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DGSE COMPANIES INC  
Form 10-Q  
October 27, 2006

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 September 30, 2006 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  
(I.R.S. 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 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  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 October 27, 2006:

Class	Outstanding
----- 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

	September 30, 2006	
	-----	
	Unaudited	
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents .....	\$ 217,282	\$
Trade receivables .....	947,897	
Inventories .....	8,451,224	
Prepaid expenses .....	208,356	
	-----	
Total current assets .....	9,824,759	
Marketable securities - available for sale .....	74,929	
Property and equipment, net .....	1,026,838	
Deferred income taxes .....	--	
Goodwill .....	837,117	
Other assets .....	632,662	
	-----	
	\$ 12,396,305	\$
	=====	=
<b>LIABILITIES</b>		
Current Liabilities:		
Notes payable .....	\$ 194,183	\$
Current maturities of long-term debt .....	259,273	
Accounts payable - trade .....	326,834	
Accrued expenses .....	419,757	
Customer deposits .....	382,346	
Federal income taxes payable .....	210,584	
	-----	
Total current liabilities .....	1,792,977	
Long-term debt, less current maturities .....	3,996,128	
Deferred income taxes .....	2,446	
	-----	
	5,791,551	
<b>STOCKHOLDERS' EQUITY</b>		
Common stock, \$.01 par value; 10,000,000 shares authorized; 4,913,290 shares issued and outstanding at the end of each period in 2006 and 2005 .....		
	49,133	
Additional paid-in capital .....	5,708,760	
Accumulated other comprehensive loss.....	(120,992)	
Retained earnings .....	967,853	
	-----	
	6,604,754	
	-----	

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\$ 12,396,305  
=====

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

	Three months ended September 30,	
	2006	2005
	----- Unaudited -----	
Revenue		
Sales .....	\$ 9,497,528	\$ 7,129,321
Consumer loan service charges .....	111,422	85,536
	-----	-----
	9,608,950	7,214,857
Costs and expenses		
Cost of goods sold .....	8,085,866	5,837,846
Selling, general and administrative expenses	1,251,108	1,124,435
Depreciation and amortization .....	29,548	46,219
	-----	-----
	9,366,522	7,008,500
Operating income .....	242,428	206,357
	-----	-----
Other (income) expense		
Other income .....	--	(3,895)
Interest expense .....	78,646	71,533
	-----	-----
Earnings before income taxes .....	163,782	138,719
Income tax expense .....	55,686	47,165
	-----	-----
Net earnings .....	\$ 108,096	\$ 91,554
	=====	=====
Earnings per common share - basic and diluted ..	\$ 0.02	\$ 0.02
	=====	=====
Weighted average number of common shares:		
Basic .....	4,913,290	4,913,290
Diluted .....	5,056,133	5,040,148

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

	Nine months ended September 30,	
	2006	2005
	-----	
	-----	
	Unaudited	
Revenue		
Sales .....	\$ 31,570,446	\$ 20,475,598
Consumer loan service charges .....	305,554	257,481
	-----	-----
	31,876,000	20,733,079
Costs and expenses		
Cost of goods sold .....	27,014,402	16,608,461
Selling, general and administrative expenses	3,724,797	3,288,686
Depreciation and amortization .....	108,563	138,090
	-----	-----
	30,847,762	20,035,237
Operating income .....	1,028,238	697,842
	-----	-----
Other (income) expense		
Other income .....	--	(3,895)
Interest expense .....	229,227	214,696
	-----	-----
Earnings before income taxes .....	799,011	487,041
Income tax expense .....	271,664	165,594
	-----	-----
Net earnings .....	\$ 527,347	\$ 321,447
	=====	=====

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Earnings per common share - basic and diluted ..	\$	0.11	\$	0.06
	=====		=====	
Weighted average number of common shares:				
Basic .....		4,913,290		4,913,290
Diluted .....		4,989,065		5,059,709

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

	Nine months ended September 30,	
	2006	2005
	-----	
	Unaudited	
Cash flows from operating activities		
Net earnings .....	\$ 527,347	\$ 321,447
Adjustments to reconcile net earnings to net cash provided by operating activities		
Depreciation and amortization .....	108,563	138,090
Realized gain on sale of marketable securities .....	--	(3,895)
(Increase) decrease in operating assets and liabilities		
Trade receivables .....	(197,173)	52,935
Inventories .....	(881,104)	(594,535)
Prepaid expenses and other current assets .....	7,204	(133,001)
Accounts payable and accrued expenses .....	(623,956)	(575,112)
Customer deposits .....	176,026	105,548
Federal income taxes payable .....	196,664	(66,258)
Other assets .....	(344,872)	27,111
	-----	-----
Net cash used in operating activities .....	(1,031,301)	(727,670)
Cash flows from investing activities		
Pawn loans made .....	(387,966)	(469,839)
Pawn loans repaid .....	319,203	338,069
Recovery of pawn loan principal through sale of forfeited collateral .....	67,503	220,356

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Pay day loans made .....	(207,428)	(100,871)
Pay day loans repaid .....	146,813	64,270
Purchase of property and equipment .....	(13,739)	(210,709)
Proceeds from sale of marketable securities .....	--	4,277
	-----	-----
Net cash used in investing activities .....	(75,614)	(154,447)
Cash flows from financing activities		
Proceeds from notes issued .....	840,000	3,481,365
Repayments of notes payable .....	(558,637)	(2,603,519)
	-----	-----
Net cash provided by financing activities .....	281,363	877,846
NET DECREASE IN CASH AND CASH EQUIVALENTS .....	(825,552)	(4,271,365)
Cash and cash equivalents at beginning of period .....	1,042,834	314,897
	-----	-----
Cash and cash equivalents at end of period .....	\$ 217,282	\$ 310,626
	=====	=====

Supplemental disclosures:

Interest paid for the nine months ended September 30, 2006 and 2005 was \$229,227 and \$214,696, respectively. Income taxes paid for the nine months ended September 30, 2006 and 2005 was \$75,000 and \$225,000, respectively. Pawn loans forfeited and transferred to inventory amounted to \$67,503 and \$220,356, respectively, for the nine months ended September 30, 2006 and 2005.

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.

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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, 2005, and our Quarterly report on Form 10-Q for the three months ended March 31, 2006 and our Quarterly report on Form 10-Q for the six months ended June 30, 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 \$112,042 and \$142,611 as of September 30, 2006 and 2005, respectively, are included in the Consolidated Balance Sheets caption trade receivables. The related pawn service charges receivable in the amount of \$37,509 and \$50,433 as of September 30, 2006 and 2005, respectively, are also included in the Consolidated Balance Sheets caption trade receivables. Pay day loans receivable in the amount of \$77,273 as of September 30, 2006 and \$27,614 as of September 30, 2005, respectively, are also included in the Consolidated Balance Sheets caption trade receivables.

(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 September 30, 2006 and 2005 is as follows:

	2006			Nine mo Net Earnings
	Nine months ended	September 30,	Per share	
	Net Earnings	Shares	Per share	Net Earnings
	-----	-----	-----	-----
Basic earnings per common share.....	\$ 527,347	4,913,290	\$ 0.11	321,447
Effect of dilutive stock options....	--	75,775	--	--
	-----	-----	-----	-----
Diluted earnings per common share...	\$ 527,347	4,989,065	\$ 0.11	321,447
	=====	=====	=====	=====

  

	2006			Three mo Net Earnings
	Three months ended	September 30,	Per share	
	Net Earnings	Shares	Per share	Net Earnings
	-----	-----	-----	-----
Basic earnings per common share.....	108,096	4,913,290	\$ 0.02	91,554
Effect of dilutive stock options....	--	142,843	--	--
	-----	-----	-----	-----
Diluted earnings per common share...	108,096	5,056,133	\$ 0.02	91,554
	=====	=====	=====	=====



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### DGSE COMPANIES, Inc. and Subsidiaries

(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 nine months ended September 30 were as follows:

(In thousands)	Retail Jewelry	Wholesale Jewelry	Bullion	Rare Coins
	-----	-----	-----	-----
Revenues				
2006	\$ 10,885	\$ 3,775	\$ 13,117	\$ 3,659
2005	9,790	2,962	5,536	1,895
Net income (loss)				
2006	171	113	181	204
2005	204	144	27	145
Identifiable assets				
2006	9,102	1,987	300	266
2005	8,041	1,742	236	145
Capital Expenditures				
2006	137	--	--	--
2005	169	--	--	--
Depreciation and amortization				
2006	67	--	--	--
2005	85	16	--	--

Our operations by segment for the three months ended September 30 were as follows:

(In thousands)	Retail Jewelry	Wholesale Jewelry	Bullion	Rare Coins
	-----	-----	-----	-----
Revenues				
2006	\$ 3,325	\$ 1,472	\$ 3,526	\$ 1,141
2005	3,362	1,015	1,964	732
Net income (loss)				
2006	18	56	31	38
2005	44	45	12	58
Identifiable assets				
2006	8,633	1,944	172	372
2005	8,041	1,742	236	145
Capital Expenditures				
2006	132	--	--	--
2005	18	--	--	--
Depreciation and amortization				

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2006	19	--	--	--
2005	29	5	--	--

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DGSE COMPANIES, Inc. and Subsidiaries

(5) 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, 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)
Unrealized gains during the period ended			
June 30, and September 30, 2006 .....	5,100	(1,734)	3,366
	-----	-----	-----
Other comprehensive loss at			
September 30, 2006 .....	\$ (152,586)	\$ 31,594	\$ (120,992)
	=====	=====	=====

(6) 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 nine months 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

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nine months of 2006 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, we have not recorded the tax effects of employee stock-based compensation and have made no adjustments to the APIC pool.

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### DGSE COMPANIES, Inc. and Subsidiaries

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 benefits) to be classified as financing cash flows. As there have been no stock options exercised, we have not reported these excess tax benefits as of September 30, 2006.

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 September 30, 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 periods ended September 30,

Three Months Ended September 3  
2006 2005

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	-----	
	2006	2005
Net earnings as reported .....	\$ 108,096	\$ 91,5
Less stock-based compensation under the fair value method .	--	--
Pro forma net earnings .....	\$ 108,096	\$ 91,5
Earnings per share:		
Basic and diluted earnings per common share, as reported	\$ 0.02	\$ 0.
Basic and diluted earnings per common share, pro forma .	\$ 0.02	\$ 0.
	-----	-----
	Nine Months Ended	September 30
	2006	2005
	-----	-----
Net earnings as reported .....	\$ 527,347	\$ 321,4
Less stock-based compensation under the fair value method .	--	--
Pro forma net earnings .....	\$ 527,347	\$ 321,4
Earnings per share:		
Basic and diluted earnings per common share, as reported	\$ 0.11	\$ 0.
Basic and diluted earnings per common share, pro forma .	\$ 0.11	\$ 0.

(7) New Accounting Pronouncements

On July 13, 2006, the FASB issued FASB Interpretation 48, Accounting for Uncertainty in Income Taxes: an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 clarifies Statement 109, Accounting for Income Taxes, to indicate the criteria that an individual tax position would have to meet for some or all of the benefit of that position to be recognized in an entity's financial statements. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the requirements under FIN 48 and the effect, if any, that the adoption of FIN 48 will have on our consolidated financial statements, statement of cash flows or earnings per share.

In September 2006, the FASB issued SFAS 157 Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The provisions of SFAS 157 are effective as of the beginning of our 2008 fiscal year. We are currently evaluating the impact of adopting SFAS 157 on our financial statements.

(8) Recent Developments

On July 17, 2006, we announced that we had executed a definitive agreement to acquire all of the issued and outstanding stock of Superior Galleries, Inc. in a transaction valued at \$ 14,000,000. For additional information regarding this transaction reference is made to our Form 8-K filed on July 17, 2006. As of September 30, 2006 we have incurred \$265,000 in legal and other cost related to this acquisition. This cost is included in the balance sheet caption "Other assets". In the event this transaction does not close, this and any additional cost incurred related to this transaction will be expensed and charged against operating results during the period in which the transaction is terminated.

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DGSE COMPANIES, Inc. and Subsidiaries

### 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:

- o uncertainties regarding price fluctuations in the price of gold and other precious metals;
- o our ability to manage inventory fluctuations and sales;
- o changes in governmental rules and regulations applicable to the specialty financial services industry;
- o the results of any unfavorable litigation;
- o interest rates;
- o economic pressures affecting the disposable income available to our customers;
- o our ability to maintain an effective system of internal controls;
- o 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, 2005. 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 and Carrollton, Texas and Mt. Pleasant, South Carolina and through our internet web sites [dgse.com](http://dgse.com); [USBullionExchange.com](http://USBullionExchange.com); and, [FairchildWatches.com](http://FairchildWatches.com).

We operate three internet sites on the World Wide Web. Through [dgse.com](http://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](http://USBullionExchange.com). [FairchildWatches.com](http://FairchildWatches.com) provides wholesale customers a virtual catalog of our fine watch inventory. Over 7,500 items are

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available for sale on our internet sites including \$10,000,000 in diamonds.

Our wholly-owned subsidiary, National Jewelry Exchange, Inc. ("NJE") operates a pawn shop in Carrollton, Texas. We have focused the operations of NJE 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 July 17, 2006, we announced that we had executed a definitive agreement to acquire all of the issued and outstanding stock of Superior Galleries, Inc. in a transaction valued at \$ 14,000,000. For additional information regarding this transaction reference is made to our Form 8-K filed on July 17, 2006. As of September 30, 2006 we have incurred \$265,000 in legal and other cost related to this acquisition. This cost is included in the balance sheet caption "Other assets". In the event this transaction does not close, this and any additional cost incurred related to this transaction will be expensed and charged against operating results during the period in which the transaction is terminated.

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### DGSE COMPANIES, Inc. and Subsidiaries

#### 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

Nine Months Ended September 30, 2006 compared to Nine Months Ended September 30, 2005

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Sales increased by \$11,094,848, or 54.2%, during the nine months ended September 30, 2006 as compared to 2005. This increase was primarily the result of a \$7,581,000, or 136.9%, increase in bullion sales, a \$1,095,000, or 11.2%, increase in retail jewelry sales, a \$813,000, or 27.4%, increase in wholesale jewelry sales and a \$1,764,000, or 93.1%, increase 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 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 \$48,073, or 18.7%, in 2006 due to an increase in pay day loans outstanding during the period. Cost of goods as a percentage of sales increased from 81.1% in 2005 to 85.6 % in 2006. This increase was due to the increase in rare coin and bullion revenue as a percentage of total sales.

Selling, general and administrative expenses increased by \$436,111, or 13.3%, during the nine months ended September 30, 2006 as compared to 2005. This increase was primarily due to an increase in staff and payroll related cost of \$256,000, higher advertising cost of \$105,000 and \$75,000 in cost related to the new pay day loan stores. The increase in staff was necessary to maintain a high level of customer service as sales increased and the opening of three pay day loan stores. The increase in advertising was necessary in order to attract new customers in our local markets. Depreciation and amortization decreased by \$29,527, or 21.4%, during 2006 due to certain assets becoming fully depreciated.

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

Three Months Ended September 30, 2006 compared to Three Months Ended September 30, 2005

Sales increased by \$2,368,207, or 33.2%, during the three months ended September 30, 2006 as compared to 2005. This increase was primarily the result of a \$1,563,000, or 79.5%, increase in bullion sales, a \$457,000, or 45.0%, increase in wholesale jewelry sales and a \$409,000, or 55.9%, increase in the sale of rare coin products during the three months ended September 30, 2006 as compared to 2005. The overall increase in jewelry sales was 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 \$25,886, or 30.3%, in 2006 due to an increase in pay day loans outstanding during the period. Cost of goods as a percentage of sales increased from 81.9% in 2005 to 85.1% in 2006. This increase was due to the increase in rare coin and bullion revenue as a percentage of total sales.

Selling, general and administrative expenses increased by \$126,673, or 11.3%, during the three months ended September 30, 2006 as compared to 2005. This increase was primarily due to an increase in staff and payroll related cost of \$42,000, higher advertising cost of \$42,000 and \$13,000 in cost related to the new pay day loan stores. The increase in staff was necessary to maintain a high level of customer service as sales increased and the opening of three pay day loan stores. The increase in advertising was necessary in order to attract new

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\$16,671, or 36.1%, during the three months ended September 30, 2006 as compared to 2005, due to certain assets becoming fully depreciated.

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

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 \$100,000 during the next twelve months. It is anticipated that these expenditures will be funded from working capital and its credit facility. As of September 30, 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 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 July 17, 2006 we announced that we had executed a definitive agreement to acquire all of the issued and outstanding stock of Superior Galleries, Inc. in a transaction valued at \$ 14,000,000. As of September 30, 2006 we have incurred \$265,000 in legal and other costs related to this acquisition. We expect to incur an additional \$150,000 in legal and other costs related to this transaction before closing. For additional information on liquidity see our Form 8-K filed on July 17, 2006.

Contractual Cash Obligations	Total	Payments due by period			The
		2006	2007 - 2008	2009 - 2010	
Notes payable .....	\$ 194,183	\$ 194,183	\$ --	\$ --	\$
Long-term debt and capital leases	4,255,401	74,037	3,845,922	145,257	
Federal income taxes .....	210,584	210,584	--	--	
Operating Leases .....	354,259	42,648	238,412	73,199	
<b>Total .....</b>	<b>\$ 5,014,427</b>	<b>\$ 521,452</b>	<b>\$ 4,084,334</b>	<b>\$ 218,456</b>	<b>\$</b>



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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.

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### DGSE COMPANIES, Inc. and Subsidiaries

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 September 30, 2006, 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.

On July 17, 2006, we announced that we executed a definitive agreement to acquire all of the issued and outstanding stock of Superior Galleries, Inc. in a transaction valued at \$ 14,000,000. For additional information regarding this

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transaction reference is made in our Form 8-K filed on July 17, 2006.

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

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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: October 27, 2006

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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.

By:/s/ L. S. Smith

Dated: October 27, 2006

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

By:/s/ W. H. Oyster

Dated: October 27, 2006

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

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By: /s/ John Benson

Dated: October 27, 2006

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John Benson  
Chief Financial Officer  
(Principal Accounting Officer)