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DGSE COMPANIES INC  
Form 10QSB  
April 27, 2004

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-QSB

(Mark One)

( X ) Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 2004  
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( ) Transition Report under Section 13 or 15(d) of the Securities Exchange Act of 1934

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

Commission File Number 1-11048  
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DGSE Companies, Inc.  
(Name of small business issuer)

Nevada  
-----  
(State or other jurisdiction of incorporation or organization)

88-0097334  
-----  
(I.R.S. Employer Identification Number)

2817 Forest Lane, Dallas, Texas  
-----  
(Address of principal executive offices)

75234  
-----  
(Zip Code)

(Issuer's telephone number, including area code) (972) 484-3662  
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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 the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class                         | Outstanding at April 14, 2004 |
|-------------------------------|-------------------------------|
| -----                         | -----                         |
| Common Stock, \$.01 per value | 4,913,290                     |

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PART I. FINANCIAL INFORMATION  
Item 1. Financial Statements

DGSE Companies, Inc. and Subsidiaries

CONSOLIDATED BALANCE SHEETS

(Unaudited)

|  | March 31,<br>2004 | December 31,<br>2003 |
|--|-------------------|----------------------|
|  | -----             | -----                |
| ASSETS   |                   |                      |
| CURRENT ASSETS   |                   |                      |
| Cash and cash equivalents  | \$ 54,438         | \$ 735,293           |
| Trade receivables  | 715,255           | 774,586              |
| Other receivables  | 204,430           | 204,430              |
| Inventories  | 6,887,659         | 6,673,865            |
| Prepaid expenses   | 143,073           | 149,277              |
|  | -----             | -----                |
| Total current assets   | 8,004,855         | 8,537,451            |
| MARKETABLE SECURITIES - AVAILABLE FOR SALE   | 349,818           | 243,446              |
| PROPERTY AND EQUIPMENT - AT COST, NET  | 957,896           | 989,966              |
| GOODWILL   | 1,151,120         | 1,151,120            |
| OTHER ASSETS   | 150,497           | 149,546              |
|  | -----             | -----                |
|  | \$ 10,614,186     | \$ 11,071,529        |
|  | =====             | =====                |
| LIABILITIES AND SHAREHOLDERS' EQUITY   |                   |                      |
| CURRENT LIABILITIES  |                   |                      |
| Notes payable  | \$ 2,403,059      | \$ 541,546           |
| Current maturities of long-term debt   | 197,315           | 197,315              |
| Accounts payable - trade   | 512,864           | 859,269              |
| Accrued expenses   | 214,202           | 705,756              |
| Customer deposits  | 91,499            | 150,088              |
| Federal income taxes payable   | 308,654           | 512,991              |
|  | -----             | -----                |
| Total current liabilities  | 3,727,593         | 2,966,965            |
| Long-term debt, less current maturities  | 1,209,438         | 2,719,482            |
| Deferred income taxes  | 58,911            | 22,743               |
|  | -----             | -----                |
| Total liabilities  | 4,995,942         | 5,709,190            |
| SHAREHOLDERS' EQUITY   |                   |                      |
| Common stock, \$.01 par value; authorized 10,000,000<br>shares; issued and outstanding 4,913,290 shares at<br>March 31, 2004 and December 31, 2003 | 49,133            | 49,133               |
| Additional paid-in capital   | 5,708,760         | 5,708,760            |
| Accumulated other comprehensive income   | 70,206            | --                   |

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|                             |               |               |
|-----------------------------|---------------|---------------|
| Retained earnings (deficit) | (209,855)     | (395,554)     |
|                             | -----         | -----         |
| Total shareholders' equity  | 5,618,244     | 5,362,339     |
|                             | \$ 10,614,186 | \$ 11,071,529 |
|                             | =====         | =====         |

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

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DGSE Companies, Inc. and Subsidiaries  
CONSOLIDATED STATEMENTS OF OPERATIONS  
Three months ended  
(Unaudited)

|  | March 31, 2004 | March 31, 2003 |
|--|----------------|----------------|
|  | -----          | -----          |
| Revenue  |                |                |
| Sales  | \$ 6,848,946   | \$ 5,217,920   |
| Pawn services charges                                  | 47,630         | 41,882         |
|  | -----          | -----          |
|  | 6,896,576      | 5,259,802      |
| Costs and expenses                                     |                |                |
| Cost of goods sold                                     | 5,486,910      | 4,190,058      |
| Selling, general and administrative expenses           | 1,020,966      | 976,462        |
| Depreciation and amortization                          | 35,285         | 34,788         |
|  | -----          | -----          |
|  | 6,543,161      | 5,201,308      |
| Operating income                                       | 353,415        | 58,494         |
|  | -----          | -----          |
| Other income (expense)                                 |                |                |
| Interest expense                                       | (72,053)       | (68,030)       |
|  | -----          | -----          |
| Total other income (expense)                           | (72,053)       | (68,030)       |
| Income (loss) before income taxes                      | 281,362        | (9,536)        |
| Income tax expense (benefit)                           | 95,663         | (3,242)        |
|  | -----          | -----          |
| Net income (loss) from continuing operations           | 185,699        | (6,294)        |
| Loss from discontinued operations, net of income taxes | --             | (15,149)       |
|  | -----          | -----          |
| Net income (loss)                                      | \$ 185,699     | \$ (21,443)    |
|  | =====          | =====          |

Earnings per common share

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|   |       |           |           |
|---|-------|-----------|-----------|
| Basic and diluted                         | \$    | .04       | --        |
|   | ===== |           | =====     |
| Weighted average number of common shares: |       |           |           |
| Basic                                     |       | 4,913,290 | 4,913,790 |
| Diluted                                   |       | 5,137,431 | 4,913,790 |

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)

|   | Three Months Ended<br>March 31, |             |
|---|---------------------------------|-------------|
|   | 2004                            | 2003        |
|   | -----                           | -----       |
| Cash Flows From Operations  |                                 |             |
| Reconciliation of net loss to net cash used in operating activities |                                 |             |
| Net income (loss)   | \$ 185,699                      | \$ (21,443) |
| Depreciation and amortization                                       | 35,285                          | 42,018      |
| Deferred taxes  | --                              | (11,046)    |
| (Increase) decrease in operating assets and liabilities             |                                 |             |
| Trade receivables   | 59,331                          | 174,824     |
| Inventories   | (213,794)                       | (236,911)   |
| Prepaid expenses and other current assets                           | 6,204                           | (3,488)     |
| Accounts payable and accrued expenses                               | (837,959)                       | (620,937)   |
| Federal income taxes payable  | (204,337)                       | (150,000)   |
| Other assets  | (951)                           | (18,044)    |
|   | -----                           | -----       |
| Total net cash used in operating activities                         | (970,522)                       | (845,027)   |
| Cash flows from investing activities                                |                                 |             |
| Purchase of property and equipment                                  | (4,164)                         | (2,393)     |
| Change in deposits  | (58,589)                        | 69,964      |
|   | -----                           | -----       |
| Net cash (used) provided by investing activities                    | (62,753)                        | 67,571      |
| Cash flows from financing activities                                |                                 |             |
| Proceeds from notes issued  | 625,000                         | 625,000     |
| Payments on notes payable   | (272,580)                       | (219,680)   |
|   | -----                           | -----       |
| Net cash provided by financing activities                           | 352,420                         | 405,320     |
|   | -----                           | -----       |
| Net decrease in cash and cash equivalents                           | (680,855)                       | (372,136)   |

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|  |           |            |
|--|-----------|------------|
| Cash and cash equivalents at beginning of year | 735,293   | 498,408    |
|  | -----     | -----      |
| Cash and cash equivalents at end of period     | \$ 54,438 | \$ 126,272 |
|  | =====     | =====      |

Supplemental schedule of non-cash, investing and financing activities:

Interest paid for the three months ended March 31, 2004 and 2003 was \$ 72,053 and \$ 68,030, respectively.

Income taxes paid for the three months ended March 31, 2004 and 2003 was \$300,000 and \$150,000, respectively.

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

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### 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 Jewelry Exchange, Inc., Silverman Consultants, Inc. and Charleston Gold And Diamond Exchange, Inc. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included.

The Company's operating results for the three months ended March 31, 2004, are not necessarily indicative of the results that may be expected for the year ended December 31, 2004. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's annual report on Form 10-KSB for the year ended December 31, 2003. Certain reclassifications were made to the prior year's consolidated financial statements to conform to the current year presentation.

#### (2) Earnings per share

No reconciliation is provided for the periods ended March 31 2004 and 2003 because the effect is not dilutive.

#### (3) Business segment information

The Company's operations by business segment for the three months ended March 31, were as follows:

|          | Jewelry | Liquidations | Discontinued<br>Operations | Corporate<br>& Other | Consolidat |
|----------|---------|--------------|----------------------------|----------------------|------------|
|          | -----   | -----        | -----                      | -----                | -----      |
| Revenues |         |              |                            |                      |            |

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|                               |              |             |             |             |             |
|-------------------------------|--------------|-------------|-------------|-------------|-------------|
| 2004                          | \$ 6,799,082 | \$ 97,494   | \$ --       | \$ --       | \$ 6,896,5  |
| 2003                          | \$ 5,141,927 | \$ 117,875  | \$ --       | \$ --       | \$ 5,259,8  |
| Net income (loss)             |              |             |             |             |             |
| 2004                          | \$ 237,729   | \$ (31,995) | \$ --       | \$ (20,035) | \$ 185,6    |
| 2003                          | \$ 19,269    | \$ (9,722)  | \$ (15,149) | \$ (15,841) | \$ (21,4    |
| Identifiable assets           |              |             |             |             |             |
| 2004                          | \$ 9,673,272 | \$ 331,678  | \$ --       | \$ 609,236  | \$ 10,614,1 |
| 2003                          | \$ 9,499,275 | \$ 775,700  | \$ --       | \$ 3,002    | \$ 10,277,9 |
| Capital expenditures          |              |             |             |             |             |
| 2004                          | \$ 4,164     | \$ --       | \$ --       | \$ --       | \$ 4,1      |
| 2003                          | \$ 2,393     | \$ --       | \$ --       | \$ --       | \$ 2,3      |
| Depreciation and amortization |              |             |             |             |             |
| 2004                          | \$ 33,410    | \$ --       | \$ --       | \$ 1,875    | \$ 35,2     |
| 2003                          | \$ 40,143    | \$ 1,875    | \$ --       | \$ --       | \$ 42,0     |

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(4) Other Comprehensive income:

Other comprehensive income is as follows:

|  | Before Tax<br>Amount | Tax<br>(Expense)<br>Benefit | Net-of-Tax<br>Amount |
|--|----------------------|-----------------------------|----------------------|
|  | -----                | -----                       | -----                |
| Other comprehensive income at<br>December 31, 2003                               | \$ --                | \$ --                       | \$ --                |
| Unrealized holding gains arising during the<br>Three months ended March 31, 2004 | 106,373              | (36,167)                    | 70,206               |
|  | -----                | -----                       | -----                |
| Other comprehensive income at<br>March 31, 2004                                  | \$ 106,373           | \$ (36,167)                 | \$ 70,206            |
|  | =====                | =====                       | =====                |
| Other comprehensive income loss at<br>December 31, 2002                          | \$ (1,728,130)       | \$ 593,180                  | \$ (1,134,950)       |
| Unrealized holding gains arising during the<br>Three months ended March 31, 2003 | 75,278               | (25,594)                    | 49,684               |
|  | -----                | -----                       | -----                |
| Other comprehensive income (loss) at<br>March 31, 2003                           | \$ (1,652,852)       | \$ 567,586                  | \$ (1,085,266)       |
|  | =====                | =====                       | =====                |

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### (5) Stock-based Compensation:

The Company accounts for stock-based compensation to employees using the intrinsic value method. Accordingly, compensation cost for stock options to employees is measured as the excess, if any, of the quoted market price of the Company's common stock at the date of the grant over the amount an employee must pay to acquire the stock.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of FASB Statement No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation.

|   | Three Months Ended March 31, |             |
|---|------------------------------|-------------|
|   | 2004                         | 2003        |
| Net income(loss) as reported  | \$ 185,699                   | \$ (21,443) |
| Deduct: Total stock-based employee compensation<br>Expense determined under fair value based method<br>For all awards, net of related tax effects | --                           | --          |
| Pro forma net loss  | \$ 185,699                   | \$ (21,443) |
| Earnings per share:   |                              |             |
| Basic - as reported   | \$ .04                       | --          |
| Basic - pro forma   | \$ .04                       | --          |
| Diluted - as reported   | \$ .04                       | --          |
| Diluted pro forma   | \$ .04                       | --          |

The fair value of these options was estimated at the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions used for grants after 1998, expected volatility of 70% to 96%, risk-free rate of 3.9% to 6.6%, no dividend yield and expected life of 5 to 8 years.

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### Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

#### Results of Operations

#### Quarter ended March 31, 2004 vs 2003:

Revenue for the first quarter of 2004 increased by \$ 1,636,774 or 31.1% when compared to the corresponding quarter of 2003. The increase was the result of a \$ 1,657,155 increase in sales from the jewelry segment. The increase in jewelry segment sales was the result of a \$ 630,214 increase in precious metal sales and a \$ 1,026,941 increase in jewelry sales. These increases were due to a nation-wide improvement in the retail environment and significant price increases in precious metal products. Pawn service fees increased by 13.7% due to an increase in loan volume. Cost of sales increased primarily due to the

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increase in sales. Gross margins increased from 19.7% in 2003 to 19.9% in 2004 due to the increase in sales of jewelry products.

Selling, general and administration expenses increased by \$ 44,504 due an increase in sales staff. Income taxes are provided at the corporate rate of 34% for both 2004 and 2003

Loss from discontinued operations during 2003 in the amount of \$ 15,149 net of income taxes is the combined results of two subsidiaries of the Company, DLS Financial Services, Inc. and eye media, inc. The operations of these two companies were discontinued during 2003.

### Liquidity and Capital Resources

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The Company's short-term debt, including current maturities of long-term debt totaled \$2,600,374 as of March 31, 2004. The ability of the Company to finance its operations and working capital needs are dependent upon management's ability to negotiate extended terms or refinance its short-term debt. The Company has historically renewed, extended or replaced short-term debt as it matures and management believes that it will be able to do so in the future as short-term debt matures.

Management of the Company expects capital expenditures to total approximately \$50,000 during the balance of 2004. It is anticipated that these expenditures will be funded from working capital.

From time to time, management has adjusted the Company's 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 the Company's investments in marketable securities may be liquidated in order to meet working capital requirements.

### Contractual Cash Obligations

-----

|                                   | Total       | Payments due by year e |             |            |           |
|-----------------------------------|-------------|------------------------|-------------|------------|-----------|
|                                   | -----       | -----                  | -----       | -----      | -----     |
|                                   | Total       | 2004                   | 2005        | 2006       | 2007      |
| Notes payable                     | \$2,403,059 | \$ 278,059             | \$2,125,000 | --         | --        |
| Long-term debt and capital leases | 1,406,753   | 185,224                | \$ 484,737  | \$ 137,906 | \$ 135,33 |
| Federal income taxes              | 308,654     | 308,654                | --          | --         | --        |
| Operating leases                  | 354,027     | 175,570                | 148,205     | 18,886     | 11,36     |
|                                   | -----       | -----                  | -----       | -----      | -----     |
|                                   | \$4,472,493 | \$ 947,507             | \$2,757,942 | \$ 156,792 | \$ 146,69 |
|                                   | =====       | =====                  | =====       | =====      | =====     |

This report contains forward-looking statements which reflect the view of Company's management with respect to future events. Although management believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to have been correct. Important factors that could cause actual results to differ materially from such expectations are a down turn in the current strong retail climate and the potential for fluctuations in precious metals prices. The forward-looking statements contained herein reflect the current views of the Company's management and the Company assumes no obligation to update the forward-looking statements or to update the reasons actual results could differ from those contemplated by such forward-looking statements.



ITEM 3. Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures within 90 days of the filing date of this quarterly report, and, based on their evaluation, our principal executive officer and principal financial officer have concluded that these controls and procedures are effective. There are no significant changes in our internal controls or other factors that could significantly affect these controls subsequent to the date of their evaluation. Disclosure controls and procedures are our controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time period specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file under the Exchange Act is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

PART II. OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

- 31.1 Certificate of L.S. Smith pursuant to Section 3026 of the Sarbanes-Oxley Act of 2002, Chief Executive Officer.
- 31.2 Certificate of John Benson pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, Chief Financial Officer .
- 32.1 Certificate of L.S. Smith pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, Chief Executive Officer.
- 32.2 Certificate of John Benson pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, Chief Financial Officer.

Reports on Form 8-K - None

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SIGNATURES

In accordance with Section 13 and 15(d) of the Exchange Act, the Registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DGSE Companies, Inc.

By: /s/ L. S. Smith Dated: April 26, 2004

-----  
L. S. Smith  
Chairman of the Board,  
Chief Executive Officer and  
Secretary

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the date indicated.

By: /s/ L. S. Smith Dated: April 26, 2004

-----  
L. S. Smith  
Chairman of the Board,  
Chief Executive Officer and  
Secretary

By: /s/ W. H. Oyster Dated: April 26, 2004

-----  
W. H. Oyster  
Director, President and  
Chief Operating Officer

By: /s/ John Benson Dated: April 26, 2004

-----  
John Benson  
Chief Financial Officer  
(Principal Accounting Officer)

