

Edgar Filing: DGSE COMPANIES INC - Form 10QSB

DGSE COMPANIES INC
Form 10QSB
November 12, 2004

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

(Mark One)

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

For the quarterly period ended September 30, 2004

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

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at October 26, 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)	
ASSETS	September 30, 2004	December 31, 2003
	-----	-----
CURRENT ASSETS		
Cash and cash equivalents	\$ 244,913	\$ 735,293
Trade receivables	796,019	774,586
Other receivables	--	204,430
Inventories	7,074,398	6,673,865
Prepaid expenses	200,379	149,277
	-----	-----
Total current assets	8,315,709	8,537,451
MARKETABLE SECURITIES - AVAILABLE FOR SALE	140,002	243,446
PROPERTY AND EQUIPMENT - AT COST, NET	977,577	989,966
DEFERRED INCOME TAX BENEFIT	12,428	--
GOODWILL	837,117	1,151,120
OTHER ASSETS	299,297	149,546
	-----	-----
	\$ 10,582,130	\$ 11,071,529
	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Notes payable	\$ 2,591,758	\$ 541,546
Current maturities of long-term debt	190,845	197,315
Accounts payable - trade	317,745	859,269
Accrued expenses	130,408	705,756
Customer deposits	110,624	150,088
Federal income taxes payable	412,672	512,991
	-----	-----
Total current liabilities	3,754,052	2,966,965
Long-term debt, less current maturities	1,137,796	2,719,482
Deferred income taxes	--	22,743
	-----	-----
Total liabilities	4,891,848	5,709,190
SHAREHOLDERS' EQUITY		
Common stock, \$.01 par value; authorized 10,000,000 shares; issued and outstanding 4,913,290 shares at eptember 30, 2004 and December 31, 2003	49,133	49,133
Additional paid-in capital	5,708,760	5,708,760

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Accumulated other comprehensive (loss)	(68,273)	--
Retained earnings (deficit)	662	(395,554)
	-----	-----
Total shareholders' equity	5,690,282	5,362,339
	\$ 10,582,130	\$ 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 September 30,
(Unaudited)

	2004	2003
	-----	-----
Revenue		
Sales	\$ 6,239,150	\$ 5,449,372
Pawn services charges	68,463	46,846
	-----	-----
	6,307,613	5,496,218
Costs and expenses		
Cost of goods sold	4,973,392	4,285,006
Selling, general and administrative expenses	987,094	884,931
Depreciation and amortization	35,031	21,390
	-----	-----
	5,995,517	5,191,327
Operating income	312,096	304,891
	-----	-----
Other income (expense)		
Gain on sale of assets	39,098	--
Interest expense	(73,005)	(73,005)
	-----	-----
Total other income (expense)	(33,907)	(73,005)
Income before income taxes	278,189	231,886
Income tax expense	94,584	78,841
	-----	-----
Net income from continuing operations	183,605	153,045
Loss from discontinued operations, net of income taxes	(73,864)	(58,239)
	-----	-----
Net income	\$ 109,741	\$ 94,806
	=====	=====

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Earnings per common share		
Basic and diluted		
From continuing operations	\$.04	\$.03
From discontinued operations	(.02)	(.01)
	-----	-----
	\$.02	\$.02
	=====	=====
Weighted average number of common shares:		
Basic	4,913,290	4,913,290
Diluted	5,155,141	4,913,290

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
Nine months ended September 30,
(Unaudited)

	2004	2003
	-----	-----
Revenue		
Sales	\$ 19,160,794	\$ 16,221,338
Pawn services charges	163,177	130,358
	-----	-----
	19,323,971	16,351,696
Costs and expenses		
Cost of goods sold	15,414,425	13,029,294
Selling, general and administrative expenses	2,792,576	2,623,105
Depreciation and amortization	107,428	106,488
	-----	-----
	18,314,429	15,758,887
Operating income	-----	-----
	1,009,542	592,809
Other income (expense)		
Gain on sale of assets	39,098	--
Interest expense	(218,063)	(214,040)
	-----	-----
Total other income (expense)	(178,965)	(214,040)
Income before income taxes	830,577	378,769

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Income tax expense	282,396	128,781
	-----	-----
Net income from continuing operations	548,181	249,988
Loss from discontinued operations, net of income taxes	(151,965)	(117,042)
	-----	-----
Net income	\$ 396,216	\$ 132,946
	=====	=====
Earnings per common share		
Basic and diluted		
From continuing operations	\$.11	\$.05
From discontinued operations	(.03)	(.02)
	-----	-----
	\$.08	\$.03
	=====	=====
Weighted average number of common shares:		
Basic	4,913,290	4,913,290
Diluted	5,159,458	4,913,290

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
 Nine months ended September 30,
 (Unaudited)

	2004	2003
	-----	-----
Cash Flows From Operations		
Reconciliation of net loss to net cash used in operating activities		
Net income (loss)	\$ 396,216	\$ 132,946
Depreciation and amortization	107,428	128,178
Gain on sale of assets	(32,529)	--
Deferred taxes	--	156,495
Other	8,704	(8,013)
(Increase) decrease in operating assets and liabilities		
Trade receivables	221,074	187,552
Inventories	(400,533)	(731,923)
Prepaid expenses and other current assets	(51,102)	(91,764)
Accounts payable and accrued expenses	(1,116,872)	(537,741)
Change in customer deposits	(39,464)	128,079
Federal income taxes payable	(100,319)	(258,274)
	-----	-----
Total net cash used in operating activities	(1,007,397)	(894,465)

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Cash flows from investing activities		
Purchase of property and equipment	(95,039)	(16,583)
Proceeds from sale of assets	150,000	--
	-----	-----
Net cash (used) provided by investing activities	54,961	(16,583)
Cash flows from financing activities		
Proceeds from notes issued	1,068,660	759,054
Payments on notes payable	(606,604)	(302,282)
	-----	-----
Net cash provided by financing activities	462,056	456,772
	-----	-----
Net decrease in cash and cash equivalents	(490,380)	(454,276)
Cash and cash equivalents at beginning of year	735,293	498,408
	-----	-----
Cash and cash equivalents at end of period	\$ 244,913	\$ 44,132
	=====	=====

Supplemental disclosures:

Interest paid for the nine months ended September 30, 2004 and 2003 was \$218,063 and \$ 214,040, respectively.

Income taxes paid for the nine months ended September 30, 2004 and 2003 were \$304,430 and \$174,683, respectively.

In July 2004 the Company sold the goodwill and trade name of Silverman Consultants, Inc. for \$ 150,000 in cash and a note with a discounted value of \$ 197,162.

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 July 2004 the Company sold the goodwill and trade name of Silverman Consultants, Inc. and discontinued the operations of this subsidiary. As a result, operating results for this subsidiary have been reclassified to discontinued operations for all periods presented. 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 nine months ended September 30, 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

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statements to conform to the current year presentation.

(2) - Earnings per share

No schedule provided for the periods ended September 30, 2004 and 2003 because the effect on earnings per share is not dilutive.

(3) - Business segment information

The Company's operations by business segment for the three months ended September 30, were as follows:

	Jewelry -----	Discontinued Operations -----	Corporate & Other -----	Consolidated -----
Revenues				
2004	\$ 6,307,613	--	--	\$ 6,307,613
2003	\$ 5,496,218	--	--	\$ 5,496,218
Net income (loss)				
2004	\$ 179,594	\$ (73,864)	\$ 4,011	\$ 109,741
2003	\$ 159,799	\$ (58,239)	\$ (6,754)	\$ 94,806
Identifiable assets				
2004	\$ 10,172,811	\$ 10,932	\$ 398,387	\$ 10,582,130
2003	\$ 9,858,205	\$ 422,910	\$ 230,730	\$ 10,511,845
Capital expenditures				
2004	\$ 26,392	\$ --	\$ --	\$ 26,392
2003	\$ 6,483	\$ --	\$ --	\$ 6,483
Depreciation and amortization				
2004	\$ 33,156	\$ --	\$ 1,875	\$ 35,031
2003	\$ 21,390	\$ --	\$ --	\$ 21,390

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The Company's operations by business segment for the nine months ended September 30, were as follows:

	Jewelry -----	Discontinued Operations -----	Corporate & Other -----	Consolidated -----
Revenues				
2004	\$ 19,323,971	\$ --	\$ --	\$ 19,323,971
2003	\$ 16,351,696	\$ --	\$ --	\$ 16,351,696
Net income (loss)				
2004	\$ 586,673	\$ (151,965)	\$ (38,492)	\$ 396,216
2003	\$ 264,254	\$ (117,042)	\$ (14,266)	\$ 132,946

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Identifiable assets						
2004	\$ 10,172,811	\$ 10,932	\$ 398,387	\$ 10,582,130		
2003	\$ 9,858,205	\$ 422,910	\$ 230,730	\$ 10,511,845		
Capital expenditures						
2004	\$ 95,039	\$ --	\$ --	\$ 95,039		
2003	\$ 16,583	\$ --	\$ --	\$ 16,583		
Depreciation and amortization						
2004	\$ 101,803	\$ --	\$ 5,625	\$ 107,428		
2003	\$ 106,488	\$ --	\$ --	\$ 106,488		

(4) Other Comprehensive income:

Other comprehensive income is as follows:

	Before Tax Amount	Tax (Expense) Benefit	Net-of-Tax Amount
Other comprehensive income at December 31, 2003	\$ --	\$ --	\$ --
Unrealized holding gains arising during the Three months ended March 31, 2004	106,373	(36,167)	70,206
Other comprehensive income at March 31, 2004	106,373	(36,167)	70,206
Unrealized holding losses during the Three months ended June 30, 2004	(86,020)	29,247	(56,773)
Other comprehensive income at June 30, 2004	20,353	(6,920)	13,433
Unrealized holding losses during the Three months ended September 30, 2004	(123,796)	42,090	(81,706)
Other comprehensive loss at September 30, 2004	\$ (103,443)	\$ 35,170	\$ (68,273)
Other comprehensive income loss at December 31, 2002	\$ (1,728,130)	\$ 593,180	\$ (1,134,950)
Unrealized holding gains arising during the Three months ended March 31, 2003	75,278	(25,594)	49,684
Other comprehensive income (loss) at March 31, 2003	(1,652,852)	567,586	(1,085,266)
Unrealized holding losses arising during the Three months ended June 30, 2003	(46,260)	15,728	(30,532)

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Other comprehensive income (loss) at June 30, 2003	\$ (1,699,112)	\$ 583,314	\$ (1,115,798)
Unrealized holding (loss) arising during the Three months ended September 30, 2003	(15,970)	5,430	(10,540)
Other comprehensive income (loss) at September 30, 2003	\$ (1,715,082)	\$ 588,744	\$ (1,126,338)

(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.

	Nine Months Ended September 30,	
	2004	2003
Net income(loss) as reported	\$ 396,216	\$ 132,946
Deduct: Total stock-based employee compensation Expense determined under fair value based method For all awards, net of related tax effects	--	--
Pro forma net loss	\$ 396,216	\$ 132,946

Earnings per share:

Basic - as reported	\$.08	\$.03
Basic - pro forma	\$.08	\$.03
Diluted - as reported	\$.08	\$.03
Diluted pro forma	\$.08	\$.03

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 September 30, 2004 vs 2003:

Sales for the third quarter of 2004 increased by \$ 789,778 or 14.5% when compared to the corresponding quarter of 2003. This was the result of a \$ 209,447 increase in jewelry sales and a \$ 580,331 increase in precious metals sales. These changes were due to a nation-wide improvement in the retail environment and price increases in precious metal products. Pawn service fees increased by 46.1% due to an increase in loan volume. Cost of sales increased primarily due to the increase in sales. Gross margins decreased from 21.4% in 2003 to 20.32% in 2004 due to the increase in sales of precious metal products. Selling, general and administrative expenses increased \$ 102,163 or 11.5% during the 2004 quarter due primarily to higher payroll and related cost.

Income taxes are provided at the corporate rate of 34% for both 2004 and 2003

Loss from discontinued operations during 2004 and 2003 in the amount of \$ 73,864 and \$ 58,239 net of income taxes is the combined results of three subsidiaries of the Company, DLS Financial Services, Inc., eye media, inc. and Silverman Consultants, Inc. The operations of these companies have been discontinued.

Nine months ended September 30, 2004 vs 2003:

Sales for the nine months ended September 30, 2004 increased by \$ 2,939,456 or 18.1% when compared to the corresponding period of 2003. This was the result of a \$ 1,573,869 increase in jewelry sales and a \$ 1,365,587 increase in precious metals sales. These changes were due to a nation-wide improvement in the retail environment and price increases in precious metal products.. Pawn service fees increased by 25.2% due to an increase in loan volume. Cost of sales increased primarily due to the increase in sales. Gross margins were 19.7% in 2003 compared to 19.6% in 2004. Selling, general and administrative expenses increased \$ 169,471 or 6.5% for the first nine months of 2004 due primarily to higher payroll and related costs.

Income taxes are provided at the corporate rate of 34% for both 2004 and 2003

Loss from discontinued operations during 2004 and 2003 in the amount of \$ 151,965 and \$ 117,042 net of income taxes is the combined results of three subsidiaries of the Company, DLS Financial Services, Inc., eye media, inc. and Silverman Consultants, Inc. The operations of these companies have been discontinued.

Liquidity and Capital Resources

The Company's short-term debt totaled \$2,782,603 as of September 30, 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.

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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.

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Contractual Cash Obligations -----	Payments due by year end				
	Total -----	2004 -----	2005 -----	2006 -----	2007 -----
Notes payable	\$2,591,758	\$ 266,758	\$2,325,000	--	--
Long-term debt and capital leases	1,328,641	47,711	\$ 544,138	\$ 137,906	\$ 135,330
Federal income taxes	412,672	412,672	--	--	--
Operating leases	236,980	58,523	148,205	18,886	11,360
	-----	-----	-----	-----	-----
	\$4,570,051	\$ 785,664	\$3,017,343	\$ 156,792	\$ 146,690
	=====	=====	=====	=====	=====

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

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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.
Exhibits:

- 31.1 Certificate of L.S. Smith pursuant to Section 302 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 .
- 32.2 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.

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Reports on Form 8-K: Form 8-K dated July 30, 2004 - Item reported - Acquisition or Disposition of Assets
 Form 8-K dated October 14, 2004 - Item reported Change in Certifying Accountants
 Form 8-K/A-1 dated October 22, 2004 - Item reported Change in Certifying Accountants
 Form 8-K/A-2 dated November 1, 2004 - Item reported Change in Certifying Accountants

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

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

Dated: November 12, 2004

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: November 12, 2004

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

By: /s/ W. H. Oyster

Dated: November 12, 2004

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

By: /s/ John Benson

Dated: November 12, 2004

John Benson
Chief Financial Officer
(Principal Accounting Officer)