DCAP GROUP INC
Form 10QSB
November 13, 2006

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

**FORM 10-QSB**

**(Mark One)**

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

For the quarterly period ended September 30, 2006

[ ] 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 Incorporation or Organization) | (I.R.S. Employer 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)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act 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 requirements for the past 90 days. Yes__X__ No____

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). Yes ____ No X _

**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: 2,896,024 shares as of October 31, 2006.

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

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**DCAP GROUP, INC. AND SUBSIDIARIES**


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Forward-Looking Statements

This Quarterly Report contains forward-looking statements as that term is 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, 2005 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.

| | | | | |
|---|---|---|---|---|
| | | | | **DCAP GROUP, INC. AND SUBSIDIARIES** |
| **Condensed Consolidated Balance Sheet (Unaudited)** | | | | |
| *September 30, 2006* | | | | |
| | | | | |
| **Assets** | | | | |
| Current Assets | | | | |
| Cash and cash equivalents | | | $ | 1,214,924 |
| Accounts receivable, net of allowance for doubtful accounts of $58,700 | | | | 1,307,564 |
| Finance contracts receivable | $ | 17,866,052 | | |
| Less: Deferred interest | | (1,367,585) | | |
| Less: Allowance for finance receivable losses | | (226,029) | | 16,272,438 |
| Prepaid expenses and other current assets | | | | 299,452 |
| Deferred income taxes | | | | 77,000 |
| Total Current Assets | | | | 19,171,378 |
| Property and Equipment, net | | | | 331,406 |
| Goodwill | | | | 2,513,978 |
| Other Intangibles, net | | | | 373,006 |
| Notes Receivable, net | | | | 3,788,730 |
| Deposits and Other Assets | | | | 154,125 |
| Total Assets | | | $ | 26,332,623 |
| | | | | |
| **Liabilities and Stockholders' Equity** | | | | |
| Current Liabilities: | | | | |
| Revolving credit line | | | $ | 11,852,707 |
| Accounts payable and accrued expenses | | | | 893,954 |
| Premiums payable | | | | 3,458,743 |
| Current portion of long-term debt | | | | 2,010,947 |
| Income tax payable | | | | 29,066 |
| Other current liabilities | | | | 165,249 |
| Total Current Liabilities | | | | 18,410,666 |
| | | | | |
| Long-Term Debt | | | | 1,101,163 |
| Deferred Income Tax | | | | 37,000 |
| Other Liabilities | | | | 1,845 |
| Mandatorily Redeemable Preferred Stock | | | | 780,000 |
| Commitments | | | | |
| | | | | |
| Stockholders' Equity: | | | | |
| Common stock, $.01 par value; authorized 10,000,000 shares issued 3,672,947 | | | | 36,730 |
| Preferred stock; $.01 par value; authorized 1,000,000 shares; 0 shares issued and outstanding | | | | - |
| Capital in excess of par | | | | 11,636,254 |
| Deficit | | | | (4,492,480) |
| | | | | 7,180,504 |

| | | |
|---|---|---|
| Treasury stock, at cost, 776,923 shares | | (1,178,555) |
| Total Stockholders' Equity | | 6,001,949 |
| Total Liabilities and Stockholders' Equity | $ | 26,332,623 |

*See notes to condensed consolidated financial statements.*

**DCAP GROUP, INC. AND SUBSIDIARIES**

**Condensed Consolidated Statements of Income (Unaudited)**

| *Nine Months Ended September 30,* | | *2006* | | *2005* |
|---|---|---|---|---|
| | | | | |
| Revenues: | | | | |
| Commissions and fees | $ | 5,390,085 | $ | 5,461,000 |
| Premium finance revenue | | 3,085,956 | | 3,951,434 |
| Total Revenues | | 8,476,041 | | 9,412,434 |
| | | | | |
| Operating Expenses: | | | | |
| General and administrative expenses | | 6,724,954 | | 6,720,444 |
| Provision for finance receivable losses | | 496,456 | | 515,180 |
| Depreciation and amortization | | 319,302 | | 338,861 |
| Premium finance interest expense | | 604,219 | | 548,680 |
| Total Operating Expenses | | 8,144,931 | | 8,123,165 |
| | | | | |
| Operating Income | | 331,110 | | 1,289,269 |
| | | | | |
| Other Income (Expense): | | | | |
| Interest income | | 3,531 | | 14,633 |
| Interest income - notes receivable | | 858,546 | | - |
| Interest expense | | (388,872) | | (254,070) |
| Interest expense - mandatorily redeemable preferred stock | | (29,250) | | (29,371) |
| Gain on sale of store | | 81,105 | | - |
| Total Other Income (Expense) | | 525,060 | | (268,808) |
| | | | | |
| Income Before Provision for Income Taxes | | 856,170 | | 1,020,461 |
| | | | | |
| Provision for Income Taxes | | 342,468 | | 409,159 |
| | | | | |
| Net Income | $ | 513,702 | $ | 611,302 |
| | | | | |
| Net Income Per Common Share: | | | | |
| Basic | $ | 0.18 | $ | 0.22 |
| Diluted | $ | 0.17 | $ | 0.20 |
| | | | | |
| Weighted Average Number of Shares Outstanding | | | | |
| Basic | | 2,886,372 | | 2,723,215 |
| Diluted | | 3,243,030 | | 3,271,246 |

*See notes to condensed consolidated financial statements.*

**DCAP GROUP, INC. AND SUBSIDIARIES**

**Condensed Consolidated Statements of Income (Unaudited)**

| *Three Months Ended September 30,* | | *2006* | | *2005* |
|---|---|---|---|---|
| Revenues: | | | | |
| Commissions and fees | $ | 1,636,855 | $ | 1,822,832 |
| Premium finance revenue | | 939,255 | | 1,196,267 |
| Total Revenues | | 2,576,110 | | 3,019,099 |
| Operating Expenses: | | | | |
| General and administrative expenses | | 2,120,989 | | 2,342,163 |
| Provision for finance receivable losses | | 168,514 | | 158,990 |
| Depreciation and amortization | | 94,681 | | 113,345 |
| Premium finance interest expense | | 196,669 | | 195,477 |
| Total Operating Expenses | | 2,580,853 | | 2,809,975 |
| Operating Income (Loss) | | (4,743) | | 209,124 |
| Other Income (Expense): | | | | |
| Interest income | | 1,250 | | 6,537 |
| Interest income - notes receivable | | 324,298 | | - |
| Interest expense | | (134,208) | | (78,773) |
| Interest expense - mandatorily redeemable preferred stock | | (9,750) | | (9,750) |
| Total Other Income (Expense) | | 181,590 | | (81,986) |
| Income Before Provision for Income Taxes | | 176,847 | | 127,138 |
| Provision for Income Taxes | | 70,739 | | 51,850 |
| Net Income | $ | 106,108 | $ | 75,288 |
| Net Income Per Common Share: | | | | |
| Basic | $ | 0.04 | $ | 0.03 |
| Diluted | $ | 0.04 | $ | 0.03 |
| Weighted Average Number of Shares Outstanding | | | | |
| Basic | | 2,896,024 | | 2,727,533 |
| Diluted | | 3,241,240 | | 3,268,981 |

*See notes to condensed consolidated financial statements.*

**DCAP GROUP, INC. AND SUBSIDIARIES**

**Condensed Consolidated Statements of Cash Flows (Unaudited)**

| *Nine months ended September 30,* | *2006* | *2005* |
|---|---|---|
| Cash Flows From Operating Activities: | | |
| Net income | $ 513,702 | $ 611,302 |
| Adjustments to reconcile net income to net cash (used in) provided by operating activities: | | |
| Depreciation and amortization | 319,302 | 338,861 |
| Bad debt expense | 1,200 | - |
| Accretion of discount on notes receivable | (658,546) | - |
| Amortization of warrants | 58,221 | 52,212 |
| Gain on sale of store | (81,105) | - |
| Changes in operating assets and liabilities: | | |
| Decrease (increase) in assets: | | |
| Accounts receivable | 390,739 | 1,186,444 |
| Prepaid expenses and other current assets | (67,001) | 23,319 |
| Deposits and other assets | (137,797) | (171,141) |
| Increase (decrease) in liabilities: | | |
| Premiums payable | (702,218) | 1,412 |
| Accounts payable and accrued expenses | 228,375 | (876,235) |
| Taxes payable | (39,793) | (280,242) |
| Other current liabilities | (31,850) | (17,799) |
| Net Cash (Used in) Provided by Operating Activities | (206,771) | 868,133 |
| | | |
| Cash Flows from Investing Activities: | | |
| Decrease in finance contracts receivable - net | 242,585 | 2,867,691 |
| Decrease in notes and other receivables - net | 9,852 | 13,664 |
| Purchase of notes | (1,771,707) | - |
| Purchase of agencies | (832,654) | - |
| Purchase of property and equipment | (86,869) | (15,093) |
| Net Cash (Used in) Provided by Investing Activities | (2,438,793) | 2,866,262 |
| | | |
| Cash Flows from Financing Activities: | | |
| Principal payments on long-term debt | (235,000) | (2,129,301) |
| Proceeds from revolving credit line | 41,785,558 | 46,052,834 |
| Payments on revolving credit line | (38,539,375) | (46,158,808) |
| Proceeds from exercise of stock options | 191,250 | 9,750 |
| Payments on note payable-related party | (1,303,434) | - |
| Net Cash Provided by (Used in) Financing Activities | 1,898,999 | (2,225,525) |
| | | |
| Net (Decrease) Increase in Cash and Cash Equivalents | (746,565) | 1,508,870 |

| | | | | |
|---|---|---|---|---|
| Cash and Cash Equivalents, beginning of period | | 1,961,489 | | 515,899 |
| Cash and Cash Equivalents, end of period | $ | 1,214,924 | $ | 2,024,769 |
| | | | | |
| Supplemental Schedule of Non-Cash Investing and Financing Activities: | | | | |
| | | | | |
| Note payable issued for purchase of notes receivable | $ | 1,303,434 | $ | - |
| Note payable issued for purchase of agencies | $ | 522,949 | $ | - |

*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, 2006 AND 2005 (UNAUDITED)**

1. The Condensed Consolidated Balance Sheet as of September 30, 2006, the Condensed Consolidated Statements of Income for the three and nine months ended September 30, 2006 and 2005 and the Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2006 and 2005 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, 2006, results of operations for the three and nine months ended September 30, 2006 and 2005 and cash flows for the nine months ended September 30, 2006 and 2005.

This report should be read in conjunction with our Annual Report on Form 10-KSB for the year ended December 31, 2005.

The results of operations and cash flows for the nine months ended September 30, 2006 are not necessarily indicative of the results to be expected for the full year.

2. 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. Refunds of commissions on the cancellation of insurance policies are reflected at the time of cancellation.

Franchise fee revenue on initial franchisee fees is recognized when substantially all of our contractual requirements under the franchise agreement are completed. Franchisees also pay a monthly franchise fee plus an applicable percentage of co-op advertising expense. We are obligated to provide marketing and training support to each franchisee.

Automobile club dues are recognized equally over the contract period.

For our premium finance operations, 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.”

Upon the establishment of a premium finance contract, we record the gross loan payments as a receivable with a corresponding reduction for deferred interest. The deferred interest is amortized to interest income using the interest method over the life of each loan. The weighted average interest rate charged with respect to financed insurance policies was approximately 26.5% per annum for the nine months ended September 30, 2006 and 2005.

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

c. Allowance for finance receivable losses

Customers who purchase insurance policies are often unable to pay the premium in a lump sum and, therefore, require extended payment terms. Premium finance involves making a loan to the customer that is backed by the unearned portion of the insurance premiums being financed. No credit checks are made prior to the decision to extend credit to a customer. 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 account. After collection attempts are exhausted, the remaining principal balance is written off against the allowance for finance receivable losses and the unrealized actual interest and late fees are charged against the premium finance revenue. 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. For the nine months ended September 30, 2006 and 2005, the provision for finance receivable losses was $496,456 and $580,683 (before estimated recoveries of $65,503 for the 2005 period which reduced the provision for finance receivable losses), respectively, and actual principal write-offs for such periods (net of recoveries of previous write-offs) were $477,293 and $617,099, respectively.

d. Reclassifications

Certain reclassifications (including the reclassification of the premium finance revenue (interest and late fees) write-offs from the "Provision for finance receivable losses" to "Premium finance revenue" (see below)) have been made to the consolidated financial statements for the nine and three months ended September 30, 2005 to conform to the classifications used for the nine and three months ended September 30, 2006. Beginning in 2005, we were able to obtain a complete detail of the interest and fee write-offs for the premium finance receivables. Effective January 1, 2006, we began reporting the premium finance revenue, net of the interest and fee write-offs as illustrated below.

Nine Months Ended September 30, 2005

| Statement of Income Accounts | Originally Reported | Reclassifications | As Restated |
|---|---|---|---|
| Premium finance revenue | $ 5,359,499 | $ 1,408,065 | $ 3,951,434 |
| Provision for finance receivable losses | 1,923,245 | (1,408,065) | 515,180 |
| Net | $ 3,436,254 | $ 0 | $ 3,436,254 |

Three Months Ended September 30, 2005

| Statement of Income Accounts | Originally Reported | Reclassifications | As Restated |
|---|---|---|---|
| Premium finance revenue | $ 1,720,232 | $ 523,965 | $ 1,196,267 |
| Provision for finance receivable losses | 682,955 | (523,965) | 158,990 |
| Net | $ 1,037,277 | $ 0 | $ 1,037,277 |

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.

Summarized financial information concerning our reportable segments for the nine months ended September 30, 2006 and 2005 is shown in the following tables:

| Nine Months Ended September 30, 2006 | Insurance | Premium Finance | Other (1) | Total |
|---|---|---|---|---|
| Revenues from external customers | $ 5,390,085 | $ 3,085,956 | $ - | $ 8,476,041 |
| Interest income | 3,388 | - | 143 | 3,531 |
| Interest income -notes receivable | - | - | 858,546 | 858,546 |
| Interest expense | 70,650 | 604,219 | 347,472 | 1,022,341 |
| Depreciation and Amortization | 168,806 | 118,446 | 32,050 | 319,302 |
| Segment profit (loss) before income taxes | 986,205 | 618,073 | (748,108) | 856,170 |
| Segment profit (loss) | 591,723 | 370,844 | (448,865) | 513,702 |
| Segment assets | 4,812,297 | 17,099,637 | 4,420,689 | 26,332,623 |

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

| Nine Months Ended<br>September 30, 2005 | Insurance | Premium<br>Finance | Other (1) | Total |
|---|---|---|---|---|
| Revenues from external customers | $ 5,461,000 | $ 3,951,434 | $ - | $ 9,412,434 |
| Interest income | 2,903 | - | 11,730 | 14,633 |
| Interest income -notes receivable | - | - | - | - |
| Interest expense | 42,185 | 548,680 | 241,256 | 832,121 |
| Depreciation and Amortization | 122,886 | 176,611 | 39,364 | 338,861 |
| Segment profit (loss) before income taxes | 1,259,965 | 1,202,276 | (1,441,780) | 1,020,461 |
| Segment profit (loss) | 755,979 | 721,365 | (866,042) | 611,302 |
| Segment assets | 3,469,241 | 20,178,784 | 1,118,291 | 24,766,316 |

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

Summarized financial information concerning our reportable segments for the three months ended September 30, 2006 and 2005 is shown in the following tables:

| Three Months Ended<br>September 30, 2006 | Insurance | Premium<br>Finance | Other (1) | Total |
|---|---|---|---|---|
| Revenues from external customers | $ 1,636,855 | $ 939,255 | $ - | $ 2,576,110 |
| Interest income | 1,217 | - | 43 | 1,250 |
| Interest income -notes receivable | - | - | 324,298 | 324,298 |
| Interest expense | 24,031 | 196,669 | 119,927 | 340,627 |
| Depreciation and Amortization | 58,314 | 25,104 | 11,263 | 94,681 |
| Segment profit (loss) before income taxes | 235,755 | 207,842 | (266,550) | 176,847 |
| Segment profit (loss) | 141,453 | 124,585 | (159,930) | 106,108 |

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

| Three Months Ended September 30, 2005 | Insurance | Premium Finance | Other (1) | Total |
|---|---|---|---|---|
| Revenues from external customers | $ 1,822,832 | $ 1,196,267 | $ - | $ 3,019,099 |
| Interest income | 724 | - | 5,813 | 6,537 |
| Interest income -notes receivable | - | - | - | - |
| Interest expense | 13,216 | 195,477 | 75,307 | 284,000 |
| Depreciation and Amortization | 40,921 | 59,302 | 13,122 | 113,345 |
| Segment profit (loss) before income taxes | 294,400 | 304,712 | (475,974) | 127,138 |
| Segment profit (loss) | 179,040 | 182,494 | (286,246) | 75,288 |

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

4. Employee Stock Compensation

In November 1998, we adopted the 1998 Stock Option Plan, which provides for the issuance of incentive stock options and non-statutory stock options. Under this plan, options to purchase not more than 400,000 shares of our Common Stock were permitted to be granted, at a price to be determined by our Board of Directors or the Stock Option Committee at the time of grant. During 2002, we increased the number of shares of Common Stock authorized to be issued pursuant to the 1998 Stock Option Plan to 750,000. Incentive stock options granted under this plan expire no later than ten years from date of grant (except no later than five years for a grant to a 10% stockholder). Our Board of Directors or the Stock Option Committee will determine the expiration date with respect to non-statutory options granted under this plan.

In December 2005, our shareholders ratified the adoption of the 2005 Equity Participation Plan, which provides for the issuance of incentive stock options, non-statutory stock options and restricted stock. Under this plan, a maximum of 300,000 shares of Common Stock may be issued pursuant to options granted and restricted stock issued. Incentive stock options granted under this plan expire no later than ten years from date of grant (except no later than five years for a grant to a 10% stockholder). Our Board of Directors or the Stock Option Committee will determine the expiration date with respect to non-statutory options, and the vesting provisions for restricted stock, granted under this plan.

Effective January 1, 2006, our plans are accounted for in accordance with the recognition and measurement provisions of Statement of Financial Accounting Standards (“FAS”) No. 123 (revised 2004), Share-Based Payment (“FAS 123(R)”), which replaces FAS No. 123, Accounting for Stock-Based Compensation, and supersedes Accounting Principles Board Opinion (“APB”) No. 25, Accounting for Stock Issued to Employees, and related interpretations. FAS 123(R) requires compensation costs related to share-based payment transactions, including employee stock options, to be recognized in the financial statements. In addition, we adhere to the guidance set forth within Securities and Exchange Commission (“SEC”) Staff Accounting Bulletin (“SAB”) No. 107, which provides the Staff's views regarding the interaction between SFAS No. 123(R) and certain SEC rules and regulations and provides interpretations with respect to the valuation of share-based payments for public companies.

Prior to January 1, 2006, we accounted for similar transactions in accordance with APB No. 25 which employed the intrinsic value method of measuring compensation cost. Accordingly, compensation expense was not recognized for fixed stock options if the exercise price of the option equaled or exceeded the fair value of the underlying stock at the grant date.

While FAS No. 123 encouraged recognition of the fair value of all stock-based awards on the date of grant as an expense over the vesting period, companies were permitted to continue to apply the intrinsic value-based method of accounting prescribed by APB No. 25 and disclose certain pro forma amounts as if the fair value approach of SFAS No. 123 had been applied. In December 2002, FAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure, an amendment of SFAS No. 123, was issued, which, in addition to providing alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation, required more prominent pro forma disclosures in both the annual and interim financial statements. We complied with these disclosure requirements for all applicable periods prior to January 1, 2006.

In adopting FAS 123(R), we applied the modified prospective approach to transition. Under the modified prospective approach, the provisions of FAS 123(R) are to be applied to new awards and to awards modified, repurchased, or cancelled after the required effective date. Additionally, compensation cost for the portion of awards for which the requisite service has not been rendered that are outstanding as of the required effective date shall be recognized as the requisite service is rendered on or after the required effective date. The compensation cost for that portion of awards shall be based on the grant-date fair value of those awards as calculated for either recognition or pro-forma disclosures under FAS 123.

As a result of the adoption of FAS 123(R), our results for the nine and three month period ended September 30, 2006 include share-based compensation expense totaling approximately $32,000 and $12,000, respectively. Such amounts have been included in the Condensed Consolidated Statements of Income within general and administrative expenses. Stock compensation expense recorded under APB No. 25 in the Consolidated Statements of Operations for both the nine and three months ended September 30, 2005 totaled $0.

Stock option compensation expense in 2006 is the estimated fair value of options granted amortized on a straight-line basis over the requisite service period for entire portion of the award.

The weighted average estimated fair value of stock options granted in the three months and nine months ended September 30, 2006 was $1.62 per share. There were no stock options granted in the three months and nine months ended September 30, 2005. The fair value of options at the date of grant was estimated using the Black-Scholes option pricing model. During 2006, we took into consideration the guidance under SFAS 123(R) and SAB No. 107 when reviewing and updating assumptions. The expected volatility is based upon historical volatility of our stock and other contributing factors. The expected term is based upon observation of actual time elapsed between date of grant and exercise of options for all employees. Previously such assumptions were determined based on historical data.

The assumptions made in calculating the fair values of options for the nine months and three months ended September 30, 2006 are as follows:

| | |
|---|---|
| Expected term (in years) | 5 |
| Expected volatility | 101% |
| Expected dividend yield | 0% |
| Risk-free interest rate | 5% |

The following table addresses the additional disclosure requirements of FAS 123(R) in the period of adoption. The table illustrates the effect on net income and earnings per share as if the fair value recognition provisions of FAS No. 123 had been applied to all outstanding and unvested awards in the prior year comparable period.

| | Nine Months Ended September 30, 2005 | Three Months Ended September 30, 2005 |
|---|---|---|
| Net income, as reported | $ 611,302 | $ 75,288 |
| Add: Stock-based compensation included in reported net income | - | - |
| Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects | (124,000) | (41,000) |
| Pro Forma Net Income | $ 487,302 | $ 34,288 |
| Net income per share: | | |
| Basic - as reported | $ 0.22 | $ 0.03 |
| Basic - pro forma | $ 0.18 | $ 0.01 |
| Diluted - as reported | $ 0.20 | $ 0.03 |
| Diluted - pro forma | $ 0.16 | $ 0.01 |

We granted 10,000 options under the 2005 Equity Participation Plan during the three months and nine months ended September 30, 2006, at an exercise price of $1.87 per share.

The following table represents our stock options granted, exercised, and forfeited during the first nine months of 2006.

| Stock Options | Number of Shares | Weighted Average Exercise Price per Share | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Outstanding at January 1, 2006 | 328,025 | $ 2.09 | | |
| Granted | 10,000 | $ 1.87 | | |
| Exercised | (127,500) | $ 1.50 | | |
| Forfeited/expired | (27,225) | $ 2.84 | | |
| Outstanding at September 30, 2006 | 183,300 | $ 2.38 | 1.73 | $ 50,508 |
| Vested and Exercisable at September 30, 2006 | 167,781 | $ 2.24 | 1.51 | $ 49,771 |

The aggregate intrinsic value of the options exercised for the nine months ended September 30, 2006 and 2005 was $135,150 and $33,868, respectively.

As of September 30, 2006, there was approximately $59,000 of total unrecognized compensation costs related to unvested stock option awards. The $59,000 is expected to vest over the weighted average of 1.46 years.

The following table represents the change in non-vested stock options during the first nine months of 2006.

| | Options | Weighted Average Grant Date Fair Value |
|---|---|---|
| Nonvested at December 31, 2005 | 30,788 | $ 1.11 |
| Granted | 10,000 | 1.87 |
| Vested | 10,494 | 1.49 |
| Forfeited | 14,775 | 2.27 |
| Nonvested at September 30, 2006 | 15,519 | 1.76 |

The total fair value of shares vested during the nine month period ended September 30, 2006 was $15,636.

5. 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, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| Weighted Average Number of Shares Outstanding | 2,886,372 | 2,723,215 | 2,896,024 | 2,727,533 |
| Effect of Dilutive Securities, common stock equivalents | 356,658 | 548,031 | 345,216 | 541,448 |
| Weighted Average Number of Shares Outstanding, used for computing diluted earnings per share | 3,243,030 | 3,271,246 | 3,241,240 | 3,268,981 |

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, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| Net Income | $ 513,702 | $ 611,302 | $ 106,108 | $ 75,288 |
| Interest Expense on Dilutive Convertible Preferred Stock | 29,250 | 29,371 | 9,750 | 9,750 |
| Net Income Available to Common Shareholders for Diluted Earnings Per Share | $ 542,952 | $ 640,673 | $ 115,858 | $ 85,038 |

6. Business Acquisitions

Effective January 1, 2006, we acquired substantially all of the assets of Accurate Agency of Western New York, Inc., Louisons Associates Limited and Accurate Agency, Inc. (collectively, “Accurate”), insurance brokerage firms with a total of four offices located in and around Rochester, New York. The results of Accurate’s operations have been included in the consolidated financial statements since that date. The acquisition allows for the expansion of our geographical footprint.

The aggregate purchase price was $1,600,000, including $800,000 of cash with the balance paid through the issuance of an $800,000 non-interest bearing note payable over 72 months commencing on January 10, 2007. The note has been recorded at its estimated present value of $612,481. Our initial allocation of the purchase price is subject to adjustment.

Our condensed consolidated statements of income include the revenue and expenses of Accurate from January 1, 2006. Had the transaction taken place on January 1, 2005, on a pro forma basis, the effect on the reported amounts for the nine months ended September 30, 2005 is considered to be insignificant.

7. Purchase of Notes Receivable

On January 31, 2006, we purchased from Eagle Insurance Company ("Eagle") two surplus notes issued by Commercial Mutual Insurance Company ("CMIC") in the aggregate principal amount of $3,750,000 (the "Surplus Notes"), plus accrued interest of $1,794,688. The aggregate purchase price for the Surplus Notes was $3,075,141, of which $1,303,434 was paid to Eagle by delivery of a six month promissory note which provides for interest at the rate of 7.5% per annum. The promissory note was paid in full on July 28, 2006. CMIC is a New York property and casualty insurer. Eagle is a New Jersey property and casualty insurer under the administrative supervision of the New Jersey Department of Banking and Insurance and owns approximately 10% of our outstanding common stock. The Surplus Notes acquired by us are past due and provide for interest at the prime rate or 8.5% per annum, whichever is less. Payments of principal and interest on the Surplus Notes may only be made out of the surplus of CMIC and require the approval of the New York State Department of Insurance. During the nine months ended September 30, 2006, an interest payment of $125,000 was received from CMIC. The discount on the Surplus Notes and the accrued interest at the time of acquisition are being accreted over a 30 month period, the estimated period to collect such amounts. Such accretion amount, together with interest on the Surplus Notes for the period ended September 30, 2006, is included in our Statement of Income as "Interest income-notes receivable."

8. Revolving Credit Facility

On July 28, 2006, we and our subsidiary, Payments, Inc., entered into a new revolving line of credit (the “New Revolver”) with Manufacturers and Traders Trust Co. (the “Bank”), which provides for a decrease in the credit line from $25,000,000 to $20,000,000 and the elimination of the Bank’s agreement to arrange an additional $10,000,000 credit facility with other lenders on a “best efforts” basis. The New Revolver bears interest, at our option, at either the Bank’s prime lending rate (8.25% at September 30, 2006) or LIBOR (5.32% at September 30, 2006) plus 2.25%, and matures on September 30, 2008. The line of credit also allows for a $2,500,000 term loan (of the $20,000,000 credit line availability) to be used to provide liquidity for ongoing working capital purposes. Any draws against the term line bear interest at LIBOR plus 2.75%. As of July 28, 2006, we made our first draw against the term line of $1,300,000. The draw is being paid back quarterly over 30 months with interest payable monthly. The New Revolver eliminates the personal guaranty required of our CEO of $1,250,000 but continues his obligation on an unlimited wind-down guaranty and his personal guaranty as to misrepresentations that relate to dishonest or fraudulent acts committed by him or known but not timely reported by him. The New Revolver also allows for a reduction of life insurance coverage on the life of our CEO from $4,000,000 to $1,500,000.

9. Sale of Store

During the nine months ended September 30, 2006, we sold one of our retail stores for $125,000 in cash and notes. The sale of the store resulted in a gain of $81,105. In addition, concurrently with the sale, the purchaser entered into a franchise agreement with us.

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

***Overview***

There are 71 store locations owned or franchised by us of which 65 are located in New York State. In the New York metropolitan area, there are 43 DCAP franchises and one joint venture DCAP store. There are also 18 Barry Scott locations and four Accurate locations outside the New York metropolitan area (all located in central and western New York State). There are five Atlantic Insurance locations in eastern Pennsylvania. All of the Barry Scott, Atlantic Insurance and Accurate locations are wholly-owned by us.

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, Atlantic Insurance and Accurate 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, 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. In addition, 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. Further, 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 those commissions that were receivable annually, for which we recognized the commission revenue ratably. Refunds of commissions on the cancellation of insurance policies are reflected at the time of cancellation.

Franchise fee revenue from initial franchise fees is recognized when substantially all of our contractual requirements under the franchise agreement are completed. Franchisees also pay a monthly franchise fee plus an applicable percentage of advertising expense. We are obligated to provide marketing and training support to each franchisee.

Automobile club dues are recognized equally over the contract period.

***Finance income, fees and receivables***

For our premium finance operations, 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."

Upon the establishment of a premium finance contract, we record the gross loan payments as a receivable with a corresponding reduction for deferred interest. The deferred interest is amortized to interest income using the interest method over the life of each loan. The weighted average interest rate charged with respect to financed insurance policies was approximately 26.5% and 26.5% per annum for the nine months ended September 30, 2006 and 2005, respectively. 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.

***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 and late fees. The majority of these shortfalls result in the write-off of the remaining principal balance against the allowance for finance receivable losses and the unrealized actual interest and late fees are charged against the premium finance revenue. 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. For the nine months ended September 30, 2006 and 2005, the provision for finance receivables losses was $496,456 and $580,683 (before estimated recoveries of $65,503 for the 2005 period which reduced the provision for finance receivable losses), respectively, and actual principal write-offs for such periods (net recoveries of previous write-offs) were $477,293 and $617,099, respectively. If our provision for finance receivable losses was understated by 10% because our actual write-offs were greater than anticipated, the effect would have been a reduction in our earnings per share by approximately $0.01 (basic) for the nine months ended September 30, 2006 and 2005.

***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, 2006.

***Stock-based compensation***

Prior to January 1, 2006, we applied the intrinsic value-based method of accounting prescribed by Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations, to account for stock-based employee compensation plans and reported 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. Effective January 1, 2006, we have begun to comply with the recent accounting pronouncements from the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard ("SFAS") No. 123 (revised 2004) "Share-Based Payment" (SFAS No. 123R) which requires us to include the compensation cost using the same method discussed above in our Statement of Income.

***Results of Operations***

Nine Months ended September 30, 2006 compared to Nine Months ended September 30, 2005

Our operating income for the nine months ended September 30, 2006 was $331,110 as compared to $1,289,269 for the nine months ended September 30, 2005.

During the nine months ended September 30, 2006, revenues from our insurance-related operations were $5,390,085 as compared to $5,461,000 for the nine months ended September 30, 2005. The revenue decrease of $70,915 was primarily attributable to a reduction in commissions received by our locations caused by a reduction in renewal commission rates and the elimination of certain other compensation by one of our major insurance carriers, offset by revenues of Accurate whose assets were acquired effective January 1, 2006.

Premium finance revenues decreased $865,478 during the nine months ended September 30, 2006 as compared to the nine months ended September 30, 2005. The total number of policies that we financed during the first nine months of 2006 decreased slightly from the first nine months of 2005. Also, there was a decline in the number of loans originated in downstate New York, which carries a higher average loan size, and an increase in loans originated in central and northern New York State at a lower average loan size. As a result, our average loan size declined resulting in a decline in our premium finance revenue.

Our general and administrative expenses for the nine months ended September 30, 2006 were $4,510 more than for the nine months ended September 30, 2005. The increase in general and administrative expenses was primarily due to the expenses related to Accurate whose assets were acquired effective January 1, 2006, offset by a decrease in executive salaries due to the resignation in October 2005 of John Willis, our former Chief Operating Officer, and a decrease in advertising expenses.

Our provision for finance receivable losses for the nine months ended September 30, 2006 was $18,724 less than for the nine months ended September 30, 2005. This was caused by a decrease in volume in the nine months ended September 30, 2006, offset by a one-time actual and anticipated recovery recorded in the nine months ended September 30, 2005 of amounts previously charged-off (no similar items were recorded in the nine months ended September 30, 2006).

Our depreciation and amortization expense during the nine months ended September 30, 2006 was $19,559 less than for the nine months ended September 30, 2005. This decrease was primarily the result of our amortizing our loan origination costs incurred in connection with our revolving loan agreement entered into in December 2004 over the life of the revolving credit agreement entered into in July 2006.

Our premium finance interest expense during the nine months ended September 30, 2006 was $55,539 more than for the nine months ended September 30, 2005. This increase was the result of an increase in LIBOR, offset by a decrease in the average outstanding balance of our revolving credit line for the nine months ended September 30, 2006 compared to the nine months ended September 30, 2005.

During the nine months ended September 30, 2006, we purchased $3,750,000 of surplus notes of Commercial Mutual Insurance Company ("CMIC") at a price of $3,075,141. Accrued but unpaid interest totaled $1,794,688 at the time of the purchase. This transaction resulted in interest income-notes receivable of $858,546 during the nine months ended September 30, 2006. No such interest-bearing notes were owned by us during the nine months ended September 30, 2005.

Our interest expense for the nine months ended September 30, 2006 was $134,802 more than for the nine months ended September 30, 2005. This increase was a result of interest on the promissory notes given in connection with the Accurate acquisition and the purchase of the CMIC surplus notes, and the borrowing against our revolving credit line to purchase the CMIC surplus notes (no similar items were recorded in the nine months ended September 30, 2005), offset by a reduction caused by our repaying a portion of our subordinated debt in 2005.

During the nine months ended September 30, 2006, we sold one of our stores, resulting in a gain of $81,105. No such sale occurred during the nine months ended September 30, 2005.

During the nine months ended September 30, 2006, our provision for income taxes was $342,468 as opposed to $409,159 for the nine months ended September 30, 2005. This was due to the lower income before income taxes in 2006.

Our insurance-related operations, on a stand-alone basis, generated a net profit before income taxes of $986,205 during the nine months ended September 30, 2006 as compared to a net profit before income taxes of $1,259,965 during the nine months ended September 30, 2005. This decrease was primarily due to decreased revenues (exclusive of the revenues of the Accurate stores that were acquired effective January 1, 2006). Our premium finance operations, on a stand-alone basis, generated a net profit before income taxes of $618,073 during the nine months ended September 30, 2006 as compared to a net profit before income taxes of $1,202,276 during the nine months ended September 30, 2005. The decrease was primarily due to reduced premium finance revenue in 2006 as discussed above. Loss before income taxes from corporate-related items not allocable to reportable segments was $748,108 during the nine months ended September 30, 2006 as compared to $1,441,780 during the nine months ended September 30, 2005. This decrease was primarily due to an increase in interest income-notes receivable related to the purchase of the surplus notes issued by CMIC and a decrease in executive compensation.

*Three Months ended September 30, 2006 compared to Three Months ended September 30, 2005*

Our operating loss for the three months ended September 30, 2006 was $4,743 as compared to operating income of $209,124 for the three months ended September 30, 2005.

During the three months ended September 30, 2006, revenues from our insurance-related operations were $1,636,855 as compared to $1,822,832 for the three months ended September 30, 2005. The revenue decrease of $185,977 was primarily attributable to a reduction in commissions received by our locations caused by a reduction in renewal commission rates and the elimination of certain other compensation by one of our major insurance carriers, offset by revenues of Accurate whose assets were acquired effective January 1, 2006.

Premium finance revenues decreased $257,012 during the three months ended September 30, 2006 as compared to the three months ended September 30, 2005. The total number of premium loans that we financed during the third quarter of 2006 decreased slightly from the third quarter of 2005. Also, there was a decline in the number of loans originated in downstate New York, which carries a higher average loan size, and an increase in loans originated in central and northern New York State at a lower average loan size. As a result, our average loan size declined resulting in a decline in our premium finance revenue.

Our general and administrative expenses for the three months ended September 30, 2006 were $221,174 less than for the three months ended September 30, 2005. The decrease in general and administrative expenses was primarily due to a decrease in executive salaries due to the resignation in October 2005 of John Willis, our former Chief Operating Officer, and a decrease in advertising expenses, offset by the expenses related to Accurate whose assets were acquired effective January 1, 2006.

Our provision for finance receivable losses for the third quarter of 2006 was $9,524 more than for the third quarter of 2005. This was caused by an increase in write offs in the third quarter of 2006, offset by a decrease in volume of contracts written in the third quarter of 2006.

Our depreciation and amortization expense during the three months ended September 30, 2006 was $18,664 less than for the three months ended September 30, 2005. This decrease was primarily the result of our amortizing our loan origination costs incurred in connection with our revolving loan agreement entered into in December 2004 over the life of the revolving credit agreement entered into in July 2006.

Our premium finance interest expense during the three months ended September 30, 2006 was $1,192 more than for the three months ended September 30, 2005. This increase was the result of an increase in LIBOR, offset by a decrease in the average outstanding balance of our revolving credit line for the three months ended September 30, 2006 compared to the three months ended September 30, 2005.

On January 31, 2006, we purchased $3,750,000 of surplus notes of CMIC at a price of $3,075,141. Accrued but unpaid interest totaled $1,794,688 at the time of the purchase. This transaction resulted in interest income-notes receivable of $324,298 during the three months ended September 30, 2006. No such interest-bearing notes were owned by us during the three months ended September 30, 2005.

Our interest expense for the three months ended September 30, 2006 was $55,435 more than for the three months ended September 30, 2005. This increase was a result of interest on the promissory notes given in connection with the Accurate acquisition and the purchase of the CMIC surplus notes, and the borrowing against our revolving credit line to purchase the CMIC surplus notes (no similar items were recorded in the third quarter of 2005), offset by a reduction caused by our repaying a portion of our subordinated debt in 2005.

During the three months ended September 30, 2006, our provision for income taxes was $70,739 as opposed to $51,850 for the three months ended September 30, 2005. This was due to the higher income before income taxes in 2006.

Our insurance-related operations, on a stand-alone basis, generated a net profit before income taxes of $235,755 during the three months ended September 30, 2006 as compared to a net profit before income taxes of $294,400 during the three months ended September 30, 2005. This decrease was primarily due to decreased revenues (exclusive of the revenues of the Accurate stores that were acquired effective January 1, 2006). Our premium finance operations, on a stand-alone basis, generated a net profit before income taxes of $207,842 during the three months ended September 30, 2006 as compared to a net profit before income taxes of $304,712 during the three months ended September 30, 2005. The decrease was primarily due to reduced premium finance revenue in 2006 as discussed above. Loss before income taxes from corporate-related items not allocable to reportable segments was $266,550 during the three months ended September 30, 2006 as compared to $475,974 during the three months ended September 30, 2005. This decrease was primarily due to an increase in interest income-notes receivable related to the recent purchase of the surplus notes issued by CMIC and a decrease in executive compensation.

***Liquidity and Capital Resources***

As of September 30, 2006, we had $1,214,924 in cash and cash equivalents and working capital of $760,712. As of December 31, 2005, we had $1,961,489 in cash and cash equivalents and working capital of $5,321,837.

During the nine months ended September 30, 2006, our cash and cash equivalents decreased by $746,565. This was due to the following:

· Net cash used in operating activities during the nine months ended September 30, 2006 was $206,771 primarily due to the following: (i) an decrease in premiums payable of $702,218 and the accretion of discount on notes receivable of $658,546, offset by (ii) our net income for the period of $513,702, our depreciation and amortization of $319,302, a decrease in accounts receivable of $390,739, and an increase in accounts payable and accrued expenses of $228,375. Premiums payable have declined due to a change in our mix of business. We finance premiums for assigned risk plans, where the loan is funded in two stages, generally over a 30 day period. We also finance premiums with carriers where the entire loan is funded at inception. As our mix of business has changed to include less assigned risk loans and more direct carrier loans, there is a reduction in the amount of our premium liability. The decrease in accounts receivable is the result of a January 2006 payment of a revenue accrual from an insurance company, which did not continue in 2006. The increase in accounts payable and accrued expenses was attributable to the purchase of Accurate as well as our ability to increase payment terms of certain vendors.

· Though fluctuations in our premium finance business impact our cash position and daily operations, our cash flows from operating activities do not reflect changes in the premium finance contract receivables or borrowings under our revolving credit facility associated with that business. Changes in the premium finance contract receivables are considered investing activities as they include the making and collection of loans and borrowings under our revolving line of credit are considered financing activities.

· Net cash of $2,438,793 was used in investing activities during the nine months ended September 30, 2006 primarily due to the following: (i) the use of $1,771,707 in cash to purchase the surplus notes issued by CMIC and the use of $832,654 in cash to purchase the Accurate agency and another agency's book of business in the nine months ended September 30, 2006, offset by (ii) a decrease in our net finance contracts receivable of $242,585.

· Net cash provided by financing activities during the nine months ended September 30, 2006 was $1,898,999 primarily due to the following: (i) proceeds of $41,785,558 from our revolving credit line from Manufacturers and Traders Trust Co. ("M&T") for premium finance purposes and for the purchase of the surplus notes issued by CMIC, offset by (ii) payments of $38,539,375 on the revolving credit line, $1,303,434 on the related party note, and $235,000 of long-term debt.

Our premium finance operations are financed pursuant to a $20,000,000 revolving line of credit from M&T entered into on July 28, 2006, which replaced our revolving line of credit agreement with M&T dated December 27, 2004. The line of credit bears interest at either (i) M&T's prime rate or (ii) LIBOR plus 2.25%, matures on September 30, 2008 and is secured by substantially all of our assets. We can borrow against the line to the extent of 85% of eligible premium finance receivables. As of September 30, 2006, $11,852,707 was outstanding under the loan. As of September 30, 2006, of the $17,866,052 reflected on the Balance Sheet as "Finance contracts receivable," approximately $14,445,721 represents eligible receivables for purposes of our finance credit agreement. The line of credit also allows for a $2,500,000 term loan (of the $20,000,000 credit line availability) to be used to provide liquidity for ongoing working capital purposes. Any draws against this line bear interest at LIBOR plus 2.75%. As of July 28, 2006, we made our first draw of $1,300,000 against the term line. The draw is being paid back quarterly over 30 months with interest payable monthly.

We have no current commitments for capital expenditures. However, we may, from time to time, consider acquisitions of complementary businesses, products or technologies.

In connection with our initial acquisition of the line of credit from M&T, we obtained a $3,500,000 secured subordinated loan to support our premium finance operations. In January 2005, we utilized the M&T line of credit to repay $1,000,000 of the subordinated debt. In May 2005, we utilized the line of credit to repay an additional $1,000,000 of the subordinated debt. The remaining balance of the loan was due in January 2006 and carries interest at the rate of 12-5/8% per annum. Effective May 25, 2005, we obtained an extension of the maturity date of the remaining subordinated debt to September 30, 2007. We have the right to prepay the subordinated debt (subject to M&T's consent) without penalty.

On January 31, 2006, we purchased $3,750,000 of surplus notes issued by CMIC for a price of $3,075,141, of which $1,303,434 was paid by delivery of a six month promissory note which provided for interest at the rate of 7.5% per annum. The promissory note was paid in full on July 28, 2006. Accrued but unpaid interest on the surplus notes totaled $1,794,688 at the time of the purchase.

***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, 2006 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, 2006 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**

(a) Not applicable
(b) Not applicable
(c) Issuer repurchases during the quarter:

**Small Business Issuer Purchases of Equity Securities**

| Period | (a) Total Number of Shares Purchased(1) | | (b) Average Price Paid per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | (d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|---|---|---|---|---|---|
| 7/1/06 - 7/31/06 | 2,390 | $ | 1.99 | - | - |
| 8/1/06 - 8/31/06 | 1,306 | $ | 2.22 | - | - |
| 9/1/06 - 9/30/06 | 895 | $ | 2.18 | - | - |
| **Total** | **4,591** | **$** | **2.09** | **-** | **-** |

(1) Represents shares acquired by "affiliated purchaser".

**Item 3.** **DEFAULTS UPON SENIOR SECURITIES**

None

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

Our Annual Meeting of Stockholders was held on September 22, 2006. The following is a listing of the votes cast for or withheld with respect to each nominee for director.

| | Number of Shares | |
|---|---|---|
| | **For** | **Withheld** |
| Barry B. Goldstein | 2,104,047 | 11,402 |
| Morton L. Certilman | 2,030,305 | 13,744 |
| Jay M. Haft | 1,990,361 | 53,688 |
| David A. Lyons | 2,032,867 | 11,182 |
| Jack D. Seibald | 2,032,867 | 11,182 |

| | | |
|---|---|---|
| Robert M. Wallach | 1,800,166 | 243,883 |

**Item 5. OTHER INFORMATION**

None

**Item 6. EXHIBITS**

| | |
|---|---|
| 3(a) | Restated Certificate of Incorporation[1] |
| 3(b) | Certificate of Designation of Series A Preferred Stock[2] |
| 3(c) | By-laws, as amended[3] |
| 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 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 September 30, 2004 and incorporated herein by reference.
[2] Denotes document filed as an exhibit to our Current Report on Form 8-K for an event dated May 28, 2003 and incorporated herein by reference.
[3] Denotes document filed as an exhibit to our Quarterly Report on Form 10-QSB for the period ended September 30, 2005 and incorporated herein by reference.

## 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.**

Date: November 13, 2006

By: /s/ Barry B. Goldstein

Barry B. Goldstein
President
(Principal Executive, Financial
and Accounting Officer)