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	(I.R.S. Employer
incorporation or organization)	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

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FIRST ALBANY COMPANIES INC. AND SUBSIDIARIES

FORM 10-Q

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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
Liabilities and Stockholders Equity				
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

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 September 30,		Nine Months Ended September 30,	
(In thousands of dollars except for per share amounts and shares outstanding)	2004	2003	2004	2003
Revenues:				
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
Expenses (excluding interest):				
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)

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 Stock Shares	Common 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)	-	-

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

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FIRST ALBANY COMPANIES INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands of dollars)	September 30, 2004	September 30, 2003
Cash flows from operating activities:		
Net income (loss)	$ (5,627)	$ 7,528
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:		
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
(Increase) decrease in operating assets:		
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
Increase (decrease) in operating liabilities:		
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)
Cash flows from investing activities:		
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)

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 September 30,		Nine Months Ended 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:

(In thousands of dollars)	September 30, 2004	December 31, 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:

(In thousands of dollars)		September 30, 2004		December 31, 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*

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

	September 30, 2004		December 31, 2003	
(In thousands of dollars)	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.

	September 30,	December 31,
(In thousands of dollars)	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,

	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

(In thousands of dollars)	September 30, 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:

(In thousands of dollars)		September 30, 2004		December 31, 2003
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.

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:

	Nine Months Ended			
	September 30, 2004		September 30, 2003	
(In thousands of dollar except for per share amounts)				
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 September 30,		Nine Months Ended September 30,	
(In thousands of dollars)	2004	2003	2004	2003
Net revenues (including net interest income)				
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
Net interest income (included in total net revenues)				
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

Parent and Affiliates	(403)	(407)	(1,258)	(897)
Total net interest income	$ 1,163	$ 786	$ 2,775	$ 2,516
Income (loss) before income taxes:				
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