

Edgar Filing: DGSE COMPANIES INC - Form 10-Q

DGSE COMPANIES INC
Form 10-Q
May 04, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

(X) Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 2006

() Transition Report under 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

(I.R.S. Employer Identification Number)

2817 Forest Lane, Dallas, Texas

(Address of principal executive offices)

75234

(Zip Code)

(Registrant's telephone number, including area code) (972) 484-3662

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 is an accelerated filer (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 the latest practicable date.

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Class	Outstanding at April 27, 2006
----- Common Stock, \$.01 per value	----- 4,913,290

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

Consolidated Balance Sheets

ASSETS	(Unaudited) March 31, 2006	December 31, 2005
	-----	-----
CURRENT ASSETS		
Cash and cash equivalents	\$ 263,022	1,042,834
Trade receivables	818,602	688,810
Inventories	7,811,166	7,570,120
Prepaid expenses	249,029	215,560
	-----	-----
Total current assets	9,141,819	9,517,324
 MARKETABLE SECURITIES - AVAILABLE FOR SALE	 69,829	 65,444
PROPERTY AND EQUIPMENT - AT COST, NET	1,084,723	1,121,662
DEFERRED INCOME TAXES	--	779
GOODWILL	837,117	837,117
OTHER ASSETS	296,792	287,790
	-----	-----
	\$ 11,430,280	\$ 11,830,116
	=====	=====
 LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Notes payable	\$ 194,183	594,183
Current maturities of long-term debt	259,273	259,152
Accounts payable - trade	558,134	789,724
Accrued expenses	175,617	580,823
Customer deposits	283,262	206,320
Federal income taxes payable	90,410	13,920
	-----	-----
Total current liabilities	1,560,879	2,444,122
 Long-term debt, less current maturities	 3,646,207	 3,314,886
Deferred income taxes	712	--
	-----	-----
Total liabilities	5,207,798	5,759,008

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SHAREHOLDERS' EQUITY

Common stock, \$.01 par value; authorized 10,000,000 shares; issued and outstanding 4,913,290 shares at The end of each period	49,133	49,133
Additional paid-in capital	5,708,760	5,708,760
Accumulated other comprehensive (loss)	(124,358)	(127,252)
Retained earnings	588,947	440,467
	-----	-----
Total shareholders' equity	6,222,482	6,071,108
	\$ 11,430,280	\$ 11,830,116
	=====	=====

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

DGSE Companies, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF OPERATIONS
Three months ended
(Unaudited)

	March 31, 2006	March 31, 2005
	-----	-----
Revenue		
Sales	\$ 9,628,653	\$ 6,637,914
Consumer loan service fees	92,344	79,898
	-----	-----
	9,720,997	6,717,812
Costs and expenses		
Cost of goods sold	8,168,080	5,316,873
Selling, general and administrative expenses	1,212,041	1,058,884
Depreciation and amortization	39,300	42,803
	-----	-----
	9,419,421	6,418,560
	-----	-----
Operating income	301,576	299,252
	-----	-----
Other income (expense)		
Interest expense	(76,606)	(71,124)
	-----	-----
Total other income (expense)	(76,606)	(71,124)
Income before income taxes	224,970	228,128
Income tax expense	76,490	77,563
	-----	-----
Net income	\$ 148,480	\$ 150,564
	=====	=====

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Earnings per common share		
Basic and diluted	\$.03	\$.03
	=====	=====
Weighted average number of common shares:		
Basic	4,913,290	4,913,290
Diluted	4,913,290	5,089,162

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

DGSE COMPANIES, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three Months Ended March 31,	
	2006	2005
	-----	-----
Cash Flows From Operations		
Reconciliation of net income to net cash used in operating activities		
Net income	\$ 148,480	\$ 150,565
Depreciation and amortization	39,300	42,803
(Increase) decrease in operating assets and liabilities:		
Trade receivables	(113,091)	177,381
Inventories	(241,046)	(443,729)
Prepaid expenses and other current assets	(33,469)	(41,503)
Accounts payable and accrued expenses	(636,787)	(573,933)
Change in customer deposits	76,942	128,319
Federal income taxes payable	76,490	2,563
Other assets	(9,002)	(9,565)
	-----	-----
Total net cash used in operating activities	(692,183)	(567,099)
Cash flows from investing activities		
Pawn loans made	(124,500)	(184,359)
Pawn loans repaid	108,699	122,699
Recovery of pawn loan principal through		
Sale of forfeited collateral	21,515	64,253
Pay day loans made	(58,583)	(12,970)
Pay day loans repaid	40,279	5,115
Purchase of property and equipment	(2,361)	(17,768)
	-----	-----
Net cash used by investing activities	(14,951)	(23,030)
Cash flows from financing activities		
Proceeds from notes issued	350,000	700,000
Payments on notes payable	(422,678)	(297,027)
	-----	-----
Net cash provided (used) by financing activities	(72,678)	402,973
	-----	-----

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Net decrease in cash and cash equivalents	(779,812)	(187,156)
Cash and cash equivalents at beginning of year	1,042,834	314,897
	-----	-----
Cash and cash equivalents at end of period	\$ 263,022	\$ 127,741
	=====	=====

Supplemental schedule of non-cash, investing and financing activities:

Interest paid for the three months ended March 31, 2006 and 2005 was \$ 79,940 and \$ 77,563, respectively.

Income taxes paid for the three months ended March 31, 2006 and 2005 was \$0 and \$75,000, respectively.

Pawn loans forfeited and transferred to inventory amounted to \$ 66,818 and \$ 119,808, respectively, for the three months ended March 31, 2006 and 2005.

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

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 made.

The Company's operating results for the period ended March 31, 2006, are not necessarily indicative of the results that may be expected for the year ended December 31, 2006. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 2005. Certain reclassifications were made to the prior year's consolidated financial statements to conform to the current year presentation.

Pawn loans receivable in the amount of \$ 105,787 and \$ 152,722 as of March 31, 2006 and 2005, respectively, are included in the Consolidated Balance Sheets caption trade receivables. The related pawn service charges receivable in the amount of \$ 31,075 and \$ 63,511 as of March 31, 2006 and 2005, respectively, are also included in the Consolidated Balance Sheets caption trade receivables. Pay day loans receivable in the amount of \$ 53,026 and \$ 6,805 as of March 31, 2006 and 2005, respectively, are also included in the Consolidated Balance Sheets caption trade receivables.

(2) - Earnings per share

Earnings Per Common Share

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A reconciliation of the income and shares of the basic earnings per common share and diluted earnings per common share for the three months ended March 31, 2006, and 2005 is as follows:

	March 31, 2006		
	Income	Shares	Per-Share Amount
Basic earnings per common share			
Income from operations allocable to common shareholders	\$ 148,480	4,913,920	\$.03 =====
Effect of dilutive securities			
Stock options	--	--	
Diluted earnings per common share			
Income from operations available to common shareholders plus assumed conversions	\$ 148,480 =====	4,913,290 =====	\$.03 =====
	March 31, 2005		
	Income	Shares	Per-Share Amount
Basic earnings per common share			
Income from operations allocable to common shareholders	\$ 150,564	4,913,920	\$.03 =====
Effect of dilutive securities			
Stock options	--	175,872	
Diluted earnings per common share			
Income from operations available to common shareholders plus assumed conversions	\$ 150,564 =====	5,089,162 =====	\$.03 =====

(3) - 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 and pay day loan operations. The Company's operations by segment were as follows:

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(Amounts in thousands)

	Retail Jewelry	Wholesale Jewelry	Bullion	Rare Coins	Corporate and Other	Conso
	-----	-----	-----	-----	-----	-----
Revenues						
2006	\$ 3,228	\$ 1,121	\$ 3,880	\$ 1,334	\$ 158	\$
2005	3,020	940	1,993	549	216	
Net income (loss)						
2006	40	24	62	68	(46)	
2005	86	55	11	47	(48)	
Identifiable Assets						
2006	8,408	1,894	325	145	658	
2005	7,633	1,721	134	166	738	
Capital Expenditures						
2006	3	--	--	--	1	
2005	8	--	--	--	10	
Depreciation and Amortization						
2006	24	--	--	--	15	
2005	28	5	--	--	10	

(4) Other Comprehensive income:

Other comprehensive income is as follows:

	Before Tax Amount	Tax (Expense) Benefit	Net-of-Tax Amount
	-----	-----	-----
Other comprehensive loss at December 31, 2004 and March 31, 2005	\$ (150,784)	\$ 28,202	\$ (122,582)
	=====	=====	=====
Other comprehensive loss at December 31, 2005	\$ (162,071)	\$ 34,819	\$ (127,252)
Unrealized gains during the period ended March 31, 2006	4,385	(1,491)	2,894
	-----	-----	-----
Other comprehensive loss at March 31, 2006	\$ (157,686)	\$ 33,328	\$ (124,358)
	=====	=====	=====

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(5) Stock-based Compensation:

Prior to January 1, 2006, we elected to follow Accounting Principles Board Opinion (APB) NO.25, Accounting for Stock Issued to Employees, and related interpretations to account for our employee and director stock options, as permitted by Statement of Financial Accounting Standards (SFAS) NO. 123, Accounting for Stock-Based Compensation. Effective January 1, 2006, we adopted the fair value recognition provision of SFAS No. 123 (revised 2004), Share-Based Payments, (SFAS No. 123(R) for all share-based payment awards to employees and directors including employee stock options. In addition, we have applied the provisions of Staff Accounting Bulletin No. 107 (SAB No. 107), issued by the Securities and Exchange Commission, in our adoption of SFAS No. 123(R).

We adopted SFAS No. 123(R) using the modified-prospective-transition method. Under this transition method, stock-based compensation expense recognized after the effective date includes: (1) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimate in accordance with the original provisions of SFAS No. 123, and (2) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimate in accordance with the provision of SFAS No. 123. Results from prior periods have not been restated and do not include the impact of SFAS No. 123(R). Stock-based compensation expense under SFAS No. 123(R) for the first quarter of 2006 was \$0, relating to employee and director stock options and our employee stock purchase plan. Stock-based compensation expense under the provision of APB No. 25 for the first quarter of 2005 was insignificant.

Stock-based compensation expense recognized each period is based on the value of the portion of share-based payment awards that is ultimately expected to vest during the period. SFAS No. 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In our pro forma disclosures required under SFAS No. 123 for periods prior to 2006, we accounted for forfeitures as they occurred.

Upon adoption of SFAS No. 123(R), we elected to use the Black-Scholes-Merton option-pricing formula to value share-based payments granted to employees subsequent to January 1, 2006 and elected to attribute the value of stock-based compensation to expense using the straight-line single option method. These methods were previously used for our pro forma information required under SFAS No. 123.

On November 10, 2005, the Financial Accounting Standards Board (FASB) issued FASB Staff Position No. FAS 123(R)-3, "Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards", which detailed an alternative transition method for calculating the tax effects of stock-based compensation pursuant to SFAS No. 123(R). This alternative transition method included simplified methods to establish the beginning balance of the additional paid-in capital pool (APIC pool) related to the tax effects of employee stock-based compensation and to determine the subsequent impact on the APIC pool and Consolidated Statement of Cash Flows of the tax effects of employee stock-based compensation awards that are outstanding upon adoption of SFAS No. 123(R). As all options outstanding have vested prior to December 31, 2005, the Company has not recorded the tax effects of employee stock-based compensation and have no APIC pool.

Prior to the adoption of SFAS No. 123(R) tax benefits of deductions resulting from the exercise of stock options were required to be presented as operating cash flows in the Consolidated Statement of Cash Flows. SFAS No. 123(R) requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax

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benefits) to be classified as financing cash flows. As there have been no stock options exercised, the Company has not reported these excess tax benefits as of March 31, 2006.

Effective January 1, 2006, the Company 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 the Company's employee stock option plan. As all options outstanding have vested prior to December 31, 2006, no stock based compensation expense has been recorded as of March 31, 2006.

The following table presents the effect on net income and net income per share compared with pro forma information as if we had adopted SFAS No. 123 for the first quarter of 2006: Three Months Ended March 31,

	2006	2005
	-----	-----
Net income as reported	\$ 148,480	\$ 150,564
Less stock-based compensation under the fair value method	--	--
	-----	-----
Pro forma net loss	\$ 148,480	\$ 150,564
	=====	=====

Earnings per share:

Basic and diluted income per common share, as reported	\$.03	\$.03
Basic and diluted income per common share, including the		
Effect of stock-based compensation expense	\$.03	\$.03

Item 2.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations

Quarter ended March 31, 2006 vs 2005:

Sales increased by \$ 2,990,739 (45.1%) in 2006. This increase was primarily the result of a \$208,000 (6.9%) increase in retail jewelry sales, a \$181,000 (19.3%) increase in wholesale jewelry sales, \$786,000 (143.0%) increase in the sale of rare coin products and a \$1,887,000 (94.7%) increase in the sale of bullion products. The increase in both retail and wholesale jewelry sales were due to higher gold prices and improved activity from our customers. The increase in rare coin and bullion sales were the result of an increase in gold prices, increased volatility in the bullion market and the company's increased focus on these segments of our business. Consumer loan service fees increased by \$12,446 in 2006 due to an increase in pay day loans outstanding during the quarter. Cost of goods as a percentage of sales increased to 84.8% in 2006 from 80.1% in 2005, This increase was due to the increase in rare coin and bullion revenue as a percentage of total sales.

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Selling, general and administrative expenses increased by \$153,157 or 14.5%. This increase was primarily due to an increase in payroll related cost of (\$90,000), higher advertising cost of (\$28,000) and \$ 34,361 in cost related to the new pay day loan stores. The increase in payroll related cost was necessary in order to maintain a high level of customer service as sales increase and to focus on the most rapidly growing segments of our business.

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 the Company operates. It is expected that due to the commodity nature of these products, future price changes for precious metals will continue to be indicative of the Company's 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.

Income taxes are provided at the corporate rate of 34% for both 2006 and 2005.

Liquidity and Capital Resources

Management of the Company expects capital expenditures to total approximately \$50,000 during the next twelve months. It is anticipated that these expenditures will be funded from working capital and its credit facility. As of March 31, 2006 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 the Company extended payment terms to finance the need for jewelry inventory growth and management of the Company believes that they will continue to do so in the future. Any significant increase in wholesale accounts receivable will be financed under the Company's bank credit facility.

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

From time to time, management has adjusted the Company's 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 the Company's investments in marketable securities may be liquidated in order to meet unforeseen working capital requirements

Contractual Cash Obligations

Payments due by year e

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	Total	2006	2007	2008	2009
Notes payable	\$ 194,183	\$ 194,183	--	--	--
Long-term debt and capital leases	3,905,480	222,111	2,966,273	\$ 381,654	\$ 74,67
Federal income taxes	90,410	90,410	--	--	--
Operating leases	433,746	122,135	137,418	100,994	54,89
	\$4,623,819	\$ 706,789	\$2,605,728	\$ 251,954	\$ 235,65

In addition, the Company estimates that it will pay approximately \$ 306,000 in interest during the next twelve months.

This report contains forward-looking statements which reflect the view of Company's management with respect to future events. Although management believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to have been correct. Important factors that could cause actual results to differ materially from such expectations are a down turn in the current strong retail climate and the potential for fluctuations in precious metals prices. The forward-looking statements contained herein reflect the current views of the Company's management and the Company assumes no obligation to update the forward-looking statements or to update the reasons actual results could differ from those contemplated by such forward-looking statements.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk.

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

The Company's 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 the Company's ability to liquidate excess jewelry inventory at an acceptable margin are dependent upon gold values. The impact on the Company's financial position and results of operations of a hypothetical change in gold values cannot be reasonably estimated.

ITEM 4. Controls and Procedures

Controls and Procedures Under the supervision and with the participation of the Company's management, including its Chief Executive Officer and Chief Financial Officer, the Company has evaluated the effectiveness of its disclosure controls and procedures, as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures are effective in enabling the Company to record, process, summarize and report information required to be included in its periodic SEC filings within the required time period. There has been no change in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter that has materially affected, or is reasonably likely to materially

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affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 6. Exhibits

- 31.1 Certificate of L.S. Smith pursuant to Section 3026 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.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DGSE Companies, Inc.

By: /s/ L. S. Smith

May 2, 2006

L. S. Smith
Chairman of the Board,
Chief Executive Officer and
Secretary

By: /s/ W. H. Oyster

Dated: May 2, 2006

W. H. Oyster
Director, President and
Chief Operating Officer

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By: /s/ John Benson

Dated: May 2, 2006

John Benson
Chief Financial Officer
(Principal Accounting Officer)