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DGSE COMPANIES INC
Form 10-K/A
February 02, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-K/A
AMENDMENT TO FORM 10-K
FILED APRIL 15, 2005
(Mark One)

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

For the Fiscal year ended December 31, 2004 or

() Transition Report under Section 13 or 15 (d) of the Securities Exchange Act of 1934 (No Fee Required)

For the transition period from ----- to -----

Commission file number 1-11048

DGSE Companies, Inc.

(formerly Dallas Gold & Silver Exchange, Inc.)
(Exact Name of registrant as specified in its charter)

NEVADA 88-0097334

(State or other jurisdiction of (I.R.S. Employer Identification
incorporation or organization) Number)

2817 Forest Lane, Dallas, Texas 75234

(Address of Principal Executive Offices) (Zip Code)

Registrant's telephone number, including area code (972) 484-3662

Securities registered under Section 12(b) of the Exchange Act:
Title of each class Name of each exchange on which registered

None None

Securities registered pursuant to Section 12 (g) of the Act:
Common Stock, \$.01 par value

(Title of Class)

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 past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirement for the past 90 days. Yes (X) No ()

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

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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. [X]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes () NO (X)

As of June 30, 2004, the aggregate market value of the voting stock held by non-affiliates of the registrant was \$ 9,265,900

As of March 3, 2005, 4,913,290 shares of Common Stock were outstanding.

Documents incorporated by reference: Portions of the proxy statement for the annual shareholders' meeting to be held June 16, 2005 are incorporated by reference into Part III.

PART I

ITEM 1. BUSINESS.

DGSE Companies, Inc (formerly Dallas Gold and Silver Exchange, Inc.) (the "Company") sells jewelry and bullion products to both retail and wholesale customers throughout the United States and makes collateralized loans to individuals. The Company's products are marketed through its facilities in Dallas and Carrollton, Texas and Mt. Pleasant South Carolina and through its internet web sites dgse.com; USBullionExchange.com; and, FairchildWatches.com.

The Company operates three internet sites on the World Wide Web. Through dgse.com the Company operates a virtual store and a real-time auction of its jewelry products. Customers and the Company buy and sell items of jewelry and are free to set their own prices in an interactive market. The Company also offers customers the key unlimited trading power to buy and sell precious metal assets. Customers have access to the Company's competitive two-way markets in all of the most popularly traded precious metal products as well as current quotations for precious metals prices on its internet site USBullionExchange.com. FairchildWatches.com provides wholesale customers a virtual catalog of the Company's fine watch inventory. Over 7,500 items are available for sale on the Company's internet sites including \$ 10,000,000 in diamonds.

The Company's wholly-owned subsidiary, National Jewelry Exchange, Inc. ("NJE") operates a pawn shop in Carrollton, Texas. The Company has focused the operations of NJE on sales and pawn loans of jewelry products.

In January 2005 the Company began offering unsecured payday loans through its wholly owned subsidiary American Pay Day Centers, Inc.

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 \$203,100.

Products and Services

The Company's jewelry operations include sales to both wholesale and retail

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customers. The Company sells finished jewelry, gem stones, and findings (gold jewelry components) and makes custom jewelry to order. Jewelry inventory is readily available from wholesalers throughout the United States. In addition, the Company purchases inventory from pawn shops and individuals.

The Company's bullion 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 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 26.4% of total revenues for 2004, 25.4% in 2003 and 18.5% in 2002 (For further details, see Item 6 below).

Products and Services (continued...)

During December 2000 the Company 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.

The Company makes pawn loans through its headquarter facility and through its 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. Revenues from the Company's pawn loans have grown at each location and management believes this activity to be a good source of jewelry inventory and provides an excellent return on investment.

In January 2005 the Company began offering unsecured payday loans through its 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. The Company currently operates one Mono-line payday loan store in New Mexico and plans to add between 3 and 8 new payday stores within the next year.

The Company's primary presence on the Internet is through its website dgse.com. This web site serves as a Corporate information site, a retail store where the Company sells its 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.

The Company's 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.

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The Company also offers wholesale customers a virtual catalog of the Company's fine watch inventory through its web site Fairchildwatches.com.

The Company did not have any customer or supplier that accounted for more than 10% of total sales or purchases during 2004, 2003 or 2002.

During 2003 the Company discontinued the operations of its internet software company eye media, inc. and its financial consulting company DLS Financial Services, Inc. These two companies had not solicited or received any new clients during the past two years and do not anticipate doing so in the future. Silverman Consultants, Inc. which offered consulting liquidation services was sold in July 2004.

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Sales and Marketing

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

The Company markets its bullion trading services through a combination of advertising in national coin publications, local print media, coin and bullion wire services and its 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 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, 2004, 2003 or 2002. Company backlogs for fabricated jewelry products were also not significant as of December 31, 2004, 2003 and 2004.

Seasonality

The retail and wholesale jewelry business are seasonal. The Company realized 32.5%, 36.4% and 33.2% of its annual sales in the fourth quarters of 2004, 2003 and 2002, respectively.

While the Company's bullion 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 have resulted in higher levels of interest in precious metals as well as higher prices for such metals. Other Company business activities are not seasonal.

Competition

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

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The bullion industry in which the Company competes is dominated by substantially larger enterprises which wholesale bullion and other precious metal products.

The Company attempts to compete in all of its activities by offering high quality products and services at prices below that of its competitors and by maintaining a staff of highly qualified employees.

Employees

As of December 31, 2004, the Company employed 50 individuals, all of whom were full time employees.

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Available Information

The Company's website is located at www.dgse.com. Through this website, the Company makes available free of charge all of its Securities and Exchange Commission filings. In addition, a complete copy of the Company's Code of Ethics is available through this website.

ITEM 2. PROPERTIES

The Company owns a 6,000 square foot building in Dallas, Texas which houses retail jewelry, consumer lending and bullion trading operations and its principal executive offices. The land and building are subject to a mortgage maturing in January 2014, with a balance outstanding of approximately \$ 465,724 as of December 31, 2004. The Company also leases 2,000 square feet of space in an office complex next door to its headquarters in Dallas, Texas. The lease expires in November 30, 2008 and requires monthly lease payments in the amount of \$ 2,707.

The Company leases a 3,300 square foot facility in Carrollton, Texas which houses National Jewelry Exchange. The lease expires on July 31, 2007 and requires monthly lease payments in the amount of \$ 2,645.

CGDE operates in a leased 11,000 square foot facility in Mt. Pleasant, South Carolina. The lease expires in August 2005 and requires monthly lease payments in the amount of \$ 16,263.

American Pay Day Centers operates in a leased 600 square foot in Albuquerque, New Mexico. The lease expires on August 15, 2005 and requires monthly lease payments in the amount of \$ 750.

The Company also maintains a resident agent office in Nevada at the office of its Nevada counsel, McDonald, Carano, Wilson, McClure, Bergin, Frankovitch and Hicks, 241 Ridge Street, Reno, Nevada 89505.

ITEM 3. LEGAL PROCEEDINGS

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

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

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Not applicable.

PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

On June 29, 1999 the Company's Common Stock began trading on the NASDAQ Small CAP Market under the symbol "DGSE". Previously, the Company's 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 two years, the Company has not declared any dividends with respect to its common stock. The Company intends 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.

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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:

| | 2004 | | 2003 | |
|----------------|-------|-------|-------|-------|
| | High | Low | High | Low |
| First Quarter | 4.190 | 2.200 | 3.040 | 1.150 |
| Second Quarter | 3.250 | 2.520 | 3.040 | 1.120 |
| Third Quarter | 3.400 | 2.290 | 1.400 | 1.150 |
| Fourth Quarter | 3.490 | 2.270 | 1.210 | 1.000 |

On March 3, 2005, the closing sales price for the Company's common stock was \$ 2.470 and there were 806 shareholders of record.

Securities authorized for issuance under equity compensation plans.

The Company has granted options to certain officers, directors and key employees to purchase shares of the Company's common stock. Each option vests according to a schedule designed by the board of directors of the Company, 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 the Company's 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, 2004:

| Plan Category | Number of securities to be issued upon | Weighted average exercise price of outstanding | Number of securities remaining available for future issuance |
|---------------|--|--|--|
| | | | |

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| | exercise of options warrants & rights | options, warrants & rights | under equity compensation plans |
|--|--|-------------------------------|------------------------------------|
| Equity Compensation Plans Approved By Security Holders | 1,420,634 | \$ 2.09 | 279,336 |
| Equity Compensation Plans Not Approved By Security Holders | None | | None |
| Total | 1,420,634 | \$ 2.09 | 279,336 |

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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.

SELECTED FINANCIAL DATA

| | Years Ended December 31, | | | | |
|--|--------------------------|--------|--------|--------|--------|
| | 2000 | 2001 | 2002 | 2003 | 2004 |
| (Amounts in thousands, except per share figures) | | | | | |
| Operating Data: | | | | | |
| Sales | 20,427 | 19,134 | 21,083 | 25,244 | 28,386 |
| Pawn service fees | 96 | 120 | 156 | 182 | 256 |
| Total revenues | 20,523 | 19,254 | 21,239 | 25,426 | 28,642 |
| Cost of goods sold | 15,958 | 14,743 | 16,239 | 20,050 | 22,743 |
| Gross profit | 4,565 | 4,511 | 5,000 | 5,376 | 5,899 |
| Selling, general & administrative Expenses | 3,689 | 3,601 | 3,948 | 4,054 | 4,724 |
| Depreciation & amortization | 217 | 235 | 158 | 160 | 123 |
| Operating Income | 3,906 | 3,836 | 4,106 | 4,214 | 4,847 |
| Other income (expense): | 659 | 675 | 894 | 1,162 | 1,052 |
| Unrealized loss on investments | | | | -1,635 | |
| Other income | 4 | 3 | 402 | | 24 |
| Interest expense | -311 | -298 | -263 | -268 | -248 |
| Total other income (expense) | -307 | -295 | 139 | -1,903 | -224 |
| Income (loss) before income taxes | 352 | 380 | 1,033 | -741 | 828 |

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| | | | | | |
|--|-------|-------|-------|-------|-------|
| Income tax expense (benefit) | 172 | 119 | 327 | -334 | 228 |
| | ----- | ----- | ----- | ----- | ----- |
| Income (loss) from continuing Operations | 180 | 260 | 706 | -407 | 600 |
| Loss from discontinued operations, Net of income taxes | 72 | -586 | -277 | -117 | -249 |
| | ----- | ----- | ----- | ----- | ----- |
| Net income (loss) | 252 | -325 | 429 | -524 | 351 |
| Earnings (loss) per common share | | | | | |
| Basic | | | | | |
| From continuing operating | .04 | .05 | .14 | -.09 | .12 |
| From discontinued operations | .01 | -.12 | -.05 | -.02 | -.05 |
| | ----- | ----- | ----- | ----- | ----- |
| Diluted | .05 | -.07 | .09 | -.11 | .07 |
| From continuing operating | | | | | |
| From discontinued operations | .04 | .05 | .14 | -.09 | .12 |
| | .01 | -.12 | -.05 | -.02 | -.05 |
| | ----- | ----- | ----- | ----- | ----- |
| Diluted | .05 | -.07 | .09 | -.11 | .07 |
| Weighted average number of common shares: | | | | | |
| Basic | 4,682 | 4,925 | 4,914 | 4,913 | 4,913 |
| Diluted | 5,043 | 4,925 | 4,917 | 4,913 | 5,135 |

(a) Beginning in Fiscal 2002, the Company adopted Statement of Financial Accounting Standards No. 142, which ceased amortization of certain indefinite lived intangible assets. Amortization expense for Fiscal 2000 and 2001 are stated on the historical accounting method, and are not directly comparable to Fiscal 2002, 2003, 2004 and 2005 amounts.

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Years Ended December 31,

| 2000 | 2001 | 2002 | 2003 | 2004 |
|------|------|------|------|------|
|------|------|------|------|------|

(Amounts in thousands, except per share figures)

BALANCE SHEET DATA:

| | | | | | |
|----------------------|-------|-------|-------|-------|-------|
| Inventory | 7,087 | 6,297 | 6,336 | 6,674 | 6,791 |
| Working Capital | 2,054 | 1,968 | 5,055 | 5,570 | 6,234 |
| Long-term debt | 950 | 764 | 3,067 | 2,719 | 2,749 |
| Shareholders' equity | 4,992 | 4,469 | 4,752 | 5,362 | 5,591 |

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION.

FORWARD-LOOKING INFORMATION

This Annual Report on Form 10-K, including Management's Discussion and Analysis of Financial Condition and Results of Operations, includes "forward-looking statements" within the meaning of Section

27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The Company intends that all forward-looking statements be subject to the safe harbors created by these laws. All statements other than statements of historical information provided herein are

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forward-looking and may contain information about financial results, economic conditions, trends, and known uncertainties. All forward-looking statements are based on current expectations regarding important risk factors. Many of these risks and uncertainties are beyond the ability of the Company to control, and, in many cases, the Company cannot predict all of the risks and uncertainties that could cause its actual results to differ materially from those expressed in the forward-looking statements. Actual results could differ materially from those expressed in the forward-looking statements, and readers should not regard those statements as a representation by the Company or any other person that the results expressed in the statements will be achieved. Important risk factors that could cause results or events to differ from current expectations are described below. These factors are not intended to be an all-encompassing list of risks and uncertainties that may affect the operations, performance, development and result of the Company's business. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. The Company undertakes no obligation to release publicly the results of any revisions to these forward-looking statements which may be made to reflect events or circumstances after the date hereon, including without limitation, changes in the Company's business strategy or planned capital expenditures, store growth plans, or to reflect the occurrence of unanticipated events.

GENERAL

The Company's 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, the Company has earned gross profit margins of from 2.0% to 3.0% on its 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 2003 management determined that the decline in the market value on its investments in marketable equity securities was other than temporary, and as a result these investment were written-down to their fair value. This write-down resulted in a charge to 2003 earnings in the amount of \$ 1,134,950, net of income taxes, or \$.23 per share.

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 and pawn operations. The Company's operations by segment were as follows:

(Amounts in thousands)

| | | | | | | |
|---------|-----------|---------|-------|--------------|-----------|-------------|
| Retail | Wholesale | | Rare | Discontinued | Corporate | |
| Jewelry | Jewelry | Bullion | Coins | Operations | and Other | Consolidate |

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| | | | | | | | | |
|------------------|-----------|----------|----------|----------|-------|--------|----|-------|
| ----- | | | | | | | | |
| Revenues | | | | | | | | |
| 2004 | \$ 14,601 | \$ 4,451 | \$ 7,482 | \$ 1,574 | -- | \$ 534 | \$ | 28,64 |
| 2003 | 13,179 | 4,218 | 6,648 | 1,014 | -- | 367 | | 25,42 |
| 2002 | 11,490 | 4,301 | 4,348 | 799 | -- | 301 | | 21,23 |
| Net income | | | | | | | | |
| (loss) | | | | | | | | |
| 2004 | 267 | 266 | 63 | 92 | (249) | (88) | | 35 |
| 2003 | 162 | 200 | 46 | 34 | (117) | (849) | | (52 |
| 2002 | 229 | 114 | 43 | 36 | (276) | 283 | | 42 |
| Identifiable | | | | | | | | |
| assets | | | | | | | | |
| 2004 | 7,519 | 1,679 | 117 | 158 | 7 | 802 | | 10,28 |
| 2003 | 7,988 | 1,737 | 129 | 100 | 588 | 530 | | 11,07 |
| 2002 | 7,548 | 1,699 | 35 | 81 | 764 | 448 | | 10,54 |
| Capital | | | | | | | | |
| Expenditures | | | | | | | | |
| 2004 | 85 | -- | -- | -- | -- | 7 | | 9 |
| 2003 | 33 | -- | -- | -- | 1 | -- | | 3 |
| 2002 | 25 | -- | -- | -- | -- | -- | | 2 |
| Depreciation and | | | | | | | | |
| Amortization | | | | | | | | |
| 2004 | 92 | 22 | -- | -- | 25 | 9 | | 14 |
| 2003 | 130 | 22 | -- | -- | 27 | 8 | | 18 |
| 2002 | 133 | 21 | -- | -- | 33 | 16 | | 20 |

During 2004, the Company sold the operations of Silverman Consultants, Inc. and, during 2003, the Company made the decision to discontinue the operations of its subsidiaries, DLS Financial Services, Inc. and eye media, inc. As a result, operating results from these subsidiaries have been reclassified to discontinued operations for all periods presented. As of December 31, 2004 and 2003, there were no operating assets to be disposed of or liabilities to be paid in completing the disposition of these operations.

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Results of Operations

2004 vs 2003

Revenues increased by \$ 3,216,670 (12.7%) in 2004. This increase was primarily the result of a \$834,293 (12.6%) increase in the sale of precious metals products, a \$1,422,537 (10.8%) increase in retail jewelry sales, a \$ 233,410 (5.5%) increase in wholesale jewelry sales and a \$ 559,268 (55.1%) increase in the sale of rare coin products. These increases were the result of a nation-wide improvement in the retail environment, a 4.8% price increase in gold products and a 5% price increase in diamonds and other jewelry products. Pawn service fees increased by \$ 74,619 in 2004 due to an increase in pawn loans outstanding during the year. Cost of goods as a percentage of sales increased from 79.4% in 2003 to 80.1% in 2004 and gross margins decreased from 20.6% in 2003 to 19.9% in 2004. These changes were due to the increase in the precious metals sales volume

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as a percentage of total sales and the increase in the cost of gold products.

Selling, general and administrative expenses increased by \$671,000 or 15.9%. This increase was primarily due to an increase in staff (\$301,000), higher advertising cost (\$97,000), higher property taxes (\$50,000) and higher legal and professional costs (\$24,000). The increase in staff was necessary to maintain a high level of customer service as sales increased. The increase in advertising was necessary in order to attract new customers in our local markets. The property tax increase was due to higher local tax rates and an increase in taxable assets. The increase in legal and professional costs was due to new regulatory requirements. Depreciation and amortization decreased by \$37,000 during 2004 due to certain assets becoming fully depreciated. Interest expense declined \$21,000 due to a reduction in debt outstanding during the year.

Historically, changes in the market prices of precious metals have had a significant impact on both revenues and cost of sales in the rare coin and precious metals segments in which the Company operates. It is expected that due to the commodity nature of these products, future price changes for precious metals will continue to be indicative of the Company's performance in these business segments. Changes in sales and cost of sales in the retail and wholesale jewelry segments are primarily influenced by the national economic environment. It is expected that this trend will continue in the future due to the nature of these product.

Marketable equity securities are comprised of investments in three small companies with thinly traded securities and low market prices. These investments 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 2003 management determined that the decline in the market value of its investments in these securities was other than temporary, and as a result these investments were written-down to their fair value. This write-down resulted in a charge to 2003 earnings in the amount of \$1,134,950, net of income tax benefits. This determination was based on the length of time during which the trading range of these securities was below their cost. During 2004 these securities traded at prices which were both higher and lower than the closing market prices at December 31, 2004. As a result, management determined that the decline in value as of December 31, 2004 was temporary. This determination was based on the conclusion that the quoted market prices for these investments provides the most reliable measure of their respective values.

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During 2004 the Company sold the goodwill (\$314,003), and trade name of Silverman Consultants, Inc. The sale of this goodwill resulted in a gain on the disposal of this reporting unit in the amount of \$39,098. This gain is included in the caption (Other income) in the consolidated statements of operations for the year ended December 31, 2004.

Loss from discontinued operations during 2004, and 2003 in the amounts of \$248,890 and \$117,097 net of income taxes is the combined results of operations of three subsidiaries of the Company. DLS Financial Services, Inc. which offered financial consulting services, and eye media, inc. which offered internet software have not solicited or received any new clients during the past two years and do not anticipate doing so in the future. Silverman Consultants, Inc., which offered consulting liquidation services was sold in July 2004.

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2003 vs 2002

Revenues increased by \$ 4,186,086 (19.7%) in 2003. This increase was primarily the result of a \$2,300,065 (52.9%) increase in the sale of precious metals products, a \$1,688,588 (14.7%) increase in retail jewelry sales, a \$ 83,299 (1.9%) decrease in wholesale jewelry sales and a \$ 215,744 (27.0%) increase in the sale of rare coin products. These increases were the result of a nation-wide improvement in the retail environment and a 19.9% price increases in the gold market. Pawn service fees increase by \$ 25,537 in 2003 due to an increase in pawn loans outstanding during the year. Cost of goods as a percentage of sales increased from 77.0% in 2002 to 79.4% in 2003 and gross margins decreased from 23.0% in 2002 to 20.6% in 2003. These changes were due to the increase in the precious metals sales volume as a percentage of total sales and the increase in the cost of gold products.

Selling, general and administrative expenses increased by \$106,000 (2.6%) due to an increase in payroll and related cost. Other income in the amount of \$ 401,849 during 2002 was the result of retirement of debt at a discount related to the acquisition of Silverman Consultants, Inc.

Marketable equity securities are comprised of investments in three small companies with thinly traded securities and low market prices. These investments 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 2003 management determined that the decline in the market value of its investments in these securities was other than temporary, and as a result these investments were written-down to their fair value. This write-down resulted in a charge to 2003 earnings in the amount of \$1,134,950, net of income tax benefits. This determination was based on the length of time during which the trading range of these securities was below their cost.

Loss from discontinued operations during 2003, and 2002 in the amounts of \$117,097 and \$276,992 net of income taxes is the combined results of operations of three subsidiaries of the Company. DLS Financial Services, Inc. which offered financial consulting services, and eye media, inc. which offered internet software have not solicited or received any new clients during the past two years and do not anticipate doing so in the future. Silverman Consultants, Inc., which offered consulting liquidation services was sold in July 2004.

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Liquidity and Capital Resources -----

The Company's short-term debt, including current maturities of long-term debt totaled \$ 624,265 as of December 31, 2004. During March 2005 the Company re-financed its outstanding bank debt. This new credit facility in the amount of \$3,500,000 extended the maturity of its bank debt to March 31, 2006 and provided the Company with an additional \$ 700,000 of unused liquidity.

Management of the Company expects capital expenditures to total approximately \$100,000 during 2005. It is anticipated that these expenditures will be funded from working capital and its new credit facility. As of December 31, 2004 there were no commitments outstanding for capital expenditures.

In the event of significant growth in retail and or wholesale jewelry sales, the demand for additional working capital will expand due to a related need to stock

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additional jewelry inventory and increases in wholesale accounts receivable. Historically, vendors have offered the Company extended payment terms to finance the need for jewelry inventory growth and management of the Company believes that they will continue to do so in the future. Any significant increase in wholesale accounts receivable will be financed under the Company's bank credit facility.

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 debt. The Company has historically renewed, extended or replaced short-term debt as it matures and management believes that it will be able to continue to do so in the near future.

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 unforeseen working capital requirements.

Critical Accounting Policies

Our reported results are impacted by the application of certain accounting policies that require us to make subjective estimates or judgments. Changes in estimates and judgments could significantly affect our results of operations, financial condition and cash flows in future years. We believe that the following critical accounting policies are affected by significant judgments and estimates used in the preparation of its consolidated financial statements:

Goodwill was accounted for in accordance with APB 16 "Business Combinations" (ABP 16) for acquisitions and SFAS No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long Lived Assets to be Disposed Of" (SFAS 121) for the periodic evaluation of goodwill impairment. Purchase accounting required by APB 16 involved judgment with respect to the valuation of the acquired assets and liabilities in order to determine the final amount of goodwill. Management believes that the estimates that it has used to record prior acquisitions were reasonable and in accordance with APB 16.

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Effective January 1, 2002, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations, SFAS No. 142, Goodwill and Intangible Assets, and SFAS No. 144, Accounting for Impairment or Disposal of Long-Lived Assets.

SFAS No. 141, SFAS No. 142 and SFAS No. 144

Major provisions of these statements and their effective dates are as follows:

- o intangible assets acquired in a business combination must be recorded separately from goodwill if they arise from contractual or other legal rights and are separable from the acquired entity and can be sold, transferred, licensed, rented or exchanged, either individually or as part of a related contract, asset or liability;

- o effective January 1, 2002, all previously recognized goodwill and intangible

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assets with indefinite lives will no longer be subject to amortization;

o effective January 1, 2002, goodwill and intangible assets with indefinite lives will be tested for impairment annually or whenever there is an impairment indicator; and

o all acquired goodwill must be assigned to reporting units for purposes of impairment testing and segment reporting

The Company amortized goodwill and intangible assets acquired prior to July 1, 2001 until December 31, 2001. Beginning January 1, 2002, quarterly and annual goodwill amortization is no longer recognized. The Company completed a fair value based impairment test of goodwill as of December 31, 2003. In the opinion of management this test indicated that the goodwill and intangibles assets of the Company are not impaired.

The Company assesses the impairment of investments and long-lived assets, which includes goodwill and property, plant and equipment, whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors considered important which could trigger an impairment review include: (i) underperformance relative to expected historical or projected future operating results (ii) changes in the manner of use of the assets or the strategy for our overall business and (iii) negative industry or economic trends.

When the Company determines that the carrying value of goodwill and long-lived assets may not be recoverable, an impairment charge is recorded. Impairment is generally measured based on a projected discounted cash flow method using a discount rate determined by our management to be commensurate with the risk inherent in our current business model or prevailing market rates of investment securities, if available.

The Company performs a goodwill impairment test at the reporting unit level annually or more frequently if events occur which indicate a potential reduction in the fair value of a reporting unit's net assets below its carrying value. To perform the impairment test the Company estimated the fair value of the reporting unit using the expected present value of corresponding future cash flows. Impairment is deemed to exist if the net book value of a reporting unit exceeds its estimated fair value. As of December 31, 2004, the Company performed its annual review for impairment of goodwill related to its Fairchild acquisition. The Company concluded that there was no evidence of impairment related to the Goodwill for this reporting unit.

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Goodwill consists of the following:

| | |
|----------|-------------------------------|
| | Wholesale Segment ----- |
| Goodwill | \$ 837,117 ===== |

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

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Company's common stock at the date of the grant over the amount an employee must pay to acquire the stock. All options are priced at the market value of the underlying common stock at the date of grant.

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.

| | Year Ended December 31, | | |
|---|-------------------------|--------------|------------|
| | 2004 | 2003 | 2002 |
| Net income (loss), as reported | \$ 350,829 | \$ (524,140) | \$ 429,311 |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | -- | -- | (236,611) |
| Pro forma net income (loss) | \$ 350,829 | \$ (524,140) | \$ 192,700 |
| Earnings per share: | | | |
| Basic - as reported | .07 | (.11) | .09 |
| Basic - pro forma | .07 | (.11) | .04 |
| Diluted - as reported | .07 | (.11) | .09 |
| Diluted - pro forma | .07 | (.11) | .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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Impairment of Investment Securities results in a charge to operations when a market decline below cost is other than temporary. Management regularly reviews each investment security for impairment based on criteria that include the extent to which cost exceeds market value, the duration of that market decline and the financial health of and specific prospects for the issuer. The Company's investment securities amounted to approximately \$243,446 as of December 31, 2003. Gross unrealized losses were \$1,684,845 at December 31, 2003.

Inventory Obsolescence Accruals may be required based on management's estimation of obsolescence or unmarketable inventory, in order to write-down inventory to its estimated net realizable value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, inventory write-downs may be required.

CAUTIONARY STATEMENT REGARDING RISKS AND UNCERTAINTIES THAT MAY AFFECT FUTURE RESULTS

RISK FACTORS

- CHANGES IN CUSTOMER DEMAND FOR THE COMPANY'S PRODUCTS AND SERVICES COULD

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RESULT IN A SIGNIFICANT DECREASE IN REVENUES. Although the Company's customer base commonly uses its products and services, the Company's failure to meet changing demands of its customers could result in a significant decrease in its revenues.

- CHANGES IN GOVERNMENTAL RULES AND REGULATIONS APPLICABLE TO THE SPECIALTY FINANCIAL SERVICES INDUSTRY COULD HAVE A NEGATIVE IMPACT ON THE COMPANY'S LENDING ACTIVITIES. The Company's 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 the Company's lending activities.

- FLUCTUATIONS IN THE COMPANY'S INVENTORY TURNOVER AND SALES

The Company regularly experiences fluctuations in its 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 the Company's profitability and ability to achieve its planned results.

- CHANGES IN THE COMPANY'S LIQUIDITY AND CAPITAL REQUIREMENTS COULD LIMIT ITS ABILITY TO ACHIEVE ITS PLANS. The Company requires continued access to capital, and a significant reduction in cash flows from operations or the availability of credit could materially and adversely affect the Company's ability to achieve its planned growth and operating results. Similarly, if actual costs to build new stores significantly exceed planned costs, this could materially restrict the Company's ability to build new stores or to operate new stores profitably. The Company's credit agreement also limits the allowable amount of capital expenditures in any given fiscal year, which could limit the Company's ability to build all planned new stores.

- CHANGES IN COMPETITION FROM VARIOUS SOURCES COULD HAVE A MATERIAL ADVERSE IMPACT ON THE COMPANY'S ABILITY TO ACHIEVE ITS PLANS. The Company encounters significant competition in connection with its retail and lending operations from other pawnshops, cash advance companies and other forms of financial institutions and other retailers, many of which have

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significantly greater financial resources than the Company. Significant increases in these competitive influences could adversely affect the Company's operations through a decrease in the number or quality of payday loans and pawn loans or the Company's ability to liquidate forfeited collateral at acceptable margins.

- THE COMPANY'S EARNINGS COULD BE NEGATIVELY IMPACTED BY AN UNFAVORABLE OUTCOME OF LITIGATION, REGULATORY ACTIONS, OR LABOR AND EMPLOYMENT MATTERS.
- A FAILURE IN THE COMPANY'S INFORMATION SYSTEMS COULD PREVENT IT FROM EFFECTIVELY MANAGING AND CONTROLLING ITS BUSINESS OR SERVING ITS 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.

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- A FAILURE OF THE COMPANY'S INTERNAL CONTROLS AND DISCLOSURE CONTROLS AND PROCEDURES, OR ITS INABILITY TO TIMELY COMPLY WITH THE REQUIREMENTS OF SECTION 404 OF THE SARBANES-OXLEY ACT COULD HAVE A MATERIAL ADVERSE IMPACT ON THE COMPANY AND ITS 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. The Company cannot be certain that significant deficiencies or material weaknesses will not be identified, or that remediation efforts will be timely to allow it 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.
- 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 the Company's 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 the Company's cost of borrowing.
- THE COMPANY FACES OTHER RISKS DISCUSSED UNDER QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK IN ITEM 7A OF THIS FORM 10-K.

ITEM 7A. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

MARKET RISK DISCLOSURES

The following discussion about the Company's market risk disclosures involves forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements. The Company is exposed to market risk related to changes in interest rates, foreign currency exchange rates, and gold values. The Company also is exposed to regulatory risk in relation to its payday loans. The Company does not use derivative financial instruments.

The Company's earnings and financial position may be affected by changes in gold values and the resulting impact on pawn lending and jewelry sales. The proceeds of scrap sales and the Company's ability to liquidate excess jewelry inventory at an acceptable margin are dependent upon gold values. The impact on the Company's financial position and results of operations of a hypothetical change in gold values cannot be reasonably estimated.

ITEM 8. FINANCIAL STATEMENTS

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(a) Financial Statements (see pages 22 - 42 of this report).

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

The information contained in the Company's Form 8-K/A-2 filed on November 1, 2004 is incorporated by reference in response to this item.

ITEM 9A. CONTROLS AND PROCEDURES

Under the supervision and with the participation of the Company's management, including its Chief Executive Officer and Chief Financial Officer, the Company has evaluated the effectiveness of its disclosure controls and procedures, as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures are effective in enabling the Company to record, process, summarize and report information required to be included in its periodic SEC filings within the required time period. There has been no change in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal year that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(a) OF THE EXCHANGE ACT

The information contained in the Company's Proxy Statement to be filed pursuant to Regulation 14A within 120 days after the end of the fiscal year covered by this Form 10-K with respect to directors and executive officers of the Company, is incorporated by reference in response to this item.

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ITEM 11. EXECUTIVE COMPENSATION

The information contained in the Company's proxy statement to be filed pursuant to Regulation 14A within 120 days after the end of the fiscal year covered by this Form 10-K, with respect to executive compensation and transactions, is incorporated by reference in response to this item.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information contained in the Company's Proxy Statement to be filed pursuant to Regulation 14A within 120 days after the end of the fiscal year covered by this Form 10-K with respect to security ownership of certain beneficial owners and management and related stockholder matters, is incorporated by reference in response to this item.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

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The information contained in the Company's Proxy Statement to be filed pursuant to Regulation 14A within 120 days after the end of the fiscal year covered by this Form 10-K with respect to certain relationships and related transactions, is incorporated by reference in response to this item.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information contained in the Company's Proxy Statement to be filed pursuant to Regulation 14A within 120 days after the end of the fiscal year covered by this Form 10-K with respect principal accounting fees and services, is incorporated by reference in response to this item.

PART IV

ITEM 15. EXHIBITS AND REPORTS ON FORM 8-K

(a) 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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- 10.1 ASSET PURCHASE AND SALE AGREEMENT dated as of July 28, 2004 by and between DGSE Companies, Inc., as Seller and Silverman Group, LLC..
- 10.2 Lease agreement dated October 5, 2004 by and between Beltline Denton Road Associates and Dallas Gold & Silver Exchange.
- 10.3 Lease agreement dated December 1, 2004 by and between Stone Lewis Properties and Dallas Gold & Silver Exchange.
- 10.4 Lease agreement dated November 18, 2004 by and between Hinkle Income Properties LLC and American Pay Day Centers, Inc.

The following exhibits are incorporated by reference to the Company's Form 10-KSB dated March 21, 2002:

- 10.1 Loan and Security Agreement dated November 22, 2002 by and between First American Bank, SSB and DGSE Companies, Inc.

The following exhibits are incorporated by reference to the Company's Form 10-KSB dated March 21, 2001:

- 10.1 EXHIBIT 10.1 - LEASE AGREEMENT dated JUNE 2, 2000 by and between SND PROPERTIES and CHARLESTON GOLD AND DIAMOND EXCHANGE, INC.

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The following exhibits are incorporated by reference to the Company's Form 10-QSB dated May 14, 2000:

- 10.2 EXHIBIT 10.1 - BILL OF SALE AND ASSET PURCHASE AGREEMENT dated March 2, 2000 by and among Dallas Gold AND Silver Exchange, INC., FAIRCHILD INTERNATIONAL, INC. and MACK H. HOSKINS.

The following exhibits are incorporated by reference to the Company's Form 8-K dated August 26, 1999:

- 10.3 EXHIBIT 1.0 AGREEMENT AND PLAN OF MERGER dated AUGUST 13, 1999 by and among Dallas Gold and Silver Exchange Silver Exchange, Inc., SILVERMAN ACQUISITION, INC., JEWEL CASH, INC. (the "COMPANY") and the COMPANY'S SHAREHOLDERS.
- 10.4 EXHIBIT 2.0 ASSIGNMENT AGREEMENT DATED AUGUST 13, 1999 between SILVERMAN JEWELRY CONSULTANTS, INC., FIRST UNION NATIONAL BANK OF SOUTH CAROLINA, and DALLAS GOLD & SILVER EXCHANGE, INC.
- 10.5 EXHIBIT 3.0 PROMISSORY NOTE DATED AUGUST 13, 1999 BY DALLAS GOLD & SILVER EXCHANGE, INC. PAYABLE TO FIRST UNION NATIONAL BANK.
- 10.6 EXHIBIT 4.0 SECURITY AGREEMENT DATED AUGUST 13, 1999 BY DALLAS GOLD & SILVER EXCHANGE, INC. and FIRST UNION NATIONAL BANK.

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- 10.7 EXHIBIT 5.0 BILL OF SALE DATED AUGUST 13, 1999 BY AND BETWEEN FIRST UNION NATIONAL BANK, SILVERMAN RETAIL CONSULTANTS, SILVERMAN JEWELRY CONSULTANTS AND DALLAS GOLD & SILVER EXCHANGE, INC.

The following exhibits are incorporated by reference to the Company's Form 10-KSB for the year ended December 31, 1998:

- 10.8 EXHIBIT 10.1 Renewal of Shopping Center Lease dated as of August 1, 1997 by and between Beltline Pawn Shop and Belt Line - Denton Road Associates.

The following exhibits are incorporated by reference to the Company's Form 10-KSB for the year ended December 31, 1996:

- 10.9 EXHIBIT 10.1 Agreement For Purchase And Sale Of Stock dated December 30, 1996 by and among Dallas Gold And Silver Exchange, Inc. and Henry Hirschman.

The following exhibits are incorporated by reference to the Company's Form 10-KSB for the year ended December 31, 1994:

- 10.12 EXHIBIT 10.2 renewal, extension, modification agreement dated January 28, 1994 by and among DGSE Corporation And Michael E. Hall and Marion Hall.

(b) Reports on Form 8-K - None

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DGSE Companies, Inc.

By: /s/ L. S. Smith Dated: February 2, 2006

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

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

By: /s/ L. S. Smith Dated: February 2, 2006

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

By: /s/ W. H. Oyster Dated: February 2, 2006

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

By: /s/ John Benson Dated: February 2, 2006

John Benson
Chief Financial Officer
(Principal Accounting Officer)

By /s/ William P. Cordeiro Dated: February 2, 2006

Director

By: /s/ Craig Allan-Lee Dated: February 2, 2006

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Director

By: /s/ Paul Hagen

Dated: February 2, 2006

Director

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To the Board of Directors and
Shareholders of DGSE Companies, Inc.

We have audited the accompanying consolidated balance sheet of DSGE Companies, Inc. and its subsidiaries as of December 31, 2004, and the related consolidated statements of operations, shareholders' equity and comprehensive income, and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The consolidated financial statements of DGSE Companies, Inc. and subsidiaries as of December 31, 2003 were audited by other auditors whose report dated March 22, 2004, stated an unqualified opinion on those financial statements.

We conducted our audit in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We have not been engaged to perform an audit of the Company's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of DGSE Companies, Inc. and subsidiaries as of December 31, 2004, and the consolidated results of operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

\s\ BKR Cornwell Jackson

BKR Cornwell Jackson
Plano, Texas
March 31, 2005

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Report of Independent Registered Public Accountants

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Board of Directors and Shareholders
DGSE Companies, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheet of DGSE Companies, Inc. and Subsidiaries as of December 31, 2003, and the related consolidated statements of operations, shareholders' equity, and cash flows for the years ended December 31, 2003 and 2002. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of DGSE Companies, Inc. and Subsidiaries as of December 31, 2003, and the consolidated results of their operations and their cash flows for the years ended December 31, 2003 and 2002, in conformity with accounting principles generally accepted in the United States of America.

CF & Co., L.L.P.

Dallas, Texas
March 22, 2004

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DGSE Companies, Inc. and Subsidiaries

Consolidated Balance Sheets

December 31,

ASSETS

| | 2004 | 2003 |
|---------------------------|------------|------------|
| | ----- | ----- |
| CURRENT ASSETS | | |
| Cash and cash equivalents | \$ 314,897 | \$ 735,293 |
| Trade receivables | 907,238 | 774,586 |
| Other receivables | -- | 204,430 |
| Inventories | 6,791,383 | 6,673,865 |
| Prepaid expenses | 161,985 | 149,277 |
| | ----- | ----- |

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| | | |
|--|---------------|---------------|
| Total current assets | 8,175,503 | 8,537,451 |
| | ===== | ===== |
| MARKETABLE SECURITIES - AVAILABLE FOR SALE | 77,062 | 243,446 |
| PROPERTY AND EQUIPMENT - AT COST, NET | 885,301 | 989,966 |
| DEFERRED INCOME TAXES | 15,994 | -- |
| GOODWILL | 837,117 | 1,151,120 |
| OTHER ASSETS | 290,722 | 149,546 |
| | ----- | ----- |
| | \$ 10,281,699 | \$ 11,071,529 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| CURRENT LIABILITIES | | |
| Notes payable | \$ 548,093 | \$ 541,546 |
| Current maturities of long-term debt | 76,172 | 197,315 |
| Accounts payable - trade | 590,412 | 859,269 |
| Accrued expenses | 513,775 | 705,756 |
| Customer deposits | 67,173 | 150,088 |
| Federal income taxes payable | 146,210 | 512,991 |
| | ----- | ----- |
| Total current liabilities | 1,941,835 | 2,966,965 |
| Long-term debt, less current maturities (Note8) | 2,749,278 | 2,719,482 |
| Deferred income taxes | -- | 22,743 |
| | ----- | ----- |
| Total liabilities | 4,691,112 | 5,709,190 |
| SHAREHOLDERS' EQUITY | | |
| Common stock, \$.01 par value; authorized 10,000,000 shares; issued and outstanding 4,913,290 shares at December 31, 2004 and 2003 | 49,133 | 49,133 |
| Additional paid-in capital | 5,708,760 | 5,708,760 |
| Accumulated other comprehensive (loss) | (122,582) | -- |
| Retained earnings (deficit) | (44,725) | (395,554) |
| | ----- | ----- |
| Total shareholders' equity | 5,590,586 | 5,362,339 |
| | \$ 10,281,699 | \$ 11,071,529 |
| | ===== | ===== |

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

DGSE Companies, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF OPERATIONS
Years ended December 31,

| | 2004 | 2003 | 2002 |
|---------|-------|-------|-------|
| | ----- | ----- | ----- |
| Revenue | | | |

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| | | | |
|---|---------------|---------------|---------------|
| Sales | \$ 28,385,770 | \$ 25,243,719 | \$ 21,083,170 |
| Pawn services charges | 256,447 | 181,828 | 156,291 |
| | ----- | ----- | ----- |
| | 28,642,217 | 25,425,547 | 21,239,461 |
| Costs and expenses | | | |
| Cost of goods sold | 22,743,073 | 20,049,583 | 16,238,552 |
| Selling, general and administrative expenses | 4,699,107 | 4,054,048 | 3,948,186 |
| Depreciation and amortization | 148,327 | 160,131 | 158,153 |
| | ----- | ----- | ----- |
| | 27,590,507 | 24,263,762 | 20,344,891 |
| Operating income | 1,051,710 | 1,161,785 | 894,570 |
| Other income (expense): | | | |
| Unrealized loss on investments | -- | (1,634,845) | -- |
| Other income | 23,500 | -- | 401,849 |
| Interest expense | (247,694) | (268,344) | (263,230) |
| | ----- | ----- | ----- |
| Total other income (expense) | (224,194) | (1,903,189) | 138,619 |
| Income before income taxes | 827,516 | (741,404) | 1,033,189 |
| Income tax expense (benefit) | 227,797 | (334,361) | 326,886 |
| | ----- | ----- | ----- |
| Net income from continuing operations | 599,719 | (407,043) | 706,303 |
| Loss from discontinued operations, net of income taxes | (248,890) | (117,097) | (276,992) |
| | ----- | ----- | ----- |
| Net income | \$ 350,829 | \$ (524,140) | \$ 429,311 |
| | ===== | ===== | ===== |
| Earnings per common share | | | |
| Basic | | | |
| From continuing operations | \$.12 | \$ (.08) | \$.14 |
| From discontinued operations | (.05) | (.03) | (.05) |
| | ----- | ----- | ----- |
| | \$.07 | \$ (.11) | \$.09 |
| | ===== | ===== | ===== |
| Diluted | | | |
| From continuing operations | \$.12 | \$ (.08) | \$.14 |
| From discontinued operations | (.05) | (.03) | (.05) |
| | ----- | ----- | ----- |
| | \$.07 | \$ (.11) | \$.09 |
| | ===== | ===== | ===== |
| Weighted average number of common shares: | | | |
| Basic | 4,913,290 | 4,913,290 | 4,913,628 |
| Diluted | 5,135,457 | 4,913,290 | 4,916,878 |

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

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DGSE Companies, Inc. and Subsidiaries

Consolidated Statements of Shareholders' Equity
For the Years Ended December 31,

| | Common Stock | | Additional Paid-in Capital | Retained Earnings (Accumulated Deficit) |
|---|--------------|-----------|----------------------------------|--|
| | Shares | Amount | | |
| Balance at January 31, 2002 | 4,913,290 | \$ 49,133 | \$ 5,708,301 | \$ (300,725) |
| Net Income | | | | 429,311 |
| Other comprehensive Income (loss): | | | | |
| Loss on marketable securities Arising during the year, net of tax | | | | |
| Reclassification adjustment | | | | |
| Unrealized loss on marketable Securities, net of tax | | | | |
| Purchase and retirement Of common stock | (500) | (5) | (606) | |
| Common stock issued | 500 | 5 | 1,065 | |
| Balance at December 31, 2002 | 4,913,290 | 49,133 | 5,708,760 | 128,586 |
| Net income (loss) | | | | (524,140) |
| Other comprehensive Income (loss): | | | | |
| Loss on marketable securities Arising during the year, net of tax | | | | |
| Reclassification adjustment | | | | |
| Unrealized loss on marketable Securities, net of tax | | | | |
| Balance at December 31, 2003 | 4,913,290 | 49,133 | 5,708,760 | (395,554) |
| Net income | | | | 350,829 |
| Unrealized loss on marketable Securities, net of tax | | | | |
| Balance at December 31, 2004 | 4,913,290 | \$ 49,133 | \$ 5,708,760 | \$ (44,725) |

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
Year ended December 31,

| | 2004 | 2003 |
|---|-------------|--------------|
| | ----- | ----- |
| Cash Flows From Operations | | |
| Reconciliation of net loss to net cash used in operating activities | | |
| Net income (loss) | \$ 350,829 | \$ (524,140) |
| Depreciation and amortization | 148,327 | 187,558 |
| Deferred taxes | (10,535) | (451,081) |
| Accretion of debt discount | -- | -- |
| Loss on disposal of assets in discontinued operations | -- | 31,072 |
| Loss on sale of marketable securities | 15,600 | 26,998 |
| Unrealized loss on marketable securities | -- | 1,634,845 |
| Gain on sale of assets | (39,098) | -- |
| (Increase) decrease in operating assets and liabilities | | |
| Trade receivables | 42,251 | 49,896 |
| Other receivables | 204,730 | (204,430) |
| Inventories | (117,518) | (338,123) |
| Prepaid expenses and other current assets | 10,840 | 3,577 |
| Accounts payable and accrued expenses | (460,838) | 340,216 |
| Change in customer deposits | (82,915) | (6,344) |
| Federal income taxes payable | (366,781) | 27,538 |
| Total net cash used in operating activities | (305,108) | 777,582 |
| | ----- | ----- |
| Cash flows from investing activities | | |
| Pawn loans made | (633,873) | (521,975) |
| Pawn loans repaid | 406,524 | 428,835 |
| Recovery of pawn loan principal through | | |
| Sale of forfeited collateral | 90,523 | 61,248 |
| Proceeds from sale of marketable securities | -- | 46,988 |
| Purchase of property and equipment | (43,662) | (34,464) |
| Purchase of investments | -- | (48,989) |
| Proceeds from sale of assets | 150,000 | -- |
| | ----- | ----- |
| Net cash (used) provided by investing activities | (30,488) | (68,357) |
| Cash flows from financing activities | | |
| Issuance of common stock | -- | -- |
| Proceeds from notes issued | 1,132,849 | 737,590 |
| Payments on notes payable | (1,217,649) | (1,209,930) |
| Purchase and retirement of common stock | -- | -- |
| | ----- | ----- |
| Net cash provided by financing activities | (84,800) | (472,340) |
| | ----- | ----- |
| Net decrease in cash and cash equivalents | (420,396) | 236,885 |
| Cash and cash equivalents at beginning of year | 735,293 | 498,408 |
| | ----- | ----- |
| Cash and cash equivalents at end of period | \$ 314,897 | \$ 735,293 |
| | ===== | ===== |

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

Supplemental disclosures:

Cash paid during the year for:

| | | | |
|--------------|-----------|-----------|-----------|
| Interest | \$242,697 | \$249,088 | \$328,732 |
| Income taxes | \$504,430 | \$246,212 | \$ -- |

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 \$203,100.

Non-cash Investing and Financing Activities:

| | | | |
|---|-----------|-----------|-----------|
| Pawn loans forfeited and transferred to inventory | \$114,069 | \$ 74,949 | \$ 73,449 |
|---|-----------|-----------|-----------|

Note 1 - Summary of Significant Accounting Policies

Nature of Operations

DGSE Companies, Inc. and its subsidiaries (the "Company"), sell jewelry and bullion products to both retail and wholesale customers throughout the United States through its facilities in Dallas, Texas, Mt. Pleasant, South Carolina, and through its internet sites.

Principles of Consolidation

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and include the accounts of the Company and its subsidiaries. All material intercompany transactions and balances have been eliminated.

Cash and Cash Equivalents

For purposes of the statements of cash flows, the Company considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

Investments in Marketable Equity Securities

Marketable equity securities have been categorized as available-for-sale and 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. The Company continually reviews its investments to determine whether a decline in fair value below the cost basis is other than temporary. If the decline in the fair values is judged to be other than temporary, the cost basis of the security is written down to fair value and the amount of the write-down is included in the consolidated statements of operations.

Inventory

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Jewelry and other inventory is valued at lower-of-cost-or-market (specific identification). Bullion inventory is valued at lower-of-cost-or-market (average cost).

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DGSE COMPANIES, INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements December 31, 2004, 2003 and 2002

Note 1 - Summary of Significant Accounting Policies, continued

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are being provided on the straight-line method over periods of five to thirty years. Machinery and equipment under capital leases are amortized on the straight-line method over the life of the lease. Expenditures for repairs and maintenance are charged to expense as incurred.

Goodwill

Effective January 1, 2002, the Company adopted Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets. Under that pronouncement, goodwill is not being amortized but is subject to periodic tests to determine the amount of impairment, if any, to be reflected during the period.

Impairment of Long-Lived Assets

The Company assesses the recoverability of its long-lived assets (including intangible assets) based on their current and anticipated future undiscounted cash flows. An impairment occurs when the discounted cash flows (excluding interest) do not exceed the carrying amount of the asset. The amount of the impairment loss is the difference between the carrying amount of the asset and its estimated fair value.

Financial Instruments

The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents, accounts receivable, marketable securities, short-term debt, accounts payable and accrued expenses approximate fair value because of the immediate or short-term maturity of these consolidated financial instruments. The carrying amount reported for long-term debt approximates fair value because substantially all of the underlying instruments have variable interest rates which reprice frequently or the interest rates approximate current market rates.

Advertising Costs

Advertising costs are expensed as incurred and amounted to \$633,873, \$589,689 and \$541,079 for 2004, 2003 and 2002, respectively.

DGSE COMPANIES, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
December 31, 2004, 2003 and 2002

Note 1 - Summary of Significant Accounting Policies, continued

Accounts Receivable

The Company records trade receivables when revenue is recognized. No product has been consigned to customers. The Company's allowance for doubtful accounts is primarily determined by review of specific trade receivables. Those accounts that are doubtful of collection are included in the allowance. These provisions are reviewed to determine the adequacy of the allowance for doubtful accounts. Trade receivables are charged off when there is certainty as to their being uncollectible. Trade receivables are considered delinquent when payment has not been made within contract terms.

Pawn loans receivable in the amount of \$ 229,071 and \$ 115,791 as of December 31, 2004 and 2003, respectively, are included in the Consolidated Balance Sheets caption trade receivables. The related pawn service charges receivable in the amount of \$ 86,671 and \$ 42,953 as of December 31 2004 and 2003, respectively, are also included in the Consolidated Balance Sheets caption trade receivables.

Income Taxes

Deferred tax liabilities and assets are recognized for the expected future tax consequences of events that have been included in the consolidated financial statements or tax returns. Under this method, deferred tax liabilities and assets are determined based on the difference between the consolidated financial statements and tax basis of assets and liabilities.

Revenue Recognition

Sales revenue consists of direct sales to customers for jewelry. Sales are recognized when title and risk of loss have passed to the customer, which is at point-of-sale for jewelry. Provisions for discounts and rebates to customers and returns, bad debts, and other adjustments are provided in the period the related sales are recorded.

Pawn loans ("loans") are made with the collateral of tangible personal property for one month with an automatic 60-day extension period. Pawn service charges are recorded at the time of redemption at the greater of \$15 or the actual interest accrued to date. If the loan is not repaid, the principal amount loaned plus accrued interest (or the fair value of the collateral, if lower) becomes the carrying value of the forfeited collateral ("inventories") which is recovered through sales to customers.

As of December 31, 2004, based on subsequent collections and operating history, management estimated no allowance for discounts, returns, bad debts and other adjustments.

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Direct cost of Pawn Loan Service Charge Revenue

The direct cost of pawn loan service charge revenue is included in the Consolidated Statements of Operations caption "Selling, general and administrative expenses".

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DGSE COMPANIES, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
December 31, 2004, 2003 and 2002

Note 1 - Summary of Significant Accounting Policies, continued

Shipping and Handling Costs

Shipping and handling costs are included in selling general and administrative expenses, and amounted to \$112,777, \$84,445 and \$100,194 for 2004, 2003 and 2002, respectively.

Earnings (Loss) Per Share

Basic earnings per common share is based upon the weighted average number of shares of common stock outstanding. Diluted earnings per share is based upon the weighted average number of common stock outstanding and, when dilutive, common shares issuable for stock options. During 2003, stock options were not included in computing diluted earnings per share because their effect was antidilutive.

Comprehensive Income

The Company reports all changes in comprehensive income in the consolidated statements of changes in shareholders' equity, in accordance with the provisions of Statement of Financial Accounting Standards No. 130, Reporting Comprehensive Income.

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.

| | Year Ended December 31, | | |
|--|-------------------------|--------------|------------|
| | 2004 | 2003 | 2002 |
| Net income (loss), as reported | \$ 350,829 | \$ (524,140) | \$ 429,311 |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, | | | |

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| | | | |
|-----------------------------|------------|--------------|------------|
| net of related tax effects | -- | -- | (236,611) |
| | ----- | ----- | ----- |
| Pro forma net income (loss) | \$ 350,829 | \$ (524,140) | \$ 192,700 |
| | ===== | ===== | ===== |
| Earnings per share: | | | |
| Basic - as reported | .07 | (.11) | .09 |
| Basic - pro forma | .07 | (.11) | .04 |
| Diluted - as reported | .07 | (.11) | .09 |
| Diluted - pro forma | .07 | (.11) | .04 |

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DGSE COMPANIES, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
December 31, 2004, 2003 and 2002

Note 1 - Summary of Significant Accounting Policies, continued

Stock-based Compensation, continued

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.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues, and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications

Certain reclassifications were made to the prior years' consolidated financial statements to conform to the current year presentation.

New Accounting Pronouncements

FAS 123(R), Share-Based Payment

This Statement establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of those equity instruments. Management is in the process of assessing the impact to the Company, however, it does not expect the impact, if any, to be material to the financial statements.

FAS 153, Exchange of Nonmonetary Assets

The guidance in APB Opinion No. 29, Accounting for Nonmonetary Transactions, is based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of

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the assets exchanged. The guidance in that Opinion, however, included certain exceptions to that principle. This Statement amends Opinion 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. Management is in the process of assessing the impact to the Company, however, it does not expect the impact, if any, to be material to the financial statements.

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DGSE COMPANIES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2004, 2003 and 2002

Note 2 - Concentration of Credit Risk

The Company maintains cash balances in financial institutions in excess of federally insured limits.

Note 3 - Inventories

A summary of inventories at December 31, is as follows:

| | 2004 | 2003 |
|------------|-------------|-------------|
| | ----- | ----- |
| Jewelry | \$6,149,955 | \$6,033,044 |
| Scrap gold | 305,801 | 439,083 |
| Bullion | 247,973 | 115,654 |
| Other | 87,654 | 86,084 |
| | ----- | ----- |
| | \$6,791,383 | \$6,673,865 |
| | ===== | ===== |

Note 4 - Investments in Marketable Equity Securities

Marketable equity securities have been classified in the consolidated balance sheet according to management's intent. The carrying amount of available-for-sale securities and their fair values at December 31, 2004 and 2003 are as follows:

| | Gross Unrealized Losses | | Fair Value |
|------|-------------------------------|---------------|---------------|
| Cost | ----- | ----- | ----- |
| | Classified as | Classified as | |
| | Operating losses | Unrealized | |

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| | | Due to long-term Impairment | Losses in other Comprehensive Income | |
|------------------------|--------------|--------------------------------|--|------------|
| Equity securities 2004 | \$ 1,864,441 | \$ (1,634,845) | \$ 152,534 | \$ 77,062 |
| | ===== | ===== | ===== | ===== |
| Equity securities 2003 | \$ 1,878,291 | \$ (1,634,845) | -- | \$ 152,534 |
| | ===== | ===== | ===== | ===== |

During 2003, management determined that the decline in fair values below cost basis to be other than temporary and that such loss should be included in the consolidated statements of operations. At December 31, 2004, management believes the equity shares owned in the publicly traded stocks have declined on a temporary basis as these stocks are thinly traded which results in volatile price fluctuations that temporarily changes the fair value of the stocks.

During 2004, the Company deemed certain marketable securities worthless and recognized \$ 15,600 as a realized loss.

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DGSE COMPANIES, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
December 31, 2004, 2003 and 2002

Note 5 - Property and Equipment

A summary of property and equipment at December 31, 2004 and 2003, is as follows:

| | 2004 | 2003 |
|---|------------|------------|
| | ----- | ----- |
| Buildings and improvements | \$ 732,488 | \$ 721,315 |
| Machinery and equipment | 727,942 | 716,280 |
| Furniture and fixtures | 226,318 | 215,272 |
| | ----- | ----- |
| | 1,686,748 | 1,652,867 |
| Less accumulated depreciation and Amortization | 1,352,747 | 1,214,201 |
| | ----- | ----- |
| | 334,001 | 438,666 |
| Land | 551,300 | 551,300 |
| | ----- | ----- |
| | \$ 885,301 | \$ 989,966 |
| | ===== | ===== |

Property and equipment acquired under capital leases is \$202,450 as of December 31, 2004 and 2003. Accumulated depreciation for these assets was \$ 188,385 and \$148,195 as of December 31, 2004 and 2003, respectively.

Note 6 - Goodwill

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At December 31, goodwill was reflected for the following reporting units:

| | 2004 | 2003 |
|----------------------------|------------|-------------|
| | ----- | ----- |
| Wholesale watch sales | \$ 837,117 | \$ 837,117 |
| Consulting and liquidation | -- | 314,003 |
| | ----- | ----- |
| | \$ 837,117 | \$1,151,120 |
| | ===== | ===== |

No impairment losses were recognized during 2004, 2003 or 2002 and no goodwill was acquired during 2004, 2003, or 2002.

During 2004 the Company sold the goodwill (\$314,003) and trade name of Silverman Consultants, Inc. The sales of this goodwill resulted in a gain on the disposal of this reporting unit in the amount of \$39,098. this gain is included in the caption ("Other income) in the consolidated statements of operations for the year ended December 31, 2004.

Note 7 - Notes Payable

At December 31, 2004, the Company was obligated to various individuals under unsecured, demand notes bearing annual interest rates of 8% to 12% totaling \$548,093.

At December 31, 2003, the Company was obligated to various individuals under unsecured, demand notes bearing annual interest rates of 8% to 14% totaling \$541,546.

At December 31, 2003, one of the notes in the amount of \$135,000 was payable to a shareholder. During January 2004, the principal amount of this note was paid in full, and the note holder forgave \$24,226 of accrued interest. As a result, no interest was paid or expensed on this note during 2003. At December 31, 2003, one of the notes in the amount of \$16,301 was payable to a relative of an officer of the Company. During 2004, the principal amount of this note was paid in full.

DGSE COMPANIES, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
December 31, 2004, 2003 and 2002

Note 8 - Long-Term Debt and Short-term Debt Expected to be Refinanced

2004

2003

A summary of long-term debt and short-term debt expected to be

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refinanced at December 31, follows:

| | | |
|---|--------------|-----------|
| Notes payable to bank, a note of \$1,600,000 and \$1,500,000 at December 31, 2004 and 2003, respectively, which bears interest at prime plus 1-1/2% (6.75% and 5.75% at December 31, 2004 and 2003, respectively, and is due March 31, 2005 and a note of \$408,333 and \$500,000, respectively, which bears interest at prime plus 1-3/4% (7.0% and 5.75% at December 31, 2004 and 2003), respectively, is due in equal monthly installments of \$8,333 through January 2009. These notes are secured by all accounts receivable, inventory, property and equipment and intangible assets. The notes contain certain covenants, restricting payment of dividends, and requiring the Company to maintain certain financial ratios | \$ 2,008,333 | \$ 2,000, |
| Mortgage payable, due in monthly installments of \$5,977, including interest based on 30 year U.S. Treasury note rate plus 2-1/2% (7.64% and 7.41% at December 31, 2004 and 2003); respectively, balance due in January 2014 | 465,724 | 503, |
| Note payable, due March 2, 2005. Interest is payable quarterly at a rate of 8% | 18,298 | 51, |
| Note payable, due January 2, 2008. Interest is payable monthly at a rate of 8% | 310,556 | 310, |
| Capital lease obligations | 22,539 | 51, |
| | 2,825,450 | 2,916, |
| Less current maturities | (76,172) | (197, |
| | \$ 2,749,278 | \$ 2,719, |

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DGSE COMPANIES, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
December 31, 2004, 2003 and 2002

Note 8 - Long-Term Debt and Short-term Debt Expected to be Refinanced, continued

The Company entered into a financing agreement subsequent to year end with a commercial bank that

the Company to borrow at any time through March 31, 2006 up to \$ 3,500,000 at the bank's prime Rate of interest plus 1/4%. Borrowings under the financing agreement mature on March 31, 2006. In March 2005, the Company borrowed \$ 2,699,699 under this new credit facility in order to liquidate its previous bank debt. The remaining portion of the new financing agreement is available to the Company for working capital

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requirements.

The following table summarizes the aggregate maturities of long-term debt and payments on the capital lease obligations and reflects the revised maturities from refinancing of certain long-term debt subsequent to year-end:

| | Long-term Debt | Obligations Under Capital Leases | Totals |
|--|-------------------|---|-------------|
| | ----- | ----- | ----- |
| December 31, | | | |
| 2005 | \$ 56,258 | \$ 21,706 | \$ 77,964 |
| 2006 | 1,840,844 | 2,852 | 1,843,696 |
| 2007 | 143,936 | -- | 143,936 |
| 2008 | 147,262 | -- | 147,262 |
| 2009 | 369,728 | -- | 369,728 |
| Thereafter | 244,884 | -- | 244,883 |
| | ----- | ----- | ----- |
| | 2,802,912 | 24,558 | 2,827,469 |
| Amounts representing interest interest rates at approximately 9%) | -- | (2,020) | (2,020) |
| | ----- | ----- | ----- |
| | 2,802,912 | 22,538 | 2,825,450 |
| Less current portion | (56,258) | (19,914) | (76,172) |
| | ----- | ----- | ----- |
| | \$2,746,654 | \$ 2,625 | \$2,749,278 |
| | ===== | ===== | ===== |

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DGSE COMPANIES, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
December 31, 2004, 2003 and 2002

Note 9 - Earnings Per Common Share

A reconciliation of the income and shares of the basic earnings per common share and diluted earnings per common share for the years ended December 31, 2004, 2003 and 2002 is as follows:

| December 31, 2004 | | |
|-------------------|--------|---------------------|
| Income | Shares | Per-Share Amount |
| ----- | ----- | ----- |
| | | |

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| | | | |
|--|--------------|-------------------|---------------------|
| Basic earnings per common share | | | |
| Income from operations allocable to common shareholders | \$ 350,829 | 4,913,920 | \$.07 |
| Effect of dilutive securities | | | |
| Stock options | -- | 221,537 | |
| | ----- | ----- | |
| Diluted earnings per common share | | | |
| Income from operations available to common shareholders plus assumed conversions | \$350,8291 | 5,135,457 | \$.07 |
| | ===== | ===== | ===== |
| | | | |
| | | December 31, 2003 | |
| | | ----- | ----- |
| | Income | Shares | Per-Share Amount |
| | ----- | ----- | ----- |
| Basic earnings per common share | | | |
| Income from operations allocable to common shareholders | (524,140) | 4,913,920 | \$ (.11) |
| Effect of dilutive securities | | | |
| Stock options | -- | -- | |
| | ----- | ----- | |
| Diluted earnings per common share | | | |
| Income from operations available to common shareholders plus assumed conversions | \$ (524,140) | 4,913,920 | \$ (.11) |
| | ===== | ===== | ===== |
| | | | |
| | | December 31, 2002 | |
| | | ----- | ----- |
| | Income | Shares | Per-Share Amount |
| | ----- | ----- | ----- |
| Basic earnings per common share | | | |
| Income from operations allocable to common shareholders | \$ 429,311 | 4,913,628 | \$.09 |
| Effect of dilutive securities | | | |
| Stock options | -- | 3,250 | |
| | ----- | ----- | |
| Diluted earnings per common share | | | |
| Income from operations available to common shareholders plus assumed conversions | \$ 429,311 | 4,916,878 | \$.09 |
| | ===== | ===== | ===== |

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Note 10 -Stock Options

The Company has granted stock options to key employees to purchase shares of the Company's common stock. Each option issued vests according to schedules designated by the Board of Directors, not to exceed three years. The exercise price is based upon the estimated fair market value of the Company's common stock at the date of grant, and is payable when the option is exercised.

The Company has adopted only the disclosure provisions of Financial Accounting Standard No. 123, Accounting for Stock-Based Compensation (FAS 123). It applies APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations in accounting for its plans and does not recognize compensation expense for its stock-based compensation as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant.

The following table summarizes the activity in common shares subject to options for the years ended December 31, 2004, 2003 and 2002:

| | December 31, 2004 and 2003 | | December 31, 2002 | |
|--|----------------------------|---------------------------------|-------------------|---------------------------------|
| | Options | Weighted Average Exercise Price | Options | Weighted Average Exercise Price |
| of year | 1,420,634 | \$ 2.09 | 1,164,777 | \$ 2.33 |
| Granted | -- | -- | 267,857 | 1.12 |
| Forfeited | -- | -- | (12,000) | 3.63 |
| Outstanding at end of year | 1,420,634 | \$ 2.09 | 1,420,634 | \$ 2.09 |
| Exercisable at end of year | 1,420,634 | \$ 2.09 | 1,420,634 | \$ 2.09 |
| Weighted average fair value of options granted during year | | \$ -- | | \$ 0.85 |

Stock options outstanding at December 31, 2004:

| Range of Exercise Price | Options Outstanding | | Options Exercisable | | |
|-------------------------|---------------------|--------------------------------|---------------------------------|-----------|---------------------------------|
| | Options | Weighted Average Expected Life | Weighted Average Exercise Price | Options | Weighted Average Exercise Price |
| \$1.12 | 267,857 | 8 Years | \$1.12 | 267,857 | \$1.12 |
| \$1.63 to \$2.25 | 1,097,777 | 8 Years | \$2.21 | 1,097,777 | \$2.21 |

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| | | | | | |
|------------------|-----------|---------|--------|-----------|--------|
| \$3.63 to \$4.19 | 20,000 | 8 Years | \$3.81 | 20,000 | \$3.83 |
| \$4.88 | 35,000 | 5 Years | \$4.88 | 35,000 | \$4.88 |
| | ----- | | | ----- | |
| | 1,420,634 | | | 1,420,634 | |
| | ===== | | | ===== | |

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DGSE COMPANIES, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
December 31, 2004, 2003 and 2002

Note 11 -Comprehensive Income

Comprehensive income at December 31, 2004, 2003 and 2002 is as follows:

| | Before-Tax Amount | Tax Benefit | Net-of-Tax Amount |
|---|----------------------|----------------|----------------------|
| | ----- | ----- | ----- |
| Accumulated comprehensive income (loss) at January 1, 2002 | \$ (1,495,874) | \$ 508,597 | \$ (987,277) |
| Unrealized holding losses arising during 2002 | (232,256) | 84,583 | (147,673) |
| | ----- | ----- | ----- |
| Accumulated comprehensive income (loss) at December 31, 2002 | (1,728,130) | 593,180 | (1,134,950) |
| Unrealized holding gains arising during 2003 | 93,285 | (32,872) | 60,413 |
| Reclassification to statement of operations | 1,634,845 | (560,308) | 1,074,537 |
| | ----- | ----- | ----- |
| Accumulated comprehensive income (loss) at December 31, 2003 | -- | -- | -- |
| Unrealized holding losses Arising during 2004 | (150,784) | 28,202 | (122,582) |
| | ----- | ----- | ----- |
| Accumulated comprehensive income (loss) at December 31, 2004 | \$ (150,784) | \$ 28,202 | \$ (122,582) |
| | ===== | ===== | ===== |

DGSE COMPANIES, INC. AND SUBSIDIARIES
 Notes to Consolidated Financial Statements
 December 31, 2004, 2003 and 2002

Note 12 -Income Taxes

The income tax provision reconciled to the tax computed at the statutory Federal rate follows:

| | 2004 | 2003 | 2002 |
|--|------------|--------------|------------|
| | ----- | ----- | ----- |
| Tax (benefit) expense at statutory rate | \$ 162,502 | \$ (294,124) | \$ 223,504 |
| Other | 24,616 | 16,484 | 5,076 |
| Benefit (expense) of discontinued operations | 100,679 | 33,279 | 98,306 |
| Change in valuation allowance | (60,000) | (90,000) | -- |
| | ----- | ----- | ----- |
| Tax expense (benefit) | \$ 227,797 | \$ (334,361) | \$ 326,886 |
| | ===== | ===== | ===== |
| | | | |
| Current | \$ 238,332 | \$ 62,191 | \$ 153,365 |
| Deferred | (10,535) | (396,552) | 173,521 |
| | ----- | ----- | ----- |
| | \$ 227,797 | \$ (334,361) | \$ 326,886 |
| | ===== | ===== | ===== |

Deferred income taxes are comprised of the following at December 31, 2004 and 2003:

| Deferred tax assets (liabilities) | 2004 | 2003 |
|--|-----------|-------------|
| | ----- | ----- |
| Inventory | \$ 25,903 | \$ 25,197 |
| Unrealized loss on available for sale securities | 28,202 | 28,202 |
| Property and equipment | 10,952 | 9,804 |
| Valuation reserve | -- | (60,000) |
| Goodwill | (49,064) | (25,946) |
| | ----- | ----- |
| | \$ 15,994 | \$ (22,743) |

Based upon a review of the remaining temporary differences in marketable securities between book and tax basis amounts at December 31, 2003, the Company determined the deferred tax asset related to marketable securities was limited to approximately \$28,000. In 2003, management of the Company determined that the loss on marketable securities was other than temporary and eliminated the balance related to marketable securities in accumulated other comprehensive income. The resulting adjustment eliminated the remaining deferred tax balances in

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other comprehensive income. In addition, the Company recognized a deferred tax benefit in 2003 of \$351,000 related to the reversal of a valuation allowance established primarily for marketable securities due to a change in management's estimate of the required remaining valuation reserve as of December 31, 2003.

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Note 13 -Operating Leases

The Company leases certain of its facilities under operating leases. The minimum rental commitments under noncancellable operating leases are as follows:

| Year Ending December 31, ----- | Lease Obligations ----- | Sub-Lease Receivables ----- | Total ----- |
|--------------------------------------|-------------------------------|-----------------------------------|----------------|
| 2005 | \$ 227,455 | \$ (36,000) | \$ 191,455 |
| 2006 | 118,447 | -- | 118,447 |
| 2007 | 108,018 | -- | 108,018 |
| 2008 | 88,394 | -- | 88,394 |
| Thereafter | 73,199 | -- | 73,199 |
| | \$ 615,513 | \$ (36,000) | \$ 579,513 |
| | ===== | ===== | ===== |

Rent expense for the years ended December 31, 2004, 2003 and 2002 was approximately \$198,050, \$223,046 and \$291,878, respectively, and was decreased by sublease income of approximately \$75,300, \$104,000 and \$90,000, respectively.

Note 14 -Discontinued Operations

During 2004, the Company sold the operations of Silverman Consultants, Inc. and, during 2003, the Company made the decision to discontinue the operations of its subsidiaries, DLS Financial Services, Inc. and eye media, inc. As a result, operating results from these subsidiaries have been reclassified to discontinued operations for all periods presented. As of December 31, 2004 and 2003, there were no operating assets to be disposed of or liabilities to be paid in completing the disposition of these operations.

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Note 15 -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 and pawn operations. The Company's operations by segment were as follows:

| | (Amounts in thousands) | | | | | | |
|--|------------------------|----------------------|----------|---------------|----------------------------|------------------------|-------------|
| | Retail Jewelry | Wholesale Jewelry | Bullion | Rare Coins | Discontinued Operations | Corporate and Other | Consolidate |
| | ----- | ----- | ----- | ----- | ----- | ----- | ----- |
| Revenues | | | | | | | |
| 2004 | \$ 14,601 | \$ 4,451 | \$ 7,482 | \$ 1,574 | -- | \$ 534 | \$ 28,64 |
| 2003 | 13,179 | 4,218 | 6,648 | 1,014 | -- | 367 | 25,42 |
| 2002 | 11,490 | 4,301 | 4,348 | 799 | -- | 301 | 21,23 |
| Net income (loss) | | | | | | | |
| 2004 | 267 | 266 | 63 | 92 | (249) | (88) | 35 |
| 2003 | 162 | 200 | 46 | 34 | (117) | (849) | (52) |
| 2002 | 229 | 114 | 43 | 36 | (276) | 283 | 42 |
| Identifiable assets | | | | | | | |
| 2004 | 7,519 | 1,679 | 117 | 158 | 7 | 802 | 10,28 |
| 2003 | 7,988 | 1,737 | 129 | 100 | 588 | 530 | 11,07 |
| 2002 | 7,548 | 1,699 | 35 | 81 | 764 | 448 | 10,54 |
| Capital Expenditures | | | | | | | |
| 2004 | 85 | -- | -- | -- | -- | 7 | 9 |
| 2003 | 33 | -- | -- | -- | 1 | -- | 3 |
| 2002 | 25 | -- | -- | -- | -- | -- | 2 |
| Depreciation and Amortization | | | | | | | |
| 2004 | 92 | 22 | -- | -- | 25 | 9 | 14 |
| 2003 | 130 | 22 | -- | -- | 27 | 8 | 18 |
| 2002 | 133 | 21 | -- | -- | 33 | 16 | 20 |

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Note 16 - Quarterly Results of Operations (Unaudited) Amounts in thousands except per share data.

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| | Sales | Operating Income | Net Income (Loss) | Income (loss) per Common Share | |
|-------------------------------------|-------|---------------------|-------------------------|-----------------------------------|---------|
| | | | | Basic | Diluted |
| Year ended December 31, 2004: | | | | | |
| First Quarter | 6,799 | 402 | 186 | .04 | .04 |
| Second Quarter | 6,217 | 296 | 100 | .02 | .01 |
| Third Quarter | 6,308 | 312 | 110 | .02 | .02 |
| Fourth Quarter | 9,318 | 42 | (45) | (.01) | -- |
| Year ended December 31, 2003: | | | | | |
| First quarter | 5,142 | 104 | (21) | -- | -- |
| Second Quarter | 5,714 | 184 | 60 | .01 | .01 |
| Third Quarter | 5,496 | 305 | 94 | .02 | .02 |
| Fourth Quarter | 9,074 | 569 | (657) | (.13) | (.13) |