DGSE COMPANIES INC
Form 10-Q
November 14, 2016

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 September 30, 2016

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.)*

15850 Dallas Parkway, Suite 140

Dallas, Texas 75248

(972) 587-4049

(Address, including zip code, and telephone

number, including area code, of registrant's

principal executive offices)

N/A

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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 ¨ Accelerated filer ¨
Non-accelerated filer ¨ Smaller reporting company x
(Do not check if a smaller reporting company)

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of November 14, 2016:

Class	Outstanding
Common stock, $0.01 par value per share	12,388,976

DGSE COMPANIES, INC.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

DGSE COMPANIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	September 30, 2016 (Unaudited)	December 31, 2015
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 1,141,818	$ 1,752,711
Trade receivables, net of allowances	225,726	229,848
Inventories	9,148,168	9,565,506
Prepaid expenses	95,303	106,547
Total current assets	10,611,015	11,654,612
Property and equipment, net	1,741,155	4,281,388
Intangible assets, net	3,446	13,784
Other assets	110,605	204,226
Total assets	$ 12,466,221	$ 16,154,010
LIABILITIES		
Current Liabilities:		
Line of credit, related party	$ 2,303,359	$ -
Current maturities of long-term debt	-	1,589,522
Current maturities of capital leases	12,457	12,069
Accounts payable-trade	7,091,127	5,689,056
Accrued expenses	814,659	1,174,458
Customer deposits and other liabilities	851,204	1,309,648
Liabilities related to discontinued operations	190,810	190,810
Total current liabilities	11,263,616	9,965,563
Line of credit, related party	-	2,303,359
Long-term debt, less current maturities	4,271	13,664
Total liabilities	11,267,887	12,282,586
Commitments and contingencies		

STOCKHOLDERS' EQUITY		
Common stock, $0.01 par value; 30,000,000 shares authorized; 12,389,976 and 12,296,446 shares issued and 12,388,976 and 12,295,446 shares outstanding	123,899	122,964
Additional paid-in capital	34,330,592	34,267,577
Accumulated deficit	(33,256,157)	(30,519,117)
Total stockholders' equity	1,198,334	3,871,424
Total liabilities and stockholders' equity	$ 12,466,221	$ 16,154,010

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

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DGSE COMPANIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	For the Three Months Ended September 30, 2016	2015	For the Nine Months Ended September 30, 2016	2015
Revenue:				
Sales	$ 10,572,071	$ 16,523,826	$ 37,844,993	$ 44,341,612
Cost of goods sold	8,704,491	14,137,085	31,546,514	37,052,512
Gross margin	1,867,580	2,386,741	6,298,479	7,289,100
Expenses:				
Selling, general and administrative expenses	2,184,041	2,689,569	7,401,556	8,108,750
Loss on the sale of assets	1,026,078	-	1,026,078	-
Depreciation and amortization	77,878	80,499	287,278	302,831
	3,287,997	2,770,068	8,714,912	8,411,581
Operating loss	(1,420,417)	(383,327)	(2,416,433)	(1,122,481)
Other expense (income):				
Other income, net	(3,110)	(3,766)	(3,371)	(7,469)
Interest expense	88,909	84,826	284,679	257,487
	85,799	81,060	281,308	250,018
Loss from continuing operations before income taxes	(1,506,216)	(464,387)	(2,697,741)	(1,372,499)
Income tax expense	4,334	18,159	39,960	43,082
Loss from continuing operations	(1,510,550)	(482,546)	(2,737,701)	(1,415,581)
Discontinued operations:				
Income from discontinued operations, net of taxes	825	13,848	661	58,095
Net loss	$ (1,509,725)	$ (468,698)	$ (2,737,040)	$ (1,357,486)
Basic net loss per common share:				
Loss from continuing operations	$ (0.12)	$ (0.04)	$ (0.22)	$ (0.11)
Income from discontinued operations	-	-	-	-
Net loss per share	$ (0.12)	$ (0.04)	$ (0.22)	$ (0.11)
Diluted net loss per common share:				

Loss from continuing operations	$(0.12)	$(0.04)	$(0.22)	$(0.11)
Income from discontinued operations	-	-	-	-
Net loss income per share	$(0.12)	$(0.04)	$(0.22)	$(0.11)
Weighted-average number of common shares				
Basic	12,358,466	12,295,446	12,327,753	12,267,475
Diluted	12,358,466	12,295,446	12,327,753	12,267,475

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

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DGSE COMPANIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	For the Nine Months Ended September 30, 2016	2015
Cash Flows From Operating Activities:		
Net loss	$ (2,737,040)	$ (1,357,486)
Income from discontinued operations, net of tax	661	58,095
Loss from continuing operations, net of tax	(2,737,701)	(1,415,581)
Adjustments to reconcile loss from continuing operations to net cash used in operating activities of continuing operations:		
Depreciation and amortization	287,278	302,831
Loss on the sale of assets	1,026,078	-
Stock based compensation to employees, officers and directors	63,950	36,882
Changes in operating assets and liabilities:		
Trade receivables, net	4,122	737,002
Inventories	417,338	465,887
Prepaid expenses	11,244	(67,217)
Other assets	93,621	2,710
Accounts payable and accrued expenses	1,042,271	(1,939,872)
Customer deposits and other liabilities	(458,444)	1,360,818
Net cash used in operating activities of continuing operations	(250,243)	(516,540)
Cash Flows From Investing Activities:		
Proceeds from sale of assets	2,124,416	-
Purchases of property and equipment	(887,201)	(235,488)
Net cash provided by (used in) investing activities of continuing operations	1,237,215	(235,488)
Cash Flows From Financing Activities:		
Repayment of debt	(1,589,521)	(97,427)
Payments on capital lease obligations	(9,005)	(9,573)
Net cash used in financing activities of continuing operations	(1,598,526)	(107,000)
Cash Flows From Discontinued Operations:		
Net cash provided by operating activities of discontinued operations	661	16,745

Net change in cash and cash equivalents	(610,893)	(842,283)
Cash and cash equivalents, beginning of period	1,752,711	2,184,435
Cash and cash equivalents, end of period	$ 1,141,818	$ 1,342,152
Supplemental Disclosures:		
Cash paid during the period for:		
Interest	$ 237,849	$ 149,884
Income taxes	$ -	$ -

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

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DGSE COMPANIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1 - Basis of Presentation

The consolidated interim financial statements of DGSE Companies, Inc., a Nevada corporation, and its subsidiaries (the “Company” or “DGSE”), included herein have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) have been condensed or omitted pursuant to the Commission’s rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading. The Company suggests that these financial statements be read in conjunction with the financial statements and notes included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2015, including Amendment No. 1 (such fiscal year, “Fiscal 2015” and such Annual Report on Form 10-K, including Amendment No. 1, the “Fiscal 2015 Annual Report”). In the opinion of the management of the Company, the accompanying unaudited interim financial statements contain all adjustments, consisting only of those of a normal recurring nature, necessary to present fairly its results of operations and cash flows for the periods presented. The results of operations for the periods presented are not necessarily indicative of the results to be expected for the full year. Certain reclassifications were made to the prior year's consolidated financial statements to conform to the current year presentation.

Note 2 - Principles of Consolidation and Nature of Operations

DGSE buys and sells jewelry and bullion products to both retail and wholesale customers throughout the United States through its facilities in South Carolina and Texas.

The interim consolidated financial statements have been prepared in accordance with U.S. GAAP and include the accounts of the Company and its subsidiaries. All material intercompany transactions and balances have been eliminated.

Note 3 - Critical Accounting Policies and Estimates

Financial Instruments

The carrying amounts reported in the consolidated balance sheets for cash equivalents, accounts receivable, accounts payable and accrued expenses approximate fair value because of the immediate or short-term maturity of these financial instruments. The line of credit, related party does not bear a market rate of interest. Management believes that, based on the Company's situation at the time the line was negotiated, it could not have obtained comparable financing, and as such cannot estimate the fair value of the line of credit, related party. The carrying amounts reported for the Company's long-term debt and capital leases approximate fair value because substantially all of the underlying instruments have variable interest rates, which adjust frequently, or the interest rates approximate current market rates. None of these instruments are held for trading purposes.

Earnings Per Share

Basic earnings per common share is computed by dividing net earnings available to holders of the Company's common stock by the weighted average number of common shares outstanding for the reporting period. Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. For the calculation of diluted earnings per share, the basic weighted average number of shares is increased by the dilutive effect of stock options outstanding determined using the treasury stock method.

Recent Accounting Pronouncement

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

On July 22, 2015, the FASB issued Accounting Standards Update No. 2015-11, *Simplifying the Measurement of Inventory* (“ASU 2015-11”). ASU 2015-11 requires an entity to measure most inventory at the lower of cost and net realizable value, thereby simplifying the current guidance under which an entity must measure inventory at the lower of cost or market. ASU 2015-11 will not apply to inventories that are measured using either the last-in, first-out (“LIFO”) method or the retail inventory method. ASU 2015-11 is effective for public entities for financial statements issued for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. However, early application is permitted. The Company is evaluating the financial statement implications of adopting ASU 2015-11.

In November 2015, the FASB issued Accounting Standards Update No. 2015-17, *Balance Sheet Classification of Deferred Taxes* (“ASU 2015-17”), which requires entities to present deferred tax assets and liabilities as non-current in a classified balance sheet. Entities are permitted to apply ASU 2015-17 prospectively or retrospectively. For the Company, the new standard is effective for annual periods beginning after December 15, 2016 and interim periods within those years. However, early adoption is permitted. The Company has adopted this standard on a retrospective basis. The adoption of this did not have an impact on the Company’s consolidated balance sheet as the Company currently has a full valuation allowance recorded on its deferred tax assets.

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

On March 30, 2016, the FASB issued Accounting Standards Update 2016-09, *Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting* (“ASU 2016-09”), which simplifies the accounting for share-based payment transactions. This update requires that excess tax benefits and tax deficiencies will be recognized as income tax expense or benefit in the consolidated statements of income rather than additional paid-in capital. Additionally, the excess tax benefits will be classified along with other income tax cash flows as an operating activity, rather than a financing activity, on the statement of cash flows. Further, the update allows an entity to make a policy election to recognize forfeitures as they occur or estimate the number of awards expected to be forfeited. ASU 2016-09 is effective for annual and interim periods beginning after December 15, 2016, and should be applied prospectively, with certain cumulative effect adjustments. The Company will adopt ASU 2016-09 no later than the required date of January 1, 2017. We do not expect this standard to have a material impact on our consolidated financial statements.

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Note 4 - Inventories

A summary of inventories is as follows:

	September 30, 2016	December 31, 2015
Jewelry	$ 7,863,571	$ 8,365,828
Scrap gold	714,238	506,560
Bullion	282,175	357,644
Rare coins and Other	288,184	335,474
	$ 9,148,168	$ 9,565,506

Note 5 - Basic and Diluted Average Shares

A reconciliation of basic and diluted weighted average common shares for the three and nine months ended September 30, 2016 and 2015 is as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
Basic weighted average shares	12,358,466	12,295,446	12,327,753	12,267,475
Effect of potential dilutive securities	-	-	-	-
Diluted weighted average shares	12,358,466			