DGSE COMPANIES INC
Form 10-Q
May 06, 2011

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, 2011

or

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

For the transition period from ___ to ___

Commission File Number 1-11048

DGSE Companies, Inc.
(Exact name of registrant as specified in its charter)

Nevada	88-0097334
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

11311 Reeder Road
Dallas, Texas 75229
(972) 484-3662
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

NONE
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES þ NO o

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

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of May 5, 2011:

Class	Outstanding
Common stock, $.01 par value per share	9,986,065

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DGSE Companies, Inc. and Subsidiaries

PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements.

CONSOLIDATED BALANCE SHEETS

	March 31, 2011 Unaudited	December 31, 2010
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 1,483,727	$ 871,468
Trade receivables	380,229	793,869
Inventories	17,833,595	17,046,716
Prepaid expenses	487,011	416,376
Prepaid federal income tax	319,772	319,772
Total current assets	20,504,334	19,448,201
Marketable securities – available for sale	7,500	7,500
Property and equipment, net	4,450,432	4,466,517
Deferred income taxes	2,688,620	2,844,511
Goodwill	837,117	837,117
Intangible assets	2,428,172	2,435,339
Other assets	198,063	220,949
	$ 31,114,238	$ 30,260,134
LIABILITIES		
Current Liabilities:		
Notes payable	$ 52,455	$ 52,455
Current maturities of long-term debt	420,170	420,170
Line of credit	3,499,887	3,499,887
Accounts payable – trade	1,150,154	1,791,451
Accrued expenses	285,930	260,361
Customer deposits	3,808,427	2,428,452
Total current liabilities	9,217,023	8,452,776
Long-term debt, less current maturities	2,947,950	3,169,647

Convertible debt, net of debt discount	148,000	148,000
	12,312,973	11,770,423
STOCKHOLDERS' EQUITY		
Common stock, $.01 par value; 30,000,000 shares authorized; 9,986,065 shares issued and outstanding at the end of each period.	99,861	99,861
Additional paid-in capital	19,093,588	19,084,646
Retained deficit	(392,184)	(694,796)
	18,801,265	18,489,711
	$ 31,114,238	$ 30,260,134

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 March 31,	
	2011	2010
	Unaudited	
Revenue		
Sales	$24,758,244	$17,347,554
Costs and expenses		
Cost of goods sold	21,457,696	14,918,715
Selling, general and administrative expenses	2,649,513	2,466,647
Depreciation and amortization	101,123	66,424
	24,208,332	17,451,786
Operating income	549,912	(104,232)
Other expense (income)		
Other income	(2,245)	(17,440)
Interest expense	88,779	110,406
Earnings before income taxes	463,378	(197,198)
Income tax (benefit) expense	160,766	(67,047)
Net earnings (loss)	302,612	(130,151)
Earnings per common share		
Basic	$0.03	$(0.01)
Diluted	$0.03	$(0.01)

Weighted average number of common shares		
Basic	9,986,065	9,833,635
Diluted	10,557,436	9,833,635

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

DGSE COMPANIES, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three months ended March 31,	
	2011	2010
Cash flows from operating activities	Unaudited	
Net earnings	302,612	$(130,151)
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	101,123	66,424
Deferred income taxes	155,891	--
Stock option expense	8,942	--
(Increase) decrease in operating assets and liabilities:		
Trade receivables	413,640	(50,478)
Inventories	(786,879)	1,138,838
Prepaid expenses and other current assets	(70,634)	15,951
Accounts payable and accrued expenses	(615,728)	(934,785)
Customer deposits	1,379,975	(433,162)
Federal income taxes payable	--	(67,047)
Other assets	--	43,999
Net cash provided by (used in) operating activities	888,942	(350,411)
Cash flows from investing activities		
Purchase of property and equipment	(54,986)	(87,762)
Net cash used in investing activities	(54,986)	(87,762)
Cash flows from financing activities		
Repayments of notes payable	(221,697)	(65,563)
Net cash used in financing activities	(221,697)	(65,563)
Net increase (decrease) in cash and cash equivalents	612,259	(503,736)
Cash and cash equivalents at beginning of period	871,468	1,446,724
Cash and cash equivalents at end of period	$1,483,727	$942,988

Supplemental disclosures:

Interest paid for the three months ended March 31, 2011 and 2010 was $88,799 and $110,406, respectively.
Income taxes paid for the three months ended March 31, 2011 and 2010 was $0 and $0, respectively.

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., Charleston Gold and Diamond Exchange, Inc., Superior Gold and Diamond Exchange, Inc. Superior Precious Metals, Inc., American Gold and Diamond Exchange, 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, 2010. 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) Inventory.

A summary of inventories is as follows:

	March 31, 2011	December 31, 2010
Jewelry	$ 12,272,803	$ 12,568,505
Rare coins	2,638,796	2,222,558
Bullion	2,107,189	1,518,801
Scrap gold	814,807	736,852
Total	$ 17,833,595	$ 17,046,716

(3) Earnings per share.

A reconciliation of the earnings and shares of the basic earnings per common share and diluted earnings per common share for the periods ended March 31, 2011 and 2010 is as follows:

	2011 Three months ended March 31,			2010 Three months ended March 31,		
	Net Earnings	Shares	Per share	Net Earnings	Shares	Per share

Basic earnings per common share	$302,602	9,986,065	$0.03	$(130,151)	9,833,635	$(0.01)
Effect of dilutive stock options	--	571,371	--	--	--	--
Diluted earnings per common share	$302,602	10,557,436	$0.03	$(130,151)	9,833,635	$(0.01)

For the three months ended March 31, 2011, 30 thousand shares related to employee stock options were not added to the denominator because inclusion of such shares would be antidilutive.

The following table sets forth outstanding shares of common stock issued in the form of stock purchase warrants and employee stock options as of March 31:

	2011	2010
Common stock options	1,498,134	1,423,134

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(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. The Company had no significant non cash items other than depreciation and amortization. Our operations by segment for the three months ended March 31 were as follows:

(In thousands)	Retail Jewelry	Wholesale Jewelry	Precious Metals	Rare Coins	Discontinued Operations	Corporate and Other	Consolidated
Revenues							
2011	$7,271	$628	$14,034	$2,825	$ --	$--	$ 24,758
2010	5,588	676	8,461	2,622	--	--	17,347
Net earnings (loss)							
2011	148	(6)	165	78	--	(82)	303
2010	(336)	1	152	72	--	(19)	(130)
Identifiable assets							
2011	22,158	1,692	2,107	2,639	--	2,518	31,114
2010	23,243	1,725	2,962	1,084	295	783	30,092
Goodwill							
2011	--	837	--	--	--	--	837
2010	--	837	--	--	--	--	837
Capital Expenditures							
2011	55	--	--	--	--	--	55
2010	88	--	--	--	--	--	88
Depreciation and amortization							
2011	44	2	13	13	--	29	101
2010	39	1	13	13	--	--	66
Interest expense							
2011	85	4	--	--	--	--	89
2010	107	3	--	--	--	--	110
Income tax expense							
2011	111	--	53	25	--	(27)	161
2010	(173)	1	78	37	--	(10)	(67)

(5) 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 includes compensation expense for new share-based awards and for share-based awards granted prior to, but not yet vested, as of January 1, 2006.

Stock-based compensation expense for the three months ended March 31, 2011 and 2010 was $8,942 and $0, respectively, relating to employee and director stock options and out employee stock purchase plan.

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, 2010. 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 buy and sell jewelry, bullion products and rare coins. Our customers include individual consumer, dealers and institutions throughout the United States. Our products and services are marketed through our facilities in Dallas and Euless, Texas; Mt. Pleasant, South Carolina; Woodland Hills, California and through our internet web sites DGSE.com; CGDEinc.com; SGBH.com; USBullionExchange.com; Americangoldandsilverexchange.com; and FairchildWatches.com.

We operate eight primary internet sites and over 900 related landing sites on the World Wide Web. Through the various sites we operate a virtual store, real-time auction of rare coin and jewelry products, free quotations of current prices on all commonly traded precious metal and related products, trading in precious metals, a mechanism for selling unwanted jewelry, rare coins and precious metals and wholesale prices and information exclusively for dealers on pre-owned fine watches. Over 7,500 items are available for sale on our internet sites including $2,000,000 in diamonds.

In June 2008, we moved Superior Galleries' operations from Beverly Hills to Woodland Hills, California. Superior's principal line of business is the sale of jewelry, rare coins and bullion on a retail and wholesale basis. Superior's retail and wholesale operations are conducted in virtually every state in the United States. Superior also conducted live and internet auctions for customers seeking to sell their own coins prior to management's decision to discontinue the live auction operations. Superior markets its services nationwide through broadcast and print media and independent sales agents, as well as on the internet through third party websites, and through its own website at SGBH.com.

Americangoldandsilverexchange.com, the over 900 proprietary Internet sites related to the home page of Americangoldandsilverexchange.com along with our existing locations in Texas, California and South Carolina, provide customers from all over the United States with a seamless and secure way to value and sell gold, silver, rare coins, jewelry, diamonds and watches.

Critical Accounting Policies and Estimates

The following discussion addresses our most critical accounting policies, which are those that are both important to the portrayal of our financial condition and results of operations and that require significant judgment or use of complex estimates.

Inventories. Jewelry and other inventories are valued at the lower of cost or market. Bullion is valued at the lower-of-cost-or-market (average cost).

The Company acquires a majority of its retail jewelry inventory from individuals that is pre-owned. The Company acquires the jewelry based on its own internal estimate of the fair market value of the items offered for sale considering factors such as the current spot market prices of precious metals and current demand for the items offered for sale. Because the overall market value for precious metals fluctuates, these fluctuations could have either a positive or negative impact to the profitability of the Company. The Company monitors these fluctuations to evaluate any impairment to its retail jewelry inventory.

Impairment of Long-Lived and Amortized Intangible Assets. The Company performs impairment evaluations of its long-lived assets, including property, plant and equipment and intangible assets with finite lives, including the customer base acquired in the Superior acquisition, whenever business conditions or events indicate that those assets may be impaired. When the estimated future undiscounted cash flows to be generated by the assets are less than the carrying value of the long-lived assets, the assets are written down to fair market value and a charge is recorded to current operations. Based on our evaluations no impairment was required as of March 31, 2011.

Impairment of Goodwill and Indefinite-Lived Intangible Assets. Goodwill and indefinite-lived intangible assets are tested for impairment annually, or more frequently if events or changes in circumstances indicate that the assets might be impaired. The Company performs its annual review at the beginning of the fourth quarter of each fiscal year.

The Company evaluates the recoverability of goodwill by estimating the future discounted cash flows of the businesses to which the goodwill relates. Estimated cash flows and related goodwill are grouped at the reporting unit level. A reporting unit is an operating segment or, under certain circumstances, a component of an operating segment that constitutes a business. When estimated future discounted cash flows are less than the carrying value of the net assets and related goodwill, an impairment test is performed to measure and recognize the amount of the impairment loss, if any. Impairment losses, limited to the carrying value of goodwill, represent the excess of the carrying amount of a reporting unit's goodwill over the implied fair value of that goodwill. In determining the estimated future cash flows, the Company considers current and projected future levels of income as well as business trends, prospects and market and economic conditions.

The Company cannot predict the occurrence of certain events that might adversely affect the carrying value of goodwill and indefinite-lived intangible assets. Such events may include, but are not limited to, the impact of the economic environment, a material negative change in relationships with significant customers, or strategic decisions made in response to economic and competitive conditions.

Revenue Recognition. Revenue is generated from wholesale and retail sales of rare coins, precious metals, bullion and second-hand jewelry. The recognition of revenue varies for wholesale and retail transactions and is, in large part, dependent on the type of payment arrangements made between the parties. The Company recognizes sales on an F.O.B. shipping point basis.

The Company sells rare coins to other wholesalers/dealers within its industry on credit, generally for terms of 14 to 60 days, but in no event greater than one year. The Company grants credit to new dealers based on extensive credit evaluations and for existing dealers based on established business relationships and payment histories. The Company generally does not obtain collateral with which to secure its accounts receivable when the sale is made to a dealer. The Company maintains reserves for potential credit losses based on an evaluation of specific receivables and its historical experience related to credit losses.

Revenues for monetary transactions (i.e., cash and receivables) with dealers are recognized when the merchandise is shipped to the related dealer.

The Company also sells rare coins to retail customers on credit, generally for terms of 30 to 60 days, but in no event greater than one year. The Company grants credit to new retail customers based on extensive credit evaluations and for existing retail customers based on established business relationships and payment histories. When a retail customer is granted credit, the Company generally collects a payment of 25% of the sales price, establishes a payment schedule for the remaining balance and holds the merchandise as collateral as security against the customer’s receivable until all amounts due under the credit arrangement are paid in full. If the customer defaults in the payment of any amount when due, the Company may declare the customer’s obligation in default, liquidate the collateral in a commercially reasonable manner using such proceeds to extinguish the remaining balance and disburse any amount in excess of the remaining balance to the customer.

Under this retail arrangement, revenues are recognized when the customer agrees to the terms of the credit and makes the initial payment. We have a limited-in-duration money back guaranty policy (as discussed below).

In limited circumstances, the Company exchanges merchandise for similar merchandise and/or monetary consideration with both dealers and retail customers, for which the Company recognizes revenue in accordance with ASC 845 Nonmonetary Transactions. When the Company exchanges merchandise for similar merchandise and there is no monetary component to the exchange, the Company does not recognize any revenue. Instead, the basis of the merchandise relinquished becomes the basis of the merchandise received, less any indicated impairment of value of the merchandise relinquished. When the Company exchanges merchandise for similar merchandise and there is a monetary component to the exchange, the Company recognizes revenue to the extent of monetary assets received and determine the cost of sale based on the ratio of monetary assets received to monetary and non-monetary assets received multiplied by the cost of the assets surrendered.

The Company has a return policy (money-back guarantee). The policy covers retail transactions involving graded rare coins only. Customers may return graded rare coins purchased within 7 days of the receipt of the rare coins for a full refund as long as the rare coins are returned in exactly the same condition as they were delivered. In the case of rare coin sales on account, customers may cancel the sale within 7 days of making a commitment to purchase the rare coins. The receipt of a deposit and a signed purchase order evidences the commitment. Any customer may return a coin if they can demonstrate that the coin is not authentic, or there was an error in the description of a graded coin.

Revenues from the sale of consigned goods are recognized as commission income on such sale if the Company is acting as an agent for the consignor. If in the process of selling consigned goods, the Company makes an irrevocable payment to a consignor for the full amount due on the consignment and the corresponding receivable from the buyer(s) has not been collected by the Company at that payment date, the Company records that payment as a purchase and the sale of the consigned good(s) to the buyer as revenue as the Company has assumed all collection risk.

Taxes Collected From Customers. The Company’s policy is to present taxes collected from customers and remitted to governmental authorities on a net basis. The Company records the amounts collected as a current liability and relieves such liability upon remittance to the taxing authority without impacting revenues or expenses.

Allowance for Doubtful Accounts. The allowance for doubtful accounts requires management to estimate a customer’s ability to satisfy its obligations. The estimate of the allowance for doubtful accounts is particularly critical in the Company’s wholesale coin segment where a significant amount of the Company’s trade receivables are recorded. The Company evaluates the collectability of receivables based on a combination of factors. In circumstances where the Company is aware of a specific customer’s inability to meet its financial obligations, a specific reserve is recorded against amounts due to reduce the net recognized receivable to the amount reasonably expected to be collected. Additional reserves are established based upon the Company’s perception of the quality of the current receivables, including the length of time the receivables are past due, past experience of collectability and underlying economic conditions. If the financial condition of the Company’s customers were to deteriorate resulting in an impairment of their ability to make payments, additional reserves would be required.

Impairment of Goodwill and Indefinite-Lived Intangible Assets. In evaluating the recoverability of goodwill, it is necessary to estimate the fair value of the reporting units. The estimate of fair value of intangible assets is generally determined on the basis of discounted future cash flows. The estimate of fair value of the reporting units is generally determined on the basis of discounted future cash flows supplemented by the market approach. In estimating the fair value, management must make assumptions and projections regarding such items as future cash flows, future revenues, future earnings and other factors. The assumptions used in the estimate of fair value are generally consistent with the past performance of each reporting unit and are also consistent with the projections and assumptions that are used in current operating plans. Such assumptions are subject to change as a result of changing economic and competitive conditions. The rate used to discount estimated cash flows is a rate corresponding to the Company's cost of capital, adjusted for risk where appropriate, and is dependent upon interest rates at a point in time. There are inherent uncertainties related to these factors and management's judgment in applying them to the analysis of goodwill impairment. It is possible that assumptions underlying the impairment analysis will change in such a manner to cause further impairment of goodwill, which could have a material impact on the Company's results of operations.

The analysis of the wholesale watch sales division resulting from the acquisition of Fairchild with a carrying value of goodwill of $837,117 resulted in no impairment as its estimated future discounted cash flows significantly exceeded the net assets and related goodwill.

Income Taxes. Income taxes are estimated for each jurisdiction in which we operate. This involves assessing the current tax exposure together with temporary differences resulting from differing treatment of items for tax and financial statement accounting purposes. Any resulting deferred tax assets are evaluated for recoverability based on estimated future taxable income. To the extent that recovery is deemed not likely, a valuation allowance is recorded.

The Company records deferred income tax assets and liabilities for differences between the book basis and tax basis of the related net assets. The Company records a valuation allowance, when appropriate, to adjust deferred tax asset balances to the amount management expects to realize. Management considers, as applicable, the amount of taxable income available in carry-back years, future taxable income and potential tax planning strategies in assessing the need for a valuation allowance.

The Company accounts for its position in tax uncertainties in accordance with ASC 740, Income Taxes. The guidance establishes standards for accounting for uncertainty in income taxes. The guidance provides several clarifications related to uncertain tax positions. Most notably, a “more likely-than-not” standard for initial recognition of tax positions, a presumption of audit detection and a measurement of recognized tax benefits based on the largest amount that has a greater than 50 percent likelihood of realization. The guidance applies a two-step process to determine the amount of tax benefit to be recognized in the financial statements. First, the Company must determine whether any amount of the tax benefit may be recognized. Second, the Company determines how much of the tax benefit should be recognized (this would only apply to tax positions that qualify for recognition.) No additional liabilities have been recognized as a result of the implementation. The Company has not taken a tax position that, if challenged, would have a material effect on the financial statements or the effective tax rate during the years ended December 31, 2010 and 2009, respectively.

Interest costs and penalties related to income taxes are classified as interest expense and general and administrative costs, respectively, in the Company’s consolidated financial statements. It is determined not to be reasonably likely for the amounts of unrecognized tax benefits to significantly increase or decrease within the next 12 months. The Company is currently subject to a three year statute of limitations by major tax jurisdictions. The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction.

Results of Operations

Three Months Ended March 31, 2011 compared to Three Months Ended March 31, 2010

Sales increased by $7,410,690 or 43%, during the three months ended March 31, 2011 as compared to 2010. This increase was primarily the result of a $5,573,000, or 66.0%, increase in the sale of precious metal products and $1,683,000, or 30.0%, increase in our jewelry sales during the first quarter of 2011 as compared to 2010. The increases in precious metal sales was a result of strong consumer demand for these products and higher gold prices. The increase in jewelry sales was due to an improved retail environment. Cost of goods as a percentage of sales increased from 86.0% in 2010 to 86.7% in 2011. This increase was due to the increase in precious metals revenue as a percentage of total sales.

Selling, general and administrative expenses increased by $182,866, or 7.4%, during the three months ended March 31, 2011 as compared to 2010. This increase was primarily due to an increase in advertising and accounting cost. The decrease in interest expense was due to a lower prime rate.

Income tax expense is directly affected by the levels of pretax income and non-deductible permanent differences

Income taxes are provided at the rate of 34.00 % for both 2011 and 2010.

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

During the three months ended March 31, 2011 and 2010 cash flows from operating activities totaled $888,942 and ($350,411), respectively. Cash flows from operating activities during the three months ended March 31, 2011 were primarily the result of a increase in inventory ($786,879), a decrease in accounts payable and accrued expenses ($615,728), a increase in customer deposits $1,379,975 and a decrease in trade receivables $413,640. The increase in inventory and customer deposits was due to a first quarter increase in demand for precious metal products. The decrease in trade receivables was a result of a decrease in the sales of wholesale jewelry products. Cash flows from operating activities during the three months ended March 31, 2010 were primarily the result of a decrease in inventory $1,138,838, a decrease in accounts payable and accrued expenses ($934,785), and a decrease in customer deposits ($433,162). The decrease in inventory was due to the sluggish retail environment and bullion deliveries made during the three months ended March 31, 2010, which also contributed to the decrease in customer deposits.

During the three months ended March 31, 2011 and 2010 cash flows from investing activities totaled ($54,986) and ($87,762), respectively. During 2011 the primary use of cash from investing activities was the result of cash used to purchase property and equipment, ($54,986). During 2010 the Company invested ($87,762) in property and equipment.

During the three months ended March 31, 2011 and 2010 cash flows from financing activities totaled ($221,697) and ($55,674), respectively. The use of cash during both years was the result of repayment of loans to Texas Capital Bank and the mortgage on our facility.

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. As of March 31, 2011 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 a new bank credit facility or from short-term loans from individuals.

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 in order to meet unforeseen working capital requirements.

On May 27, 2010, the Company announced that Texas Capital Bank has agreed to renew and increase the size of its current credit facility. The new facility is composed of a $3.5 million revolving note and a $1.0 million term loan provided immediate availability to finance current operations. The agreement was finalized and funded June 2, 2010. Borrowings under the revolving credit facility are collateralized by a general security interest in substantially all of our assets (other than the assets of Superior). As of December 31, 2010, approximately $4.5 million was outstanding under the term loan and revolving credit facility. If we were to default under the terms and conditions of the revolving credit facility, Texas Capital Bank would have the right to accelerate any indebtedness outstanding and foreclose on our assets in order to satisfy our indebtedness. Such a foreclosure could have a material adverse effect on our business, liquidity, results of operations and financial position. This credit facility matures in June 2011. As of March 31, 2011 the Company was not in full compliance of the loan covenants, however, management believes the non-compliance will be cured during the three months ending June 30, 2011.

The covenants associated with our credit facility with Texas Capital Bank, N.A., excluding Superior Galleries, are as follows:

As of March 31, 2011	Requirement	Actual calculation
Minimum tangible net worth	17,750,000	15,535,976
Maximum total liabilities to tangible net worth	Not to exceed .75	.66
Minimum debt service coverage	Must be greater than 1.40	2.18

On October 17, 2007, we closed on the purchase of our new headquarters location. As a result, we assumed a new loan with a remaining principal balance of $2,323,484 and an interest rate of 6.70%. The loan has required monthly payments of $20,192 with the final payment due on August 1, 2016.

Payments due by period

Contractual Cash Obligations					Thereafter
Notes payable	$ 3,552,342	$ 3,552,342	$ --	$ --	$ --
Long-term debt and capital leases	3,508,314	338,667	1,038,321	536,858	1,594,468
Operating Leases	1,433,815	465,272	845,741	122,802	--
Total	$ 8,494,471	$ 4,356,281	$ 1,884,062	$ 659,660	$ 1,594,468

In addition, we estimate that we will pay approximately $356,000 in interest during the next twelve months.

Off-Balance Sheet Arrangements.

We have no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to stockholders.

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 pawn 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. Under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) of the Exchange Act) 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, as of March 31, 2011, these disclosure controls and procedures were ineffective to ensure that all information required to be disclosed by us in the reports that we file or submit under the Exchange Act is: (i) recorded, processed, summarized and reported, within the time periods specified in the Commission's rule and forms; and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. See our December 31, 2010 Form 10-K filing for specific control deficiencies.

Changes in internal controls. For the quarter ended March 31, 2011, 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 may, from time to time, be involved in various claims, lawsuits, disputes with third parties, actions involving allegations of discrimination, or breach of contract actions incidental to the operation of its business. Except as set forth above, we are not currently involved in any such litigation which we believe could have a material adverse effect on our financial condition or results of operations, liquidity or cash flows.

Item 5. Other Information.

None.

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

Exhibits:

Exhibit No.	Description	Filed Herein	Incorporated by Reference	Form	Date Filed with SEC	Exhibit No.
2.1	Amended and Restated Agreement and Plan of Merger and Reorganization, dated as of January 6, 2007		×	8-K	January 9, 2007	2.1
2.2	Limited Joinder Agreement, dated as of January 6, 2007		×	8-K	January 9, 2007	2.9
3.1	Articles of Incorporation dated September 17, 1965		×	8-A12G	June 23, 1999	3.1
3.2	Certificate of Amendment to Articles of Incorporation, dated October 14, 1981		×	8-A12G	June 23, 1999	3.2
3.3	Certificate of Resolution, dated October 14, 1981		×	8-A12G	June 23, 1999	3.3
3.4	Certificate of Amendment to Articles of Incorporation , dated July 15, 1986		×	8-A12G	June 23, 1999	3.4
3.5	Certificate of Amendment to Articles of Incorporation, dated August 23, 1998		×	8-A12G	June 23, 1999	3.5
3.6	Certificate of Amendment to Articles of Incorporation, dated June 26, 1992		×	8-A12G	June 23, 1999	3.6

3.7	Certificate of Amendment to Articles of Incorporation, dated June 26, 2001	×	8-K	July 3, 2001	1.0
3.8	Certificate of Amendment to Articles of Incorporation, dated May 22, 2007	x	8-K	May 31, 2007	3.1
3.9	By-laws, dated March 2, 1992	×	8-A12G	June 23, 1999	3.7
4.1	Specimen Common Stock Certificate	×	S-4	January 6, 2007	4.1
10.1	Renewal, Extension And Modification Agreement dated January 28, 1994, by and among DGSE Corporation and Michael E. Hall And Marian E. Hall	×	10-KSB	March 1995	10.2
10.2	Lease Agreement dated June 2, 2000 by and between SND Properties and Charleston Gold and Diamond Exchange, Inc.	×	10-KSB	March 29, 2001	10.1
10.3	Lease agreement dated October 5, 2004 by and between Beltline Denton Road Associates and Dallas Gold & Silver Exchange	×	10-K	April 15, 2005	10.2
10.4	Lease agreement dated December 1, 2004 by and between Stone Lewis Properties and Dallas Gold & Silver Exchange	×	10-K	April 15, 2005	10.3
10.5	Lease agreement dated November 18, 2004 by and between Hinkle Income Properties LLC and American Pay Day Centers, Inc.	×	10-K	April 15, 2005	10.4
10.6	Lease Agreement dated January 17, 2005 by and between Belle-Hall Development Phase III Limited Partnership and DGSE Companies, Inc.	×	S-4	January 6, 2007	10.6
10.7	Sale agreement dated executed July 5, 2007 by and between DGSE Companies, Inc. and Texas Department of Transportation	×	8-K	July 11, 2007	10.1

10.8	Purchase agreement dated July 5, 2007 by and between DGSE Companies, Inc. and 11311 Reeder Road Holdings, LP	×	8-K	July 11, 2007	10.2
10.9	Loan Agreement, dated as of December 22, 2005, between DGSE Companies, Inc. and Texas Capital Bank, N.A.	×	8-K/A	August 17, 2006	10.1
10.10	Third Amendment to Loan Agreement, dated as of May 10, 2007, by and between DGSE Companies, Inc. and Texas Capital Bank, N.A.	×	8-K	May 9, 2007	3.0
10.11	Support Agreement, DGSE stockholders, dated as of January 6, 2007	×	8-K	January 9, 2007	99.1
10.12	Securities Exchange Agreement, dated as of January 6, 2007	×	8-K	January 9, 2007	99.2
10.13	Warrant to DiGenova, issued January 6, 2007	×	8-K	January 9, 2007	99.3
10.14	Support Agreement, Superior stockholders, dated as of January 6, 2007	×	8-K	January 9, 2007	99.5
10.15	Asset purchase agreement, dated May 9, 2007, by and between DGSE Companies, Inc. and Euless Gold & Silver, Inc.	×	8-K	May 9, 2007	1.0
10.16	Subordinated Promissory Note dated May 9, 2007	×	8-K	May 9, 2007	2.0
10.17	Registration Rights Agreement with Stanford International Bank Ltd., dated as of May 30, 2007	×	8-K	May 31, 2007	99.1
10.18	Corporate Governance Agreement with Dr. L.S. Smith and Stanford International Bank Ltd., dated as of May 30, 2007	×	8-K	May 31, 2007	99.2

10.19	Escrow Agreement with American Stock Transfer & Trust Company and Stanford International Bank Ltd., as stockholder agent, dated as of May 30, 2007		×	8-K	May 31, 2007	99.3
10.20	Form of Warrants		×	8-K	May 31, 2007	99.4
10.21	Amended and Restated Commercial Loan and Security Agreement, by and between Superior Galleries Inc. and Stanford International Bank Ltd., dated as of May 30, 2007		×	8-K	May 31, 2007	99.5
10.22	Employment Agreement with L.S. Smith, dated as of May 30, 2007		×	8-K	May 31, 2007	99.6
10.23	Employment Agreement with William H. Oyster, dated as of May 30, 2007		×	8-K	May 31, 2007	99.7
10.24	Employment Agreement with John Benson, dated as of May 30, 2007		×	8-K	May 31, 2007	99.8
10.25	Eighth Amendment to Loan Agreement, dated as of June 3, 2010, by and between DGSE Companies, Inc. and Texas Capital Bank, N.A.		×	8-K	June 3, 2010	99.2
31.1	Certification pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934 implementing Section 302 of the Sarbanes-Oxley Act of 2002 by Dr. L.S. Smith	×				
31.2	Certification pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934 implementing Section 302 of the Sarbanes-Oxley Act of 2002 by John Benson	×				
32.1	Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by Dr. L.S. Smith	×				
32.2	Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by John Benson	×				

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 L. S. Smith Chairman of the Board, Chief Executive Officer and Secretary	Dated: May 6, 2011

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 L. S. Smith Chairman of the Board, Chief Executive Officer and Secretary	Dated: May 6, 2011
By: /s/ W. H. Oyster W. H. Oyster Director, President and Chief Operating Officer	Dated: May 6, 2011
By: /s/ John Benson John Benson Chief Financial Officer (Principal Accounting Officer)	Dated: May 6, 2011