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DCAP GROUP INC/
Form 10QSB
November 15, 2004

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

FORM 10-QSB

(Mark One)

Quarterly report under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2004

Transition report under Section 13 or 15(d) of the Exchange Act

For the transition period from _____ to _____

Commission File Number: 0-1665

DCAP GROUP, INC.

(Exact Name of Small Business Issuer as Specified in its Charter)

Delaware 36-2476480

(State or Other Jurisdiction of (I.R.S Employer
Incorporation or Organization) Identification No.)

1158 Broadway, Hewlett, NY 11557

(Address of Principal Executive Offices)

(516) 374-7600

(Issuer's Telephone Number, Including Area Code)

(Former Name, Former Address and Former Fiscal Year, if Changed
Since Last Report)

APPLICABLE ONLY TO ISSUERS INVOLVED IN
BANKRUPTCY PROCEEDINGS DURING THE
PRECEDING FIVE YEARS

Check whether the registrant filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Exchange Act after the distribution of securities under a plan confirmed by a court. Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: 2,512,424 shares as of October 31, 2004.

Transitional Small Business Disclosure Format (check one):
Yes No X

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DCAP GROUP, INC. AND SUBSIDIARIES

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Explanatory Note

All references in this Quarterly Report to numbers of common shares and per share information give retroactive effect to the one-for-five reverse split of our common shares effected as of August 26, 2004.

Forward-Looking Statements

This Quarterly Report contains forward-looking statements as that term is

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defined in the federal securities laws. The events described in forward-looking statements contained in this Quarterly Report may not occur. Generally these statements relate to business plans or strategies, projected or anticipated benefits or other consequences of our plans or strategies, projected or anticipated benefits from acquisitions to be made by us, or projections involving anticipated revenues, earnings or other aspects of our operating results. The words "may," "will," "expect," "believe," "anticipate," "project," "plan," "intend," "estimate," and "continue," and their opposites and similar expressions are intended to identify forward-looking statements. We caution you that these statements are not guarantees of future performance or events and are subject to a number of uncertainties, risks and other influences, many of which are beyond our control, that may influence the accuracy of the statements and the projections upon which the statements are based. Factors which may affect our results include, but are not limited to, the risks and uncertainties discussed in Item 6 of our Annual Report on Form 10-KSB for the year ended December 31, 2003 under "Factors That May Affect Future Results and Financial Condition".

Any one or more of these uncertainties, risks and other influences could materially affect our results of operations and whether forward-looking statements made by us ultimately prove to be accurate. Our actual results, performance and achievements could differ materially from those expressed or implied in these forward-looking statements. We undertake no obligation to publically update or revise any forward-looking statements, whether from new information, future events or otherwise.

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PART I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

DCAP GROUP, INC. AND SUBSIDIARIES

Condensed Consolidated Balance Sheet (Unaudited)

September 30, 2004

Assets

Current Assets:

| | | |
|---|--------------|--------------|
| Cash and cash equivalents | | \$ 2,247,163 |
| Accounts receivable, net of allowance for doubtful accounts of \$62,000 | | 1,973,081 |
| Finance contracts receivable | \$25,980,085 | |
| Less: Deferred Interest | (1,841,522) | |
| Less: Allowance for doubtful accounts | (169,804) | 23,968,759 |
| | ----- | |

| | | |
|---|--|---------|
| Prepaid expenses and other current assets | | 234,515 |
| | | ----- |

| | | |
|----------------------|--|------------|
| Total Current Assets | | 28,423,518 |
|----------------------|--|------------|

| | | |
|-----------------------------|--|-----------|
| Property and Equipment, net | | 420,967 |
| Goodwill | | 1,171,551 |
| Other Intangibles, net | | 285,698 |
| Deposits and Other Assets | | 319,027 |
| | | ----- |

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| | | |
|--|--|--------------|
| Total Assets | | \$30,620,761 |
| | | ===== |
| Liabilities and Stockholders' Equity | | |
| Current Liabilities: | | |
| Revolving credit line | | \$13,512,193 |
| Accounts payable and accrued expenses | | 907,859 |
| Premiums payable | | 6,419,638 |
| Current portion of long-term debt | | 125,000 |
| Income taxes payable | | 657,532 |
| Other current liabilities | | 365,039 |
| | | ----- |
| Total Current Liabilities | | 21,987,261 |
| | | ----- |
| Long-Term Debt | | 3,661,500 |
| | | ----- |
| Other Liabilities | | 32,003 |
| | | ----- |
| Mandatorily Redeemable Preferred Stock | | 904,000 |
| | | ----- |
| Commitments | | |
| Stockholders' Equity: | | |
| Common Stock, \$.01 par value; 10,000,000 | | |
| shares authorized; 3,255,347 shares issued | | 32,553 |
| Preferred Stock, \$.01 par value; 1,000,000 | | |
| shares authorized; 0 shares issued and outstanding | | - |
| Capital in excess of par | | 10,712,533 |
| Deficit | | (5,780,434) |
| | | ----- |
| | | 4,964,652 |
| Treasury Stock, at cost, 742,923 shares | | (928,655) |
| | | ----- |
| Total Stockholders' Equity | | 4,035,997 |
| | | ----- |
| Total Liabilities and Stockholders' Equity | | \$30,620,761 |
| | | ===== |

See notes to condensed consolidated financial statements.

DCAP GROUP, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Income (Unaudited)

| | 2004 | 2003 |
|---------------------------------|--------------|--------------|
| Nine months ended September 30, | | |
| | | |
| Revenues: | | |
| Commissions and fees | \$ 5,326,539 | \$ 4,600,853 |
| Premium finance revenue | 6,049,173 | 1,074,406 |
| | ----- | ----- |
| | 11,375,712 | 5,675,259 |
| | ----- | ----- |

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| | | |
|--|--------------|-------------|
| Operating Expenses: | | |
| General and administrative expenses | 8,345,040 | 4,675,907 |
| Depreciation and amortization | 313,423 | 165,189 |
| Premium finance interest expense | 932,146 | 92,651 |
| | ----- | ----- |
| Total Operating Expenses | 9,590,609 | 4,933,747 |
| | ----- | ----- |
| Operating Income | 1,785,103 | 741,512 |
| | ----- | ----- |
| Other (Expense) Income: | | |
| Interest income | 7,212 | 7,597 |
| Interest expense | (24,965) | (44,962) |
| Interest expense - mandatorily redeemable preferred stock | (33,900) | (18,833) |
| Gain on sale of stores | - | 89,700 |
| Gain on sale of book of business | - | 88,962 |
| | ----- | ----- |
| | (51,653) | 122,464 |
| | ----- | ----- |
| Income Before Provision for (Benefit of) Income Taxes | 1,733,450 | 863,976 |
| Provision for (Benefit of) Income Taxes | 637,578 | (182,922) |
| | ----- | ----- |
| Income from Continuing Operations | 1,095,872 | 1,046,898 |
| Discontinued Operations: | | |
| Loss from discontinued operations | - | (46,096) |
| | ----- | ----- |
| Net Income | \$ 1,095,872 | \$1,000,802 |
| | ===== | ===== |
| Net Income Per Common Share: | | |
| Basic: | | |
| Income from continuing operations | \$ 0.44 | \$ 0.43 |
| Loss from discontinued operations | - | (0.02) |
| | ----- | ----- |
| Net income | \$ 0.44 | \$ 0.41 |
| | ===== | ===== |
| Diluted: | | |
| Income from continuing operations | \$ 0.35 | \$ 0.40 |
| Loss from discontinued operations | - | (0.02) |
| | ----- | ----- |
| Net income | \$ 0.35 | \$ 0.38 |
| | ===== | ===== |
| Weighted Average Number of Shares Outstanding: | | |
| Basic | 2,491,333 | 2,470,680 |
| | ===== | ===== |
| Diluted | 3,244,947 | 2,681,088 |
| | ===== | ===== |

See notes to condensed consolidated financial statements.

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DCAP GROUP, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Income (Unaudited)

| Three months ended September 30, | 2004 | 2003 |
|--|--------------|--------------|
| Revenues: | | |
| Commissions and fees | \$ 1,853,700 | \$ 1,585,191 |
| Premium finance revenue | 2,094,087 | 377,134 |
| | 3,947,787 | 1,962,325 |
| Operating Expenses: | | |
| General and administrative expenses | 2,955,019 | 1,732,745 |
| Depreciation and amortization | 102,957 | 90,271 |
| Premium finance interest expense | 337,434 | 92,651 |
| Total Operating Expenses | 3,395,410 | 1,915,667 |
| Operating Income | 552,377 | 46,658 |
| Other (Expense) Income: | | |
| Interest income | 1,771 | 2,794 |
| Interest expense | (6,846) | (11,168) |
| Interest expense - mandatorily redeemable preferred stock | (11,300) | (11,041) |
| Gain on sale of book of business | - | 88,962 |
| | (16,375) | 69,547 |
| Income Before Provision for (Benefit of) Income Taxes | 536,002 | 116,205 |
| Provision for (Benefit of) Income Taxes | 161,191 | (188,586) |
| Net Income | \$ 374,811 | \$ 304,791 |
| Net Income Per Common Share: | | |
| Basic | \$ 0.15 | \$ 0.12 |
| Diluted | \$ 0.12 | \$ 0.11 |
| Weighted Average Number of Shares Outstanding: | | |
| Basic | 2,512,497 | 2,470,680 |
| Diluted | 3,245,876 | 2,811,636 |

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See notes to condensed consolidated financial statements.

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DCAP GROUP, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows (Unaudited)

| Nine months ended September 30, | 2004 | 2003 |
|---|--------------------|---------------------|
| Cash Flows from Operating Activities: | | |
| Net income | \$ 1,095,872 | \$ 1,000,802 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 313,423 | 165,189 |
| Bad debt expense | - | 42,098 |
| Amortization of warrants | 44,100 | - |
| Gain on sale of stores | - | (89,700) |
| Gain on sale of book of business | - | (88,962) |
| Deferred income tax benefit | - | (200,000) |
| Changes in operating assets and liabilities: | | |
| Decrease (increase) in assets: | | |
| Accounts receivable | (176,721) | (478,848) |
| Prepaid expenses and other current assets | (123,606) | (222,475) |
| Deposits and other assets | (114,474) | (82,745) |
| Increase (decrease) in liabilities: | | |
| Premiums payable | (110,581) | 5,830,101 |
| Accounts payable and accrued expenses | (419,670) | 91,107 |
| Income taxes payable | 657,532 | - |
| Other current liabilities | 152,849 | (25,296) |
| Net Cash Provided by Operating Activities | 1,318,724 | 5,941,271 |
| Cash Flows from Investing Activities: | | |
| Increase in finance contracts receivable - net | (4,884,598) | (11,819,646) |
| Decrease in notes and other receivables - net | 12,493 | 19,441 |
| Business acquisition | - | (39,039) |
| Purchase of property and equipment | (129,605) | (74,535) |
| Proceeds from disposition of discontinued subsidiary | - | 500,000 |
| Proceeds on sale of book of business | - | 112,925 |
| Proceeds from sale of stores | - | 141,383 |
| Net Cash Used in Investing Activities | (5,001,710) | (11,159,471) |
| Cash Flows from Financing Activities: | | |
| Principal payments on long-term debt | (158,263) | (368,965) |
| Proceeds from long-term debt | - | 3,500,000 |
| Proceeds from revolving credit line | 51,895,399 | 3,387,479 |
| Payments on revolving credit line | (47,351,288) | (770,018) |
| Proceeds from exercise of warrants | 194,997 | - |

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| | | |
|--|-------------|-------------|
| Net Cash Provided by Financing Activities | 4,580,845 | 5,748,496 |
| Net Increase in Cash and Cash Equivalents | 897,859 | 530,296 |
| Cash and Cash Equivalents, beginning of period | 1,349,304 | 607,403 |
| Cash and Cash Equivalents, end of period | \$2,247,163 | \$1,137,699 |

See notes to condensed consolidated financial statements.

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DCAP GROUP, INC. AND SUBSIDIARIES
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
 NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003 (UNAUDITED)

- The Condensed Consolidated Balance Sheet as of September 30, 2004, the Condensed Consolidated Statements of Income for the three and nine months ended September 30, 2004 and 2003 and the Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2004 and 2003 have been prepared by us without audit. In our opinion, the accompanying unaudited condensed consolidated financial statements contain all adjustments necessary to present fairly in all material respects our financial position as of September 30, 2004, results of operations for the three and nine months ended September 30, 2004 and 2003 and cash flows for the nine months ended September 30, 2004 and 2003.

This report should be read in conjunction with our Annual Report on Form 10-KSB for the year ended December 31, 2003.

The results of operations and cash flows for the nine months ended September 30, 2004 are not necessarily indicative of the results to be expected for the full year.

- Summary of Significant Accounting Policies:

a. Principles of consolidation

The accompanying consolidated financial statements include the accounts of all subsidiaries and joint ventures in which we have a majority voting interest or voting control. All significant intercompany accounts and transactions have been eliminated.

b. Revenue recognition

We recognize commission revenue from insurance policies at the beginning of the contract period (except for contingent commissions that are receivable annually, which we recognize on a ratable basis) and on automobile club dues equally over the contract period. Franchise fee revenue is recognized when substantially all of our contractual requirements under the franchise agreement are completed. Refunds of commissions on the cancellation of insurance policies are reflected at the time of cancellation.

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Prior to July 14, 2003, premium financing fee revenue was earned based upon the origination of premium finance contracts sold by agreement to third parties. The contract fee gave consideration to an estimate as to the collectability of the loan amount. Periodically, actual results were compared to estimates previously recorded, and adjusted accordingly.

On July 14, 2003, we changed our business model with respect to our premium finance operations from selling finance contracts to third parties to internally financing those contracts. To accomplish this, we obtained a credit facility and commenced recording interest and fee-based revenue over the life of each loan (generally 9 to 10 months) and expenses of operating a finance company, such as servicing, bad debts and interest expense.

Thus, rather than recording a one-time fee per contract (as we did prior to July 14, 2003), we are now recording income and expense over the life of each contract, as well as receivables and payables relating to the operations of a premium finance company. We are using the interest method to recognize interest income over the life of each loan in accordance with Statement of Financial Accounting Standard No. 91, "Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases."

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Delinquency fees are earned when collected. Upon completion of collection efforts, after cancellation of the underlying insurance policies, any uncollected earned interest or fees are charged off.

c. Website Development Costs

Technology and content costs are generally expensed as incurred, except for certain costs relating to the development of internal-use software, including those relating to operating our website, that are capitalized and depreciated over two years. A total of \$47,043 and \$40,500 in such costs was incurred during the nine months ended September 30, 2004 and 2003, respectively.

d. Reclassifications

Certain reclassifications have been made to the consolidated financial statements for the nine months ended September 30, 2003 to conform with the classifications used for the nine months ended September 30, 2004.

3. Business Segments:

We currently have two reportable business segments: Insurance and Premium Finance. The Insurance segment sells retail auto, motorcycle, boat, life, business, and homeowner's insurance and franchises. In addition, this segment offers tax preparation services and automobile club services for roadside emergencies. Insurance revenues are derived from activities within the United States, and all long-lived assets are located within the United States. The Premium Finance segment offers property and casualty policyholders loans to finance the policy premiums.

In December 2002, we disposed of our Hotel segment as part of a settlement agreement. Accordingly, the segment information shown in the following table excludes the activity of this segment for the nine months ended September 30, 2004 and 2003.

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Summarized financial information concerning our reportable segments is shown in the following tables:

| Nine Months Ended September 30, 2004 | Insurance | Premium Finance | Other (1) | Total |
|---|-------------|--------------------|-----------|--------------|
| Revenues from external customers | \$5,326,539 | \$6,049,173 | \$ - | \$11,375,712 |
| Interest income | 7,212 | - | - | 7,212 |
| Interest expense | 57,682 | 932,146 | 1,183 | 991,011 |
| Depreciation and amortization | 128,458 | 161,934 | 23,031 | 313,423 |
| Segment profit (loss) before income taxes | 1,284,412 | 1,379,568 | (930,530) | 1,733,450 |
| Segment profit (loss) | 770,647 | 827,741 | (502,516) | 1,095,872 |
| Segment assets | 3,915,060 | 25,680,697 | 1,025,004 | 30,620,761 |

(1) Column represents corporate-related items and, as it relates to segment profit (loss), income, expense and assets not allocated to reportable segments.

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| Nine Months Ended September 30, 2003 | Insurance | Premium Finance | Other (1) | Total |
|---|-------------|--------------------|-----------|-------------|
| Revenues from external customers | \$4,600,853 | \$1,074,406 | \$ - | \$5,675,259 |
| Interest income | 1,223 | - | 6,374 | 7,597 |
| Interest expense | 63,795 | 92,651 | - | 156,446 |
| Depreciation and amortization | 111,848 | 46,341 | - | 165,189 |
| Segment profit (loss) before income taxes | 795,501 | 604,361 | (535,886) | 863,976 |
| Segment profit (loss) | 795,501 | 604,361 | (352,964) | 1,046,898 |
| Segment assets | 3,046,295 | 12,598,948 | 1,200,361 | 16,845,604 |

(1) Column represents corporate-related items and, as it relates to segment profit (loss), income, expense and assets not allocated to reportable segments.

4. Stock Options

We have elected the disclosure only provisions of Statement of Financial Accounting Standard No. 123, "Accounting for Stock-Based Compensation" ("FASB 123") in accounting for our employee stock options. Accordingly, no compensation expense has been recognized. Had we recorded compensation expense for the stock options based on the fair value at the grant date for awards in the nine and three months ended September 30, 2004 and 2003 consistent with the provisions of SFAS 123, our net income and net income per share would have been adjusted as follows:

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| | Nine Months Ended September 30, | | Three Mon Septem |
|---|------------------------------------|-------------|---------------------|
| | 2004 | 2003 | 2004 |
| Net income, as reported | \$1,095,872 | \$1,000,802 | \$374,811 |
| Deduct: Total stock-based employee compensation expense determined under fair value based method, net of related tax effects | (50,000) | (59,000) | (17,000) |
| Pro forma net income | \$1,045,872 | \$941,802 | \$357,811 |
| Net income per share: | | | |
| Basic - as reported | \$0.44 | \$0.41 | \$0.15 |
| Basic - pro forma | \$0.42 | \$0.38 | \$0.14 |
| Diluted - as reported | \$0.35 | \$0.38 | \$0.12 |
| Diluted - pro forma | \$0.33 | \$0.36 | \$0.11 |

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5. Sale of Stores and Book of Business

During the nine months ended September 30, 2003, we sold two of our retail offices (part of our Insurance segment) and the book of business relating to one store for cash consideration aggregating approximately \$254,000 and a note receivable of approximately \$97,000. These sales resulted in a gain of approximately \$179,000. The assets included accounts receivable of approximately \$97,000, goodwill with a carrying amount of \$57,000, and fixed assets with a carrying amount of approximately \$10,000. In addition, concurrently with the sale of the two retail stores, the purchasers entered into franchise agreements with us.

6. Income Taxes

Our tax benefit for the three and nine months ended September 30, 2003 reflects the anticipated utilization of estimated net operating loss carryforwards that had previously been fully reserved and the reversal of approximately 50% of the valuation allowance relating to the net operating

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loss carryforward not subject to Internal Revenue Code Section 382. Our tax provision for the three and nine months ended September 30, 2004 differs from statutory rates as it results from an underaccrual of the 2003 tax benefit.

7. Net Income Per Share

Basic net income per share is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding. Diluted earnings per share reflect, in periods in which they have a dilutive effect, the impact of common shares issuable upon exercise of stock options and conversion of mandatorily redeemable preferred stock.

The reconciliation is as follows:

| | Nine Months Ended September 30, | | Three Months Ended September 30, | |
|---|------------------------------------|-----------|-------------------------------------|-----------|
| | 2003 | 2004 | 2003 | 2004 |
| Weighted Average Number of Shares Outstanding | 2,491,333 | 2,470,680 | 2,512,497 | 2,470,680 |
| Effect of Dilutive Securities, Common Stock Equivalents | 753,614 | 210,408 | 733,379 | 340,909 |
| Weighted Average Number of Shares Outstanding, used for computing diluted earnings per share | 3,244,947 | 2,681,088 | 3,245,876 | 2,811,600 |

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Net income available to common shareholders for the computation of diluted earnings per share is computed as follows:

| | Nine Months Ended September 30, | | Three Months Ended September 30, |
|--|------------------------------------|-------------|-------------------------------------|
| | 2004 | 2003 | 2004 |
| Net Income | \$1,095,872 | \$1,000,802 | \$374,811 |
| Interest Expense on Dilutive Convertible Preferred Stock | 33,900 | 18,833 | 11,300 |
| Net Income Available to Common Shareholders for Diluted Earnings Per Share | \$1,129,772 | \$1,019,635 | \$386,111 |

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8. Exercise of Warrants -----

During the nine months ended September 30, 2004, warrants were exercised for the purchase of 22,727 common shares at an exercise price of \$5.50 per share and 19,090 common shares at an exercise price of \$3.65 per share.

9. Reverse Stock Split -----

On August 26, 2004, we effected a one-for-five reverse split of our common shares. The \$0.01 par value per share was not changed as a result of the reverse split and \$130,218 was transferred from common stock to capital in excess of par value. Total shares outstanding decreased from 12,562,487 to 2,512,424 as a result of the reverse split. All references to numbers of common shares and per share information give retroactive effect to the one-for-five reverse split.

In connection with the reverse split, the number of authorized common shares was reduced from 40,000,000 to 10,000,000.

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

Overview

We operate 25 storefronts, including 19 Barry Scott locations acquired through our August 2002 acquisition of Barry Scott Companies, Inc., and five Atlantic Insurance locations acquired through our May 2003 acquisition of substantially all the assets of AIA Acquisition Corp. We also have 42 franchised DCAP locations.

Our insurance storefronts serve as insurance agents or brokers and place various types of insurance on behalf of customers. We focus on automobile, motorcycle and homeowner's insurance and our customer base is primarily individuals rather than businesses.

The stores receive commissions from insurance companies for their services. We receive fees from the franchised locations in connection with their use of the DCAP name. Neither we nor the stores currently serve as an insurance company and therefore do not assume underwriting risks. The stores also offer automobile club services for roadside assistance and income tax preparation services.

Payments Inc., our wholly-owned subsidiary, is an insurance premium finance agency that offers premium financing to clients of DCAP, Barry Scott and Atlantic Insurance offices, as well as non-affiliated insurance agencies. We currently operate within the states of New York, Pennsylvania and New Jersey.

Critical Accounting Policies

Our consolidated financial statements include accounts of DCAP Group, Inc. and all majority-owned and controlled subsidiaries. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires our management to make estimates and assumptions in certain circumstances that affect amounts reported in our consolidated financial statements and related notes. In preparing these financial statements, our management has utilized information available including our past history,

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industry standards and the current economic environment, among other factors, in forming its estimates and judgments of certain amounts included in the consolidated financial statements, giving due consideration to materiality. It is possible that the ultimate outcome as anticipated by our management in formulating its estimates inherent in these financial statements might not materialize. However, application of the critical accounting policies below involves the exercise of judgment and use of assumptions as to future uncertainties and, as a result, actual results could differ from these estimates. In addition, other companies may utilize different estimates, which may impact comparability of our results of operations to those of companies in similar businesses.

Commission and fee income

We recognize commission revenue from insurance policies at the beginning of the contract period, except for contingent commissions that are receivable annually, for which we recognize the commission revenue ratably. Refunds of commissions on the cancellation of insurance policies are reflected at the time of cancellation.

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Franchise fee revenue is recognized when substantially all of our contractual requirements under the franchise agreement are completed.

Automobile club dues are recognized equally over the contract period.

Finance income, fees and receivables

Finance income consists of interest, service fees and delinquency fees. Finance income, other than delinquency fees, is recognized using the interest method or similar methods that produce a level yield over the life of each loan (generally nine to ten months). Delinquency fees are earned when collected.

Allowance for finance receivable losses

Losses on finance receivables include an estimate of future credit losses on premium finance accounts. Credit losses on premium finance accounts occur when the unearned premiums received from the insurer upon cancellation of a financed policy are inadequate to pay the balance of the premium finance loan amount, which includes accrued interest. The majority of these shortfalls result in the write-off of such interest. We review historical trends of such losses relative to finance receivable balances to develop estimates of future losses. However, actual write-offs may differ materially from the write-off estimates that we used.

Goodwill and intangible assets

The carrying value of goodwill was initially reviewed for impairment as of January 1, 2002, and is reviewed annually or whenever events or changes in circumstances indicate that the carrying amount might not be recoverable. If the fair value of the operations to which goodwill relates is less than the carrying amount of those operations, including unamortized goodwill, the carrying amount of goodwill is reduced accordingly with a charge to expense. Based on our most recent analysis, we believe that no impairment of goodwill exists at September 30, 2004.

Stock-based compensation

We apply the intrinsic value-based method of accounting prescribed by Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to

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Employees, and related interpretations, to account for stock-based employee compensation plans and report pro forma disclosures in our Form 10-QSB filings by estimating the fair value of options issued and the related expense in accordance with SFAS No. 123. Under this method, compensation cost is recognized for awards of common shares or stock options to our directors, officers and employees only if the quoted market price of the stock at the grant date (or other measurement date, if later) is greater than the amount the grantee must pay to acquire the stock.

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Results of Operations

Our operating income for the nine months ended September 30, 2004 was \$1,785,103 as compared to \$741,512 for the nine months ended September 30, 2003.

During the nine months ended September 30, 2004, revenues from our insurance-related operations were \$5,326,539 as compared to \$4,600,853 for the nine months ended September 30, 2003. The increase was generally due to the revenues of our Atlantic Insurance stores (whose assets were acquired effective May 1, 2003) as well as an increase in contingent commissions during the 2004 period.

Premium finance revenues increased \$4,974,767 during the nine months ended September 30, 2004 as compared to the nine months ended September 30, 2003, as indicated by the following table:

| | Nine Months Ended September 30, | |
|----------------------------------|------------------------------------|-------------|
| | 2004 | 2003 |
| Revenue from sale of receivables | \$ - | \$ 683,497 |
| Interest and late fee revenue | 6,049,173 | 390,909 |
| Total | \$6,049,173 | \$1,074,406 |

During the period from January 1, 2003 until July 13, 2003, we recognized premium finance revenue from the sale of premium finance receivables to a third party and recorded a one-time fee per contract. On July 14, 2003, we obtained an \$18,000,000 two-year line of credit from Manufacturers and Traders Trust Co. to finance our premium finance operations. Concurrently, we obtained \$3,500,000 in funding from a private placement of subordinated debt and warrants to support our premium finance operations. We then began utilizing these credit facilities and commenced recording interest and fee-based revenue over the life of each loan and the expenses of operating a finance company, such as servicing, bad debts and interest expense. Thus, rather than recording a one-time fee per contact, we are recording income and expense over the life of each contract.

Effective November 2003, we began providing premium finance services to our Barry Scott locations (following the expiration of a requirement that the locations use another provider), and in March 2004 we began providing premium finance services to our Atlantic Insurance offices.

Our general and administrative expenses for the nine months ended September

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30, 2004 were \$3,669,133 more than for the nine months ended September 30, 2003. This increase was primarily due to the expenses of our Atlantic Insurance stores (whose assets were acquired effective May 1, 2003) and the expenses of operating a finance company, as discussed above, which we commenced on July 14, 2003.

Our depreciation and amortization expense for the nine months ended September 30, 2004 was \$148,234 more than for the nine months ended September 30, 2003. This increase was primarily the result of our recording amortization of costs associated with obtaining the financing

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discussed above.

During the nine months ended September 30, 2004, we incurred premium finance interest expense of \$932,146 as compared to \$92,651 during the nine months ended September 30, 2003. This increase was the result of the change in our premium finance business in July 2003 as discussed above.

In May 2003, we issued redeemable preferred shares in connection with the acquisition of the assets of AIA Acquisition Corp. and incurred interest expense of \$33,900 during the nine months ended September 30, 2004 as compared to \$18,833 during the nine months ended September 30, 2003.

During the nine months ended September 30, 2003, we sold two of our stores and the book of business relating to one store, resulting in a gain of \$178,662. No such sales occurred during the nine months ended September 30, 2004.

During the nine months ended September 30, 2004, our provision for income taxes was \$637,578 as opposed to a tax benefit of \$182,922 for the nine months ended September 30, 2003. This was primarily due to the reversal of the valuation allowance on our net operating loss carryforwards for the nine months ended September 30, 2003. Our tax provision for the nine months ended September 30, 2004 differs from statutory rates as it results from an underaccrual of the 2003 tax benefit.

Our insurance-related operations, on a stand-alone basis, generated a net profit before income taxes of \$1,284,412 during the nine months ended September 30, 2004 as compared to a net profit before income taxes of \$795,501 during the nine months ended September 30, 2003. This increase was primarily the result of the inclusion of AIA's operations and an increase in contingent commission revenue during the 2004 period. Our premium finance operations, on a stand-alone basis, generated a net profit before income taxes of \$1,379,568 during the nine months ended September 30, 2004 as compared to a net profit before income taxes of \$604,361 during the nine months ended September 30, 2003. The increase was primarily due to increased profits resulting from the change in our business model as discussed above. Loss before income taxes from corporate-related items not allocable to reportable segments was \$930,530 during the nine months ended September 30, 2004 as compared to \$535,886 during the nine months ended September 30, 2003. This increase was primarily due to the gain on sale of stores and book of business during the nine months ended September 30, 2003 while no sale of stores or book of business occurred during the nine months ended September 30, 2004 as well as increased salary expense and the purchase of directors and officers liability insurance during the nine months ended September 30, 2004.

In January 2003, we discontinued the operations of the International Airport Hotel in San Juan, Puerto Rico. During the nine months ended September 30, 2003, this discontinued operation generated a net loss of \$46,096. There were no such operations during the nine months ended September 30, 2004.

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An action was recently brought by the New York State Attorney General against Marsh & McLennan Companies, the nation's leading insurance brokerage firm, alleging, among other things, that it had improperly steered clients to insurers with whom it had lucrative contingent commission

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arrangements. As a result of the ongoing investigation of this matter by the Attorney General's office and others, we anticipate that there may be an industry-wide change in the method by which insurance brokers are compensated. We do not believe that any such change would have a material adverse effect on our results of operations.

Liquidity and Capital Resources

As of September 30, 2004, we had \$2,247,163 in cash and cash equivalents and working capital of \$6,436,257. As of December 31, 2003, we had \$1,349,304 in cash and cash equivalents and working capital of \$5,168,694.

During the nine months ended September 30, 2004, our cash and cash equivalents increased by \$897,859. This was due to the following:

- o Net cash provided by operating activities was \$1,318,724 primarily due our net income for the period of \$1,095,872, plus an increase in taxes payable of \$657,532 and depreciation and amortization expenses of \$313,423, offset by a decrease in accounts payable and accrued expenses of \$419,670.
- o We used \$5,001,710 in investing activities primarily due to an increase in our net finance contracts receivable of \$4,884,598.
- o Net cash provided by financing activities was \$4,580,845 primarily due to proceeds of \$51,895,399 from our revolving credit line from Manufacturers and Traders Trust Co. for premium finance purposes, offset by payments of \$47,351,288 on the revolving line.

Liquidity at September 30, 2004 was sufficient, in the opinion of management, to meet our cash requirements for the 12 month period ending September 30, 2005.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

Item 3. CONTROLS AND PROCEDURES

Our Chief Executive Officer and Chief Financial Officer conducted an evaluation of the effectiveness of our disclosure controls and procedures. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of September 30, 2004 in alerting him in a timely manner to material information required to be included in our SEC reports. In addition, no change in our internal control over financial reporting occurred during the fiscal quarter ended September 30, 2004 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

None

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

Item 3. DEFAULTS UPON SENIOR SECURITIES

None

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

None

Item 5. OTHER INFORMATION

None

Item 6. EXHIBITS

3(a) Restated Certificate of Incorporation, as amended

3(b) Certificate of Amendment of the Restated Certificate of Incorporation, filed August 25, 2004

3(c) By-laws, as amended(1)

10 Employment Agreement, dated September 24, 2004, by and between DCAP Group, Inc. and Jack Willis

31 Rule 13a-14(a)/15d-14(a) Certification as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32 Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

1 Denotes document filed as an exhibit to our Quarterly Report on Form 10-QSB for the period ended June 30, 2004 and incorporated herein by reference.

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SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DCAP GROUP, INC.

Dated: November 9, 2004

By: /s/ Barry Goldstein

Barry Goldstein
President, Chairman of the Board,
Chief Executive Officer, Chief
Financial Officer and Treasurer
(Principal Executive, Financial and
Accounting Officer)