

FIRST ALBANY COMPANIES INC

Form 10-Q

November 09, 2004

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

[X]

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

For the quarterly period ended September 30, 2004

- or -

[]

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 0-14140

FIRST ALBANY COMPANIES INC.

(Exact name of registrant as specified in its charter)

New York 22 - 2655804

(State or other jurisdiction of
incorporation or organization) (I.R.S. Employer
Identification No.)

30 South Pearl St., Albany, NY 12207

(Address of principal executive offices) (Zip Code)

(518) 447-8500

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X (1) No _____

Indicate by check mark whether the registrant is an accelerated filer (as defined by rule 12b-2 of the Act)

Yes X No _____

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

14,769,937 shares of Common Stock were outstanding as of the close of business on October 29, 2004

#

FIRST ALBANY COMPANIES INC. AND SUBSIDIARIES

FORM 10-Q

INDEX

| | Page |
|--|------|
| Part I | |
| Financial Information | |
| Item 1. | |
| Financial Statements | |
| Condensed Consolidated Statements of Financial Condition at September 30, 2004 (unaudited) and December 31, 2003 | 3 |
| Condensed Consolidated Statements of Operations for the Three Months and Nine Months Ended September 30, 2004 and September 30, 2003 (unaudited) | 4 |
| Consolidated Statement of Changes in Stockholders Equity and Temporary Capital for the Nine Months Ended September 30, 2004 (unaudited) | 5 |
| Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2004 and September 30, 2003 (unaudited) | 6 |
| | 4 |

Edgar Filing: FIRST ALBANY COMPANIES INC - Form 10-Q

| | | |
|--|---|-------|
| Notes to Condensed Consolidated Financial Statements | | 7-20 |
| Item 2. | Management's Discussion and Analysis of Financial Condition and Results of Operations | 21-32 |
| Item 3. | Quantitative and Qualitative Disclosure About Market Risk | 33-34 |
| Item 4. | Controls and Procedures | 35 |
| Part II | Other Information | |
| Item 1. | Legal Proceedings | 36 |
| Item 6. | Exhibits and Reports on Form 8-K | 37 |

#

FIRST ALBANY COMPANIES INC.

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(Unaudited)

Item 1. Financial Statements*(In thousands of dollars)*

| As of | September 30, 2004 | December 31, 2003 |
|--|--------------------|----------------------|
| Assets | | |
| Cash | \$ 746 | \$ 92 |
| Cash and securities segregated for regulatory purposes | 13,400 | - |
| Securities purchased under agreement to resell | 61,583 | 56,261 |
| Receivables from: | | |
| Brokers, dealers and clearing agencies | 13,351 | 12,550 |
| Customers, net | 9,593 | 3,867 |
| Others | 5,970 | 7,149 |
| Securities owned | 311,680 | 239,888 |
| Investments | 40,250 | 55,864 |
| Office equipment and leasehold improvements, net | 5,754 | 6,176 |
| Other assets | 42,641 | 12,500 |
| Total assets | \$ 504,968 | \$ 394,347 |
| <i>Liabilities and Stockholders' Equity</i> | | |
| Liabilities | | |
| Short-term bank loans | \$ 165,645 | \$ 138,500 |
| Payables to: | | |
| Brokers, dealers and clearing agencies | 48,994 | 20,375 |
| Customers | 5,870 | 5,585 |
| Others | 18,611 | 4,654 |
| Securities sold, but not yet purchased | 109,035 | 58,069 |
| Accounts payable | 3,598 | 3,749 |
| Accrued compensation | 20,461 | 46,693 |
| Accrued expenses | 8,949 | 10,211 |
| Notes payable | 32,703 | 14,422 |
| Deferred tax liability | - | 1,751 |
| Obligations under capitalized leases | 2,278 | 3,183 |
| Total liabilities | 416,144 | 307,192 |

Edgar Filing: FIRST ALBANY COMPANIES INC - Form 10-Q

Commitments and Contingencies

| | | |
|--|------------|------------|
| Subordinated debt | 3,695 | 3,721 |
| Temporary capital | 3,374 | - |
| Stockholders' Equity | | |
| Common stock | 154 | 120 |
| Additional paid-in capital | 146,208 | 109,531 |
| Unearned compensation | (17,074) | (5,229) |
| Deferred compensation | 3,691 | 2,699 |
| Retained (deficit) | (46,851) | (20,160) |
| Treasury stock, at cost | (4,373) | (3,527) |
| Total stockholders' equity | 81,755 | 83,434 |
| Total liabilities and stockholders' equity | \$ 504,968 | \$ 394,347 |

See notes to condensed consolidated financial statements.

FIRST ALBANY COMPANIES INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|----------|-------------------|-----------|
| | September 30, | | September 30, | |
| <i>(In thousands of dollars except for per share amounts and shares outstanding)</i> | 2004 | 2003 | 2004 | 2003 |
| <i>Revenues:</i> | | | | |
| Commissions | \$ 4,963 | \$ 4,510 | \$ 16,121 | \$ 12,405 |
| Principal transactions | 24,601 | 22,837 | 69,864 | 81,421 |
| Investment banking | 11,697 | 8,628 | 31,155 | 21,598 |
| Investment gains (losses) | (6,204) | 6,356 | (2,341) | 14,116 |
| Interest income | 2,972 | 1,742 | 6,895 | 4,946 |
| Fees and other | 663 | 795 | 1,794 | 3,197 |
| Total revenues | 38,692 | 44,868 | 123,488 | 137,683 |
| Interest expense | 1,809 | 956 | 4,120 | 2,430 |
| Net revenues | 36,883 | 43,912 | 119,368 | 135,253 |
| <i>Expenses (excluding interest):</i> | | | | |
| Compensation and benefits | 32,254 | 27,683 | 91,916 | 89,316 |
| Clearing, settlement and brokerage costs | 1,396 | 1,374 | 4,230 | 3,761 |
| Communications and data processing | 3,587 | 3,532 | 11,369 | 10,564 |
| Occupancy and depreciation | 2,417 | 2,247 | 6,982 | 6,766 |
| Selling | 1,966 | 1,642 | 5,671 | 5,018 |
| Impairment loss | 1,375 | - | 1,375 | - |
| Restructuring | 750 | - | 750 | - |
| Other | 3,589 | 2,100 | 9,743 | 6,427 |
| Total expenses (excluding interest) | 47,334 | 38,578 | 132,036 | 121,852 |
| Income (loss) before income taxes | (10,451) | 5,334 | (12,668) | 13,401 |
| Income tax (benefit) expense | (4,458) | 2,219 | (8,188) | 5,300 |
| Income (loss) from continuing operations | (5,993) | 3,115 | (4,480) | 8,101 |
| Income (loss) from discontinued operations, | (378) | (316) | (1,147) | (573) |

Edgar Filing: FIRST ALBANY COMPANIES INC - Form 10-Q

| | | | | | |
|------------------------------------|----|------------|------------|------------|------------|
| net of taxes | | | | | |
| Net income (loss) | \$ | (6,371) | \$ 2,799 | \$ (5,627) | 7,528 |
| Per share data: | | | | | |
| Basic earnings: | | | | | |
| Continued operations | \$ | (0.45) | \$ 0.29 | \$ (0.37) | 0.78 |
| Discontinued operations | | (0.03) | (0.03) | (0.09) | (0.06) |
| Net income (loss) | \$ | (0.48) | \$ 0.26 | \$ (0.46) | 0.72 |
| Diluted earnings: | | | | | |
| Continued operations | \$ | (0.45) | \$ 0.25 | \$ (0.37) | 0.70 |
| Discontinued operations | | (0.03) | (0.03) | (0.09) | (0.05) |
| Net income (loss) | \$ | (0.48) | \$ 0.22 | \$ (0.46) | 0.65 |
| Weighted average common and common | | | | | |
| equivalent shares outstanding: | | | | | |
| Basic | | 13,148,611 | 10,607,897 | 12,275,353 | 10,438,582 |
| Diluted | | 13,148,611 | 12,456,224 | 12,275,353 | 11,545,145 |

See notes to condensed consolidated financial statements.

FIRST ALBANY COMPANIES INC.

CONDENSED STATEMENT OF CHANGES

IN STOCKHOLDERS EQUITY AND TEMPORARY CAPITAL

For the Nine Months Ended September 30, 2004

(In thousands of dollars except for number of shares)

| | Temporary Capital | Common Shares | Stock Amount | Additional Paid-In Capital | Unearned Compensation | Deferred Compensation | Retained Earnings (Deficit) | Treasury Stock Shares | Treasury Stock Amount |
|---|----------------------|------------------|-----------------|----------------------------------|--------------------------|--------------------------|-----------------------------------|--------------------------|--------------------------|
| Balance as of December 31, 2003 | \$ | -11,995,247 | \$120 | \$109,531 | \$ (5,229) | \$2,699 | \$ (20,160) | (541,867) | \$ (3,527) |
| Amortization of unearned compensation | - | - | - | - | 5,237 | - | - | - | - |
| Forfeitures of restricted stock | - | - | - | (1,461) | 2,508 | - | -(275,435) | (1,047) | |
| Issuance of restricted stock | - | 1,098,918 | 11 | 17,552 | (16,800) | - | - | 102,365 | 341 |
| Issuance of restricted stock, Descap acquisition | - | 270,843 | 3 | 2,787 | (2,790) | - | - | - | - |
| Issuance of shares, Descap acquisition | 3,374 | 549,476 | 5 | 2,220 | - | - | - | - | - |
| Cash dividends paid | - | - | - | - | - | - | (2,218) | - | - |
| Options exercised | - | 505,654 | 5 | 4,824 | - | - | - | 124,731 | 601 |
| Options expense recognized | - | - | - | 348 | - | - | - | - | - |
| Employee stock trust | - | 94,204 | 1 | 847 | - | 992 | - | (89,957) | (805) |
| Employee benefit plans | - | - | - | 242 | - | - | - | 13,017 | 64 |
| Private placement | - | 896,040 | 9 | 9,318 | - | - | - | - | - |
| Special dividend - distribution of PLUG | - | - | - | - | - | - | (18,846) | - | - |

Edgar Filing: FIRST ALBANY COMPANIES INC - Form 10-Q

| | | | | | | | | | |
|---------------|---------|------------|-------|-----------|------------|---------|------------|-----------|------------|
| Net income | | | | | | | | | |
| (loss) | - | - | - | - | - | - | (5,627) | - | - |
| Balance as of | | | | | | | | | |
| September 30, | | | | | | | | | |
| 2004 | \$3,374 | 15,410,382 | \$154 | \$146,208 | \$(17,074) | \$3,691 | \$(46,851) | (667,146) | \$ (4,373) |

See notes to condensed consolidated financial statements

+

FIRST ALBANY COMPANIES INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

| | September 30, | September 30, |
|---|---------------|---------------|
| <i>(In thousands of dollars)</i> | 2004 | 2003 |
| <i>Cash flows from operating activities:</i> | | |
| Net income (loss) | \$ (5,627) | \$ 7,528 |
| <i>Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:</i> | | |
| Depreciation and amortization | 2,241 | 2,193 |
| Deferred compensation | 1,034 | 897 |
| Deferred income taxes | (12,331) | (5,815) |
| Unrealized investment losses (gains) | 11,990 | (14,160) |
| Realized (gain) loss on sale of investments | (9,649) | 44 |
| Loss on abandonment of fixed assets | 823 | 12 |
| Services provided in exchange for common stock | 8,306 | 2,097 |
| <i>(Increase) decrease in operating assets:</i> | | |
| Cash and securities segregated under federal regulations | (13,400) | 8,900 |
| Securities purchased under agreement to resell | (5,322) | (16,318) |
| Net receivables from customers | (5,441) | (7,017) |
| Securities owned, net | 16,911 | 10,170 |
| Other assets | 3,469 | 7,756 |
| <i>Increase (decrease) in operating liabilities:</i> | | |
| Net payables to brokers, dealers and clearing agencies | (6,878) | 24,098 |
| Net payables to others | 2,598 | (682) |
| Accounts payable and accrued expenses | (29,444) | (19,292) |
| Income taxes payable, net | - | (3,068) |
| Net cash (used in) provided by operating activities | \$ (40,720) | \$ (2,657) |
| <i>Cash flows from investing activities:</i> | | |
| Acquisition of Descap Securities, Inc. | \$ (21,558) | - |
| Additional cash consideration related to intangible assets | (84) | - |
| Purchase of furniture, equipment, and leaseholds, net | (1,085) | (452) |
| Purchase of investments | (5,315) | (1,620) |
| Proceeds from sale of investments | 535 | 33 |
| Net cash (used in) provided by investing activities | \$ (27,507) | \$ (2,039) |

Edgar Filing: FIRST ALBANY COMPANIES INC - Form 10-Q

Cash flows from financing activities:

| | | | | |
|---|----|---------|----|----------|
| Net proceeds of short-term bank loans | \$ | 27,145 | \$ | 7,125 |
| Payments on notes payable | | (1,869) | | (2,234) |
| Payments on subordinated debt | | (26) | | - |
| Proceeds of notes payable | | 20,000 | | 8,994 |
| Proceeds from issuance of warrants | | - | | 1,006 |
| Payments of obligations under capitalized leases | | (1,539) | | (1,285) |
| Payments for purchases of common stock for treasury | | - | | (102) |
| Proceeds from issuance of common stock | | 13,445 | | 2,924 |
| Net increase (decrease) in drafts payable | | 13,943 | | (10,042) |
| Dividends paid | | (2,218) | | (1,668) |
| Net cash provided by (used in) financing activities | \$ | 68,881 | \$ | 4,718 |
| Increase in cash | \$ | 654 | \$ | 22 |
| Cash at beginning of the year | | 92 | | 176 |
| Cash at end of period | \$ | 746 | \$ | 198 |

In 2004 the Company entered into capital leases for office and computer equipment totaling approximately \$0.6 million.

Refer to Investments footnote for non-cash investing activity.

See notes to condensed consolidated financial statements

FIRST ALBANY COMPANIES INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all normal, recurring adjustments necessary for a fair presentation of results for such periods. The results for any interim period are not necessarily indicative of those for the full year. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes for the year ended December 31, 2003.

2. Reclassification

Certain 2003 amounts have been reclassified to conform to the 2004 presentation.

3. Comprehensive Income

The Company has no components of other comprehensive income; therefore comprehensive income equals net income.

4. Earnings Per Common Share

Basic earnings per share have been computed based upon the weighted average number of common shares outstanding. Dilutive earnings per share have been computed based upon the weighted average number of common shares outstanding plus the effect of all potentially dilutive common stock equivalents outstanding during the reporting period.

| | Three Months Ended | | Nine Months Ended | |
|---|--------------------|------------|-------------------|------------|
| | September 30, | | September 30, | |
| | 2004 | 2003 | 2004 | 2003 |
| Weighted average shares for basic earnings per share | 13,148,611 | 10,607,897 | 12,275,353 | 10,438,582 |
| Effect of dilutive common stock equivalents (stock options and stock issuable under employee benefit plans) | - | 1,848,327 | - | 1,106,563 |
| Weighted average shares and dilutive common stock | 13,148,611 | 12,456,224 | 12,275,353 | 11,545,145 |

equivalents for dilutive earnings
per share

For the three months and the nine months ended September 30, 2004, the Company excluded approximately 0.7 million and 1.2 million, respectively, common stock equivalents in its computation of dilutive earnings per share because they were anti-dilutive.

5. Receivables from and Payables to Brokers, Dealers and Clearing Agencies

Amounts receivable from brokers, dealers and clearing agencies consisted of the following at:

| | September 30, | December 31, |
|--|---------------|--------------|
| <i>(In thousands of dollars)</i> | 2004 | 2003 |
| Securities borrowed | \$ 915 | \$ 6,004 |
| Securities failed-to-deliver | 7,969 | 3,311 |
| Receivable from clearing organizations | 4,467 | 3,235 |
| Total | \$ 13,351 | \$ 12,550 |

Amounts payable to brokers, dealers and clearing agencies consisted of the following at:

| | September 30, | December 31, |
|--|---------------|--------------|
| <i>(In thousands of dollars)</i> | 2004 | 2003 |
| Adjustment to record securities owned on a trade date basis, net | \$ 23,096 | \$ 16,593 |
| Payable to clearing organizations | 10,292 | - |
| Securities failed-to-receive | 15,606 | 3,782 |
| Total | \$ 48,994 | \$ 20,375 |

Proprietary securities transactions are recorded on trade date, as if they had settled. The related amounts receivable and payable for unsettled securities transactions are recorded net in receivables or payables to brokers, dealers and clearing agencies on the Statement of Financial Condition.

6. *Receivables from Customers*

The majority of the Company's non-institutional customer securities transactions, including those of officers, directors, employees and related individuals, are cleared through a third party under a clearing agreement. Under this agreement, the clearing agent executes and settles customer securities transactions, collects margin receivables related to these transactions, monitors the credit standing and required margin levels related to these customers and, pursuant to margin guidelines, requires the customer to deposit additional collateral with them or to reduce positions, if necessary. In the event the customer is unable to fulfill its contractual obligations, the clearing agent may purchase or sell the financial instrument underlying the contract, and as a result may incur a loss.

If the clearing agent incurs a loss, it has the right to pass the loss through to the Company which exposes the Company to off-balance-sheet risk. The Company has retained the right to pursue collection or performance from customers who do not perform under their contractual obligations and monitors customer balances on a daily basis along with the credit standing of the clearing agent. As the potential amount of losses during the term of this contract has no maximum, the Company believes there is no maximum amount assignable to this right. At September 30, 2004, substantially all customer obligations were fully collateralized and the Company has not recorded a liability related to the clearing agent's right to pass losses through to the Company.

At September 30, 2004, receivables from customers are mainly comprised of the purchase of securities by institutional clients. Delivery of these securities is made only when the Company is in receipt of the funds from the institutional client.

7. *Securities Owned And Sold, But Not Yet Purchased*

Edgar Filing: FIRST ALBANY COMPANIES INC - Form 10-Q

Securities owned and sold, but not yet purchased consisted of the following at:

| <i>(In thousands of dollars)</i> | September 30, 2004 | | December 31, 2003 | |
|--|--------------------|-----------------------------|-------------------|-----------------------------|
| | Owned | Sold, but not yet Purchased | Owned | Sold, but not yet Purchased |
| Marketable Securities | | | | |
| U.S. Government and federal agency obligations | \$ 64,503 | \$ 89,186 | \$ 11,103 | \$ 55,815 |
| State and municipal bonds | 151,143 | 2,673 | 190,163 | 96 |
| Corporate obligations | 81,473 | 1,842 | 27,837 | 534 |
| Corporate stocks | 10,216 | 15,334 | 9,077 | 1,620 |
| Options | 456 | - | 153 | 4 |
| Not Readily Marketable Securities | | | | |
| Securities with no publicly quoted market | 117 | - | 117 | - |
| Securities subject to restrictions | 3,772 | - | 1,438 | - |
| Total | \$ 311,680 | \$ 109,035 | \$ 239,888 | \$ 58,069 |

Securities not readily marketable include securities (a) for which there is no market on a securities exchange or no independent publicly quoted market, (b) that cannot be publicly offered or sold unless registration has been effected under the Securities Act of 1933, or (c) that cannot be offered or sold because of other arrangements, restrictions or conditions applicable to the securities or to the Company.

8. Investments

The Company's investment portfolio includes interests in publicly and privately held companies. Information regarding these investments has been aggregated and is presented below.

| <i>(In thousands of dollars)</i> | September 30, | December 31, |
|---|------------------|------------------|
| | 2004 | 2003 |
| Carrying Value | | |
| Public | \$ 19,802 | \$ 41,505 |
| Private | 14,445 | 11,511 |
| Consolidation of Employee Investment Funds, net of Company's ownership interest | 6,003 | 2,848 |
| Total carrying value | \$ 40,250 | \$ 55,864 |

For the nine months ending:

September 30,

Edgar Filing: FIRST ALBANY COMPANIES INC - Form 10-Q

| | September 30, 2004 | 2003 |
|-------------------------------------|-----------------------|-----------|
| Net realized gains (losses) | | |
| Public | \$ 9,603 | \$ 14 |
| Private | 46 | (58) |
| Total net realized gains (losses) | \$ 9,649 | \$ (44) |
| Net unrealized gains (losses) | | |
| Public | \$ (11,971) | \$ 12,983 |
| Private | (19) | 1,177 |
| Total net unrealized gains (losses) | \$ (11,990) | \$ 14,160 |
| Investment gains (losses) | \$ (2,341) | \$ 14,116 |

Publicly held investments include 853,924 shares of META Group Inc. (METG) with a market value of \$4.0 million. These shares are freely tradable and transferable. Also, included in publicly held investments are 2,991,040 shares of Mechanical Technology Incorporated (MKTY). As of September 30, 2004, the MKTY shares have a market value of \$12.0 million and cannot be sold until after December 23, 2004 as a result of a lock-up agreement entered into by the Company with MKTY. Following the expiration of the lock-up period, the MKTY shares are subject to the trading restriction provisions of Rule 144 of the Securities Act of 1933 (Rule 144).

In April 2004, the Company declared a special dividend of one share of Plug Power (PLUG) stock for every seven shares of the Company's stock, payable May 18, 2004 to shareholders of record as of May 4, 2004. In May 2004, the Company distributed approximately 2 million shares of PLUG as a special dividend to the Company's shareholders, which represents a reduction of retained earnings of \$18.8 million. Due to this distribution, the Company recorded a realized investment gain of \$9.5 million offset by unrealized losses relating to Plug for the six months ended June 30, 2004 of \$5.4 million. The Company also realized an approximate \$2.2 million tax benefit due to a difference in the accounting versus tax treatment of this distribution. In August 2004, the Company sold 100,000 shares of PLUG stock, recognizing a gain of \$55.0 thousand. At September 30, 2004, the Company owned 576,834 shares of PLUG with a market value of \$3.7 million. The remaining PLUG shares may be sold pursuant to Rule 144. Under the restrictions of Rule 144 as applied to PLUG currently, the Company may sell the entire 576,834 shares at any time.

Privately held investments include an investment of \$6.5 million in FA Technology Ventures L.P. (the Partnership). At September 30, 2004, \$6.5 million is the Company's maximum exposure to loss in the Partnership. The Partnership's primary purpose is to provide investment returns consistent with risks of investing in venture capital. At September 30, 2004 total Partnership capital for all investors in the Partnership equaled \$25.8 million. The Partnership is considered a variable interest entity, but since the Company is not the primary beneficiary, it has not consolidated the Partnership in these financial statements but has only recorded the value of its investment. FA Technology Ventures Corporation (FATV), a wholly owned subsidiary of the Company, is the investment advisor for the Partnership. Revenues derived from management of this investment for the nine months ended September 30, 2004 were \$1.2 million .

The Company has consolidated its Employee Investment Funds (EIF). The EIF are limited liability companies, established by the Company for the purpose of having select employees invest in private equity placements. The EIF is managed by FAC Management Corp., a wholly owned subsidiary of the Company, which has contracted with FATV to act as an investment advisor with respect to funds invested. At September 30, 2004, the Company's exposure to loss as a result of its involvement with the EIF includes the following: the Company's direct investment of \$0.8 million in the EIF and a \$3.8 million loan to the EIF and a commitment to loan an additional \$0.5 million to the EIF. The effect of consolidating the EIF was to increase Investments by \$6.0 million, decrease Receivable from Others by \$3.8 million (to reclassify the amount loaned by the Company to the EIF) and increase Payable to Others by \$2.2 million. The Payable to Others amount relates to the value of the EIF owned by employees.

9. *Intangible Assets*

| | September 30, | |
|--|---------------|-------------------|
| <i>(In thousands of dollars)</i> | 2004 | December 31, 2003 |
| Amortized intangible assets | | |
| Customer related: | | |
| Descap Securities, Inc. - Acquisition | \$ 641 | \$ - |
| Institutional convertible bond arbitrage group - Acquisition | 1,418 | 1,418 |
| Accumulated amortization | (230) | (102) |
| Total | \$ 1,829 | \$ 1,316 |
| Unamortized intangible assets | | |
| Goodwill: | | |
| Descap Securities, Inc. Acquisition | \$ 21,298 | \$ - |
| Institutional convertible bond arbitrage group - Acquisition | 438 | 354 |
| Total | \$ 21,736 | \$ 354 |

Both customer related intangible assets and goodwill increased due to the acquisition of Descap Securities, Inc. (see Acquisition footnote).

The carrying amount of goodwill for the institutional convertible bond arbitrage group acquisition increased by \$84 thousand for the nine months ended September 30, 2004, related primarily to additional cash consideration under the purchase agreement based on the amount of assets under management.

Customer related intangible assets are being amortized over 10 to 12 years. Amortization expense for the nine-month period ending September 30, 2004 and 2003 was \$128 thousand and \$76 thousand, respectively.

| | | |
|--------------------------------|------------------|----------|
| Estimated Amortization Expense | | |
| (year ended December 31) | | |
| | 2004 (remainder) | \$ 50 |
| | 2005 | 195 |
| | 2006 | 195 |
| | 2007 | 195 |
| | 2008 | 195 |
| Thereafter | | 999 |
| Total | | \$ 1,829 |

The intangible assets are recorded in Other assets on the Statement of Financial Condition, and will be tested annually for impairment in the quarter ending December 31 of each fiscal year.

10. Payables to Others

Amounts payable to others consisted of the following at:

| | | |
|---|--------------------|----------------------|
| | September 30, 2004 | December 31, 2003 |
| <i>(In thousands of dollars)</i> | | |
| Drafts payable | \$ 15,592 | \$ 1,649 |
| Others | 841 | 2,012 |
| Payable to Employees for the Employee Investment Funds (see Investments footnote) | 2,178 | 993 |
| Total | \$ 18,611 | \$ 4,654 |

Drafts payable represent amounts drawn by the Company against bank overdrafts under a sweep agreement with a bank.

11. Notes Payable

Notes payable include a note for \$3.45 million collateralized by marketable securities included in the Company's investment portfolio, which is payable in quarterly principal payments of \$525,000 plus interest. The interest rate is fixed at 7% for the term of the loan. This loan matures September 1, 2006.

Edgar Filing: FIRST ALBANY COMPANIES INC - Form 10-Q

Notes payable also include Senior Notes dated June 13, 2003 for \$10 million with a fixed interest rate of 8.5%, payable semiannually, maturing on June 30, 2010. Principal payments of \$2 million are due on June 30th of each year, commencing June 30, 2006 through June 30, 2010. The purchasers of these notes are customers of the Company.

There were 437,000 warrants issued to the purchasers of the Senior Notes, which are exercisable between \$10.08 and \$11.54 per share through June 13, 2010. The value assigned to the warrants was \$1 million. The value of the Senior Notes was discounted by the value of the warrants and is being amortized over the term of the notes.

The Senior Notes contain various covenants, as defined in the agreements, including restrictions on the incurrence of debt, the maintenance of not less than \$50 million of net worth (as of September 30, 2004, the Company's net worth was \$81.8 million) and an adjusted cash flow coverage rate for First Albany Capital Inc. (a wholly owned subsidiary) of not less than 1.2 to 1 at the end of each fiscal quarter based on the most recently concluded period of four consecutive quarters (at the end of the September 30, 2004 quarter, the Company's adjusted cash flow coverage rate was 19.7 to 1). As of September 30, 2004, the Company was in compliance with these covenants.

Notes payable also include a \$20 million Term Loan to finance the acquisition of Descap Securities, Inc. Interest rate is 2.4% over the 30-day London InterBank Offered Rate (LIBOR) (1.84% at September 30, 2004). Interest only is payable for first six months, and thereafter monthly payments of principal and interest over the life of loan which matures on May 14, 2011.

As of September 30, 2004, the Company was not in compliance with certain covenants contained in the Term Loan. The Company had forty-five days under the Term Loan Agreement to comply with the covenants or it would be considered in default. On November 2, 2004, the Company and the bank amended selected covenants in the Term Loan Agreement retroactively to July 1, 2004 and as such the Company is in compliance with the covenant requirements. The covenants require the maintenance of not less than \$22.5 million of earnings before interest, taxes, depreciation, amortization and lease expense plus pro forma adjustments related to Descap, Scheduled Adjustment Expenditures and Scheduled Adjustment Earnings (as defined in the modified term loan agreement and referred to as EBITDAR) (for the twelve month period ending September 30, 2004, the Company's EBITDAR was \$24.5 million), operating cash flow to total fixed charge ratio (as defined) of not less than 1.15 to 1 (for the twelve month period ending September 30, 2004, the operating cash flow to total fixed charge ratio was 1.17 to 1) and modified total funded debt to EBITDAR ratio of less than 1.75 to 1 (for the twelve month period ending September 30, 2004, modified total funded debt to EBITDAR ratio was 1.48 to 1).

Principal payments for all notes, which include \$747,000 discounted on the Senior Notes, are due as follows:

(In thousands of dollars)

| | | |
|---|----|--------|
| 2004 (remaining) | \$ | 754 |
| 2005 | | 4,897 |
| 2006 | | 5,722 |
| 2007 | | 5,000 |
| 2008 | | 5,106 |
| Thereafter | | 11,971 |
| Total principal payments | | 33,450 |
| Less: remaining amortization of value of warrants | | 747 |
| Total principal payments remaining | \$ | 32,703 |

12. Obligations Under Capitalized Leases

The following is a schedule of future minimum lease payments under capital leases for office equipment and the present value of the minimum lease payments at September 30, 2004:

(In thousands of dollars)

| | | |
|---|----|-------|
| 2004 (remaining) | \$ | 525 |
| 2005 | | 873 |
| 2006 | | 592 |
| 2007 | | 307 |
| 2008 | | 134 |
| Thereafter | | 4 |
| Total minimum lease payments | | 2,435 |
| Less: amount representing interest | | 157 |
| Present value of minimum lease payments | \$ | 2,278 |

13. Commitments and Contingencies

Commitments: As of September 30, 2004, the Company had a commitment through July 2006 to invest up to \$11.5 million in FA Technology Ventures L.P. (the Partnership). The Company intends to fund this commitment from the sale of other investments and operating cash flow. The Partnership's primary purpose is to provide investment returns consistent with risks of investing in venture capital. In addition to the Company, certain other limited partners of the Partnership are officers or directors of the Company. The majority of the commitments to the Partnership are from non-affiliates of the Company.

The General Partner for the Partnership is FATV GP LLC. The General Partner is responsible for the management of the Partnership, including among other things, making investments for the Partnership. The members of the General

Partnership are George McNamee, Chairman of the Company, First Albany Enterprise Funding, Inc., a wholly owned subsidiary of the Company, and other employees and former employees of the Company or its subsidiaries. Mr. McNamee is required under the Partnership agreement to devote a majority of his business time to the conduct of the affairs of the Partnership and any parallel funds. Subject to the terms of the Partnership agreement, under certain conditions, the General Partnership is entitled to share in the gains received by the Partnership in respect of its investment in a portfolio company. The General Partner will receive a carried interest on customary terms. The General Partner has contracted with FA Technology Ventures Corporation (FATV), a wholly owned subsidiary of the Company, to act as investment advisor to the General Partner.

As of September 30, 2004, the Company had an additional commitment through July 2006 to invest up to \$8.7 million in funds that invest in parallel with the Partnership, which it intends to fund, at least in part, through current and future Employee Investment Funds (EIF). EIF are limited liability companies, established by the Company for the purpose of allowing select employees to invest their own funds in private equity placements.

The EIF are managed by FAC Management Corp., a wholly owned subsidiary of the Company, which has contracted with FATV to act as an investment advisor with respect to funds invested in parallel with the Partnership. The Company anticipates that the portion of the commitment that is not funded by employees through the EIF will be funded by the Company through the sale of other investments and operating cash flow.

Litigation: In 1998 the Company was named in lawsuits by Lawrence Group, Inc. and certain related entities (the Lawrence Parties) in connection with a private sale of Mechanical Technology Incorporated stock from the Lawrence Parties that was previously approved by the United States Bankruptcy Court for the Northern District of New York (the "Bankruptcy Court"). The Company acted as placement agent in that sale, and a number of employees and officers of the Company, who have also been named as defendants, purchased shares in the sale. The complaints alleged that the defendants did not disclose certain information to the sellers and that the price approved by the court was therefore not proper. The cases were initially filed in the Bankruptcy Court and the United States District Court for the Northern District of New York (the "District Court"), and were subsequently consolidated in the District Court. The District Court dismissed the cases, and that decision was subsequently vacated by the United States Court of Appeals for the Second Circuit, which remanded the cases for consideration of the plaintiffs' claims as motions to modify the Bankruptcy Court sale order. The plaintiffs' claims have now been referred back to the Bankruptcy Court for such consideration. The Company believes that it has strong defenses to, and intends to vigorously defend itself against the plaintiffs' claims, and believes that the claims lack merit.

In the normal course of business, the Company has been named a defendant, or otherwise has possible exposure, in several claims. Certain of these are class actions, which seek unspecified damages, which could be substantial.

Although there can be no assurance as to the eventual outcome of litigation in which the Company has been named as a defendant or otherwise has possible exposure, the Company has provided for those actions most likely of adverse dispositions. Although further losses are possible, the opinion of management, based upon the advice of its attorneys and General Counsel, is that such litigation will not, in the aggregate, have a material adverse effect on the Company's liquidity or financial position, although it could have a material effect on quarterly or annual operating results in the period in which it is resolved.

Other: The Company enters into underwriting commitments to purchase securities, as part of its investment banking business and may also purchase or sell securities on a when-issued basis. As of September 30, 2004, the Company had \$3.3 million in outstanding underwriting commitments and had purchased no securities on a when-issued basis.

In connection with a \$47.4 million underwriting transaction, the Company sent unauthorized emails to 223 addressees, each of which may have constituted a nonconforming prospectus under the Securities Act of 1933. A recipient of the unauthorized emails may be entitled to rescission rights if they purchased shares of common stock issued through the underwriting transaction. The rescission rights would allow any recipient of the communication, for a period of one year from March 30, 2004, the date of such recipient's purchase of shares of common stock issued through the underwriting, to seek recovery of the consideration paid in connection with the purchase. The Company has agreed to indemnify the company whose common stock was underwritten for losses, costs and expenses that might be incurred as a result of the unauthorized communications. In an effort to avoid further Securities Act implications and to minimize the risk related to the indemnification provided as a result of the unauthorized communication, the Company took a number of steps to control the solicitation, allocation and distribution of the shares of common stock issued in the transaction, which included selling only to institutional investors and prohibiting sales to those who were among the 223 original addressees. As of September 30, 2004, the Company has not accrued any liability related to this agreement.

14. Temporary Capital

In connection with the Company's acquisition of Descap Securities, Inc., the Company issued 549,476 shares of stock which provides the Sellers the right to require the Company to purchase back the shares issued, at a price of \$6.14 per share. Accordingly, the Company has recognized as temporary capital the amount that it may be required to pay under the agreement. The put right expires on May 31, 2007. If the put is not exercised by the time it expires, the Company will reclassify the temporary capital to stockholders' equity.

15. Stockholders' Equity

Dividend

In October 2004, the Board of Directors declared a quarterly dividend of \$.05 per share for the third quarter ended September 30, 2004, payable November 29, 2004 to stockholders of record on November 15, 2004.

In July 2004, the Board of Directors declared a quarterly dividend of \$.05 per share for the second quarter ended June 30, 2004, payable August 30, 2004 to stockholders of record on August 16, 2004.

In April 2004, the Board of Directors declared a quarterly dividend of \$.05 per share for the first quarter ended March 31, 2004, payable on May 28, 2004 to stockholders of record on May 14, 2004.

Special Dividend

In May 2004, the Company distributed approximately 2 million shares of PLUG as a special dividend (see Investments footnote).

Private Placement

The Company raised \$9.3 million, net of issuance costs in equity through a private placement of approximately 896,000 shares of the Company's stock.

Acquisition Descap Securities, Inc.

The shares issued to the sellers of Descap provide the sellers the right to require the Company to purchase back these shares at a price of \$6.14 per share. The Company also has the right to purchase back these shares from the sellers at a price of \$14.46. Both the put and call rights expires on May 31, 2007. The value assigned to the shares of common stock issued (\$10.39 per share) approximated the market value of the stock on the date Descap was acquired (\$10.30 per share). The difference in the value assigned and the market value was due to the put and call features attached to the stock.

Deferred Compensation and Employee Stock Trust

The Company has adopted various nonqualified deferred compensation plans (the Plans) for the benefit of a select group of highly compensated employees who contribute significantly to the continued growth and development and future business success of the Company. Plan participants may elect under the Plans to have the value of their Plan accounts track the performance of one or more investment benchmarks available under the Plans, including First Albany Companies Common Stock Investment Benchmark, which tracks the performance of First Albany Companies Inc. common stock (Company Stock). With respect to the First Albany Companies Common Stock Investment Benchmark, the Company contributes Company Stock to a rabbi trust (the Trust) it has established in connection with meeting its related liability under the Plans.

Assets of the Trust have been consolidated with those of the Company. The value of the Company's stock at the time contributed to the Trust has been classified in stockholders' equity as treasury stock. The deferred compensation arrangement requires the related liability to be settled by delivery of a fixed number of shares of Company stock.

Accordingly, the related liability is classified in stockholders' equity as deferred compensation and changes in the fair market value of the amount owed to the participant in the Plan is not recognized.

Unearned Compensation

The Company has established several stock incentive plans through which employees of the Company may be awarded stock options, stock appreciation rights and restricted common stock. The unamortized amount related to restricted common stock awarded under these plans is classified in equity under unearned compensation.

16. Benefit Plans

First Albany Companies Inc. has established several stock incentive plans through which eligible employees of the Company may be awarded stock options, stock appreciation rights and restricted common stock of the Company. The purpose of these stock incentive plans are to promote the interests of the Company, its subsidiaries and its stockholders by enabling the Company and its subsidiaries to attract, retain and motivate employees and officers or those who will become employees or officers of the Company and/or its subsidiaries, and to align the interest of those individuals with the Company's stockholders. To do this, these plans offer performance-based incentive awards and equity-based opportunities to provide such persons with a proprietary interest in maximizing the growth, profitability and overall success of the Company.

Restricted Stock: 1,201,283 shares of restricted stock were awarded under the plans during the nine months of 2004, at a weighted average grant date price of \$13.99. 270,843 shares of restricted stock were awarded to employees of Descap Securities at a weighted average grant price of \$10.30. The fair market value of the awards will be amortized over the three-year period in which the restrictions are outstanding.

Options: Stock-based compensation cost related to stock options awards is measured at the grant date based on the value of the award and is recognized as expense over the vesting period for awards granted after December 31, 2002.

The following table reflects the effect on net income if the fair value based method had been applied to all outstanding and unvested stock options in each period:

| | <u>Nine Months Ended</u> | |
|--|--------------------------|-----------------------|
| | September 30, 2004 | September 30, 2003 |
| <i>(In thousands of dollar except for per share amounts)</i> | | |
| Net income (loss), as reported | \$ (5,627) | \$ 7,528 |
| Add: Stock-based employee compensation expense included in reported net income, net of tax | 236 | 55 |
| Less: Total stock-based employee compensation expense determined under fair value based method for all stock options, net of tax | (1,173) | (1,002) |
| Pro forma net (loss) income | \$ (6,564) | \$ 6,581 |
| Earnings per share | | |
| As reported | | |
| Basic | \$ (0.46) | \$ 0.72 |
| Diluted | \$ (0.46) | \$ 0.65 |
| Pro forma | | |
| Basic | \$ (0.53) | \$ 0.63 |
| Diluted | \$ (0.53) | \$ 0.57 |

17 Net Capital Requirements

The Company's broker-dealer subsidiary, First Albany Capital Inc. (the Corporation) is subject to the Securities and Exchange Commission's Uniform Net Capital Rule, which requires the maintenance of a minimum net capital. The Corporation has elected to use the alternative method permitted by the rule, which requires the Corporation to maintain a minimum net capital amount of 2% of aggregate debit balances arising from customer transactions as defined or \$1 million, whichever is greater. As of September 30, 2004, the Corporation had aggregate net capital, as defined, of \$10.4 million, which equaled 85.45% of aggregate debit balances and \$9.4 million in excess of required minimum net capital.

Descap is subject to the Securities and Exchange Commission Uniform Net Capital Rule (15c3-1), which requires the maintenance of minimum net capital and that the ratio of aggregate indebtedness to net capital, both as defined by the rule, shall not exceed 15:1. The rule also provides that capital may not be withdrawn or cash dividends paid if the resulting net capital ratio would exceed 10:1. At September 30, 2004, Descap had net capital of \$6.2 million, which was \$6.1 million in excess of its required net capital. Descap's ratio of Aggregate Indebtedness to Net Capital was 0.33 to 1.

18. Segment Analysis

With the exception of the institutional convertible bond arbitrage advisory group, the Company has discontinued its asset management business (FA Asset Management, Inc.). As a result, the convertible bond arbitrage advisory group is now included in the Parent and Affiliates segment and the remainder of the FA Asset Management segment is included in Discontinued Operations.

The Company's reportable segments include Taxable Fixed Income, Municipal Capital Markets, Equity Capital Markets, Fixed Income-Other and Corporate-Other, which collectively comprise First Albany Capital Inc. and Descap Securities, Inc., which collectively comprise the Company's brokerage operations. The Company's reportable segments also include Parent & Affiliates and Investments. The Company evaluates the performance of its segments and allocates resources to them based on various factors, including prospects for growth, return on revenue and expected profitability.

The Taxable Fixed Income segment includes institutional sales and trading of corporate, federal government and agency securities. The Municipal Capital Markets segment includes underwriting and institutional sales and trading of municipal securities as well as financial advisory services for municipalities. The Equity Capital Markets segment includes institutional sales and trading of equity securities, corporate finance advisory services and underwritings. The Fixed Income-Other segment includes institutional sales and trading of fixed income middle markets and taxable municipal securities. The Corporate-Other segment includes internal operations and support costs, along with other unallocated revenues and expenses. The Descap Securities, Inc. segment includes institutional sales and trading of mortgage-backed securities.

The Parent and Affiliates segment includes the Parent company, excluding its investment portfolio, the asset management services of FATV, and the Company's institutional convertible bond arbitrage advisory group. The Investment segment includes realized gains and losses and unrealized gains and losses from the Company's investment portfolio. The Investment segment does not include revenues the Company receives through FATV for management of some of its private investments, which are eliminated in consolidation in investment gains (losses). These revenues are included in the Parent and Affiliates segment.

Intersegment revenue has been eliminated for purposes of presenting net revenue so that total net revenue presented is from external sources. Interest revenue is allocated to the operating segments and is presented net of interest expense for purposes of assessing the performance of the business segment. Depreciation and amortization is allocated to the business segments.

Information concerning operations in these segments is as follows for the three months and nine months ending September 30:

| | Three Months Ended | | Nine Months Ended | |
|---|--------------------|-----------|-------------------|------------|
| | September 30, | | September 30, | |
| | 2004 | 2003 | 2004 | 2003 |
| <i>(In thousands of dollars)</i> | | | | |
| <i>Net revenues (including net interest income)</i> | | | | |
| Taxable Fixed Income | \$ 6,643 | \$ 8,985 | \$ 21,189 | \$ 40,202 |
| Municipal Capital Markets | 6,838 | 10,580 | 23,485 | 29,467 |
| Equity Capital Markets | 18,958 | 13,017 | 57,341 | 34,749 |
| Fixed Income-Other | 3,818 | 3,938 | 8,699 | 12,762 |
| Corporate-Other | 610 | 832 | 2,157 | 2,196 |
| Descap Securities, Inc. | 6,068 | - | 8,544 | - |
| Total Brokerage Operations | 42,935 | 37,352 | 121,415 | 119,376 |
| Parent and Affiliates | 283 | 335 | 686 | 2,149 |
| Investments | (6,335) | 6,225 | (2,733) | 13,728 |
| Total net revenues | \$ 36,883 | \$ 43,912 | \$ 119,368 | \$ 135,253 |
| <i>Net interest income (included in total net revenues)</i> | | | | |
| Taxable Fixed Income | \$ 87 | \$ 107 | \$ 203 | \$ 456 |
| Municipal Capital Markets | 320 | 193 | 946 | 783 |
| Equity Capital Markets | 1 | 8 | 24 | 22 |
| Fixed Income-Other | 59 | 209 | 204 | 195 |
| Corporate-Other | 638 | 676 | 2,178 | 1,957 |
| Descap Securities, Inc. | 461 | - | 478 | - |
| Total Brokerage Operations | 1,566 | 1,193 | 4,033 | 3,413 |

Edgar Filing: FIRST ALBANY COMPANIES INC - Form 10-Q

| | | | | | | | |
|---|----|----------|----|---------|-------------|----|----------|
| Parent and Affiliates | | (403) | | (407) | (1,258) | | (897) |
| Total net interest income | \$ | 1,163 | \$ | 786 | \$ 2,775 | \$ | 2,516 |
| <i>Income (loss) before income taxes:</i> | | | | | | | |
| Taxable Fixed Income | \$ | 638 | \$ | 1,311 | \$ 2,379 | \$ | 7,870 |
| Municipal Capital Markets | | 635 | | 2,153 | 994 | | 5,586 |
| Equity Capital Markets | | 678 | | 598 | 3,937 | | (466) |
| Fixed Income-Other | | 1,731 | | 1,637 | 4,009 | | 6,220 |
| Corporate-Other | | (7,078) | | (4,687) | (17,644) | | (14,174) |
| Descap Securities, Inc. | | 2,109 | | - | 2,518 | | - |
| Total Brokerage Operations | | (1,287) | | 1,012 | (3,807) | | 5,036 |
| Parent and Affiliates | | (2,829) | | (1,903) | (6,128) | | (5,363) |
| Investments | | (6,335) | | 6,225 | (2,733) | | 13,728 |
| Income (loss) before income taxes and discontinued operations | \$ | (10,451) | \$ | 5,334 | \$ (12,668) | \$ | 13,401 |

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|--------|-------------------|----------|
| | September 30, | | September 30, | |
| <i>(In thousands of dollars)</i> | 2004 | 2003 | 2004 | 2003 |
| <i>Depreciation and amortization expense</i> | | | | |
| <i>(charged to each segment in measuring the</i> | | | | |
| <i>income (loss) before income taxes)</i> | | | | |
| Taxable Fixed Income | \$ 62 | \$ 67 | \$ 196 | \$ 212 |
| Municipal Capital Markets | 92 | 91 | 277 | 292 |
| Equity Capital Markets | 263 | 255 | 793 | 833 |
| Fixed Income-Other | 8 | 10 | 26 | 35 |
| Corporate-Other | 164 | 187 | 526 | 610 |
| Descap Securities, Inc. | 33 | - | 38 | - |
| Total Brokerage Operations | 622 | 610 | 1,856 | 1,982 |
| Parent and Affiliates | 110 | 86 | 312 | 167 |
| Discontinued Operations | 24 | 14 | 73 | 44 |
| Total | \$ 756 | \$ 710 | \$ 2,241 | \$ 2,193 |

The financial policies of the Company's segments are the same as those described in the Summary of Significant Accounting Policies footnote (Note 1 to the annual report on Form 10-K). Asset information by segment is not reported since the Company does not produce such information. All assets are located in the United States of America. Prior periods' financial information has been reclassified to conform to the current presentation.

19. Discontinued Operations

During the three-month period ending September 30, 2004, the Company committed to a plan to dispose of its asset management business (FA Asset Management) other than its institutional convertible bond arbitrage advisory group. Accordingly, the Company will account for the disposition of the asset management business as discontinued operations. It is expected that the disposition will be complete by December 31, 2004. Any gain or loss to be recognized related to the disposition will be recognized at the date of sale.

Additionally, in 2000 the Company sold its Private Client Group and continues to report the receipt and settlement of pending contractual obligations as discontinued operations.

Amounts reflected in the condensed consolidated statement of operations are presented in the following table:

| Three Months Ended | Nine Months Ended |
|--------------------|-------------------|
| September 30, | September 30, |

(In thousands of dollars)

| | 2004 | 2003 |
|----------------------|------|-------|
| Net revenues | | |
| FA Asset Management | \$ | 578 |
| | \$ | 387 |
| | \$ | 1,638 |
| | \$ | 1,652 |
| Private Client Group | | - |
| | | - |

| | |
|----------------------|-------|
| | 458 |
| | 250 |
| Total net revenues | |
| | 578 |
| | 387 |
| | 2,096 |
| | 1,902 |
| Expenses | |
| FA Asset Management | |
| | 1,221 |
| | 924 |
| | 4,047 |
| | 2,870 |
| Private Client Group | |
| | - |
| | 34 |

| | |
|----------------------------|---------|
| | - |
| | - |
| | - |
| Total expenses | 1,221 |
| | 924 |
| | 4,047 |
| | 2,870 |
| (Loss) before income taxes | (643) |
| | (537) |
| | (1,951) |
| | (968) |
| Income tax (benefit) | |

| | | |
|---|----|---------|
| | | (265) |
| | | (221) |
| | | (804) |
| | | (395) |
| (Loss) from discontinued operations, net of taxes | | |
| | \$ | |
| | | (378) |
| | \$ | |
| | | (316) |
| | \$ | |
| | | (1,147) |
| | \$ | |
| | | (573) |

20. Acquisition

On May 14, 2004, the Company acquired 100% of the outstanding common shares of Descap Securities, Inc.

(Descap), a New York-based broker-dealer and investment bank. Descap specializes in the primary issuance and secondary trading of mortgage-backed securities, asset-backed securities, collateralized mortgage obligations and derivatives, and commercial mortgage-backed securities. Its investment banking group provides advisory and capital raising services, and specializes in structured finance and asset-backed securities and should serve to enhance the Company's product offering. Descap will continue to operate under its current name.

The value of the transaction was approximately \$31 million, which approximated Descap's revenue for its previous fiscal year, and consisted of \$25 million in cash and 549,476 shares of the Company's common stock, plus future contingent consideration based on financial performance. Approximately \$9.4 million of the purchase price was to acquire the net assets of the business, which consisted of assets of \$68.7 million and liabilities of \$59.3 million. The purchase price in excess of net assets (\$21.9 million) was preliminarily allocated to intangible assets based upon an independent third party valuation (see Intangible Asset footnote). These shares issued to the sellers of Descap provide the sellers the right to require the Company to purchase back these shares at a price of \$6.14 per share. The Company also has the right to purchase back these shares from the sellers at a price of \$14.46. Both the put and call rights expires on May 31, 2007. The value assigned to the shares of common stock issued (\$10.39 per share) approximated the market value of the stock on the date Descap was acquired (\$10.30 per share). The difference in the value assigned and the market value was due to the put and call features attached to the stock. The Company also issued 270,843 shares of restricted stock to employees of Descap, which vests over a three-year period.

Per the acquisition agreement, Descap Securities Inc. can receive future contingent consideration based on the following: For each of the next three years ending June 1, 2007, if Descap's Pre-Tax Net Income (as defined) (i) is greater than \$10 million, the Company shall pay to the Sellers an aggregate amount equal to fifty percent (50%) of Descap's Pre-Tax Net Income for such period, or (ii) is equal to or less than \$10 million, the Company shall pay to the Sellers an aggregate amount equal to forty percent (40%) of Descap's Pre-Tax Net Income for such period

Based upon Descap's Pre-Tax Net Income from June 1, 2004 through September 30, 2004, \$1.3 million of contingent consideration would be payable to the Sellers. The contingent consideration will not be accrued in the Company's financial statement until the contingency is resolved and the consideration is distributable.

The following table presents pro forma information as if the acquisition of Descap Securities, Inc. had occurred on January 1, 2004 and 2003.

Three Months Ended
September 30,

Nine Months Ended
September 30,

Edgar Filing: FIRST ALBANY COMPANIES INC - Form 10-Q

(In thousands of dollars except for per share amounts and shares outstanding)

| | | |
|-------------------------------------|------|---------|
| | 2004 | |
| | 2003 | |
| | 2004 | |
| | 2003 | |
| Net revenues (including interest) | | |
| | \$ | 36,883 |
| | \$ | 51,254 |
| | \$ | 125,831 |
| | \$ | 158,538 |
| Total expenses (excluding interest) | | |
| | | 47,334 |
| | | 42,826 |
| | | 137,955 |

| | |
|--|----------|
| | 135,220 |
| (Loss) income before income taxes | |
| | (10,451) |
| | 8,428 |
| | (12,124) |
| | 23,318 |
| Income tax (benefit) expense | |
| | (4,458) |
| | 3,488 |
| | (7,965) |
| | 9,366 |
| (Loss) income from continuing operations | |
| | (5,993) |
| | 4,940 |
| | (4,159) |
| | 40 |

| | | |
|--------------------------------------|----|---------|
| | | 13,952 |
| (Loss) from discontinued operations, | | |
| net of taxes | | |
| | | (378) |
| | | (316) |
| | | (1,147) |
| | | (573) |
| Net (loss) income | | |
| | \$ | (6,371) |
| | \$ | 4,624 |
| | \$ | (5,306) |
| | \$ | 13,379 |
| Per share data: | | |
| Basic earnings: | | |
| Continued operations | | |

Edgar Filing: FIRST ALBANY COMPANIES INC - Form 10-Q

| | | |
|-------------------------|----|--------|
| | \$ | (0.45) |
| | \$ | 0.44 |
| | \$ | (0.33) |
| | \$ | 1.27 |
| Discontinued operations | | (0.03) |
| | | (0.03) |
| | | (0.09) |
| | | (0.05) |
| Net income | | |
| | \$ | (0.48) |
| | \$ | 0.41 |
| | \$ | (0.42) |
| | \$ | 1.22 |
| | | 42 |

Diluted earnings:

Continued operations

\$

(0.45)

\$

0.38

\$

(0.33)

\$

1.14

Discontinued operations

(0.03)

(0.02)

(0.09)

(0.05)

Net income

\$

(0.48)

\$

0.36

\$

(0.42)

\$

1.09

21. Impairment

During the three-month period ended September 30, 2004, the Company abandoned a software development project. Accordingly, the Company recognized as an impairment expense the costs related to the project that had been capitalized as well as the costs incurred to terminate the project. The impairment expense was allocated to Corporate-Other for segment reporting purposes.

22. Restructuring

During the three-month period ended September 30, 2004, the Company undertook an internal review of its operations in an effort to reduce costs. One of the results of this review was the streamlining of certain functions and a reduction in personnel. The reduction in personnel was initiated during the period ended September 30, 2004 and is expected to be completed by December 31, 2004. The Company expects to incur restructuring expenses of approximately \$1.4 million related to this effort of which \$750 thousand was accrued and expensed in the period ended September 30, 2004. The nature of these costs are compensation and benefits and the amount expensed through September 30, 2004 relates to employees who were terminated by September 30, 2004. It is expected that all restructuring expenses will be paid by January 2005. Restructuring costs to date were allocated 83% to Corporate-Other, with the remainder allocated among the other business units for segment reporting purposes. Total restructuring costs are expected to be allocated 82% to Corporate-Other, with the remainder allocated among the other business units for segment reporting purposes.

Edgar Filing: FIRST ALBANY COMPANIES INC - Form 10-Q

FIRST ALBANY COMPANIES INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION

AND RESULTS OF OPERATIONS

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Three Months Ended

September 30,

(In thousands of dollars)

2004

2003

Revenues:

Commissions

\$

4,963

\$

4,510

Principal transactions

24,601

22,837

Investment banking

11,697

8,628

Investment (losses) gains

(6,204)

| | |
|------------------|--------|
| | 6,356 |
| Interest | |
| | 2,972 |
| | 1,742 |
| Fees and other | |
| | 663 |
| | 795 |
| Total revenues | |
| | 38,692 |
| | 44,868 |
| Interest expense | |
| | 1,809 |
| | 956 |
| Net revenues | |
| | 36,883 |
| | 43,912 |
| | 48 |

Expenses (excluding interest):

Compensation and benefits

32,254

27,683

Clearing, settlement and brokerage costs

1,396

1,374

Communications and data processing

3,587

3,532

Occupancy and depreciation

2,417

2,247

Selling

1,966

| | |
|-------------------------------------|----------|
| | 1,642 |
| Impairment loss | |
| | 1,375 |
| | - |
| Restructuring | |
| | 750 |
| | - |
| Other | |
| | 3,589 |
| | 2,100 |
| Total expenses (excluding interest) | |
| | 47,334 |
| | 38,578 |
| (Loss) income before income taxes | |
| | (10,451) |
| | 5,334 |
| | 50 |

Income tax (benefit) expense

(4,458)

2,219

(Loss) income from continuing operations

(5,993)

3,115

(Loss) from discontinued operations, net of taxes

(378)

(316)

Net (loss) income

\$

(6,371)

\$

2,799

Net interest income:

Interest income

\$

2,972

51

| | |
|---------------------|-------|
| | \$ |
| | 1,742 |
| Interest expense | |
| | 1,809 |
| | 956 |
| Net interest income | |
| | \$ |
| | 1,163 |
| | \$ |
| | 786 |

The following is management's discussion and analysis of certain significant factors, which have affected the Company's financial position and results of operations during the periods included in the accompanying condensed consolidated financial statements.

Business Environment

First Albany Companies Inc. (the Company) is the parent company whose principal subsidiaries include First Albany Capital Inc. (First Albany Capital), Descap Securities, Inc. (Descap), FA Technology Ventures Corporation and FA Asset Management Inc. First Albany Capital Inc. provides investment banking services to corporate and public clients, and engages in market making and trading of corporate, government and municipal securities. Descap is a New York-based broker-dealer and investment bank specializing in mortgage-backed securities. FA Technology Ventures Corporation provides venture capital and merchant banking to the investment and corporate communities, and FA Asset Management Inc. provides asset management services to individuals and institutions.

The investment banking and brokerage businesses generate revenues in direct correlation with the general level of trading activity in the stock and bond markets. The Company cannot control this level of activity, however many of the Company's costs are fixed. Therefore, the Company's earnings, like those of others in the industry, reflect the

activity in the markets and can fluctuate accordingly.

Business Overview

The Company's 2004 third quarter net revenues from continuing operations were \$36.9 million compared with \$43.9 million for the same period in 2003. The decline in revenue was driven by a \$12.6 million decline in revenue related to the value of the firm's investment portfolio. The Company reported a net loss from continuing operations for the third quarter 2004 of \$6.0 million, compared with net income of \$3.1 million for the same period in 2003. Results for the third quarter were negatively impacted by a \$3.7 million loss, net of taxes, in the firm's investment portfolio and \$1.9 million in one-time charges, net of taxes, related to an increase in legal expenses, restructuring expense, and an asset impairment. Consolidated net income was a loss of \$6.4 million for the third quarter of 2004 compared with net income of \$2.8 million in the third quarter of 2003.

For the nine months ended September 30, 2004, net revenues from continuing operations were \$119.4 million compared with \$135.3 million for the same period in 2003. The Company reported a net loss from continuing operations of \$4.5 million compared with net income of \$8.1 million for the same period in 2003. Included in results for the nine months ended September 30, 2004 is a charge of \$3.1 million, net of tax, related to increases in legal expenses, restructuring expense, and an asset impairment. Consolidated net income was a net loss of \$5.6 million for the nine months ended September 30, 2004 compared with net income of \$7.5 million in the same period of 2003.

Major Segment Operating Results

Brokerage Operations

Brokerage Operations is comprised of First Albany Capital and Descap.

Net revenues from the Company's Brokerage Operations were \$42.9 million for the third quarter ended September 30, 2004, compared with \$37.4 million for the same period in 2003. The Company's Brokerage Operations reported a net loss of \$0.7 million for the third quarter 2004, compared with net income of \$0.6 million for the same period in 2003.

Results for the third quarter were negatively impacted by \$1.4 million in charges, net of taxes, related to an increase in legal reserves, severance and an asset impairment. For the first nine months of 2004, net revenues from the Brokerage Operations were \$121.4 million compared with \$119.4 million for the first nine months of 2003. For the first nine months of 2004, the Company's Brokerage Operations reported a net loss of \$1.7 million compared with net income of \$3.2 million for the same period in 2003.

Results for the divisions of the Company's Brokerage Operations are:

- Net revenues for Equity Capital Markets were \$19.0 million for the third quarter of 2004, up from \$13.0 million in the third quarter of 2003. Continued strength in investment banking fees was the primary reason for the year-over-year improvement for the quarter. Compared with the third quarter of 2003, investment banking revenues were \$8.1 million, up from \$2.6 million. During the third quarter of 2004, the Company booked the largest investment banking fee in the firm's history. During the quarter the Company acted as a co-manager on four equity transactions and one debt transaction and an advisor on two advisor transactions and two private placements. For the first nine months of 2004, net revenues for Equity Capital Markets were \$57.3 million compared with \$34.7 million for the first nine months of 2003.

- The Municipal Capital Markets group net revenue was \$6.8 million for the third quarter of 2004 compared with \$10.6 million for the same period in 2003. During the third quarter the firm acted as a sole or senior manager on eleven negotiated and competitive bid transactions, a co-manager on 26 negotiated and competitive bid transactions and an advisor on 12 transactions. For the first nine months of 2004, net revenues for Municipal Capital Markets were \$23.5 million compared with \$29.5 million for the first nine months of 2003.

- The Taxable Fixed Income unit reported net revenue for the third quarter of \$6.6 million compared with \$9.0 million in the third quarter of 2003. Declining institutional investor transaction activity and the overall compression spreads in their markets continued to negatively impact net revenue in Taxable Fixed Income. For the first nine months of 2004, net revenues were \$21.2 million compared with \$40.2 million for the first nine months of 2003.

- Descap reported net revenue of \$6.1 million for the third quarter of 2004 and an operating margin, including acquisition related costs, of 35 percent. Since closing the transaction on May 14, 2004, Descap has reported net revenue of \$8.5 million and an operating margin, including acquisition related costs, of 29 percent.

Parent & Affiliates

- The Company has executed a letter of intent for the sale of the investment advisory business of FA Asset Management, other than its convertible arbitrage based business, and anticipates the transaction will close by the end of the year.

Investment losses for the quarter ended September 30, 2004 were \$3.7 million, net of tax, due to a decrease in the fair market value of the investment portfolio held by First Albany Companies.

Three-Month Period Ended September 30, 2004

Commissions

Commission revenue represents revenues generated by the Company in executing customers' orders to buy or sell listed securities and securities in which it does not make a market. Commission revenue was generated from the following business segments:

| <i>(In thousands of dollars)</i> | Three Months Ended | |
|-------------------------------------|--------------------|----------|
| | September 30 | |
| | 2004 | 2003 |
| Taxable Fixed Income | \$ 70 | \$ 43 |
| Municipal Capital Markets | 6 | 12 |
| Equity Capital Markets | 4,887 | 4,448 |
| Parent & Affiliates/Corporate-Other | - | 7 |
| Total Commissions Revenue | \$ 4,963 | \$ 4,510 |

For the three months ended September 30, 2004, Commission revenue increased 10 percent to \$5.0 million. The increase in commission revenue was due to an increase in listed commission transactions in the Equity Capital Markets segment.

Principal Transactions

Principal transactions revenue represents trading of municipal debt (tax-exempt and taxable) through its Municipal Capital Markets segment, U.S. government and federal agency obligations, corporate debt and convertible securities through its Taxable Fixed Income and Descap segments and equity securities through its Equity Capital Markets segment as a "market maker" for sale of those securities to other dealers and to customers. Most of the trading is for the purpose of generating sales credits for the institutional sales force. Principal transactions revenue was generated from the following business segments:

| <i>(In thousands of dollars)</i> | Three Months Ended | |
|--------------------------------------|--------------------|-----------|
| | September 30 | |
| | 2004 | 2003 |
| Taxable Fixed Income | \$ 6,480 | \$ 8,799 |
| Municipal Capital Markets | 2,931 | 4,343 |
| Equity Capital Markets | 5,885 | 5,861 |
| Fixed Income - Other | 3,754 | 3,729 |
| Descap Securities | 5,579 | - |
| Parent & Affiliates/Corporate-Other | (28) | 105 |
| Total Principal Transactions Revenue | \$ 24,601 | \$ 22,837 |

For the three months ended September 30, 2004 principal transaction revenue increased 7.7 percent to \$24.6 million. The increase in revenue was driven by a \$5.6 million increase in principal transaction revenue related to Descap. Principal transaction revenue in Municipal Capital Markets was down 32.5 percent compared to the same period in 2003. Declining transaction volume and price spread compression continue to negatively impact Taxable Fixed Income principal transaction revenue.

Investment Banking

Investment Banking revenue represents revenues generated by the Company managing, co-managing, and participating in corporate securities offerings through its Equity Capital Markets segment and municipal securities offerings through its Municipal Capital Markets segment. Investment Banking revenue was generated from the following business segments:

| <i>(In thousands of dollars)</i> | Three Months Ended | |
|----------------------------------|--------------------|----------|
| | September 30 | |
| | 2004 | 2003 |
| Taxable Fixed Income | \$ 6 | \$ 14 |
| Municipal Capital Markets | 3,528 | 6,018 |
| Equity Capital Markets | 8,130 | 2,596 |
| Descap Securities | 28 | - |
| Fixed Income - Other | 5 | - |
| Total Investment Banking | \$ 11,697 | \$ 8,628 |

Investment banking revenues increased \$3.1 million to \$11.7 million for the three months ended September 30, 2004. The increase was driven by a \$5.5 million increase in investment banking fees in Equity Capital Markets. During the third quarter, the Equity Capital Markets Investment Banking group booked the largest fee in the Company's history.

After a historically strong 2003, Municipal Capital Markets Investment Banking revenues were down 41.3 percent to \$3.5 million for the three months ended September 30, 2004. The decline in net revenue was driven by a reduction in underwriting transaction revenue.

Investment Gains (losses)

For the three months ended September 30, 2004, losses on the Company's investment portfolio were \$6.2 million due to a decline in fair market value of the Company's investments held by the Parent & Affiliates segment.

Compensation and Benefits

Compensation and benefits expense includes salaries, sales-related compensation and benefits.

| | Three Months Ended | |
|-------------------------------------|--------------------|-----------|
| | September 30 | |
| <i>(In thousands of dollars)</i> | 2004 | 2003 |
| Taxable Fixed Income | \$ 4,954 | \$ 6,552 |
| Municipal Capital Markets | 4,494 | 6,874 |
| Equity Capital Markets | 12,287 | 7,292 |
| Fixed Income - Other | 1,890 | 2,102 |
| Parent & Affiliates/Corporate-Other | 5,271 | 4,863 |
| Descap Securities | 3,358 | - |
| Total Compensation and Benefits | \$ 32,254 | \$ 27,683 |

For the three months ended September 30, 2004, compensation and benefits expense increased 17 percent to \$32.3 million. Compensation and benefits in Equity Capital Markets increased \$5.0 million as a result of an increase in revenues. Descap added \$3.4 million in total compensation expense during the period. Declines in net revenue in Taxable Fixed Income and Municipal Capital Markets resulted in a \$4.0 million decrease in compensation and benefits.

Impairment Loss

For the three months ended September 30, 2004, the Company reported \$1.4 million in impairment loss related to the abandonment of a corporate software development initiative.

Restructuring

For the three months ended September 30, 2004, the Company recorded \$0.8 million in restructuring charges related primarily to severance costs associated with headcount reductions in the Company's support groups.

Other

Other expense mainly includes litigation costs, professional fees, postage and printing costs and insurance costs.

Three Months Ended
September 30

Edgar Filing: FIRST ALBANY COMPANIES INC - Form 10-Q

| <i>(In thousands of dollars)</i> | 2004 | 2003 |
|-------------------------------------|----------|----------|
| Taxable Fixed Income | \$ 26 | \$ 22 |
| Municipal Capital Markets | 293 | 301 |
| Equity Capital Markets | 775 | 177 |
| Fixed Income - Other | 2 | 2 |
| Descap Securities | 63 | - |
| Parent & Affiliates/Corporate-Other | 2,430 | 1,598 |
| Total Other | \$ 3,589 | \$ 2,100 |

For the three months ended September 30, 2004, other expense increased \$1.5 million. The increase was driven by a \$1.1 million increase in expenses related to litigation and \$0.5 million in professional fees related to the Company's preparation in meeting the requirements of Section 404 of the Sarbanes-Oxley Act of 2002.

Income Tax (Benefit) Expense

For the three months ended September 30, 2004, income tax benefit was \$4.5 million, an effective tax rate of 42.7 percent, compared to \$2.2 million in income tax expense, an effective rate of 41.6 percent, for the three months ended September 30, 2003.

Nine Months Ended

September 30,

(In thousands of dollars)

2004

2003

Revenues:

Commissions

\$

16,121

\$

12,405

Principal transactions

69,864

81,421

Investment banking

31,155

21,598

Investment (losses) gains

(2,341)

| | |
|------------------|---------|
| | 14,116 |
| Interest | |
| | 6,895 |
| | 4,946 |
| Fees and other | |
| | 1,794 |
| | 3,197 |
| Total revenues | |
| | 123,488 |
| | 137,683 |
| Interest expense | |
| | 4,120 |
| | 2,430 |
| Net revenues | |
| | 119,368 |
| | 135,253 |
| | 62 |

Expenses (excluding interest):

Compensation and benefits

91,916

89,316

Clearing, settlement and brokerage costs

4,230

3,761

Communications and data processing

11,369

10,564

Occupancy and depreciation

6,982

6,766

Selling

5,671

| | |
|-------------------------------------|----------|
| | 5,018 |
| Impairment loss | |
| | 1,375 |
| | - |
| Restructuring | |
| | 750 |
| | - |
| Other | |
| | 9,743 |
| | 6,427 |
| Total expenses (excluding interest) | |
| | 132,036 |
| | 121,852 |
| Income (loss) before income taxes | |
| | (12,668) |
| | 13,401 |
| | 64 |

Income tax (benefit) expense

(8,188)

5,300

Income (loss) from continuing operations

(4,480)

8,101

Income from discontinued operations, net of taxes

(1,147)

(573)

Net (loss) income

\$

(5,627)

\$

7,528

Net interest income:

Interest income

\$

6,895

\$

65

| | |
|---------------------|-------|
| | 4,946 |
| Interest expense | |
| | 4,120 |
| | 2,430 |
| Net interest income | |
| | \$ |
| | 2,775 |
| | \$ |
| | 2,516 |

Nine-Month Period Ended September 30, 2004Commissions

Commission revenue represents revenues generated by the Company in executing customers' orders to buy or sell listed securities and securities in which it does not make a market. Commission revenue was generated from the following business segments:

| <i>(In thousands of dollars)</i> | Nine Months Ended September 30 | |
|-------------------------------------|-----------------------------------|-----------|
| | 2004 | 2003 |
| Taxable Fixed Income | \$ 179 | \$ 80 |
| Municipal Capital Markets | 20 | 38 |
| Equity Capital Markets | 15,920 | 12,265 |
| Fixed Income - Other | - | - |
| Parent & Affiliates/Corporate-Other | 2 | 22 |
| Total Commissions Revenue | \$ 16,121 | \$ 12,405 |

For the nine months ended September 30, 2004, Commission revenue increased 30 percent to \$16.1 million. The increase in commission revenue was due to an increase in listed commission transactions in the Equity Capital Markets segment.

Principal Transactions

Principal transactions revenue represents trading of municipal debt (tax-exempt and taxable) through its Municipal Capital Markets segment, U.S. government and federal agency obligations, corporate debt and convertible securities through its Taxable Fixed Income and Descap Securities segments and equity securities through its Equity Capital Markets segment as a "market maker" for sale of those securities to other dealers and to customers. Most of the trading is for the purpose of generating sales credits for the institutional sales force. Principal transactions revenue was generated from the following business segments:

| <i>(In thousands of dollars)</i> | Nine Months Ended September 30 | |
|----------------------------------|-----------------------------------|-----------|
| | 2004 | 2003 |
| Taxable Fixed Income | \$ 20,268 | \$ 39,316 |
| Municipal Capital Markets | 9,406 | 11,639 |
| Equity Capital Markets | 23,775 | 17,636 |
| Fixed Income - Other | 8,400 | 12,664 |

Edgar Filing: FIRST ALBANY COMPANIES INC - Form 10-Q

| | | |
|--------------------------------------|-----------|-----------|
| Descap Securities | 8,037 | - |
| Parent & Affiliates/Corporate-Other | (22) | 166 |
| Total Principal Transactions Revenue | \$ 69,864 | \$ 81,421 |

For the nine months ended September 30, 2004, principal transaction revenue declined \$11.6 million or 14.2 percent primarily as a result of a \$19.0 million decline in Taxable Fixed Income. The decline in Taxable Fixed Income was driven by a decline in institutional investor activity and spread compression in the secondary corporate bond market. Principal transaction revenue in Fixed Income Other was down 34 percent as a result of declining customer volumes and a more challenging trading environment. The Company's increased focus on NASDAQ trading coupled with a stronger NASDAQ trading environment in 2004 resulted in a 35 percent or \$6.1 million increase in principal transaction revenue in its Equity Capital Markets segment.

Investment Banking

Investment Banking revenue represents revenues generated by the Company managing, co-managing, and participating in corporate securities offerings through its Equity Capital Markets segment and municipal securities offerings through its Municipal Capital Markets segment. Investment Banking revenue was generated from the following business segments:

| <i>(In thousands of dollars)</i> | Nine Months Ended September | |
|-------------------------------------|-----------------------------|-----------|
| | 30 | |
| | 2004 | 2003 |
| Taxable Fixed Income | \$ 538 | \$ 234 |
| Municipal Capital Markets | 13,037 | 16,931 |
| Equity Capital Markets | 17,457 | 4,529 |
| Fixed Income - Other | 95 | (96) |
| Descap Securities | 28 | - |
| Parent & Affiliates/Corporate-Other | - | - |
| Total Investment Banking | \$ 31,155 | \$ 21,598 |

Investment banking revenues increased \$9.6 million or 44 percent for the nine months ended September 30, 2004.

Investment banking fees in the Equity Capital Markets group increased \$12.9 million as investments in key personnel over the past twelve months resulted in an increase in transaction activity in both public offering business and advisory assignments. Also for the nine months ended September 30, 2004, the Equity Capital Markets Group booked the largest fee in the Company's history. Compared to a historically strong 2003, Municipal Capital Markets investment banking revenue for the nine months ended September 30, 2004 was down \$3.9 million or 23 percent, due primarily to a decline in underwriting transaction revenue.

Investment Gains (losses)

Investment losses for the nine months ended September 30, 2004 total \$2.3 million compared with an investment gain of \$14.1 million in the same period in 2003. The investment losses for the quarter were the result of a decline in the fair market value of the Company's investment portfolio.

Fees and Other

A majority of the fees the Company earns in this category relates to the activity of FA Technology Ventures Corporation (managing private equity funds, and providing venture financing to emerging growth companies) and the institutional convertible bond arbitrage advisory group, both of which are included in the Parent and Affiliates segment.

| <i>(In thousands of dollars)</i> | Nine Months Ended September | |
|----------------------------------|-----------------------------|--------|
| | 30 | |
| | 2004 | 2003 |
| Taxable Fixed Income | \$ - | \$ 115 |
| Municipal Capital Markets | 77 | 77 |
| Equity Capital Markets | 165 | 296 |

Edgar Filing: FIRST ALBANY COMPANIES INC - Form 10-Q

| | | |
|-------------------------------------|----------|----------|
| Parent & Affiliates/Corporate-Other | 1,552 | 2,709 |
| Total Fees and Other | \$ 1,794 | \$ 3,197 |

For the nine months ended September 30, 2004, Fees and other revenue declined \$1.4 million or 44 percent. Incentive fees in the convertible arbitrage group were down \$1.1 million as a result of investment performance below the group's investment benchmark.

Compensation and Benefits

Compensation and benefits expense includes salaries, sales-related compensation and benefits.

| | Nine Months Ended September 30 | |
|-------------------------------------|-----------------------------------|-----------|
| <i>(In thousands of dollars)</i> | 2004 | 2003 |
| Taxable Fixed Income | \$ 15,622 | \$ 29,123 |
| Municipal Capital Markets | 16,137 | 18,916 |
| Equity Capital Markets | 34,776 | 19,943 |
| Fixed Income - Other | 4,096 | 5,955 |
| Parent & Affiliates/Corporate-Other | 16,268 | 15,379 |
| Descap Securities | 5,017 | - |
| Total Compensation and Benefits | \$ 91,916 | \$ 89,316 |

For the nine months ended September 30, 2004, compensation and benefits expense increased 2.9 percent to \$91.9 million. Compensation and benefits expense in Equity Capital Markets was up \$14.8 million on higher net revenue. Taxable Fixed Income compensation and benefits was down \$13.5 million as a result of a decrease in principal transaction revenue. Compensation in Fixed Income-Other decreased \$1.9 million or 31 percent as a result of a decline in net revenue.

Impairment Loss

For the nine months ended September 30, 2004, the Company reported \$1.4 million in impairment loss related to the abandonment of a corporate software development initiative.

Restructuring

For the nine months ended September 30, 2004, the Company recorded \$0.8 million in restructuring charges related primarily to severance costs associated with headcount reductions in the Company's support groups.

Other

Other expense mainly includes litigation costs, professional fees, postage and printing costs and insurance costs.

| | Nine Months Ended September 30 | |
|----------------------------------|-----------------------------------|-------|
| <i>(In thousands of dollars)</i> | 2004 | 2003 |
| Taxable Fixed Income | \$ 94 | \$ 67 |

Edgar Filing: FIRST ALBANY COMPANIES INC - Form 10-Q

| | | | |
|-------------------------------------|----------|----|-------|
| Municipal Capital Markets | 2,386 | | 1,227 |
| Equity Capital Markets | 1,747 | | 640 |
| Fixed Income - Other | 9 | | 5 |
| Parent & Affiliates/Corporate-Other | 5,425 | | 4,488 |
| Descap Securities | 82 | | - |
| Total Other | \$ 9,743 | \$ | 6,427 |

Other expense increased \$3.3 million for the nine months ended September 30, 2004 due to a \$2.6 million increase in expenses related to a previously-disclosed customer dispute (Municipal Capital Markets segment) and employment arbitration awards (Equity Capital Markets segment) and \$0.8 million in expenses related to other litigation.

Income Tax (Benefit) Expense

Income tax benefit was \$8.2 million, an effective tax rate of 64.6 percent for the nine months ended September 30, 2004 compared to \$5.3 million in income tax expense, an effective rate of 39.6 percent, for the same period in 2003.

Increase in the effective tax rate was primarily driven by the difference in accounting versus tax treatment of the Plug Power stock distribution (see Investments footnote in the Notes to Condensed Consolidated Financial Statements).

Liquidity and Capital Resource

A substantial portion of the Company's assets, similar to other brokerage and investment banking firms, are liquid, consisting of cash and assets readily convertible into cash. These assets are financed primarily by the Company's payables to brokers, dealers and clearing agencies, bank lines of credit and customer payables. The level of assets and liabilities will fluctuate as a result of the changes in the level of positions held to facilitate customer transactions and changes in market conditions.

As of September 30, 2004, First Albany Capital Inc. and Descap Securities, Inc., both registered broker-dealer subsidiaries of First Albany Companies Inc., were in compliance with the net capital requirements of the Securities and Exchange Commission. The net capital rules restrict the amount of a broker-dealer's net assets that may be distributed. Also, a significant operating loss or extraordinary charge against net capital may adversely affect the ability of the Company's broker-dealer subsidiaries to expand or even maintain their present levels of business and the ability to support the obligations or requirements of the Company. As of September 30, 2004, First Albany Capital Inc. had net capital of \$10.4 million, which exceeded minimum net capital requirements by \$9.4 million, while Descap Securities, Inc. had net capital of \$6.2 million, which exceeded minimum net capital requirements by \$6.1 million.

As of September 30, 2004, the Company had a commitment through July 2006 to invest up to \$11.5 million in FA Technology Ventures, LP (the Partnership). The Company intends to fund this commitment from the sale of other investments and operating cash flow. The Partnership's primary purpose is to provide investment returns consistent with risks of investing in venture capital. In addition to the Company, certain other limited partners of the Partnership are officers or directors of the Company. The majority of the commitments to the Partnership are from non-affiliates of the Company.

The General Partner for the Partnership is FATV GP LLC. The General Partner is responsible for the management of the Partnership, including among other things, making investments for the Partnership. The members of the General Partnership are George McNamee, Chairman of the Company, First Albany Enterprise Funding, Inc., a wholly owned subsidiary of the Company, and other employees and former employees of the Company or its subsidiaries. Mr. McNamee is required under the Partnership agreement to devote a majority of his business time to the conduct of the affairs of the Partnership and any parallel funds. Subject to the terms of the Partnership agreement, under certain conditions, the General Partnership is entitled to share in the gains received by the Partnership in respect of its investment in a portfolio company. The General Partner will receive a carried interest on customary terms. The General Partner has contracted with FA Technology Ventures Corporation, a wholly owned subsidiary of the Company, to act as investment advisor to the General Partner.

As of September 30, 2004, the Company had an additional commitment through July 2006 to invest up to \$8.7 million in funds that invest in parallel with the Partnership, which it intends to fund, at least in part, through current and future Employee Investment Funds (EIF). EIF are limited liability companies, established by the Company for the purpose of allowing select employees to invest their own funds in private equity placements.

The Company has deferred tax assets of \$15.4 million and deferred tax liabilities of \$4.8 million as of September 30, 2004. The Company expects that it will realize the benefit of the deferred tax assets as a result of future taxable income. The net deferred tax asset of \$10.6 million is recorded in Other Assets on the Statement of Financial Condition. At December 31, 2003 the Company had a net deferred tax liability of \$1.8 million.

The Company enters into underwriting commitments to purchase securities as part of its investment banking business and may also purchase and sell securities on a when-issued basis. As of September 30, 2004, the Company had \$3.3 million outstanding underwriting commitments and had purchased no securities on a when-issued basis.

On May 14, 2004, the Company acquired 100 percent of the outstanding common shares of Descap Securities, Inc., a New York-based broker-dealer and investment bank. The value of the transaction was approximately \$31 million, which consisted of \$25 million in cash and 549,476 shares of the Company's common stock, plus future consideration based on financial performance (see Acquisition footnote in the Notes to Condensed Consolidated Financial Statements). The shares of the Company's stock issued to the sellers of Descap Securities, Inc. provide the sellers the right to require the Company to purchase back these shares at a price of \$6.14 per share. The Company also has the right to purchase back these shares from the sellers at a price of \$14.46. Both the put and call rights expires on May 31, 2007.

The Company's notes payable include Senior Notes for \$10 million which contain various covenants, as defined in the agreements, including restrictions on the incurrence of debt, the maintenance of not less than \$50 million of net worth (at September 30, 2004, the Company's net worth was \$81.8 million) and an adjusted cash flow coverage rate for First Albany Capital Inc. (a wholly owned subsidiary) of not less than 1.2 to 1 as at the end of each fiscal quarter based on the most recently concluded period of four consecutive quarters (as of the end of the September 2004 quarter, the Company's adjusted cash flow coverage rate was 19.7 to 1). As of September 30, 2004, the Company was in compliance with these covenants.

The Company's notes payable also include a \$20 million Term Loan to finance the acquisition of Descap Securities, Inc. which contains various covenants, as defined in the agreement. As of September 30, 2004, the Company was not in compliance with certain covenants contained in the Term Loan. The Company had forty-five days under the Term Loan Agreement to comply with the covenants or it would be considered in default. On November 2, 2004, the Company and the bank amended selected covenants in the Term Loan Agreement retroactively to July 1, 2004 and as such is in compliance with the covenant requirements. The covenants require the maintenance of not less than \$22.5 million of earnings before interest, taxes, depreciation, amortization and lease expense plus pro forma adjustments related to Descap, Scheduled Adjustment Expenditures and Scheduled Adjustment Earnings (as defined in the modified term loan agreement and referred to as EBITDAR) (for the twelve month period ending September 30, 2004, the Company's EBITDAR was \$24.5 million), operating cash flow to total fixed charge ratio (as defined) of not less than 1.15 to 1 (for the twelve month period ending September 30, 2004, the operating cash flow to total fixed charge ratio was 1.17 to 1) and modified total funded debt to EBITDAR ratio of less than 1.75 to 1 (for the twelve month period ending September 30, 2004, modified total funded debt to EBITDAR ratio was 1.48 to 1).

Management believes that funds provided by operations and a variety of bank lines of credit totaling at least \$300 million, of which approximately \$134 million were unused as of September 30, 2004, will provide sufficient resources to meet present and reasonably foreseeable short-term and long-term financial needs. These bank lines of credit consist of credit lines that the Company has been advised are available but for which no contractual lending obligations exist and are repayable on demand. These bank lines of credit are limited to financing securities eligible for collateralization, which includes Company owned securities.

CONTRACTUAL OBLIGATIONS

First Albany Companies Inc. has contractual obligations to make future payments in connection with our short-term debt, long-term debt, capital leases, and operating leases. See Notes to Consolidated Financial Statements for additional disclosures related to our commitments.

The following table sets forth these contractual obligations by fiscal year:

| <i>(In thousands of dollars)</i> | 2004 | 2005 | 2006 | 2007 | 2008 | Thereafter | Total |
|----------------------------------|-------------|-------------|-------------|-------------|-------------|-------------------|--------------|
| Short-term bank loans | \$ 165,645 | \$ - | \$ - | \$ - | \$ - | \$ - | 165,645 |
| Long term debt (1) | 1,234 | 6,615 | 7,128 | 6,121 | 5,951 | 12,861 | 39,910 |
| Capital lease obligations | 525 | 873 | 592 | 307 | 134 | 4 | 2,435 |
| Operating leases (2) | 1,583 | 6,114 | 5,600 | 5,658 | 5,094 | 13,161 | 37,210 |
| Subordinated debt (3) | - | - | 1,328 | 1,442 | 93 | 832 | 3,695 |
| Total | \$ 168,987 | \$ 13,602 | \$ 14,648 | \$ 13,528 | \$ 11,272 | \$ 26,858 | \$ 248,895 |

(1)

The Company has several notes payable which have principal and interest payments associated with each. For notes payable with variable interest rates, current interest rates were used for the calculation of interest payment for future periods. See Notes to the Consolidated Financial Statements.

(2)

The Company's headquarters and sales offices, and certain office and communication equipment, are leased under non-cancelable operating leases, certain of which contain escalation clauses and which expire at various times through 2015.

(3)

A select group of management and highly compensated employees are eligible to participate in the First Albany Companies Inc. Deferred Compensation Plan for Key Employees (the Plan). The employees enter into subordinate loans with the Company to provide for the deferral of compensation and employer allocations under the Plan. The accounts of the participants of the Plan are credited with earnings and/or losses based on the performance of various investment benchmarks selected by the participants. Maturities of the subordinated debt are based on the distribution election made by each participant, which may be deferred to a later date by the participant.

FIRST ALBANY COMPANIES INC.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Item 3. Quantitative and Qualitative Disclosures about Market Risk**MARKET RISK**

Market risk generally represents the risk of loss that may result from the potential change in the value of a financial instrument as a result of fluctuations in interest rates and equity prices, changes in the implied volatility of interest rates and equity prices and also changes in the credit ratings of either the issuer or its related country of origin.

Market risk is inherent to both derivative and non-derivative financial instruments, and accordingly, the scope of the Company's market risk management procedures extends beyond derivatives to include all market-risk-sensitive financial instruments. The Company's exposure to market risk is directly related to its role as a financial intermediary in customer-related transactions and to its proprietary trading.

The Company trades tax exempt and taxable debt obligations, including U.S. Treasury bills, notes, and bonds; U.S. Government agency notes and bonds; bank certificates of deposit; mortgage-backed securities, and corporate obligations. The Company is also an active market maker in the NASDAQ equity markets. In connection with these activities, the Company may be required to maintain inventories in order to ensure availability and to facilitate customer transactions. In connection with some of these activities, the Company attempts to mitigate its exposure to such market risk by entering into hedging transactions, which may include highly liquid future contracts, options and U.S. Government securities.

The following table categorizes the Company's market risk sensitive financial instruments by type of security and maturity date. The amounts shown are net of long and short positions:

| <i>(In thousands of dollars)</i> | 2004 | 2005 | 2006 | 2007 | 2008 | Thereafter | Total |
|----------------------------------|-------------|-------------|-------------|-------------|-------------|-------------------|--------------|
| Fair value of securities | | | | | | | |
| Corporate bonds | \$ 15 | \$ 1,447 | \$ 16,880 | \$ 2,197 | \$ 612 | \$ 62,178 | \$ 83,329 |
| State and municipal bonds | 289 | 4,762 | 3,091 | 18,289 | 2,975 | 119,119 | 148,525 |
| US Government obligations | 28 | 484 | (1,540) | (11,453) | (289) | (11,913) | (24,683) |

Edgar Filing: FIRST ALBANY COMPANIES INC - Form 10-Q

| | | | | | | | |
|--------------------------|--------|----------|-----------|----------|----------|------------|------------|
| Subtotal | 332 | 6,693 | 18,431 | 9,033 | 3,298 | 169,384 | 207,171 |
| Equity securities | - | - | - | - | - | (4,526) | (4,526) |
| Fair value of securities | \$ 332 | \$ 6,693 | \$ 18,431 | \$ 9,033 | \$ 3,298 | \$ 164,858 | \$ 202,645 |

Following is a discussion of the Company's primary market risk exposures as of September 30, 2004, including a discussion of how those exposures are currently managed.

Interest Rate Risk

Interest rate risk is a consequence of maintaining inventory positions and trading in interest-rate-sensitive financial instruments. In connection with trading activities, the Company exposes itself to interest rate risk, arising from changes in the level or volatility of interest rates or the shape and slope of the yield curve. The Company's fixed income activities also expose it to the risk of loss related to changes in credit spreads. The Company attempts to hedge its exposure to interest rate risk primarily through the use of U.S. Government securities, highly liquid futures and options designed to reduce the Company's risk profile.

A sensitivity analysis has been prepared to estimate the Company's exposure to interest rate risk of its net inventory positions. The fair market value of these securities included in the Company's inventory at September 30, 2004 was \$177.5 million and \$147.2 million at December 31, 2003 (net of municipal futures positions). Interest rate risk is estimated as the potential loss in fair value resulting from a hypothetical one-half percent change in interest rates. At September 30, 2004, the potential change in fair value using a yield to maturity calculation and assuming this hypothetical change, was \$3.9 million and at year-end 2003 was \$4.5 million. The actual risks and results of such adverse effects may differ substantially.

Equity Price Risk

The Company is exposed to equity price risk as a consequence of making markets in equity securities. Equity price risk results from changes in the level or volatility of equity prices, which affect the value of equity securities or instruments that derive their value from a particular stock. The Company attempts to reduce the risk of loss inherent in its inventory of equity securities by monitoring those security positions constantly throughout each day.

Marketable equity securities included in the Company's inventory were recorded at a fair value of \$4.5 million in securities sold but not yet purchased at September 30, 2004 and \$7.6 million in securities owned at December 31, 2003, have exposure to equity price risk. This risk is estimated as the potential loss in fair value resulting from a hypothetical 10% adverse change in prices quoted by stock exchanges and amounts to \$0.5 million at September 30, 2004 and \$0.8 million at year-end 2003.

The Company's investment portfolio excluding the consolidation of Employee Investment Fund (see Investments footnote in the Notes to Condensed Consolidated Financial Statements) at September 30, 2004 and December 31, 2003, had a fair market value of \$34.2 million and \$53.0 million, respectively. This equity price risk is also estimated as the potential loss in fair value resulting from a hypothetical 10% adverse change in prices quoted by stock exchanges and amounts to \$3.4 million at September 30, 2004 and \$5.3 million at year-end 2003. The actual risks and results of such adverse effects may differ substantially.

CREDIT RISK

The Company is engaged in various trading and brokerage activities whose counter parties primarily include broker-dealers, banks, and other financial institutions. In the event counter parties do not fulfill their obligations, the Company may be exposed to risk. The risk of default depends on the credit worthiness of the counter party or issuer of the instrument. The Company seeks to control credit risk by following an established credit approval process, monitoring credit limits, and requiring collateral where it deems appropriate.

The Company purchases debt securities and may have significant positions in its inventory subject to market and credit risk. In order to control these risks, security positions are monitored on at least a daily basis. Should the Company find it necessary to sell such a security, it may not be able to realize the full carrying value of the security due to the size of the position sold. The Company attempts to reduce its exposure to changes in municipal securities valuation with the use as hedges of highly liquid municipal bond index futures contracts.

OPERATING RISK

Operating risk is the potential for loss arising from limitations in the Company's financial systems and controls, deficiencies in legal documentation and the execution of legal and fiduciary responsibilities, deficiencies in technology and the risk of loss attributable to operational problems. These risks are less direct than credit and market risk, but managing them is critical, particularly in a rapidly changing environment with increasing transaction volumes. In order to reduce or mitigate these risks, the Company has established and maintains an internal control environment that incorporates various control mechanisms at different levels throughout the organization and within such departments as Finance and Accounting, Operations, Legal, Compliance and Internal Audit. These control mechanisms attempt to ensure that operational policies and procedures are being followed and that the Company's various businesses are operating within established corporate policies and limits.

OTHER RISKS

Other risks encountered by the Company include political, regulatory and tax risks. These risks reflect the potential impact that changes in local laws, regulatory requirements or tax statutes have on the economics and viability of current or future transactions. In an effort to mitigate these risks, the Company seeks to review new and pending regulations and legislation and their potential impact on its business.

FIRST ALBANY COMPANIES INC.

CONTROLS AND PROCEDURES

Item 4. Controls and Procedures

Disclosure Controls

As of the end of the period covered by this Form 10-Q, the Company's management, including the Chief Executive Officer and the Principal Financial Officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on that evaluation, the Company's management, including the Chief Executive Officer and the Principal Financial Officer, concluded that the Company's disclosure controls and procedures were effective in timely alerting management, including the Chief Executive Officer and the Principal Financial Officer, of material information about the Company required to be included in periodic Securities and Exchange Commission filings. However, in evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. There have been no significant changes in the Company's internal controls or in other factors that could significantly affect its internal controls subsequent to the date of the evaluation.

Sarbanes-Oxley Section 404

Section 404 of the Sarbanes-Oxley Act of 2002 (the Act) will require the Company to include an internal control report from management in its Annual Report on Form 10-K for the year ended December 31, 2004 and in subsequent Annual Reports thereafter. The internal control report must include the following: (1) a statement of management's responsibility for establishing and maintaining adequate internal control over financial reporting, (2) a statement identifying the framework used by management to conduct the required evaluation of the effectiveness of the Company's internal control over financial reporting, (3) management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2004, including a statement as to whether or not internal control over financial reporting is effective, and (4) a statement that the Company's independent auditors have issued an attestation report on management's assessment of internal control over financial reporting.

Management acknowledges its responsibility for establishing and maintaining internal controls over financial reporting and seeks to continually improve those controls. In addition, in order to achieve compliance with Section 404 of the Act within the required timeframe, the Company has been conducting a process to document and evaluate its internal controls over financial reporting. The Company has dedicated internal resources, engaged outside consultants and adopted a work plan to: (i) assess and document the adequacy of internal control over financial reporting; (ii) take steps to improve control processes where required; (iii) validate through testing that controls are functioning as documented; and (iv) implement a continuous reporting and improvement process for internal control over financial reporting.

Given the risks inherent in the design and operation of internal controls over financial reporting, the Company can provide no assurance as to its, or its independent auditor's conclusions at December 31, 2004 with respect to the effectiveness of its internal controls over financial reporting. If the Company fails to have an effectively designed and operating system of internal control, it will be unable to comply with the requirements of SEC 404 in a timely manner. If the Company does not effectively complete its assessment or if its internal controls are not designed or operating effectively, its external auditors may either disclaim an opinion as it relates to management's assessment of the effectiveness of its internal control or may issue a qualified opinion on the effectiveness of the Company's internal controls.

It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the control system are met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events. Because of these and other inherent limitations of control systems, there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

Part II-Other Information

Item 1. Legal Proceedings

In 1998 the Company was named in lawsuits by Lawrence Group, Inc. and certain related entities (the "Lawrence Parties") in connection with a private sale of Mechanical Technology Incorporated stock from the Lawrence Parties that was previously approved by the United States Bankruptcy Court for the Northern District of New York (the "Bankruptcy Court"). The Company acted as placement agent in that sale, and a number of employees and officers of the Company, who have also been named as defendants, purchased shares in the sale. The complaints alleged that the defendants did not disclose certain information to the sellers and that the price approved by the court was therefore not proper. The cases were initially filed in the Bankruptcy Court and the United States District Court for the Northern District of New York (the "District Court"), and were subsequently consolidated in the District Court. The District Court dismissed the cases, and that decision was subsequently vacated by the United States Court of Appeals for the Second Circuit, which remanded the cases for consideration of the plaintiffs' claims as motions to modify the Bankruptcy Court sale order. The plaintiffs' claims have now been referred back to the Bankruptcy Court for such consideration. The Company believes that it has strong defenses to and intends to vigorously defend itself against the plaintiffs' claims, and believes that the claims lack merit.

In the normal course of business, the Company has been named a defendant, or otherwise has possible exposure, in several claims. Certain of these are class actions, which seek unspecified damages, which could be substantial.

Although there can be no assurance as to the eventual outcome of litigation in which the Company has been named as a defendant or otherwise has possible exposure, the Company has provided for those actions most likely of adverse dispositions. Although further losses are possible, the opinion of management, based upon the advice of its attorneys and General Counsel, is that such litigation will not, in the aggregate, have a material adverse effect on the Company's liquidity or financial position, although it could have a material effect on quarterly or annual operating results in the period in which it is resolved.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

| Item |
|---|
| <u>Number</u> <u>Item</u> |
| 10.16 Stock Purchase Agreement and among Shareholders Descap Securities, Inc. and First Albany Companies dated February 18, 2004 (filed as Exhibit 10.16 to Form 10-Q for quarter ended March 31, 2004) |
| 10.17 Loan Agreement dated February 18, 2004 between First Albany Companies and KeyBank National Association (filed as Exhibit 10.17 to Form 10-Q for quarter ended March 31, 2004) |
| 10.18 Stock Purchase Agreement and among Albany Companies and certain purchasers |

private
placement,
dated Febru
29, 2004 (fi
as Exhibit 1
to Form 10-
for quarter
ended Marc
31, 2004)

10.19 Employment
Agreement
Robert Fine
executive
officer of th
Company, o
May 14, 20
(filed herew

10.20 Form of
Restricted S
Agreement
pursuant to
First Alban
Companies
1999
Long-Term
Incentive P
(cliff vestin
(filed herew

10.21 Form of
Restricted S
Agreement
pursuant to
First Alban
Companies
1999
Long-Term
Incentive P
(three-year
vesting) (fil
herewith)

10.22 First
Amendmen
Loan

Agreement
dated May
2004 between
First Alban
Companies
and Key Ba
National
Association
(filed herev

10.23 Second
Amendmen
Loan
Agreement
dated Nove
2, 2004 bet
First Alban
Companies
and Key Ba
National
Association
(filed herev

(31) Certificatio
CEO and C
pursuant to
Section 302
the
Sarbanes-O
Act

(32) Certificatio
CEO and C
pursuant to
Section 906
the
Sarbanes-O
Act

(b) Reports on Form 8-K

The following reports on Form 8-K were filed during the quarter ended June 30, 2004:

1. Form 8-K filed June 1, 2004, announcing the acquisition of the assets of Descap Securities, Inc.

Edgar Filing: FIRST ALBANY COMPANIES INC - Form 10-Q

2. Form 8-K filed April 26, 2004, announcing First Albany Companies Inc. s financial results for the first quarter ending March 31, 2004.

3. Form 8-K filed April 22, 2004 announcing the record and distribution dates for the special dividend of its holdings in Plug Power Inc.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

First Albany Companies Inc.

(Registrant)

Date: 11/08/04

/S/ALAN P. GOLDBERG

Alan P. Goldberg

Chief Executive Officer

Date: 11/08/04

/S/STEVEN R. JENKINS

Steven R. Jenkins

Chief Financial Officer

(Principal Accounting Officer)