DCAP GROUP INC
Form 10KSB
March 31, 2008

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-KSB

(Mark One)
(x) ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2007

( ) TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number 0-1665

DCAP GROUP, INC.
(Name of small business issuer in its charter)

Delaware	36-2476480
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1158 Broadway, Hewlett, New York	11557
(Address of principal executive offices)	(Zip Code)

(516) 374-7600
(Issuer's telephone number, including area code)

Securities registered under Section 12(b) of the Exchange Act:

Title of each class	Name of each exchange on which registered
Common Stock, $.01 par value	The NASDAQ Stock Market LLC

Securities registered under Section 12(g) of the Exchange Act:

None
(Title of class)

Check whether the issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. [ ]

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 [ ]

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. ( )

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

State issuer's revenues for its most recent fiscal year: $5,745,197

State the aggregate market value of the voting stock held by non-affiliates computed by reference to the price at which the stock was sold, or the average bid and asked prices of such stock, as of a specified date within the past 60 days: $2,024,471 as of February 29, 2008.

(ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PAST FIVE YEARS)

Check whether the issuer has filed all documents and reports 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 REGISTRANTS)

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: 2,969,024 shares as of March 5, 2008.

DOCUMENTS INCORPORATED BY REFERENCE

None

Transitional Small Business Disclosure Format: Yes [ ] No [X]

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Signatures

PART I

Forward-Looking Statements

This Annual 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 Annual 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,” “proj “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 this Annual Report 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 publicly update or revise any forward-looking statements, whether from new information, future events or otherwise.

ITEM 1. DESCRIPTION OF BUSINESS

(a) Business Development

General

Our continuing operations consist of franchising, ownership and operation of storefront insurance agencies under the DCAP, Barry Scott, Atlantic Insurance and Accurate Agency brand names.

Our discontinued operations consist of premium financing of insurance policies for our DCAP, Barry Scott, Atlantic Insurance and Accurate Agency clients as well as clients of non-affiliated entities. On February 1, 2008, we sold our outstanding premium finance loan portfolio. As a result of the sale, our business of internally financing insurance contracts has been reclassified as discontinued operations and prior periods have been restated.

Recent Developments

The following developments have occurred since January 1, 2008:

- On February 1, 2008, our wholly-owned subsidiary, Payments Inc., sold its outstanding premium finance loan portfolio. The purchase price for the net loan portfolio was approximately $11,845,000, of which approximately $268,000 was paid to Payments. The remainder of the purchase price was satisfied by the assumption of liabilities, including the satisfaction of Payments' premium finance revolving credit line obligation to Manufacturers and Traders Trust Company ("M&T"). As additional consideration, Payments will be entitled to receive an amount based upon the net earnings generated by the loan portfolio as it is collected. The purchaser of the portfolio also agreed that, during the five year period ending January 31, 2013 (subject to automatic renewal for successive two year terms under certain circumstances), it will purchase, assume and service all eligible premium finance contracts originated by Payments in the states of New York, New Jersey and Pennsylvania. In connection with such purchases, Payments will be entitled to receive a fee generally equal to a percentage of the amount financed.

Developments During 2007

- On February 2, 2007, Robert Wallach resigned as a director.

- During 2007, the holders of $1,500,000 of the outstanding principal amount of our subordinated debt agreed to extend the maturity date of the debt from September 30, 2007 to September 30, 2008. In consideration for the extension of the due date of the subordinated debt, we extended the expiration date of warrants held by the debtholders for the purchase of 97,500 of our common shares from September 30, 2007 to September 30, 2008. See Item 12 of this Annual Report.

- Effective March 23, 2007, the holder of our Series A preferred shares exchanged such shares for an equal number of Series B preferred shares. The terms of the Series B preferred shares are identical to those of the Series A preferred shares, except that they are mandatorily redeemable on April 30, 2008 (as opposed to April 30, 2007 for the Series A preferred shares). See Item 12 of this Annual Report.

- In March 2007, Commercial Mutual Insurance Company's Board of Directors adopted a resolution to convert Commercial Mutual from an advance premium insurance company to a stock property and casualty insurance company. We hold surplus notes of Commercial Mutual in the aggregate principal amount of $3,750,000. In the event the conversion occurs, we may be able to convert such notes into a controlling equity interest in Commercial Mutual. See Items 1(b), 6 and 12 of this Annual Report.

Developments During 2006

The following material events occurred during 2006:

- On January 31, 2006, we purchased from Eagle Insurance Company two surplus notes issued by Commercial Mutual Insurance Company in the aggregate principal amount of $3,750,000 plus accrued interest of $1,794,688. Commercial Mutual is a New York property and casualty insurer. Eagle is a New Jersey property and casualty insurer that is subject to an Order of Liquidation issued by the New Jersey Department of Banking and Insurance (which order has been stayed pending appeal). Eagle owns approximately 10% of our outstanding common shares. See Items 1(b), 6 and 11 of this Annual Report.

- On July 28, 2006, we and our premium finance subsidiary, Payments Inc., entered into a new revolving line of credit with M&T which provided for a decrease in the credit line to $20,000,000. The new revolver bore interest, at our option, at either M&T's prime lending rate (8.25% at December 31, 2006) or LIBOR (5.35% at December 31, 2006) plus 2.25%, and was scheduled to mature on June 30, 2008. The line of credit also allowed 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 bore interest at LIBOR plus 2.75%. Concurrently with the obtaining of the new credit line, we borrowed $1,300,000 as a draw against the term line. See Items 6 and 7 of this Annual Report.

Developments During 2005

The following material events occurred during 2005:

- During 2005, we utilized our line of credit with M&T to repay an aggregate of $2,000,000 of our $3,500,000 subordinated debt.

- Effective May 25, 2005, the holders of the remaining $1,500,000 outstanding principal amount of our subordinated debt agreed to extend the maturity date of the debt from January 10, 2006 to September 30, 2007. This extension was given to satisfy a requirement of M&T that arose in connection with the increase in our revolving line of credit to $25,000,000 and the extension of the line to June 30, 2007. In consideration for the extension of the due date of the subordinated debt, we extended the expiration date of warrants held by the debtholders for the purchase of 97,500 of our common shares from January 10, 2006 to September 30, 2007.

- On November 15, 2005, we entered into an agreement for the acquisition of substantially all of the assets of Accurate Agency, Inc., Louisons Associates Limited and Accurate Agency of Western New York, Inc., insurance brokerage firms with a total of four offices located in and around Rochester, New York that operate under the Accurate Agency brand. The transaction was consummated effective as of January 1, 2006.

(b) Business of Issuer

General

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

Currently there are 69 store locations owned or franchised by us of which 64 are located in New York State. In the New York metropolitan area, there are 42 DCAP franchises. There are also 17 Barry Scott locations and five Accurate Agency 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 Agency locations are wholly-owned by us.

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; however, as discussed below under “Commercial Mutual Insurance Company”, Commercial Mutual is seeking to convert from an advance premium insurance company to a stock property and casualty insurance company. In the event of such conversion, the surplus notes issued by Commercial Mutual and held by us may be converted into a controlling equity interest in Commercial Mutual.

Through our wholly-owned subsidiary, Payments Inc., until February 1, 2008, we provided insurance premium financing services to our DCAP, Barry Scott, Atlantic Insurance and Accurate Agency locations as well as non-affiliated insurance agencies. Payments Inc. is licensed as an insurance premium finance agency in the states of New York, Pennsylvania and New Jersey. Effective February 1, 2008, Payments Inc. sold its outstanding finance contracts. Payments Inc. now receives revenues through placement fees rather than through the internally financing of contracts.

We also offer automobile club services for roadside emergencies. Income tax preparation services are also offered in connection with the franchise operation of the DCAP stores.

We were incorporated in 1961 and assumed our current name in 1999.

Our executive offices are located at 1158 Broadway, Hewlett, New York 11557; our telephone number is (516) 374-7600 and our fax number is (516) 295-7216.

Insurance Agencies

Insurance Brokerage

Our storefront agencies deal primarily with the insurance needs of individuals. In the states in which we operate, all automobile owners must secure liability insurance coverage. We provide various choices to the insured depending on market conditions.

Our agencies currently operate under the DCAP, Barry Scott, Atlantic Insurance and Accurate Agency brand names. During 2006, we began the transition, planned to take two to three years, to change all store names to DCAP.

During the fiscal year ended December 31, 2007, approximately 89% of our revenues were derived from commissions and other fees received in connection with the selling of automobile and other property and casualty insurance policies.

In addition to automobile insurance, we offer:

- property and casualty insurance for motorcycles, boats and livery/taxis
- life insurance
- business insurance
- homeowner's insurance
- excess coverage

We have obtained the right to receive calls placed to "1-888-411-DCAP" and "1-800-LOWEST-1" on a nationwide basis as a way to increase our insurance brokerage business.

Franchises

An important part of our strategy has been to increase our name recognition. We decided that granting others DCAP franchises is an important step in achieving this goal.

Franchisees currently pay us an initial franchise fee of $25,000 to offer insurance products under the DCAP name. Franchisees are obligated to also pay us monthly fees during the term of the franchise agreement, generally commencing after a six to twelve month period from the date on which the storefront opens for business. Initial franchise fees and monthly fees payable by franchisees constituted approximately 2% and 8%, respectively, of our revenues during the year ended December 31, 2007.

Automobile Club

As a complement to our automobile insurance operations, we offer automobile club services for roadside emergencies. We offer memberships for such services, and we make arrangements with towing dispatch companies to fulfill service call requirements.

During fiscal 2007, fees received in connection with automobile club services constituted approximately 1% of our revenues.

Internet

During fiscal 2006, we developed a website (www.dcapagents.com), a secure site for use by personnel of our company-owned stores as well as our franchises. Incorporated within the website are tools for managing the location's business, including comparative quoting, lead generation and tracking.

Policy placement generates commission revenue. Since policy sales can be measured as they relate to the number of inquiries or leads, increased marketing will result in more leads. During fiscal 2006, we developed a plan to generate more leads by increasing our presence on the Internet through Search Engine Optimization, or SEO, and lead procurement through contracting with third party lead aggregators. Our websites, including www.dcapinsurance.com, now offer the prospective insured the opportunity to provide us the needed information in the very same manner as provided face to face or over the telephone. With the information provided, we can give multiple quotes to the prospect as well as track the status of the lead from the moment it is received.

Income Tax Return Preparation

A number of our franchise locations provide income tax return preparation services. The tax return preparation service allows them to offer an additional service to the walk-in customers who comprise the bulk of their customer base, as well as to existing customers.

Structure and Operations

As stated above, we currently have 69 offices, of which 42 are franchises, and 27 are wholly-owned. Our franchises consist of both "conversion" and "startup" operations. In a conversion operation, an existing insurance brokerage with an established business becomes a DCAP office. In a startup operation, an entrepreneur begins operations as a DCAP office. Our wholly-owned offices are managed by our employees; each franchise is managed by or under the supervision of the franchisee.

In order to promote consistency and efficiency, and as a service to our franchises, we offer training to office managers. Our training program covers:

- marketing, sales and underwriting
- office and logistics
- computer information

We provide the administrative services and functions of a "central office" to our wholly-owned offices. The services provided to these storefront offices are:

- sales training
- bookkeeping and accounting
- processing services

Franchises operate without the assistance of our "central office" services.

We also provide support services to stores such as:

- assistance with regard to the hiring of employees
- assistance with regard to the writing of local advertising
- advice regarding potential carriers for certain customers

We also manage the cooperative advertising program in which all of our offices participate.

In addition to the above services, we provide to all of our offices a direct business relationship with nationally-known and local insurance carriers that may otherwise be beyond the reach of small, privately-owned retail insurance operations.

In 2007, we obtained and began to utilize a new agency software system, AMS 360, that is used in connection with the management and operations of our stores. We also intend to offer the new system to our franchisees.

Premium Financing

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 secured by the unearned portion of the insurance premiums being financed and held by the insurance carrier. Our wholly-owned subsidiary, Payments Inc., is licensed as a premium finance agency in the states of New York, Pennsylvania and New Jersey.

Prior to February 1, 2008, Payments Inc. provided premium financing in connection with the obtaining of insurance policies. Effective February 1, 2008, Payments Inc. sold its outstanding premium finance loan portfolio. The purchaser of the portfolio has agreed that, during the five year period following the closing (subject to automatic renewal for successive two year terms under certain circumstances), it will purchase, assume and service all eligible premium finance contracts originated by Payments in the states of New York, New Jersey and Pennsylvania. In connection with such purchases, Payments will be entitled to receive a fee generally equal to a percentage of the amount financed. Our premium financing business currently consists of the placement fees that Payments will earn from placing contracts.

The regulatory framework under which our premium finance procedures are established is generally set forth in the premium finance statutes of the states in which we operate. Among other restrictions, the interest rate that may be charged the insureds for financing their premiums is limited by these state statutes. See "Government Regulation."

Commercial Mutual Insurance Company

In March 2007, Commercial Mutual Insurance Company's Board of Directors approved a resolution to convert Commercial Mutual from an advance premium insurance company to a stock property and casualty insurance company pursuant to Section 7307 of the New York Insurance Law. Commercial Mutual has advised us that it has obtained permission from the Superintendent of Insurance of the State of New York to proceed with the conversion process (subject to certain conditions as discussed below).

As discussed in Item 1(a) hereof, we hold two surplus notes issued by Commercial Mutual in the aggregate principal amount of $3,750,000. Previously earned but unpaid interest on the notes as of December 31, 2007 was approximately $2,984,000. The surplus notes 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 Commercial Mutual and require the approval of the Insurance Department of the State of New York. As of December 31, 2007, the statutory surplus of Commercial Mutual, as reported to the Insurance Department, was approximately $6,057,000.

The conversion by Commercial Mutual to a stock property and casualty insurance company is subject to a number of conditions, including the approval of the plan of conversion by the Superintendent of Insurance and Commercial Mutual's policyholders. As part of the approval process, the Superintendent of Insurance has conducted a five year examination of Commercial Mutual as of December 31, 2006 and had an appraisal performed with respect to the fair market value of Commercial Mutual as of such date. We, as a holder of the Commercial Mutual surplus notes, at our option, would be able to exchange the surplus notes for an equitable share of the securities or other consideration, or both, of the corporation into which Commercial Mutual would be converted. Based upon the amount payable on the surplus notes and the statutory surplus of Commercial Mutual, we believe that, following any conversion by Commercial Mutual into a stock corporation, we could hold a controlling equity interest in Commercial Mutual. It is anticipated that the conversion will occur during 2008. No assurances can be given that the conversion will occur.

Competition

We compete with numerous insurance agents and brokers in our market. The amount of capital required to commence operations is generally small and the only material barrier to entry is the ability to obtain the required licenses and appointments as a broker or agent for insurance carriers. There is no price competition between us and other agents and brokers. All must sell a particular carrier's policies at exactly the same price. Because we may be able to offer a different payment plan through the placement of premium financing, we are able to differentiate ourselves.

In recent years, extensive competition has come from direct sales entities, such as Progressive Direct, Esurance and GEICO Insurance, who have concentrated their advertising efforts on television and radio. In addition, the Internet sales effort of some of our competitors has shown promise. Further, legislation that allows banks to offer insurance to their customers has taken market share from the storefront insurance operators.

Government Regulation

Our premium finance subsidiary, Payments Inc., is regulated by governmental agencies in the states in which it conducts business. The regulations, which generally are designed to protect the interests of policyholders who elect to finance their insurance premiums, vary by jurisdiction, but usually, among other matters, involve:

- regulating the interest rates, fees and service charges we may charge our customers
- imposing minimum capital requirements for our premium finance subsidiary or requiring surety bonds in addition to or as an alternative to such capital requirements
- governing the form and content of our financing agreements
- prescribing minimum notice and cure periods before we may cancel a customer’s policy for non-payment under the terms of the financing agreement
- prescribing timing and notice procedures for collecting unearned premium from the insurance company, applying the unearned premium to our customer’s premium finance account, and, if applicable, returning any refund due to our customer
- requiring our premium finance company to qualify for and obtain a license and to renew the license each year
- conducting periodic financial and market conduct examinations and investigations of our premium finance company and its operations
- requiring prior notice to the regulating agency of any change of control of our premium finance company

Employees

We currently employ 68 persons. We believe that our relationship with our employees is good.

ITEM 2. DESCRIPTION OF PROPERTY

Our principal executive offices and the administrative offices of Payments Inc. are located at 1158 Broadway, Hewlett, New York. Our central processing offices are located at 1762 Central Avenue, Albany, New York.

Our 17 Barry Scott offices and five Accurate Agency offices are located in upstate New York. Our five Atlantic Insurance offices are located in eastern Pennsylvania.

Our 27 wholly-owned storefront locations, and our executive and other offices are operated pursuant to lease agreements that expire from time to time through 2015. The current yearly aggregate base rental for the offices is approximately $448,000.

ITEM 3. LEGAL PROCEEDINGS

None.

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

Our Annual Meeting of Stockholders was held on November 20, 2007. 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	2,066,386	150,064
Morton L. Cer		