DGSE COMPANIES INC
Form 10-Q
May 15, 2017

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, 2017

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.)*

13022 Preston Road

Dallas, Texas 75240

(972) 587-4049

(Address, including zip code, and telephone

number, including area code, of registrant’s

principal executive offices)

N/A

(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 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 (§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 x No ¨

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company” and “emerging growth company” in Rule 12b-2 of the Exchange Act. (Check one):

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the

Exchange Act. ¨

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of May 12, 2017:

Class	Outstanding
Common stock, $0.01 par value per share	26,905,631

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

DGSE COMPANIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	March 31, 2017 (Unaudited)	December 31, 2016
ASSETS		
Current Assets:		
Cash and cash equivalents	$462,228	$1,412,082
Trade receivables, net of allowances	84,712	245,095
Trade receivables, net of allowances, related party	108,612	40,627
Inventories	9,540,577	9,384,136
Prepaid expenses	319,326	55,029
Total current assets	10,515,455	11,136,969
Property and equipment, net	1,613,611	1,665,103
Other assets	80,079	110,605
Total assets	$12,209,145	$12,912,677
LIABILITIES		
Current Liabilities:		
Current maturities of capital leases	$9,427	$12,590
Accounts payable - trade	890,511	1,103,022
Accounts payable - trade, related party	3,954,014	4,107,425
Accrued expenses	564,265	1,209,902
Customer deposits and other liabilities	665,090	572,362
Total current liabilities	6,083,307	7,005,301
Capital lease obligations, less current maturities	-	1,074
Total liabilities	6,083,307	7,006,375
Commitments and contingencies		
STOCKHOLDERS' EQUITY		

Common stock, $0.01 par value; 60,000,000 shares authorized 26,905,631 and 12,328,956 shares issued and outstanding	269,056	269,056
Additional paid-in capital	40,162,177	40,162,177
Accumulated deficit	(34,305,395)	(34,524,931)
Total stockholders' equity	6,125,838	5,906,302
Total liabilities and stockholders' equity	$ 12,209,145	$ 12,912,677

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, 2017	2016
Revenue		
Sales	$ 15,123,845	$ 11,774,516
Cost of goods sold	12,629,604	9,625,473
Gross margin	2,494,241	2,149,043
Expenses:		
Selling, general and administrative expenses	2,118,833	2,624,356
Depreciation and amortization	85,242	99,764
	2,204,075	2,724,120
Operating income (loss)	290,166	(575,077)
Other (income) expense:		
Other (income) expense, net	4,931	(614)
Interest expense	49,840	95,207
	54,771	94,593
Income (loss) from continuing operations before income taxes	235,395	(669,670)
Income tax expense	15,859	20,564
Income (loss) from continuing operations	219,536	(690,234)
Discontinued operations:		
(Loss) from discontinued operations, net of taxes	-	(97)
Net income (loss)	$ 219,536	$ (690,331)
Basic net income (loss) per common share:		
Income (loss) from continuing operations	$ 0.01	$ (0.06)
Income (loss) from discontinued operations	-	-
Net income (loss) per share	$ 0.01	$ (0.06)
Diluted net income (loss) per share:		
Income (loss) from continuing operations	$ 0.01	$ (0.06)
Income (loss) from discontinued operations	-	-

Net income (loss) per share	$ 0.01	$ (0.06)
Weighted-average number of common shares		
Basic	26,905,631	12,297,501
Diluted	27,416,909	12,297,501

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, 2017	2016
Cash Flows From Operating Activities		
Net income (loss)	$219,536	$(690,331)
Loss from discontinued operations, net of tax	-	(97)
	219,536	(690,234)
Adjustments to reconcile income (loss) from continuing operations to net cash used in operating activities of continuing operations:		
Depreciation and amortization	85,242	99,764
Stock based compensation to employees, officers and directors	-	16,050
Changes in operating assets and liabilities:		
Trade receivables, net	92,398	62,895
Inventories	(156,391)	(684,498)
Prepaid expenses	(264,297)	(40,965)
Other assets	30,526	60,675
Accounts payable and accrued expenses	(1,011,559)	(201,346)
Customer deposits and other liabilities	92,728	1,198,860
Net cash used in operating activities of continuing operations	(911,817)	(178,799)
Cash Flows From Investing Activities:		
Purchase of property and equipment	(33,750)	(14,706)
Net cash used in investing activities of continuing operations	(33,750)	(14,706)
Cash Flows From Financing Activities:		
Repayment of debt	-	(34,141)
Payments on capital lease obligations	(4,287)	(2,970)
Net cash used in financing activities of continuing operations	(4,287)	(37,111)
Cash Flows from Discontinued Operations:		
Net cash used in operating activities of discontinued operations	-	(97)
Net change in cash and cash equivalents	(949,854)	(230,713)
Cash and cash equivalents, beginning of period	1,412,082	1,752,711

Cash and cash equivalents, end of period	$462,228	$1,521,998
Supplemental Disclosures:		
Cash paid during the period for:		
Interest	$49,840	$64,599
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., a Nevada corporation, and its subsidiaries (the “Company” or “DGSE”), 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, 2016 (such fiscal year, “Fiscal 2016” and such Annual Report on Form 10-K, the “Fiscal 2016 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 buys and sells jewelry and bullion products to both retail and wholesale customers throughout the United States through its facilities in South Carolina 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

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 carrying amount reported for the Company's capital lease approximate fair value because the underlying instrument has an interest rate with current market rates. This instrument is not 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.

Recent Accounting Pronouncement

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers* ("ASU 2014-09"), which supersedes nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, more judgment and estimates may be required within the revenue recognition process than are required under existing U.S. GAAP. In August 2015, the FASB issued Accounting Standards Update No. 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*, which delays the effective date of ASU 2014-09 by one year. ASU 2014-09 is now effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. The standard is to be applied retrospectively, with early application permitted for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. The Company is evaluating the new standard, but does not anticipate a material impact to the consolidated financial statements once implemented in 2018.

On February 25, 2016, the FASB issued its new lease accounting guidance in Accounting Standards Update No. 2016-02 ("ASU 2016-02"), *Leases* (Topic 842). Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, *Revenue from Contracts with Customers.* Under the new guidance, lessees will be required to recognize a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis and a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term for all leases (with the exception of short-term leases) at the commencement date. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The Company is evaluating the financial statement implications of adopting ASU 2016-02.

(4) Inventories

A summary of inventories is as follows:

	March 31, 2017	December 31, 2016
Jewelry	$ 8,501,740	$ 7,193,126
Scrap gold	552,267	885,194
Bullion	321,156	292,591
Rare coins and Other	165,414	1,013,225
	$ 9,540,577	$ 9,384,136

(5) Basic and Diluted Average Shares

A reconciliation of basic and diluted weighted average common shares for the three months ended March 31, 2017 and 2016 is as follows:

	For the Three Months Ended March 31,	
	2017	2016

Basic weighted average shares	26,905,631	12,297,501
Effect of potential dilutive securities	511,278	-
Diluted weighted average shares	27,416,909	12,297,501

For the three months ended March 31, 2017 and 2016 there were 1,148,250 and 5,108,530 common share options, warrants, and Restricted Stock Units (RSU's) unexercised respectively. For the three months ended March 31, 2016, there were 5,108,530 common share options, warrants, and RSUs not added to the diluted average shares because inclusion of such shares would be antidilutive. On October 26, 2016, 5,000,000 stock option shares expired unexercised by Elemetal at a price of $15 a share.

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(6) Long-Term Debt

	Outstanding Balance			
	March 31, 2017	December 31, 2016	Current Interest Rate	Maturity
Capital leases (1)	$ 9,427	$ 13,664	4.20 %	May 1, 2018
Sub-Total	9,427	13,664		
Less: Current maturities of capital leases	9,427	12,590		
Long term debt, less current maturities	$ -	$ 1,074		

(1) On April 3, 2011, DGSE entered into a capital lease for $58,563 with Graybar Financial Services for phones at the new corporate headquarters. The non-cancelable lease agreement required an advanced payment of $2,304 and monthly payments of $1,077 for 60 months at an interest rate of 4.2% beginning in May 2011. At the end of the lease in May 2018, the equipment can be purchased for $1. As of March 31, 2017, we are five payments ahead of schedule and expect to pay off the capital lease early.

(7) Stock-Based Compensation

The Company accounts for share-based compensation by measuring the cost of the employee services received in exchange for an award of equity instruments, including grants of stock options, based on the fair value of the award at the date of grant. In addition, to the extent that the Company receives an excess tax benefit upon exercise of an award, such benefit is reflected as cash flow from financing activities in the consolidated statement of cash flows.

Stock-based compensation expense for the three months ended March 31, 2017 and 2016 was $0 and $16,050, respectively relating to employee and director RSUs, and included in selling, general and administrative expenses in the accompanying consolidated statements of operations.

(8) Related Party Transactions

DGSE has a corporate policy governing the identification, review, consideration and approval or ratification of transactions with related persons, as that term is defined in the Instructions to Item 404(a) of Regulation S-K, promulgated under the Securities Act ("Related Party"). Under this policy, all Related Party transactions are identified and approved prior to consummation of the transaction to ensure they are consistent with DGSE's best interests and the best interests of its stockholders. Among other factors, DGSE's Board considers the size and duration of the transaction, the nature and interest of the of the Related Party in the transaction, whether the transaction may involve a conflict of interest and if the transaction is on terms that are at least as favorable to DGSE as would be available in a comparable transaction with an unaffiliated third party. DGSE's Board reviews all Related Party transactions at least annually to determine if it is in DGSE's best interests and the best interests of DGSE's stockholders to continue, modify, or terminate any of the Related Party transactions. DGSE's Related Person Transaction Policy