DGSE COMPANIES INC
Form 10-K
April 02, 2007

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO SECTIONS 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

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

For the fiscal year ended December 31, 2006

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

Commission File No. 001-11048

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.)

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)

Securities registered pursuant to Section 12(b) of the Act: **None**
Securities registered pursuant to Section 12(g) of the Act:
Common Stock, par value $.01 per share
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

YES o NO þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.

YES o NO þ

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

YES þ NO o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

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 o Accelerated filer o Non-accelerated filer þ

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

Aggregate market value of the 2,733,926 shares of Common Stock held by non-affiliates of the registrant at the closing sales price as reported on the National Association of Securities Dealers Automated Quotation System National Market System on June 30, 2006	**$6,534,083**
Number of shares of Common Stock outstanding as of the close of business on March 27, 2007:	**4,913,290**

Documents incorporated by reference:

Portions of the definitive proxy statement relating to the 2007 Annual Meeting of Stockholders of DGSE Companies, Inc. are incorporated by reference into Part III of this report.

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PART I

ITEM 1. BUSINESS.

Overview

Unless the context indicates otherwise, references to we, us and our refers to the consolidated business operations of DGSE Companies, Inc., the parent, and all of its direct and indirect subsidiaries.

We sell jewelry, bullion products and rare coins to both retail and wholesale customers throughout the United States and make collateralized loans to individuals. Our products are marketed through our facilities in Dallas and Carrollton, Texas and Mt. Pleasant, South Carolina and through our internet web sites dgse.com; USBullionExchange.com; and, FairchildWatches.com.

We operate three internet sites on the World Wide Web. Through dgse.com we operate a virtual store and a real-time auction of our jewelry products. We and our customers buy and sell items of jewelry and are free to set prices in an interactive market. We also offer customers the key unlimited trading power to buy and sell precious metal assets. Customers have access to our competitive two-way markets in all of the most popularly traded precious metal products as well as current quotations for precious metals prices on our internet site USBullionExchange.com. FairchildWatches.com provides wholesale customers a virtual catalog of our fine watch inventory. Over 7,500 items are available for sale on our internet sites including $2,000,000 in diamonds.

Our wholly-owned subsidiary, National Pawn, formerly Jewelry Exchange, Inc. (NJE), operates a pawn shop in Dallas, Texas. We have focused the operations of the pawn location on sales and pawn loans of jewelry products.

In January 2005, we began offering unsecured payday loans through our wholly owned subsidiary American Pay Day Centers, Inc. which operates three locations in New Mexico.

In July 2004, we sold the goodwill and trade name of Silverman Consultants, Inc. for $150,000 in cash and a non-interest bearing note with a discounted value of $203,100.

Products and Services

Our jewelry operations include sales to both wholesale and retail customers. We sell finished jewelry, gem stones, and findings (gold jewelry components) and make custom jewelry to order. Jewelry inventory is readily available from wholesalers throughout the United States. In addition, we purchase inventory from pawn shops and individuals. Jewelry repair is also available to our customers in our Dallas, Texas and Mt. Pleasant, South Carolina locations.

Our bullion and rare coin trading operations buy and sell all forms of precious metals products including United States and other government coins, medallions, art bars and trade unit bars.

Bullion and rare coin products are purchased and sold based on current market price. The availability of precious metal products is a function of price as virtually all bullion items are actively traded. Precious metals sales amounted to 36.9% of total revenues for 2006, 30.0% in 2005 and 26.4% in 2004 (For further details, see Item 6 below).

During December 2000 we opened a new jewelry super store located in Mt. Pleasant, South Carolina. The store operates through a wholly owned subsidiary, Charleston Gold and Diamond Exchange, Inc. (CGDE). CGDE operates in a leased facility located in Mt. Pleasant, South Carolina.

We make pawn loans through our headquarter facility and through our National Jewelry Exchange, Inc. subsidiary. Pawn loans (loans) are made on the pledge of tangible personal property, primarily jewelry, for one month with an automatic sixty-day extension period (loan term). Pawn service charges are recorded on a constant yield basis over the loan term. If the loan is not repaid, the principal amount loaned plus accrued pawn service charges become the carrying value of the forfeited collateral and are transferred to inventory.

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Products and Services (*continued*)

In January 2005, we began offering unsecured payday loans through our wholly-owned subsidiary, American Pay Day Centers, Inc. Payday loans are made based on a limited review of several factors, including a customer s employment and check-writing history, and generally are made for periods of less than 30 days, averaging about 14 days. The services charge for these loans ranges between $15 and $25 per $100 loaned. We currently operate three Mono-line payday loan stores in New Mexico.

Our primary presence on the internet is through its website dgse.com. This web site serves as a corporate information site, a retail store where we sell our products and an auction site for jewelry and other products. The internet store functions as a CyberCashTM authorized site which allows customers to purchase products automatically and securely on line. Auctions close at least five times per week.

Our internet activities also includes a web site, USBullionExchange.com, which allows customers unlimited access to current quotations for prices on approximately 200 precious metals, coins and other bullion related products. In March 2005 this web site was significantly expanded to allow customers to enter immediate real-time buy and sell orders in dozens of precious metal products. This newly redesigned functionality allows our customers to fix prices in real time and to manage their precious metals portfolios in a comprehensive way.

We also offer wholesale customers a virtual catalog of our fine watch inventory through our web site Fairchildwatches.com.

We did not have any customer or supplier that accounted for more than 10% of total sales or purchases during 2006, 2005 or 2004.

Sales and Marketing

All of our activities rely heavily on local television, radio and print media advertising. Marketing activities emphasize our broad and unusual array of products and services and the attractiveness of its pricing and service.

We market our bullion and rare coin trading services through a combination of advertising in national coin publications, local print media, coin and bullion wire services and our internet web site. Trades are primarily with coin and bullion dealers on a cash on confirmation basis which is prevalent in the industry. Cash on confirmation means that once credit is approved the buyer remits funds by mail or wire concurrently with the mailing of the precious metals. Customer orders for bullion or rare coin trades are customarily delivered within three days of the order or upon clearance of funds depending on the customer s credit standing. Consequently, there was no significant backlog for bullion orders as of December 31, 2006, 2005 or 2004. Our backlogs for fabricated jewelry products were also not significant as of December 31, 2006, 2005 and 2004.

Seasonality

The retail and wholesale jewelry business is seasonal. We realized 27.7%, 41.8% and 32.5% of our annual sales in the fourth quarters of 2006, 2005 and 2004, respectively.

While our bullion and rare coin business is not seasonal, management believes it is directly impacted by the perception of inflation trends. Historically, anticipation of increases in the rate of inflation has resulted in higher levels of interest in precious metals as well as higher prices for such metals. Our other business activities are not seasonal.

Competition

We operate in a highly competitive industry where competition is based on a combination of price, service and product quality. Our jewelry and consumer loan activities compete with numerous other retail jewelers and consumer lenders in Dallas, Texas and Mt. Pleasant, South Carolina and the surrounding areas.

The bullion and rare coin industry in which we compete is dominated by substantially larger enterprises which wholesale bullion, rare coin and other precious metal products.

We attempt to compete in all of our activities by offering high quality products and services at prices below that of our competitors and by maintaining a staff of highly qualified employees.

Employees

As of December 31, 2006, we employed 50 individuals, all of whom were full time employees.

Available Information

Our website is located at www.dgse.com. Through this website, we make available free of charge all of our Securities and Exchange Commission filings. In addition, a complete copy of our Code of Ethics is available through this website.

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Proposed Acquisition of Superior Galleries, Inc.

On January 6, 2007, we entered into an Amended and Restated Agreement and Plan of Merger and Reorganization, which we refer to as the merger agreement, with Superior Galleries, Inc., a Delaware corporation which we refer to as Superior, DGSE Merger Corp., a wholly-owned subsidiary of our company which we refer to as our merger subsidiary, and Stanford International Bank Ltd., the largest Superior stockholder which we refer to as SIBL, as stockholder agent. Subject to terms and conditions of the merger agreement, our company will issue approximately 3.6 million shares of our common stock to the Superior stockholders and Superior will become a wholly-owned subsidiary of DGSE. In addition, our company will assume a number of options (including options granted to Superior employees, officers and directors pursuant to Superior s stock option plans) disclosed by Superior in connection with the merger. The consummation of the acquisition is subject to a number of conditions, including effectiveness of the registration statement on Form S-4, File No. 333-140890, which we filed with the SEC on February 26, 2007.

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, Overstock.com and Amazon.com and through its own website at SGBH.com. Superior s principal offices are located in Beverly Hills, California.

In connection with the parties entering into the merger agreement, our merger subsidiary entered into a management agreement with Superior. Pursuant to this agreement, our merger subsidiary has been providing senior management to Superior on a part-time basis since January 6, 2007, and will continue to provide these services until the consummation of the merger or the earlier termination of the merger agreement. Pursuant to the management agreement, William H. Oyster, our chief operating officer, has been appointed interim chief executive officer of Superior; Scott Williamson, our executive vice president, has been appointed interim chief operating officer of Superior; and John Benson, our chief financial officer, has been appointed vice president, finance and interim chief financial officer of Superior. All three officers manage Superior part-time pursuant to the management agreement, while continuing to provide us services as part of our senior management. All three individuals also currently serve on the Superior board of directors.

We expect the acquisition of Superior to close in the second quarter of our 2007 fiscal year. For additional information about the planned acquisition, please see our current report on Form 8-K filed with the SEC on January 9, 2007 and our related registration statement on Form S-4, File No. 333-140890, filed with the SEC on February 26, 2007.

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ITEM 1A. RISK FACTORS.

You should carefully consider the risks described below before making an investment decision. We believe these are all the material risks currently facing our business. Our business, financial condition or results of operations could be materially adversely affected by these risks. The trading price of our common stock could decline due to any of these risks, and you may lose all or part of your investment. You should also refer to the other information included or incorporated by reference in this report, including our financial statements and related notes.

Changes in customer demand for our products and services could result in a significant decrease in our 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 exceed planned costs, this could materially restrict our ability to build new stores or to operate new stores profitably. Our credit agreement also limits the allowable amount of capital expenditures in any given fiscal year, which could limit our ability to build all planned 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.

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

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, 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 timely comply with the requirements of sections 404 of the Sarbanes-Oxley Act 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.

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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 previously owned merchandise.

Interest rate fluctuations could increase the company s interest expense.

Although the weakness in the U.S. economy over the past several quarters has resulted in relatively low bank interest rates, a significant economic recovery could result in a substantial rise in interest rates that would, in turn, increase our cost of borrowing.

We face other risks discussed under qualitative and quantitative disclosures about market risk in Item 7A of this Form 10-K.

Risks Related to the Acquisition of Superior Galleries, Inc.

If we fail to effectively integrate our operations with Superior, the combined company may not realize the potential benefits of the combination.

The integration of our company and Superior will be a time-consuming and expensive process and may disrupt the combined company s operations if it is not completed in a timely and efficient manner. If this integration effort is not successful, the combined company s results of operations could be harmed, employee morale could decline, key employees could leave, customers could choose not to place new orders and the combined company could have difficulty complying with regulatory requirements. In addition, the combined company may not achieve anticipated synergies or other benefits of the combination. Following the combination, our company and Superior must operate as a combined organization utilizing common information and communication systems, operating procedures, financial controls and human resources practices. The combined company may encounter the following difficulties, costs and delays involved in integrating operations:

- failure to manage relationships with customers and other important constituents successfully;
- failure of customers to accept new services or to continue using the products and services of the combined company;
- difficulties in successfully integrating our management teams and employees with Superior s;
- challenges encountered in managing larger, more geographically dispersed operations;
- the loss of key employees;
- diversion of the attention of management from other ongoing business concerns;
- potential incompatibilities of technologies and systems;
- potential difficulties integrating and harmonizing financial reporting systems; and
- potential incompatibility of business cultures.

If the combined company s operations after the combination do not meet the expectations of our or Superior s existing customers, then these customers may cease doing business with the combined company altogether, which would harm the results of operations and financial condition of the combined company.

If the anticipated benefits of the combination are not realized or do not meet the expectations of financial or industry analysts, the market price of our common stock may decline after the combination. The market price of our common stock may decline as a result of the combination if:

- the integration of our company and Superior is unsuccessful;

- the combined company does not achieve the expected benefits of the combination as quickly as anticipated or the costs of or operational difficulties arising from the combination are greater than anticipated;

- the combined company s financial results after the combination are not consistent with the expectations of financial or industry analysts;

- the anticipated operating and product synergies of the combination are not realized; or

- the combined company experiences the loss of significant customers or employees as a result of the combination.

Failure to complete the combination could adversely affect the future business and operations of our company as well as the market price of our common stock.

The combination is subject to the satisfaction or waiver of numerous closing conditions, including the approval of the merger and reorganization by both Superior and DGSE stockholders, and may not be successfully completed. In the event that the combination is not completed, we may be subject to a number of risks, including:

The price of our common stock may decline to the extent that the current market price of the respective companies common stock reflects a market assumption that the combination will be completed.

We could suffer the loss of customers, revenues and employees due to uncertainties resulting from the uncompleted combination.

Our costs related to the proposed combination, such as legal, accounting and advisory fees, must be paid even if the combination is not completed, and these costs would reduce our reported earnings or increase our reported loss, for the period when it was determined that the combination would not be consummated.

Completion of the combination may result in our common stock being delisted from the Nasdaq Capital Market.

The completion of the combination may result in our stock being delisted from the Nasdaq Capital Market. Under Nasdaq Marketplace Rule 4340(a), an issuer must apply for initial inclusion following a transaction in which the issuer combines with a non-Nasdaq entity if the combination results in a change of control of the issuer and potentially allows the non-Nasdaq entity to obtain a Nasdaq listing. Superior is a non-Nasdaq entity and we do not currently, and may not at the time of the acquisition, satisfy the initial listing requirements of the Nasdaq Capital Market. Accordingly, if Nasdaq determines that the acquisition will result in a change of control of our company for purposes of its Rule 4340(a), Nasdaq may initiate proceedings to delist our common stock from the Nasdaq Capital Market. In this case, we may seek to be listed on the American Stock Exchange, though we do not currently, and there can be no assurances that we will at the time of the combination, satisfy the initial listing requirements of the American Stock Exchange.

Completion of the combination may result in dilution of future earnings per share to our stockholders.

The completion of the combination may not result in improved earnings per share of our common stock or a financial condition superior to that which would have been achieved by our company on a stand-alone basis. The combination could fail to produce the benefits that we anticipate, or could have other adverse effects that we currently do not foresee. In addition, some of the assumptions that we have made, such as the achievement of operating synergies, may not be realized. In this event, the combination could result in a reduction of earnings per share as compared to the earnings per share that would have been achieved by us if the combination had not occurred.

The costs associated with the combination are difficult to estimate, may be higher than expected and may harm the financial results of the combined company.

We estimate that we and Superior will each incur direct transaction costs of approximately $400,000 associated with the planned acquisition, and additional costs associated with consolidation and integration of operations, which cannot be estimated accurately at this time. If the total costs of the combination exceed estimates or the benefits of the combination do not exceed the total costs of the combination, the financial results of the combined company could be adversely affected.

Our and Superior s businesses could suffer due to the announcement and closing of the combination.

The announcement and closing of the combination may have a negative impact on our or Superior s ability to sell our respective products and services, attract and retain key management, technical, sales or other personnel, maintain and attract new customers and maintain strategic relationships with third parties. For example, we and Superior may experience deferral, cancellations or a decline in the size or rate of orders for our respective products or services or a deterioration in our respective customer or business partner relationships. Any such events could harm the operating results and financial condition of the combined company following the acquisition.

Risks Related to the Combined Company After the Combination

To facilitate a reading of the risks that we believe will apply to us and Superior as a combined company following completion of the combination, in referring to we , us and other first person declarations in these risk factors, we are referring to the combined company as it would exist following the combination.

Superior has a history of losses and may incur future losses.

Superior recorded a net loss of $2,489,000 for its fiscal year ended June 30, 2006 and a net loss of $616,000 for its fiscal year ended June 30, 2005. Superior recorded net income of $552,000 for its fiscal year ended June 30, 2004 and has incurred losses in prior fiscal years since July 1999. We cannot be certain that following the combination, Superior will become profitable as our subsidiary. If Superior does not become profitable and sustain profitability, the market price of our common stock may decline.

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.

Upon consummation of the acquisition, Stanford International Bank Ltd., which we refer to as SIBL, and Dr. L.S. Smith, our chairman and chief executive officer, will collectively have the power to vote approximately 58% of our voting securities, and beneficially own approximately 57% of our voting securities on a fully-diluted basis. 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 the board of directors, mergers and other business combinations involving our company, or the liquidation of our company. In addition, we expect to enter into a corporate governance agreement with SIBL and Dr. Smith in connection with the acquisition, which entitles SIBL and Dr. Smith to each nominate two independent directors to the DGSE board and entitles Dr. Smith and William H. Oyster, our president and chief operating officer, to be nominated to the DGSE board for so long as each remains an executive officer of DGSE. Through this control of company nominations to our board of directors and through their voting power, SIBL and Dr. Smith would be 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), and our acquisition or disposition of assets. Also, the concentration of voting power in the hands of SIBL 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, and may adversely affect the market price of our common stock.

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 Superior s 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 Superior has not been contacted by any state authorities seeking to enforce sales or use tax regulations, we cannot assure you that Superior will not be contacted by authorities in the future with inquiries concerning its 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.

The revolving credit facilities with Stanford International Bank Ltd. and Texas Capital Bank, N.A. is each collateralized by a general security interest in Superior s and our assets, respectively. If either company were to default under the terms of its 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 million. Borrowings under the revolving credit facility are collateralized by a general security interest in substantially all of our assets. As of December 31, 2006, $3.785 million was outstanding under the 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 SIBL. The facility currently permits borrowings up to a maximum principal amount of $19.89 million, and will be reduced to $11.5 million in connection with the closing of the acquisition (after the exchange by SIBL of approximately $8.4 million of outstanding debt into shares of Superior common stock). Borrowings under the revolving credit facility are collateralized by a general security interest in substantially all of Superior s assets. As of December 31, 2006, $10.85 million was outstanding under the revolving credit facility; however, in connection with the combination, it is expected that $8.4 million of that debt will be exchanged for Superior common stock and up to $6 million of the credit facility will be made available to our company. If Superior were to default under the terms and conditions of the revolving credit facility, SIBL would have the right to accelerate any indebtedness outstanding and foreclose on Superior s assets, and, subject to inter-creditor arrangements with Texas Capital Bank, 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.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

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ITEM 2. PROPERTIES.

We own a 6,000 square foot building in Dallas, Texas which houses retail and wholesale jewelry, consumer lending, bullion and rare coin trading operations and our principal executive offices. The land and building are subject to a mortgage maturing in January 2014, with a balance outstanding of approximately $427,756 as of December 31, 2006. We also lease 2,000 square feet of space in an office complex next door to our headquarters in Dallas, Texas. The lease expires on November 30, 2008 and requires monthly lease payments in the amount of $2,707.

At December 31, 2006 we were leasing a 3,600 square foot facility in Carrollton, Texas which housed National Jewelry Exchange. The lease was due to expire on July 31, 2007 and requires monthly lease payments in the amount of $2,452. In January 2007, we renamed and relocated our pawn location. National Pawn, the new name of our pawn store, is now located in Dallas, Texas. The new facility is a 4,700 square foot facility and it requires monthly lease payments in the amount of $6,552. The current lease is due to expire on December 31, 2009.

CGDE operates in a leased 22,000 square foot facility in Mt. Pleasant, South Carolina. The lease expires in June 2010 and requires monthly lease payments in the amount of $4,575.

American Pay Day Centers operates in three leased facilities averaging 800 square feet in Albuquerque, New Mexico. The leases expire on February 28, 2007, September 28, 2008 and October 31, 2007 and require monthly lease payments in the amount of $1,300, $1,400 and $1,000, respectively.

We also maintain a resident agent office in Nevada at the office of our Nevada counsel, McDonald, Carano, Wilson, McClure, Bergin, Frankovitch and Hicks, 241 Ridge Street, Reno, Nevada 89505.

ITEM 3. LEGAL PROCEEDINGS.

We are not a party to any material pending legal proceedings which are expected to have a material adverse effect on us and none of our property is the subject of any material pending legal proceedings.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

Not applicable.

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PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

On June 29, 1999, our Common Stock began trading on the NASDAQ Small CAP Market under the symbol DGSE . Previously, our Common Stock was traded on the American Stock Exchange (ASE) pursuant to its Emerging Companies listing program under the symbol DLS.EC . The following table sets forth for the period indicated, the per share high and low bid quotations as reported by NASDAQ for the common stock. During the past three years, we have not declared any dividends with respect to our common stock. We intend to retain all earnings to finance future growth; accordingly, it is not anticipated that cash dividends will be paid to holders of common stock in the foreseeable future.

The following quotations reflect inter-dealer prices without retail mark-ups, mark-downs or commissions and may not reflect actual transactions. High and low bid quotations for the last two years were:

2006	**High**	**Low**
Fourth Quarter	$4.480	$2.100
Third Quarter	3.340	1.950
Second Quarter	2.850	2.090
First Quarter	2.490	1.500

2005	**High**	**Low**
Fourth Quarter	$3.380	$1.990
Third Quarter	2.750	2.180
Second Quarter	3.150	2.080
First Quarter	3.050	2.210

On March 27, 2007, the closing sales price for our common stock was $2.52 and there were 413 shareholders of record.

Securities authorized for issuance under equity compensation plans.

We have granted options to certain officers, directors and key employees to purchase shares of our common stock. Each option vests according to a schedule designed by our board of directors, not to exceed three years. Each option expires 180 days from the date of termination of the employee or director. The exercise price of each option is equal to the market value of our common stock on the date of grant. These option grants have been approved by security holders.

The following table summarizes options outstanding as of December 31, 2006:

Plan Category	Number of securities to be issued upon exercise of options, warrants & rights	Weighted average exercise price of outstanding options, warrants & rights	Number of securities remaining available for future issuance under equity compensation plans
Equity compensation plans approved by security holders	1,435,634	$ 2.10	264,336
Equity compensation plans not approved by security holders	None		None
Total	1,435,634	$ 2.10	264,336

Stock Performance Table

The following table represents a comparison of the five year total return of our common stock to the NASDAQ Composite Index, the S&P 600 Small Cap Index and the S&P Retail Index for the period from January 1, 2002 to December 31, 2006. The comparison assumes $100 was invested on December 31, 2001 and dividends, if any, were reinvested for all years ending December 31.

Comparison of Five Year Cumulative Return

Date:	DGSE Common Stock	NASDAQ Composite Index	S&P Retail Index	S&P 600 Small Cap Index
2001	100	100	100	100
2002	31	68	78	85
2003	69	103	111	116
2004	83	111	136	142
2005	59	113	134	151
2006	75	124	146	172

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ITEM 6. SELECTED FINANCIAL DATA.

The following selected financial information should be read in conjunction with, and is qualified in its entirety by reference to the financial statements of the Company and accompanying notes included elsewhere in this Form 10-K.

	Year ended December 31,				
	2006	2005	2004	2003	2002
	(In thousands, except per share data)				
Operating Data:					
Revenues					
Sales	$ 43,669	$ 35,319	$ 28,386	$ 25,244	$ 21,083
Pawn and pay day service fees	414	320	256	182	156
Total revenue	44,083	35,639	28,642	25,426	21,239
Cost of goods sold	36,848	29,118	22,743	20,050	16,239
Gross profit	7,235	6,521	5,899	5,376	5,000
Selling, general & administrative expenses	5,773	5,349	4,724	4,054	3,948
Depreciation & amortization	139	145	123	160	158
Total operating expenses	5,912	5,494	4,847	4,214	4,106
Operating income	1,323	1,027	1,052	1,162	894
Other income (expense)					
Unrealized loss on investments				(1,635)	
Other income	16	18	24		402
Interest expense	(408)	(291)	(248)	(268)	(263)
Total other income (expense)	(392)	(273)	(224)	(1,903)	139
Income (loss) before income taxes	931	754	828	(741)	1,103
Income tax expense (benefit)	320	269	228	(334)	327
Income (loss) from continuing operations	611	485	600	(407)	706
Loss from discontinued operations, net of income taxes			(249)	(117)	(277)
Net income (loss)	$ 611	$ 485	$ 351	$ (524)	$ 429
Earnings (loss) per common share:					
Basic					
From continuing operations	$ .12	$ .10	$ .12	$ (.09)	$ .14
From discontinued operations			(.05)	(.02)	(.05)
	$ .12	$ .10	$ .07	$ (.11)	$ .09
Diluted					
From continuing operations	$ .12	$ .10	$ .12	$ (.09)	$ .14
From discontinued operations			(.05)	(.02)	(.05)
	$ .12	$ .10	$ .07	$ (.11)	$ .09

Weighted average number of common shares:					
Basic	4,913	4,913	4,913	4,913	4,914
Diluted	5,007	5,037	5,135	4,913	4,917

	Year ended December 31,				
	2006	**2005**	**2004**	**2003**	**2002**
	(In thousands, except per share data)				
Balance sheet data:					
Inventory	$7,796	$7,570	$6,791	$6,674	$6,336
Working Capital	8,178	7,073	6,234	5,570	5,055
Long-term debt	4,304	3,315	2,749	2,719	3,067
Shareholders equity	6,680	6,071	5,591	5,362	4,752

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

GENERAL

Our bullion trading operation has the ability to significantly increase or decrease sales by adjusting the spread or gross profit margin added to bullion products. In addition, economic factors such as inflation and interest rates as well as political uncertainty are major factors affecting both bullion sales volume and gross profit margins. Historically, we have earned gross profit margins of from 2.0% to 3.0% on our bullion trading operations compared to 29.0% to 32.0% on the sale of jewelry products.

Marketable equity securities have been categorized as available-for-sale and are carried at fair value. Unrealized gains and losses for available-for-sale securities are included as a component of shareholders equity net of tax until realized. Realized gains and losses on the sale of securities are based on the specific identification method.

During 2004, we sold the operations of Silverman Consultants, Inc. As a result, operating results from this subsidiary has been reclassified to discontinued operations for all periods presented. As of December 31, 2004, there were no operating assets to be disposed of or liabilities to be paid in completing the disposition of these operations.

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, pay day lending and pawn operations. Our operations by segment for the years ended December 31 were as follows: