff was necessary to build our intra-structure in preparation for potential acquisitions, including Superior Galleries, Inc. and the opening of our new pawn shop in January 2007. The increase in advertising was necessary in order to attract new customers in our local markets. Depreciation and amortization increased by \$10,480, or 26.7%, during 2007 due to certain assets becoming fully depreciated in 2006 and additional assets being purchased in the first quarter of 2007.

Income taxes are provided at the corporate rate of 34% for both 2007 and 2006.

Historically, changes in the market prices of precious metals have had a significant impact on both revenues and cost of sales in the rare coin and precious metals segments in which we operate. It is expected that due to the commodity nature of these products, future price changes for precious metals will continue to be indicative of our performance in these business segments. Changes in sales and cost of sales in the retail and wholesale jewelry segments are primarily influenced by the national economic environment. It is expected that this trend will continue in the future due to the nature of these product.

### **Liquidity and Capital Resources**

We expect capital expenditures to total approximately \$150,000 during the next twelve months. It is anticipated that these expenditures will be funded from working capital and our credit facility. As of March 31, 2007 there were no commitments outstanding for capital expenditures.

In the event of significant growth in retail and or wholesale jewelry sales, the demand for additional working capital will expand due to a related need to stock additional jewelry inventory and increases in wholesale accounts receivable. Historically, vendors have offered us extended payment terms to finance the need for jewelry inventory growth and our management believes that we will continue to do so in the future. Any significant increase in wholesale accounts receivable will be financed under our bank credit facility.

Our ability to finance our operations and working capital needs are dependent upon management's ability to negotiate extended terms or refinance its debt. We have historically renewed, extended or replaced short-term debt as it matures and management believes that we will be able to continue to do so in the near future.

From time to time, we have adjusted our inventory levels to meet seasonal demand or in order to meet working capital requirements. Management is of the opinion that if additional working capital is required, additional loans can be obtained from individuals or from commercial banks. If necessary, inventory levels may be adjusted or a portion of our investments in marketable securities may be liquidated in order to meet unforeseen working capital requirements.

On January 6, 2007, we entered into an Amended and Restated Agreement and Plan of Merger and Reorganization with Superior Galleries, Inc. For further information please refer to the "Recent Developments" section earlier in this report and our Form 8-K filed on January 6, 2007. As of March 31, 2007, we have incurred \$654,746, in legal and other costs related to this acquisition. Legal and other cost related to the acquisition has been classified as other assets on the balance sheet.

**Payments Due by Period**

| <b>Contractual Cash Obligations</b> | <b>Total</b>        | <b>2007</b>       | <b>2008</b>         | <b>2009</b> | <b>2010</b>       | <b>2011</b> | <b>Thereafter</b> |
|-------------------------------------|---------------------|-------------------|---------------------|-------------|-------------------|-------------|-------------------|
| Notes payable                       | \$ 183,708          | \$ 183,708        | \$                  |             | \$                |             | \$                |
| Long-term debt and capital leases   | 4,494,934           | 212,887           | 4,039,780           |             | 123,800           |             | 118,467           |
| Federal income taxes                | 269,807             | 269,807           |                     |             |                   |             |                   |
| Operating Leases                    | 493,473             | 162,032           | 313,141             |             | 18,300            |             |                   |
| <b>Total</b>                        | <b>\$ 5,441,922</b> | <b>\$ 828,434</b> | <b>\$ 4,352,921</b> |             | <b>\$ 142,100</b> |             | <b>\$ 118,467</b> |

In addition, we estimate that we will pay approximately \$320,000 in interest during the next twelve months.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

The following discussion about our market risk disclosures involves forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements. We are exposed to market risk related to changes in interest rates and gold values. We are also exposed to regulatory risk in relation to its payday loans. We do not use derivative financial instruments.

Our earnings and financial position may be affected by changes in gold values and the resulting impact on pawn lending and jewelry sales. The proceeds of scrap sales and our ability to liquidate excess jewelry inventory at an acceptable margin are dependent upon gold values. The impact on our financial position and results of operations of a hypothetical change in gold values cannot be reasonably estimated.

**Item 4. Controls and Procedures.**

*Evaluation of disclosure controls and procedures.* An evaluation was performed under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this quarterly report. Our disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934, as amended, is (1) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and (2) accumulated and communicated to our management, including our Chief Executive Officer, to allow timely decisions regarding required disclosure. Based on that evaluation, our management, including our Chief Executive Officer and our Chief Financial Officer, concluded that our disclosure controls and procedures were effective.

*Changes in internal controls.* For the quarter ended March 31, 2007, there have been no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II OTHER INFORMATION**

**Item 3. Legal Proceedings**

We are not a party to any material pending legal proceedings which are expected to have a material adverse effect on us and none of our property is the subject of any material pending legal proceedings.

**Item 5. Other Information.**

None.

**Item 6. Exhibits and Reports on Form 8-K.**

***Exhibits:***

- 31.1 Certificate of L.S. Smith pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, Chief Executive Officer.
- 31.2 Certificate of John Benson pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, Chief Financial Officer.
- 32.1 Certificate of L.S. Smith pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, Chief Executive Officer.
- 32.2 Certificate of John Benson pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, Chief Financial Officer.

***Reports on Form 8-K:***

None.

**SIGNATURES**

In accordance with Section 13 and 15(d) of the Exchange Act, the Registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DGSE Companies, Inc.

By: /s/ L. S. Smith Dated: May 7, 2007  
L. S. Smith  
Chairman of the Board,  
Chief Executive Officer and  
Secretary

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the date indicated.

DGSE Companies, Inc.

By: /s/ L. S. Smith Dated: May 7, 2007  
L. S. Smith  
Chairman of the Board,  
Chief Executive Officer and  
Secretary

By: /s/ W. H. Oyster Dated: May 7, 2007  
W. H. Oyster  
Director, President and  
Chief Operating Officer

By: /s/ John Benson Dated: May 7, 2007  
John Benson  
Chief Financial Officer  
(Principal Accounting Officer)