

# Mossberg's Investor Digest

## Best Idea Profile:

## DGSE Companies, Inc. (NYSEAMEX:DGSE)

### DESCRIPTION:

Headquartered in Dallas, DGSE Companies, Inc. is a buyer and seller of jewelry, precious metals, and rare coins through retail locations and eight websites. Over 7,500 items are available for sale on DGSE internet sites. The Company's four "flagship" retail store locations range in size from 2,000 to 20,000 square feet, and its largest location produces \$70 million in annual revenue by itself. In addition, since mid-2011 DGSE has opened a half dozen new, smaller format stores named Bullion Express, and in 3Q11 acquired Southern Bullion Trading, which has approximately 25 locations in 5 southern states.

### KEY INVESTMENT CONSIDERATIONS:

**Excellent way to play gold with less volatility** - A long-term expansion in the money supply continues to create uncertainty as to the value of paper money. This trend has created a very favorable climate for trading in metals and collectables. DGSE will continue to benefit from these trends and with far less volatility than buying gold directly. In addition to uncertainty of global currencies, DGSE offers a hedge on and economic recovery, as the un-employed seek to monetize jewelry, rare coins, and precious metals to pay the rent.

**Attractive return potential** – The DGSE model is based on high asset turnover. At current run rates, DGSE is turning assets approximately 5x per year. (By comparison, jewelry stores turn inventory 1x per year) With net margins of 3-4% and modest balance sheet leverage, the business should be able to drive returns north of 20% annually. With the additional retail footprint, which will not require significant expansion of assets, the company could drive returns even higher.

**NTR Metals Relationship** – NTR Metals is the primary buyer of DGSE bullion. NTR has also acquired a 60% interest in DGSE over the past several years in a series of open market purchases and transactions. The DGSE investment more closely aligns NTR's interest with DGSE's. This may lead to better bullion prices for DGSE bullion as NTR is a large shareholder that may seek to enhance the value of its investment. Interestingly, in October NTR Metals canceled debt owed to it by DGSE worth \$2.5 million, for an option to buy 5 million shares at \$15 per share. This implies that NTR believes there is significant upside value in the shares of DGSE. Assuming NTR exercises their option, the company would raise \$75 million for expansion.

**Attractive store level economics** - The cost to build new SBT stores is \$30k to \$70k, and the average unit should generate \$1.5 MM in annual revenue. New Bullion Express stores can be opened for \$75k to \$200k, and the goal for these is \$5MM+ per store.

**Expanded retail footprint should drive 50%+ growth in 2012 & 25%+ sustainable growth long term** – With over 25 locations in 5 southern states, SBT is one of the largest precious metal dealer chains in the Southeast. SBT brings a much larger platform for DGSE to scale its operations and drive significantly higher revenue during 2012. Adding the full benefit of approximately 6-8 new Bullion Express stores, revenue should expand by greater than 50% during 2012. Longer term, the business model is easily replicable, very scalable and importantly, requires little capital to roll out on a much broader geographic area.

### VALUATION:

By simply annualizing Q311 results and adding revenues from a few new store openings, revenue could range from \$200 million to \$250 million during 2012. At 3% to 4% net margin, the business could produce \$0.50 to \$0.90 in earnings this year. Applying a 20x multiple (appropriate based on return potential) to the midpoint of the range, the stock should be capable of reaching a mid-teens valuation.

#### DGSE, Inc. (NYSEAMEX:DGSE) Investment Data (as of 2/28/12)

<b>Recent Price</b>	<b>\$7.74</b>
52-Week Range	\$4.10 - \$10.53
Fiscal Year End	Dec
Dividend	NA
Yield	NA
Shares Outstanding	11.2MM
Average Trading Volume (3 mos)	9.4K
Market Capitalization	\$84MM
Cash	\$6MM
Long Term Debt	\$8.7MM
Enterprise Value (EV)	\$90MM
Book Value	\$2.48
TTM Revenue	\$132MM
P/ Revenue	0.66x
TTM EPS	\$0.10
P/ EPS	76x
TTM EBITDA	\$3.8MM
EV/ EBITDA	24x

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