

DGSE COMPANIES INC  
Form 10-Q  
November 14, 2007

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**Form 10-Q**

(Mark One)

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

**For the quarterly period ended September 30, 2007**

**or**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number 1-11048**

**DGSE Companies, Inc.**

*(Exact name of registrant as specified in its charter)*

**Nevada**

*(State or other jurisdiction of  
incorporation or organization)*

**88-0097334**

*(I.R.S. Employer  
Identification No.)*

**2817 Forest Lane  
Dallas, Texas 75234  
(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  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

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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 November 12, 2007:

<u>Class</u>	<u>Outstanding</u>
Common stock, \$.01 par value per share	9,899,664

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**PART I. FINANCIAL INFORMATION****Item 1. Consolidated Financial Statements.***DGSE Companies, Inc. and Subsidiaries***CONDENSED CONSOLIDATED BALANCE SHEETS**

	<b>September 30, 2007 Unaudited</b>	<b>December 31, 2006</b>
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 1,380,668	\$ 1,210,282
Trade receivables	4,073,794	1,053,454
Inventories	12,437,162	7,796,028
Prepaid expenses	609,816	192,379
Prepaid federal income tax	—	97,472
Total current assets	18,501,440	10,349,615
Marketable securities - available for sale	57,879	57,879
Property and equipment, net	590,847	1,024,405
Deferred income taxes	18,031	7,152
Goodwill	13,211,152	837,117
Other assets	393,915	869,398
	\$ 32,773,264	\$ 13,145,566
<b>LIABILITIES</b>		
Current Liabilities:		
Notes payable	\$ 183,708	\$ 183,708
Current maturities of long-term debt	215,354	259,273
Accounts payable - trade	1,000,047	828,323
Accrued expenses	783,787	721,305
Customer deposits	360,274	171,912
Federal income tax payable	302,157	—
Total current liabilities	2,845,327	2,164,521
Long-term debt, less current maturities	9,794,247	4,303,685
	12,639,574	6,468,206
<b>STOCKHOLDERS' EQUITY</b>		
Common stock, \$.01 par value; 30,000,000 shares authorized; 9,470,357 and 4,913,290 shares issued and outstanding at the end of each period in 2007 and 2006, respectively	94,704	49,133
Additional paid-in capital	18,374,867	5,708,760
Accumulated other comprehensive loss	(132,245)	(132,245)
Retained earnings	1,796,364	1,051,712
	20,133,690	6,677,360
	\$ 32,773,264	\$ 13,145,566

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**

	<b>Three months ended September 30,</b>	
	<b>2007</b>	<b>2006</b>
	<b>Unaudited</b>	
Revenue		
Sales	\$ 16,771,838	\$ 9,497,528
Consumer loan service charges	84,475	51,119
	16,856,313	9,548,647
Costs and expenses		
Cost of goods sold	13,891,332	8,077,048
Selling, general and administrative expenses	2,726,610	1,186,023
Depreciation and amortization	96,584	19,515
	16,714,526	9,282,586
Operating income	141,787	266,061
Other expense (income)		
Interest expense	182,704	78,646
Other income	(577,198)	—
Earnings before income taxes	536,281	187,415
Income tax expense	182,336	63,721
Net earnings from continuing operations	353,945	123,694
Discontinued operations:		
Loss from discontinued operations (less applicable income tax benefit of \$771 and \$7,623, respectively)	1,498	14,798
Loss on disposal of discontinued operations (less applicable income tax benefit of \$35,053 and \$0, respectively)	68,043	—
Net earnings	\$ 284,404	\$ 108,896
Earnings per common share - basic	\$ 0.03	\$ 0.02
Earnings per common share - diluted	\$ 0.03	\$ 0.02
Weighted average number of common shares:		
Basic	8,582,357	4,913,290
Diluted	10,392,717	5,056,133

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

*DGSE Companies, Inc. and Subsidiaries***CONSOLIDATED STATEMENTS OF OPERATIONS**

	<b>Nine months ended September 30,</b>	
	<b>2007</b>	<b>2006</b>
	<b>Unaudited</b>	
Revenue		
Sales	\$ 39,100,108	\$ 31,570,446
Consumer loan service charges	193,775	144,666
Management fees	250,000	—
	39,543,883	31,715,112
Costs and expenses		
Cost of goods sold	32,518,275	26,986,825
Selling, general and administrative expenses	5,697,795	3,543,562
Depreciation and amortization	196,127	69,154
	38,412,197	30,599,541
Operating income	1,131,686	1,115,571
Other expense (income)		
Interest expense	427,840	229,227
Other income	(579,449)	—
Earnings before income taxes	1,283,295	886,344
Income tax expense	436,321	301,357
Net earnings from continuing operations	846,974	584,987
Discontinued operations:		
Loss from discontinued operations (less applicable income tax benefit of \$17,659 and \$29,693, respectively)	34,279	57,640
Loss disposal of discontinued operations (less applicable income tax benefit of \$35,053 and \$0, respectively)	68,043	—
Net earnings	\$ 744,652	\$ 527,347
Earnings per common share - basic	\$ 0.11	\$ 0.11
Earnings per common share - diluted	\$ 0.10	\$ 0.11
Weighted average number of common shares:		
Basic	6,543,986	4,913,290
Diluted	7,395,848	4,989,065

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





*DGSE COMPANIES, Inc. and Subsidiaries***CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>Nine months ended</b>	
	<b>September 30,</b>	
	<b>2007</b>	<b>2006</b>
	<b>Unaudited</b>	
<b>Cash flows from operating activities</b>		
Net earnings	\$ 744,652	\$ 527,347
Adjustments to reconcile net earnings to net cash provided by operating activities		
Depreciation and amortization	196,127	69,154
Deferred taxes	(10,879)	—
Loss on discontinued operations	102,322	57,640
Gain on sale of building	(579,447)	—
Change in assets and liabilities:		
(Increase) Decrease in trade receivables	(2,380,792)	(185,711)
(Increase) Decrease in Inventories	(390,218)	(881,104)
(Increase) Decrease in prepaid expenses and other assets	(221,140)	7,204
(Increase) Decrease in other long term assets	(98,745)	(344,872)
Increase (Decrease) in accounts payable and accrued expenses	(998,300)	(623,956)
Increase (Decrease) in customer deposits	69,549	176,026
Increase (Decrease) in income taxes payable	399,629	166,971
Net cash used in operating activities	(3,167,242)	(1,031,301)
<b>Cash flows from investing activities</b>		
Pawn loans made	(391,136)	(387,966)
Pawn loans repaid	241,425	319,203
Recovery of pawn loan principal through sale of forfeited collateral	94,973	67,503
Pay day loans made	(164,289)	(207,428)
Pay day loans repaid	125,982	146,813
Purchase of property and equipment	(119,772)	(13,739)
Proceeds from sale of discontinued operations	77,496	—
Proceeds from sale of building	924,742	—
Acquisition of Eules Gold & Silver	(600,000)	—
Deal cost for Superior Galleries acquisition	(395,280)	—
Net cash used in investing activities	(205,859)	(75,614)
<b>Cash flows from financing activities</b>		
Proceeds from notes issued	4,219,352	840,000
Repayments of notes payable	(754,228)	(558,637)
Conversion of warrants	78,363	—
Net cash provided by financing activities	3,543,487	281,363
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>		
	170,386	(825,552)
Cash and cash equivalents at beginning of period	1,210,282	1,042,834
Cash and cash equivalents at end of period	\$ 1,380,668	\$ 217,282

**Supplemental disclosures:**

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Interest paid for the three months ended September 30, 2007 and 2006 was \$134,921 and \$80,632, respectively.

Income taxes paid during the three months ended September 30, 2007 and 2006 was \$0 and \$0, respectively.

Pawn loans forfeited and transferred to inventory amounted to \$36,086 and \$21,960 respectively, for the three months ended September 30, 2007 and 2006.

Interest paid for the nine months ended September 30, 2007 and 2006 was \$344,159 and \$229,227, respectively.

Income taxes paid during the nine months ended September 30, 2007 and 2006 was \$235,000 and \$75,000, respectively.

Pawn loans forfeited and transferred to inventory amounted to \$94,973 and \$67,503, respectively, for the nine months ended September 30, 2007 and 2006.

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

*DGSE COMPANIES, Inc. and Subsidiaries***NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(1) Basis of Presentation.**

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

The interim financial statements of DGSE Companies, Inc. included herein have been prepared by us pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the Commission's rules and regulations, although we believe that the disclosures are adequate to make the information presented not misleading. We suggest that these financial statements be read in conjunction with the financial statements and notes included in our Annual Report on Form 10-K and 10-K/A for the year ended December 31, 2006 and our quarterly reports on Form 10Q for the three months ended March 31, 2007 and the six months ended June 30, 2007. 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.

On July 13, 2007, we sold the loan balances from our American Pay Day Center locations and discontinued operations in those locations. See Note 7, "Acquisitions and Discontinued Operations." As a result of this disposition, the Consolidated Financial Statements and related notes have been restated to present the results of the American Pay Day Center locations as discontinued operations.

**(2) Inventory.**

A summary of inventories is as follows:

	September 30, 2007	December 31 2006
Jewelry	\$ 9,140,854	\$ 7,022,453
Rare coins	2,235,141	235,099
Bullion	354,580	113,867
Scrap gold	439,853	374,284
Other	266,734	50,325
Total	\$ 12,437,162	\$ 7,796,028

**(3) Trade Receivables.**

Pawn loans receivable in the amount of \$206,492 and \$112,042 as of September 30, 2007 and 2006, respectively, are included in the Consolidated Balance Sheets caption trade receivables as of these respective dates. The related pawn service charges receivable in the amount of \$58,231 and \$37,509 as of September 30, 2007 and 2006, respectively, are also included in the Consolidated Balance Sheets caption trade receivables as of these respective dates.



*DGSE COMPANIES, Inc. and Subsidiaries***(4) 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 three and nine month periods ended September 30, 2007 and 2006 is as follows:

	2007			2006		
	Three months ended September 30, Net Earnings	Shares	Per share	Three months ended September 30, Net Earnings	Shares	Per share
Basic earnings per common share	\$ 284,404	8,582,357	\$ 0.03	\$ 108,096	4,913,290	\$ 0.02
Effect of dilutive stock options	—	1,810,360	—	—	142,843	—
Diluted earnings per common share	\$ 284,404	10,392,717	\$ 0.03	\$ 108,096	5,056,133	\$ 0.02

  

	2007			2006		
	Nine months ended September 30, Net Earnings	Shares	Per share	Nine months ended September 30, Net Earnings	Shares	Per share
Basic earnings per common share	\$ 744,652	6,543,986	\$ 0.11	\$ 527,347	4,913,290	\$ 0.11
Effect of dilutive stock options	—	851,862	(0.01)	—	75,775	—
Diluted earnings per common share	\$ 744,652	7,395,848	\$ 0.10	\$ 527,347	4,989,065	\$ 0.11

**(5) 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:

<i>(In thousands)</i>	Retail	Wholesale	Rare	Auctions	Corporate	Consolidated	
	Jewelry	Jewelry			Bullion		Coins
Revenues							
2007	\$ 12,153	\$ 3,948	\$ 12,027	\$ 9,530	\$ 1,037	\$ 39,544	
2006	10,885	3,775	13,117	3,659	—	31,715	
Net earnings (loss)							
2007	325	93	132	34	164	(3)	745
2006	171	113	181	204	—	(142)	527

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Identifiable assets

2007	12,004	1,067	355	3,339	1,814	983	19,562
2006	9,102	1,150	300	266	—	741	11,559

Goodwill

2007	—	837	—	—	—	12,374	13,211
2006	—	837	—	—	—	—	837

Capital Expenditures

2007	106	—	—	—	—	14	120
2006	14	—	—	—	—	—	14

Depreciation and amortization

2007	91	—	18	18	18	51	196
2006	67	—	—	—	—	2	69

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*DGSE COMPANIES, Inc. and Subsidiaries***(5) Business segment information. - (continued)**

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

<i>(In thousands)</i>	<b>Retail Jewelry</b>	<b>Wholesale Jewelry</b>	<b>Bullion</b>	<b>Rare Coins</b>	<b>Auctions</b>	<b>Corporate and Other</b>	<b>Consolidated</b>
<b>Revenues</b>							
2007	\$ 4,097	\$ 1,105	\$ 5,740	\$ 4,908	\$ 711	\$ 295	\$ 16,856
2006	3,325	1,472	3,526	1,141	—	85	9,549
<b>Net earnings (loss)</b>							
2007	232	27	63	4	17	(59)	284
2006	18	56	31	38	—	(35)	108
<b>Identifiable assets</b>							
2007	12,004	1,067	355	3,339	1,814	983	19,562
2006	9,102	1,150	300	266	—	741	11,559
<b>Goodwill</b>							
2007	—	837	—	—	—	12,374	13,211
2006	—	837	—	—	—	—	837
<b>Capital Expenditures</b>							
2007	13	—	—	—	—	3	16
2006	13	—	—	—	—	—	13
<b>Depreciation and amortization</b>							
2007	38	—	13	13	13	19	96
2006	19	—	—	—	—	1	20

*DGSE COMPANIES, Inc. and Subsidiaries*

**(6) Stock-based Compensation.**

Effective January 1, 2006, we adopted the fair value recognition provisions of SFAS No. 123(R) for all share based payment awards to employees and directors including employee stock options granted under our employee stock option plan. 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 nine and three months ended September 30, 2007 and 2006, respectively, was \$34,833 and \$0, relating to employee and director stock options and our employee stock purchase plan.

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.

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.

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 of September 30, 2007, we have not recorded the tax effects of employee stock-based compensation and have made no adjustments to the APIC pool.

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, 2007.

**(7) Acquisitions and Discontinued Operations.**

*Discontinued Operations.*

On July 13, 2007, we sold the loan balances from our American Pay Day Center locations for \$77,496 and discontinued operations in those locations. The receivables sold, including interest due, had a balance of \$120,573 at the time of the sale. The sales price was determined based on the age of the outstanding receivables. As a result of the sale and discontinued operations, we recognized a pretax loss of \$103,196 on the disposal and a pretax loss on



discontinued operations of \$51,938 for the nine months ended September 31, 2007.

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*DGSE COMPANIES, Inc. and Subsidiaries*

*Superior Galleries, Inc.* On May 30, 2007, we completed our acquisition of Superior Galleries, Inc., which we refer to as Superior, pursuant to an amended and restated agreement and plan of merger and reorganization dated as of January 6, 2007, which we refer to as the merger agreement, with Superior and Stanford International Bank Ltd., then Superior's largest stockholder and its principal lender, which we refer to as Stanford, as stockholder agent for the Superior stockholders, whereby Superior became a wholly owned subsidiary of DGSE Companies, Inc. Superior operates a store in Beverly Hills, CA. The total purchase price of approximately \$13.6 million was broken down as follows:

	Shares	Stock Price	Extended Price
Common stock	3,669,067	\$ 2.55	\$ 9,356,121
A warrants	845,634	1.27 <sup>(1)</sup>	1,073,955
B warrants	863,000	2.55	2,220,650
Exercise Price B warrants	863,000	\$ 0.001	(863)
Direct transaction costs			965,062
Total purchase price			\$ 13,594,925

<sup>(1)</sup> The \$1.27 is the fair value of the warrants calculated under the Black Sholes method as of the acquisition date.

The allocation of the purchase price is preliminary, and is pending the completion of various analyses and finalization of estimates. The total purchase price has been allocated to the fair value of assets acquired and liabilities assumed as follows:

Goodwill	\$ 12,374,035
Property and other assets	1,068,958
Inventory	3,260,766
Liabilities assumed	(3,108,834)
Total purchase price	\$ 13,594,925

In accordance with SFAS 142, the goodwill will not be amortized but instead tested for impairment in accordance with the provisions of SFAS 142 at least annually and more frequently upon the occurrence of certain events.

The operating results of Superior have been included in the consolidated financial statements since the acquisition date of May 30, 2007. The following unaudited pro forma condensed consolidated financial information reflects the results of operations for the three and nine months ended September 30, 2007 and 2006 as if the acquisition of Superior had occurred on January 1 of each year after giving effect to purchase accounting adjustments. These pro forma results have been prepared for comparative purposes only and do not purport to be indicative of what operating results would have been had the acquisition actually taken place at the beginning of the period, and may not be indicative of future operating results (in thousands, except per share data):

<i>(In thousands, except per share data)</i>	Three Months Ended September		Nine Months Ended September	
	2007	2006	2007	2006
	(Unaudited)		(Unaudited)	
Pro forma total revenue	\$ 16,856	\$ 18,109	\$ 50,142	\$ 65,313
Pro forma net earnings (loss)	284	(830)	(2,932)	(1,678)
Pro forma net earnings per share — basic	\$ 0.03	\$ (0.13)	\$ (0.45)	\$ (0.27)
	\$ 0.03	\$ (0.13)	\$ (0.45)	\$ (0.27)

Pro forma net earnings per share —  
diluted

Pro forma weighted average shares — basic	8,582	9,889	6,544	9,889
Pro forma weighted average shares — diluted	10,393	9,962	7,396	9,960

In relation to the acquisition, as of June 29, 2007, Stanford and Dr. L.S. Smith, our chairman and chief executive officer, collectively had the power to vote approximately 63% of our voting securities, and beneficially owned approximately 56.4% of our voting securities on a fully-diluted basis (after giving effect to the exercise of all options and warrants held by them which are exercisable within sixty days of June 29, 2007 but not giving effect to the exercise of any other options or warrants). Consequently, these two stockholders may have sufficient voting power to control the outcome of virtually all corporate matters submitted to the vote of our common stockholders. Those matters could include the election of directors, changes in the size and composition of our board of directors, mergers and other business combinations involving us, or the liquidation of our company. In addition, Stanford and Dr. Smith have entered into a corporate governance agreement with us, which entitles Stanford and Dr. Smith to each nominate two “independent” directors to our board and entitles Dr. Smith, our chairman and chief executive officer, and William H. Oyster, our president and chief operating officer, to be nominated to our board for so long as each remains an executive officer.

***DGSE COMPANIES, Inc. and Subsidiaries***

Through this control of company nominations to our board of directors and through their voting power, Stanford and Dr. Smith are able to exercise substantial control over certain decisions, including decisions regarding the qualification and appointment of officers, dividend policy, access to capital (including borrowing from third-party lenders and the issuance of additional equity securities), a merger or consolidation with another company, and our acquisition or disposition of assets. Also, the concentration of voting power in the hands of Stanford and Dr. Smith could have the effect of delaying or preventing a change in control of our company, even if the change in control would benefit our other stockholders. The significant concentration of stock ownership may adversely affect the trading price of our common stock due to investors' perception that conflicts of interest may exist or arise.

*Eules Gold & Silver, Inc.* On May 9, 2007 we purchased all of the tangible assets of Eules Gold and Silver, Inc., located in Eules, Texas. The purchase price paid for these assets totaled \$1,000,000 including \$600,000 in cash and a two year note in the amount of \$400,000. We opened a new retail store in the former Eules Gold & Silver facility and operate under the name of Dallas Gold & Silver Exchange. Of the assets received, \$990,150 was inventory and the remainder was fixed assets.

We entered into these transactions seeing them as opportunistic acquisitions that would allow us to expand our operations and provide a platform for future growth.

**(8) New Accounting Pronouncements**

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measures" ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value and enhances disclosures about fair value measures required under other accounting pronouncements, but does not change existing guidance as to whether or not an instrument is carried at fair value. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. We are currently evaluating the impact of adopting SFAS 157 on our financial statements.

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

In June 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes". This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, and disclosure. We adopted FIN 48 as of January 1, 2007. The adoption of FIN 48 had no impact on our financial statements for the quarter or nine months ended September 30, 2007.

**(9) Recent Developments**

On October 17, we closed on the purchase of our new headquarters location. As a result, we assumed a new loan with a remaining principal balance of \$2,441,922 and an interest rate of 6.70%. The loan has required monthly payments of \$20,192.00 with the final payment due on August 1, 2016.

On October 31, 2007, we changed the listing of our common stock from the NASDAQ market to the American Stock Exchange. Our trading symbol changed from DGSE to DGC.



*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:

- 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;
- our ability to assimilate the operations of our recent acquisitions;
- 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 Forms 10-K for our fiscal year ended December 31, 2006. You should not unduly rely on these forward-looking statements, which speak only as of the date of this report. Except as required by law, we are not obligated to publicly release any revisions to these forward-looking statements to reflect events or circumstances occurring after the date of this report or to reflect the occurrence of unanticipated events.

**Our Business**

We sell jewelry, rare coin and bullion products to both retail and wholesale customers throughout the United States and make uncollateralized and collateralized loans to individuals. Our products are marketed through our facilities in Dallas and Euless, Texas, Mt. Pleasant, South Carolina and Beverly Hills, California and through our five internet websites. Through [www.DGSE.com](http://www.DGSE.com), we operate a virtual store and a real-time auction of our jewelry products. Customers and we buy and sell items of jewelry and are free to set prices in an interactive market. We also offer customers the ability to buy and sell precious metal assets. Customers have access to our two-way markets in all of the most popularly traded precious metal products as well as current quotations for precious metals prices on our other internet website, [www.USBullionExchange.com](http://www.USBullionExchange.com). [www.FairchildWatches.com](http://www.FairchildWatches.com) (Fairchild International) provides wholesale customers a virtual catalog of our fine watch inventory. [www.CGDEInc.com](http://www.CGDEInc.com) (Charleston Gold & Diamond Exchange) provides information about our subsidiary and inventory available to purchase, including fine watches, diamonds, rare coins and bullion, and jewelry. Over 7,500 items are available for sale on our internet sites, including

\$2,000,000 in diamonds, consisting of both inventory and consignments.

Our wholly-owned subsidiary, National Pawn (f/k/a National Jewelry Exchange, Inc.), operates two pawn shops in Dallas, Texas. We have focused the subsidiary's operations on sales and pawn loans of jewelry products.

On May 9, 2007 we purchased all of the tangible assets of Eules Gold and Silver, Inc., located in Eules, Texas. We opened a new retail store in the former Eules Gold & Silver facility and operate under the name of Dallas Gold & Silver Exchange.

On May 30, 2007, we completed the acquisition of Superior Galleries, Inc. Superior's principal line of business is the sale of rare coins on a retail, wholesale, and auction basis. Superior's retail and wholesale operations are conducted in virtually every state in the United States. Superior also provides auction services for customers seeking to sell their own coins. Superior markets its services nationwide through broadcasting and print media and independent sales agents, as well as on the internet through third party websites such as eBay.com, Overstock.com and Amazon.com, and through its own website at SGBH.com. Its headquarters are in Beverly Hills, California. For more information on this acquisition, see the section entitled "Acquisitions" beginning on page 7.

***DGSE COMPANIES, Inc. and Subsidiaries***

On July 13, 2007, we sold the loan balances from our American Pay Day Center locations and discontinued operations in those locations.

On August 3, 2007 we announced the launch of Americangoldandsilverexchange.com along with the simultaneous activation of over 900 proprietary Internet sites related to the home page of Americangoldandsilverexchange.com. This site, along with our existing locations in Texas, California and South Carolina, will provide customers from all over the United States with a safe and seamless way to value and sell gold, silver, rare coins, jewelry, diamonds and watches. We anticipate that Americangoldandsilverexchange.com will contribute to our growth and profitability in future periods.

**Recent Developments**

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 \$2,441,922 and an interest rate of 6.70%. The loan has required monthly payments of \$20,192.00 with the final payment due on August 1, 2016.

On October 31, 2007, we changed the listing of our common stock from the NASDAQ market to the American Stock Exchange. Our trading symbol changed from DGSE to DGC.

**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, rebates, 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.

Our auction business generates revenue in the form of commissions received from buyers and sellers of auction lots. Auction commissions include buyers’ commissions, sellers’ commissions, and buyback commissions, each of which is calculated based on a percentage of the hammer price (sale price). Buyers’ and sellers’ commissions are recognized upon the confirmation of the identification of the winning bidders. Funds received from winning bidders include the hammer price plus the commission. Only the commission portion of the funds received from winning bidders is recorded as revenue.



Buyback commissions represent an agreed upon rate charged by us for goods entered in the auction and not sold. Goods remain unsold when an auction lot does not meet the consignor reserve, which is the minimum sales price as determined prior to auction, and when items sold at auction are returned subsequent to the winning bidder taking possession. Buyback commission is recognized along with sellers' commission or at the time an item is returned. Returns from winning bidders are very limited and primarily occur when a rare coin sold at auction has an error in its description in which the winning bidder relied upon to purchase the item.

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*DGSE COMPANIES, Inc. and Subsidiaries*

**Results of Operations**

**Nine Months Ended September 30, 2007 compared to Nine Months Ended September 30, 2006**

Sales increased by \$7,529,662 or 23.9%, during the nine months ended September 30, 2007 as compared to 2006. This increase was primarily the result of additional sales from the acquired locations of Superior Galleries and Eules Gold & Silver, Inc. off set by a slight decrease in bullion revenue. The decrease in bullion sales was the result of less volatile gold prices during the first nine months of 2007 as compared to 2006. Consumer loan service fees increased \$49,109, or 33.9%, in 2007 due to an increase in pawn loans outstanding during the period. Cost of goods as a percentage of sales decreased from 85.5% in 2006 to 83.2% in 2007. This decrease was due to the decrease in bullion revenue as a percentage of total sales and that the gross margins on bullion transactions are generally low.

Selling, general and administrative expenses increased by \$2,154,233 or 60.8%, during the nine months ended September 30, 2007 as compared to 2006. This increase was primarily due to an increase in staff and payroll related cost of \$1,173,642 and higher advertising cost of \$314,796. The additional increase was due to the approximately \$623,000 in normal operating expenses (other than payroll and advertising) associated with the acquired stores. The increase in staff was necessary to support our recent acquisitions, including Superior Galleries, Inc. and the opening of our new pawn shops, one in January 2007 and one in November 2007. The increase in advertising was necessary in order to attract new customers in our local markets as well as the additional advertising associated with the start of American Gold and Silver Exchange. Depreciation and amortization increased by \$126,973, or 183.6%, during 2007 due to additional assets being purchased through our recent acquisitions and in relation to our new pawn shop openings.

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

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

**Three Months Ended September 30, 2007 compared to Three Months Ended September 30, 2006**

Sales increased by \$7,274,310 or 76.6%, during the three months ended September 30, 2007 as compared to 2006. This increase was primarily the result of additional sales from the acquired locations of Superior Galleries and Eules Gold & Silver, Inc. Consumer loan service fees increased \$33,356, or 65.3%, in 2007 due to an increase in pawn loans outstanding during the period. Cost of goods as a percentage of sales decreased from 85.0% in 2006 to 82.8% in 2007. This decrease was due to the decrease in bullion revenue as a percentage of total sales and that the gross margins on bullion transactions are generally low.

Selling, general and administrative expenses increased by \$1,540,587 or 129.9%, during the three months ended September 30, 2007 as compared to 2006. This increase was primarily due to an increase in staff and payroll related cost of \$750,376 and higher advertising cost of \$207,558. The additional increase was due to the approximately \$580,000 in normal operating expenses (other than payroll and advertising) associated with the acquired stores. The increase in staff was necessary to support our recent acquisitions, including Superior Galleries, Inc. and the opening of our new pawn shops, one in January 2007 and one in November 2007. The increase in advertising was necessary in order to attract new customers in our local markets as well as the additional advertising associated with the start of

American Gold and Silver Exchange. Depreciation and amortization increased by \$77,069, or 394.9%, during 2007 due to additional assets being purchased through our recent acquisitions and in relation to our new pawn shop openings.

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

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

*DGSE COMPANIES, Inc. and Subsidiaries*

**Liquidity and Capital Resources**

We expect capital expenditures to total approximately \$500,000 during the next twelve months. It is anticipated that these expenditures will be funded from working capital and our credit facility. As of September 30, 2007 there were no commitments outstanding for capital expenditures.

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

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

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

In December 2005, we entered into a revolving credit facility with Texas Capital Bank, N.A., which currently permits borrowings up to a maximum principal amount of \$4.3 million. 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 September 30, 2007, approximately \$4.2 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.

Upon the consummation of our acquisition of Superior, and after the exchange by Stanford of \$8.4 million of Superior debt for shares of Superior common stock, Superior amended and restated its credit facility with Stanford. The amended and restated commercial loan and security agreement, which we refer to as the loan agreement, decreased the available credit line from \$19.89 million to \$11.5 million, reflecting the \$8.4 million debt exchange. Interest on the outstanding principal balance will continue to accrue at the prime rate, as reported in the Wall Street Journal, or, during an event of default, at a rate 5% greater than the prime rate as so reported.

The new credit facility is split into two revolving loans of \$5 million and \$6.5 million. Loan proceeds can only be used for customer loans consistent with specified loan policies and procedures and for permitted inter-company transactions. Permitted inter-company transactions are loans or dividends paid to us or our other subsidiaries. We guaranteed the repayment of these permitted inter-company transactions pursuant to a secured guaranty in favor of Stanford. In connection with the secured guarantee, Stanford and Texas Capital Bank, N.A., our primary lender, entered into an intercreditor agreement with us, and we entered into a subordination agreement with Superior, both of which subordinate Stanford's security interests and repayment rights to those of Texas Capital Bank.

As of September 30, 2007, approximately \$5.3 million was outstanding under the revolving credit facility.

The new credit facility matures on May 1, 2011, provided that in case any of several customary events of default occurs, Stanford may declare the entire principal amount of both loans due immediately and take possession and dispose of the collateral described below. An event of default includes, among others, the following events: failure to make a payment when due under the loan agreement; breach of a covenant in the loan agreement or any related agreement; a representation or warranty made in the loan agreement or related agreements is materially incorrect; a default in repayment of borrowed money to any person; a material breach or default under any material contract; certain bankruptcy or insolvency events; and a default under a third-party loan. Superior is obligated to repay the first revolving loan from the proceeds of the inventory or other collateral purchased with the proceeds of the loan.

***DGSE COMPANIES, Inc. and Subsidiaries***

The loans will be secured by a first priority security interest in substantially all of Superior's assets, including inventory, accounts receivable, promissory notes, books and records and insurance policies, and the proceeds of the foregoing. In addition, pursuant to the secured guaranty and intercreditor arrangements described above, Stanford will have a second-order security interest in all of our accounts and inventory.

The loan agreement includes a number of customary covenants applicable to Superior, including, among others: punctual payments of principal and interest under the credit facility; prompt payment of taxes, leases and other indebtedness; maintenance of corporate existence, qualifications, licenses, intellectual property rights, property and assets; maintenance of satisfactory insurance; preparation and delivery of financial statements for us and separately for Superior in accordance with generally accepted accounting principles, tax returns and other financial information; inspection of offices and collateral; notice of certain events and changes; use of proceeds; notice of governmental orders which may have a material adverse effect, SEC filings and stockholder communications; maintenance of property and collateral; and payment of Stanford expenses.

In addition, Superior has agreed to a number of negative covenants in the loan agreement, including, among others, covenants not to: create or suffer a lien or other encumbrance on any collateral, subject to customary exceptions; incur, guarantee or otherwise become liable for any indebtedness, subject to customary exceptions; acquire indebtedness of another person, subject to customary exceptions and permitted inter-company transactions; issue or acquire any shares of its capital stock; pay dividends other than permitted inter-company transactions or specified quarterly dividends, or directors' fees; sell or abandon any collateral except in the ordinary course of business or consolidate or merge with another entity; enter into affiliate transactions other than in the ordinary course of business on fair terms or permitted inter-company transactions; create or participate in any partnership or joint venture; engage in a new line of business; pay principal or interest on subordinate debt except as authorized by the credit facility; or make capital expenditures in excess of \$100,000 per fiscal year.

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 \$2,441,922 and an interest rate of 6.70%. The loan has required monthly payments of \$20,192.00 with the final payment due on August 1, 2016.

We estimate that we will pay approximately \$945,000 in interest during the next twelve months.

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

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

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

**Item 4. Controls and Procedures.**

*Evaluation of disclosure controls and procedures.* An evaluation was performed under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e)

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

*Changes in internal controls.* For the quarter ended September 30, 2007, there have been no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

*DGSE COMPANIES, Inc. and Subsidiaries*

**PART II- OTHER INFORMATION**

**Item 1. Legal Proceedings**

On June 6, 2006 Superior Galleries was sued in the U.S. District Court for Central California by Elaine and Dean Sanders in connection with a loan made to them against 32 coins placed on consignment on June 26, 2004. Fourteen of the coins were sold, and the proceeds from this sale of approximately \$186,750 were insufficient to repay the remaining loan balance of \$359,471 that Superior made to the Sanders. The plaintiffs subsequently paid an additional \$155,000 in December 2005 with respect to the loan, but now allege that Superior violated its agreement with them relating to the sale of the coins. Superior strongly denies that it violated the agreement or that it acted improperly in any way. The complaint seeks undefined dollar amounts, accrued interest and reimbursement of plaintiffs' legal costs.

In April 2004 Superior sued its former Chief Financial Officer, Malingham Shrinivas, in Los Angeles Superior Court for breach of contract, fraud and conspiracy. In that lawsuit, Superior alleged that he fraudulently arranged to receive more salary than he was entitled to, to pay personal expenses using Superior's funds, and to pay third party vendors with Superior's funds for services which were not rendered. In July 2004 Mr. Shrinivas filed a counterclaim in this litigation, claiming that he was terminated without just cause and was therefore entitled to \$58,250 in severance pay. Although the case had been scheduled for trial in August 2006, prior to that time the case was stayed by order of the Superior Court because the Court had been advised that criminal charges against Mr. Shrinivas related to this matter were imminent. Those criminal charges were subsequently filed and then dropped, and therefore further proceedings in connection with the civil case will continue, but a trial date has not been scheduled. Superior believes that Mr. Shrinivas was terminated with cause and that he is therefore not entitled to any severance pay. The stay of our civil case was lifted and mediation has been scheduled in November 2007. Superior intends to vigorously pursue its claims and defend Mr. Shrinivas' claims for severance pay.

On November 7, 2006 Superior was sued in the United States District Court for the Northern District of Texas by a competitor, Heritage Numismatic Auctions, Inc. ("Heritage"). In its complaint, Heritage alleges that Superior violated Heritage's copyright rights by copying Heritage's catalog descriptions of certain coins and currency offered for sale by Heritage. Heritage claims that these alleged actions also violate the California Unfair Competition Act. Heritage seeks an injunction ordering Superior to cease the alleged acts of infringement and to destroy the infringing items and damages in unspecified amounts. Superior denies that they have infringed any of Heritage's legal rights and intends to vigorously defend this suit. Superior had reserved for its own legal costs, estimated to be \$50,000.

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.



*DGSE COMPANIES, Inc. and Subsidiaries*

**Item 1A. Risk Factors.**

***Changes in customer demand for our products and services could result in a significant decrease in revenues.***

Although our customer base commonly uses our products and services, our failure to meet changing demands of our customers could result in a significant decrease in our revenues.

***Changes in governmental rules and regulations applicable to the specialty financial services industry could have a negative impact on our lending activities.***

Our lending is subject to extensive regulation, supervision and licensing requirements under various federal, state and local laws, ordinances and regulations. New laws and regulations could be enacted that could have a negative impact on our lending activities.

***Fluctuations in our inventory turnover and sales.***

We regularly experience fluctuations in our inventory balances, inventory turnover and sales margins, yields on loan portfolios and pawn redemption rates. Changes in any of these factors could materially and adversely affect our profitability and ability to achieve our planned results.

***Changes in our liquidity and capital requirements could limit our ability to achieve our plans.***

We require continued access to capital, and a significant reduction in cash flows from operations or the availability of credit could materially and adversely affect our ability to achieve our planned growth and operating results. Similarly, if actual costs to build new stores significantly exceeds planned costs, our ability to build new stores or to operate new stores profitably could be materially restricted. The DGSE credit agreement also limits the allowable amount of capital expenditures in any given fiscal year, which could limit our ability to build new stores.

***Changes in competition from various sources could have a material adverse impact on our ability to achieve our plans.***

We encounter significant competition in connection with our retail and lending operations from other pawnshops, cash advance companies and other forms of financial institutions and other retailers, many of which have significantly greater financial resources than us. Significant increases in these competitive influences could adversely affect our operations through a decrease in the number or quality of payday loans and pawn loans or our ability to liquidate forfeited collateral at acceptable margins.

In the coins and other collectibles business, we will compete with a number of comparably sized and smaller firms, as well as a number of larger firms throughout the United States. Our primary competitors are Heritage Auction Galleries, a large scale coin dealer and auctioneer, and American Numismatic Rarities, a comparably-sized coin auctioneer. Many of our competitors have the ability to attract customers as a result of their reputation and the quality collectibles they obtain through their industry connections. Additionally, other reputable companies that sell or auction rare coins and other collectibles may decide to enter our markets to compete with us. These companies have greater name recognition and have greater financial and marketing resources than we do. If these auction companies are successful in entering the specialized market for premium collectibles in which we participate or if dealers and sellers participate less in our auctions, we may attract fewer buyers and our revenue could decrease.

***Our earnings could be negatively impacted by an unfavorable outcome of litigation, regulatory actions, or labor and employment matters.***

From time to time, we are involved in litigation, regulatory actions and labor and employment matters arising from our normal operations. Currently we are a defendant in several actions. Although we believe the resolution of these actions will not have a material adverse effect on our financial condition, results of operation or liquidity, there can be no assurance as to the ultimate outcome of these or future actions.

***DGSE COMPANIES, Inc. and Subsidiaries***

***A failure in our information systems could prevent us from effectively managing and controlling our business or serving our customers.***

We rely on our information systems to manage and operate our stores and business. Each store is part of an information network that permits us to maintain adequate cash inventory, reconcile cash balances daily and report revenues and expenses timely. Any disruption in the availability of our information systems could adversely affect our operation, the ability to serve our customers and our results of operations.

***A failure of our internal controls and disclosure controls and procedures, or our inability to comply with the requirements of section 404 of the Sarbanes-Oxley Act in a timely fashion could have a material adverse impact on us and our investors' confidence in our reported financial information.***

Effective internal controls and disclosure controls and processes are necessary for us to provide reliable financial reports and to detect and prevent fraud. We are currently performing the system and process evaluation required to comply with the management certification and auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act. This evaluation may conclude that enhancements, modifications or changes to our controls are necessary. Completing this evaluation, performing testing and implementing any required remedial changes will require significant expenditures and management attention. We cannot be certain as to the timing of completion of our evaluation, testing and remediation actions or the impact of these on our operations. We cannot be certain that significant deficiencies or material weaknesses will not be identified, or that remediation efforts will be timely to allow us to comply with the requirements of Section 404 of the Sarbanes-Oxley Act. If we are unable to comply with the requirements of Section 404 of the Sarbanes-Oxley Act, investors could lose confidence in our reported financial information.

***Changes in general economic conditions could negatively affect loan performance and demand for our products and services.***

A sustained deterioration in the economic environment could adversely affect our operations by reducing consumer demand for the products we sell.

***Interest rate fluctuations could increase our interest expense.***

Although the U.S. Federal Reserve halted a sustained period of regular interest rate hikes in August 2006, interest rates could continue to rise which would, in turn, increase our cost of borrowing.

***Our success depends on our ability to attract, retain and motivate management and other skilled employees.***

Our future success and growth depend on the continued services of our key management and employees. The loss of the services of any of these individuals or any other key employee or contractor could materially affect our business. Our future success also depends on our ability to identify, attract and retain additional qualified personnel. Competition for employees in our industry is intense and we may not be successful in attracting or retaining them. There are a limited number of people with knowledge of, and experience in, our industry. We do not have employment agreements with many of our key employees. We do not maintain life insurance policies on many of our employees. Our loss of key personnel, especially without advance notice, or our inability to hire or retain qualified personnel, could have a material adverse effect on sales and our ability to maintain our technological edge. We cannot guarantee that we will continue to retain our key management and skilled personnel, or that we will be able to attract, assimilate and retain other highly qualified personnel in the future.

***The voting power in our company is substantially controlled by a small number of stockholders, which may, among other things, delay or frustrate the removal of incumbent directors or a takeover attempt, even if such events may be beneficial to our stockholders.***

As of June 29, 2007, Stanford International Bank Ltd., which we refer to as Stanford, and Dr. L.S. Smith, our chairman and chief executive officer, collectively had the power to vote approximately 63% of our voting securities, and beneficially owned approximately 56.4% of our voting securities on a fully-diluted basis (after giving effect to the exercise of all options and warrants held by them which are exercisable within sixty days of June 29, 2007 but not giving effect to the exercise of any other options or warrants). Consequently, these two stockholders may have sufficient voting power to control the outcome of virtually all corporate matters submitted to the vote of our common stockholders. Those matters could include the election of directors, changes in the size and composition of our board of directors, mergers and other business combinations involving us, or the liquidation of our company. In addition, Stanford and Dr. Smith have entered into a corporate governance agreement with us, which entitles Stanford and Dr. Smith to each nominate two “independent” directors to our board and entitles Dr. Smith, our chairman and chief executive officer, and William H. Oyster, our president and chief operating officer, to be nominated to our board for so long as he remains an executive officer.

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Through this control of company nominations to our board of directors and through their voting power, Stanford and Dr. Smith are able to exercise substantial control over certain decisions, including decisions regarding the qualification and appointment of officers, dividend policy, access to capital (including borrowing from third-party lenders and the issuance of additional equity securities), a merger or consolidation with another company, and our acquisition or disposition of assets. Also, the concentration of voting power in the hands of Stanford and Dr. Smith could have the effect of delaying or preventing a change in control of our company, even if the change in control would benefit our other stockholders. The significant concentration of stock ownership may adversely affect the trading price of our common stock due to investors' perception that conflicts of interest may exist or arise.

***We could be subject to sales taxes, interest and penalties on interstate sales for which we have not collected taxes.***

Superior has not collected California sales tax on mail-order sales to out-of-state customers, nor has it collected use tax on its interstate mail order sales. We believe that our sales to interstate customers are generally tax-exempt due to varying state exemptions relative to the definitions of being engaged in business in particular states and the lack of current Internet taxation. While we have not been contacted by any state authorities seeking to enforce sales or use tax regulations, we cannot assure you that we will not be contacted by authorities in the future with inquiries concerning our compliance with current statutes, nor can we assure you that future statutes will not be enacted that affect the sales and use tax aspects of our business.

***We may incur losses as a result of accumulating inventory.***

In addition to auctioning rare coins on consignment, a substantial portion of the rare coins that Superior sells comes from its own inventory. Superior purchases these rare coins from dealers and collectors and assumes the inventory and price risks of these items until they are sold. If Superior is unable to resell the rare coins that it purchases when it wants or needs to, or at prices sufficient to generate a profit from their resale, or if the market value of the inventory of purchased rare coins were to decline, our revenue would likely decline.

***If we experience an increase in the rescission of sales, our revenue and profitability could decrease.***

Our operating results could suffer if we experience a significant increase in the number of sales that are rescinded due to questions about title, provenance or authenticity of an item. Superior warrants the title, provenance and authenticity of each item that it sells at auction. A buyer who believes that any of these characteristics is in doubt must notify Superior in writing within a certain number of days after the date of sale of the property. If Superior cannot substantiate the questioned characteristics, the buyer may rescind the purchase and Superior will refund the price paid at auction to the buyer. When a purchase is rescinded, the seller is required to refund the item's sale price less sellers' commissions and other sellers' fees.

***Our planned expansion and enhancement of our website and internet operations may not result in increased profitability.***

The satisfactory performance, reliability and availability of our website and network infrastructure are and will be critical to our reputation and our ability to attract and retain customers and technical personnel and to maintain adequate customer service levels. Any system interruptions or reduced performance of our website could materially adversely affect our reputation and our ability to attract new customers and technical personnel. We are in the process of development and/or enhancement of several portions of our websites that will offer content and auctions for rare coins that may have a lower average selling price than many of the rare coins in the markets we currently serve, and in the future we plan to integrate various of our websites. Continued development of our websites will require significant resources and expense. If the planned expansion of our websites does not result in increased revenue, we may

experience decreased profitability.

***Our websites may be vulnerable to security breaches and similar threats which could result in our liability for damages and harm to our reputation.***

Despite the implementation of network security measures, our websites are vulnerable to computer viruses, break-ins and similar disruptive problems caused by internet users. These occurrences could result in our liability for damages, and our reputation could suffer. The circumvention of our security measures may result in the misappropriation of customer or other confidential information. Any such security breach could lead to interruptions and delays and the cessation of service to our customers and could result in a decline in revenue and income.

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***DGSE COMPANIES, Inc. and Subsidiaries***

***Changes to financial accounting standards and new exchange rules could make it more expensive to issue stock options to employees, which would increase compensation costs and may cause us to change our business practices.***

We prepare our financial statements to conform with generally accepted accounting principles, or GAAP, in the United States. These accounting principles are subject to interpretation by the Public Company Accounting Oversight Board, the SEC and various other bodies. A change in those policies could have a significant effect on our reported results and may affect our reporting of transactions completed before a change is announced.

***We are subject to new corporate governance and internal control reporting requirements, and our costs related to compliance with, or our failure to comply with existing and future requirements could adversely affect our business.***

We face new corporate governance requirements under the Sarbanes-Oxley Act of 2002, as well as new rules and regulations subsequently adopted by the SEC, the Public Company Accounting Oversight Board and the American Stock Exchange. These laws, rules and regulations continue to evolve and may become increasingly stringent in the future. In particular, we will be required to include management's report on internal controls as part of our annual report for the year ending December 31, 2007 pursuant to Section 404 of the Sarbanes-Oxley Act. We are in the process of evaluating our control structure to help ensure that we will be able to comply with Section 404 of the Sarbanes-Oxley Act. We cannot assure you that we will be able to fully comply with these laws, rules and regulations that address corporate governance, internal control reporting and similar matters. Failure to comply with these laws, rules and regulations could materially adversely affect our reputation, financial condition and the value and liquidity of our securities.

***The revolving credit facilities with Stanford International Bank Ltd. and Texas Capital Bank, N.A. is each collateralized by a general security interest in our assets. If we were to default under the terms of either credit facility, the lender would have the right to foreclose on our assets.***

In December 2005, we entered into a revolving credit facility with Texas Capital Bank, N.A., which currently permits borrowings up to a maximum principal amount of \$4.3 million. 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 September 30, 2007, approximately \$4.2 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.

In October 2003, Superior entered into a revolving credit facility with Stanford Financial Group Company, which we refer to as SFG, which has assigned the facility to Stanford. The facility currently permits borrowings up to a maximum principal amount of \$11.5 million, up to \$6 million of which Superior may upstream to DGSE. Borrowings under the revolving credit facility are collateralized by a general security interest in substantially all of Superior's assets and, to the extent of money upstreamed to DGSE, substantially all of DGSE's assets. As of September 30, 2007, approximately \$5.3 million was outstanding under the revolving credit facility. If Superior were to default under the terms and conditions of the revolving credit facility, Stanford would have the right to accelerate any indebtedness outstanding and foreclose on Superior's assets, and, subject to intercreditor arrangements with Texas Capital Bank and other limitations, our assets, in order to satisfy Superior's indebtedness. Such a foreclosure could have a material adverse effect on our business, liquidity, results of operations and financial position.

***We have not paid dividends on our common stock in the past and do not anticipate paying dividends on our common stock in the foreseeable future.***

We have not paid common stock dividends since our inception and do not anticipate paying dividends in the foreseeable future. Our current business plan provides for the reinvestment of earnings in an effort to complete development of our technologies and products, with the goal of increasing sales and long-term profitability and value. In addition, our revolving credit facility with Texas Capital Bank currently restricts, and any other credit or borrowing arrangements that we may enter into may in the future restrict or limit, our ability to pay dividends to our stockholders.



*DGSE COMPANIES, Inc. and Subsidiaries***Item 4. Submission of Matters to a Vote of Security Holders.**

On July 27, 2007, we held our annual meeting of shareholders to elect directors to the our board of directors, to serve until their successors are elected and qualified or their earlier resignation or removal and to ratify the selection of BKR Cornwell Jackson as the independent registered public accounting firm for our fiscal year ending December 31, 2007.

The voting on the above proposals was as follows:

<b>Proposal</b>	<b>For</b>	<b>Against</b>	<b>Abstain</b>
Election of the following directors to our board of directors:			
Dr. L.S. Smith, Ph.D	5,803,479	—	1,300
William H. Oyster	5,803,479	—	1,300
Dr. William P. Cordeiro, Ph.D.	5,803,479	—	1,300
Craig Alan-Lee	5,803,479	—	1,300
Richard M. Gozia	5,803,479	—	1,300
David Rector	5,803,479	—	1,300

To ratify the selection of BKR Cornwell Jackson as our independent registered public account firm for our fiscal year ending December 31, 2007

5,769,944	34,835	—
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**Item 5. Other Information.**

None.

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

<b>Exhibit No.</b>	<b>Description</b>	<b>Filed Herein</b>	<b>Incorporated by Reference</b>	<b>Form</b>	<b>Date Filed with SEC</b>	<b>Exhibit No.</b>
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

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3.3	Certificate of Resolution, dated October 14, 1981	×	8-A12G	June 23, 1999	3.3
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*DGSE COMPANIES, Inc. and Subsidiaries*

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

*DGSE COMPANIES, Inc. and Subsidiaries*

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	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
10.8	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
10.9	Support Agreement, DGSE stockholders, dated as of January 6, 2007	×	8-K	January 9, 2007	99.1
10.10	Securities Exchange Agreement, dated as of January 6, 2007	×	8-K	January 9, 2007	99.2
10.11	Warrant to DiGenova, issued January 6, 2007	×	8-K	January 9, 2007	99.3
10.12	Support Agreement, Superior stockholders, dated as of January 6, 2007	×	8-K	January 9, 2007	99.5
10.13	Asset purchase agreement, dated May 9, 2007, by and between DGSE Companies, Inc. and Eules Gold & Silver, Inc.	×	8-K	May 9, 2007	1.0
10.14	Subordinated Promissory Note dated May 9, 2007	×	8-K	May 9, 2007	2.0
10.15	Registration Rights Agreement with Stanford International Bank Ltd., dated as of May 30, 2007	×	8-K	May 31, 2007	99.1
10.16	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



*DGSE COMPANIES, Inc. and Subsidiaries*

10.17	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
10.18	Form of Warrants	×	8-K	May 31, 2007	99.4
10.19	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
10.20	Employment Agreement with L.S. Smith, dated as of May 30, 2007	×	8-K	May 31, 2007	99.6
10.21	Employment Agreement with William H. Oyster, dated as of May 30, 2007	×	8-K	May 31, 2007	99.7
10.22	Employment Agreement with John Benson, dated as of May 30, 2007	×	8-K	May 31, 2007	99.8
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	×			

**(b) Reports on Form 8-K :**

None.

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