

FIRST ALBANY COMPANIES INC  
Form 10-Q  
May 10, 2006

**UNITED STATES**  
**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 March 31, 2006

- 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 014140

**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.)

**677 Broadway, Albany, New York**

**12207**

(Address of principal executive offices)

(Zip Code)

**Registrant's telephone number, including area code**

**(518) 447-8500**

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 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  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

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

16,445,844 shares of Common Stock were outstanding as of the close of business on April 28, 2006

**FIRST ALBANY COMPANIES INC. AND SUBSIDIARIES**

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**FIRST ALBANY COMPANIES INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**

**(Unaudited)**

**Item 1. Financial Statements**

<i>(In thousands of dollars)</i>	March 31	December 31
As of	2006	2005
Assets		
Cash	\$ 1,924	\$ 1,926
Cash and securities segregated for regulatory purposes	5,100	7,100
Securities purchased under agreement to resell	26,037	27,824
Receivables from:		
Brokers, dealers and clearing agencies	40,303	36,221
Customers	5,565	5,346
Others	7,092	7,015
Securities owned	265,997	265,794
Investments	43,563	52,497
Office equipment and leasehold improvements, net	12,136	10,304
Intangible assets	25,952	25,990

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Other assets		4,506		3,524
Total assets	\$	438,175	\$	443,541
<i>Liabilities and Stockholders Equity</i>				
<i>Liabilities</i>				
Short-term bank loans	\$	180,740	\$	150,075
<i>Payables to:</i>				
Brokers, dealers and clearing agencies		7,006		50,595
Customers		8,793		3,263
Others		8,905		14,099
Securities sold, but not yet purchased		82,145		52,445
Accounts payable		4,142		6,696
Accrued compensation		16,737		25,414
Accrued expenses		9,321		8,960
Notes payable		28,726		30,027
Obligations under capitalized leases		5,265		5,564
Total liabilities		351,780		347,138
<i>Commitments and Contingencies</i>				
Temporary capital		3,374		3,374
Subordinated debt		5,711		5,307
<i>Stockholders Equity</i>				
Preferred stock; \$1.00 par value; authorized 500,000 shares; none issued				
Common stock; \$.01 par value; authorized 50,000,000 shares; issued 17,165,792 and 17,129,649 respectively		172		171
Additional paid-in capital		146,468		158,470
Unearned compensation		-		(13,882)
Deferred compensation		3,662		3,448
Retained (deficit)		(68,842)		(56,624)
Treasury stock, at cost		(4,150)		(3,861)
Total Stockholders Equity		77,310		87,722
Total Liabilities and Stockholders Equity	\$	438,175	\$	443,541

The accompanying notes are an integral part  
of these consolidated financial statements.

**FIRST ALBANY COMPANIES INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(Unaudited)**

	Three Months Ended March 31	
<i>(In thousands of dollars except for per share amounts and shares outstanding)</i>	2006	2005
<i>Revenues:</i>		
Commissions	\$ 3,598	\$ 4,587
Principal transactions	19,770	17,625
Investment banking	11,513	8,462
Investment gains (losses)	(6,143)	(3,798)
Interest	3,100	3,385
Fees and other	619	736
Total revenues	32,457	30,997
Interest expense	4,305	2,385
Net revenues	28,152	28,612
<i>Expenses (excluding interest):</i>		
Compensation and benefits	29,036	28,945
Clearing, settlement and brokerage costs	1,748	1,734
Communications and data processing	3,348	3,659
Occupancy and depreciation	3,100	2,732
Selling	1,539	1,733
Other	1,861	1,654
Total expenses (excluding interest)	40,632	40,457
Income (loss) before income taxes	(12,480)	(11,845)
Income tax (benefit) expense	-	(5,106)
Income (loss) from continuing operations	(12,480)	(6,739)
Income (loss) from discontinued operations, (net of taxes \$0 in 2006, \$(113) in 2005)	(165)	(156)
Income (loss) before cumulative effect of change in accounting principles	(12,645)	(6,895)

Cumulative effect of accounting change, (net of taxes \$0 in 2006) (see Benefit Plans note)		427	-
Net loss	\$	(12,218)	\$ (6,895)
Per share data:			
Basic earnings:			
Continued operations	\$	(0.81)	\$ (0.51)
Discontinued operations		(0.01)	(0.01)
Cumulative effect of accounting change		0.03	-
Net loss	\$	(0.79)	\$ (0.52)
Diluted earnings:			
Continued operations	\$	(0.81)	\$ (0.51)
Discontinued operations		(0.01)	(0.01)
Cumulative effect of accounting change		0.03	-
Net loss	\$	(0.79)	\$ (0.52)
Weighted average common and common equivalent shares outstanding:			
Basic		15,377,662	13,256,692
Dilutive		15,377,662	13,256,692

The accompanying notes are an integral part  
of these consolidated financial statements.

FIRST ALBANY COMPANIES INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

		Three Months Ended	
		2006	2005
<i>Cash flows from operating activities:</i>			
Net loss	\$	(12,218)	\$ (6,895)



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*Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:*

Depreciation and amortization	710	745
Amortization of warrants	498	50
Deferred compensation	214	91
Deferred income taxes	-	(4,734)
Unrealized investment (gains)/loss	7,959	4,646
Realized (gains) losses on sale of investments	(1,816)	(848)
(Gain) loss on sale of fixed assets	81	4
Services provided in exchange for common stock	1,537	2,225

*Changes in operating assets and liabilities:*

Cash and securities segregated for regulatory purposes	2,000	(7,300)
Securities purchased under agreement to resell	1,787	7,648
Net receivables from brokers, dealers and clearing agencies	(47,671)	30,191
Securities owned, net	29,497	(15,130)
Other assets	(982)	(931)
Net payable to customers	5,311	(9,955)
Net payables to others	(1,639)	6,263
Accounts payable and accrued expenses	(10,860)	(29,396)
Net cash provided by (used in) operating activities	(25,592)	(23,326)

*Cash flows from investing activities:*

Purchases of office equipment and leasehold improvements	(2,190)	(153)
Purchase of Noddings	-	(125)
Purchases of investments	(928)	(36)
Proceeds from sale of investments	3,368	3,233
Net cash provided by (used in) investing activities	250	2,919

*Cash flows from financing activities:*

Proceeds (payments) of short-term bank loans, net	30,665	14,075
Proceeds of notes payable	9,023	306
Payments of notes payable	(10,822)	(3,218)
Payments of obligations under capitalized leases	(459)	(327)
Proceeds from obligations under capitalized leases	-	305
Proceeds on subordinated debt	159	1,612
Proceeds from issuance of common stock under stock option plans	55	184
Payments for purchases of treasury stock	-	(140)
Net (decrease) increase in drafts payable	(3,281)	8,264
Dividends paid	-	(833)
Net cash provided by (used in) financing activities	25,340	20,228
(Decrease) increase in cash	(2)	(179)
Cash at beginning of the period	1,926	1,285

Cash at the end of the period	\$	1,924	\$	1,106
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**Non-Cash Investing and Financing Activities**

In the first three months of 2006 and 2005, the Company entered into capital leases for office equipment and leasehold improvements for approximately \$0.2 million and \$1.4 million, respectively.

In the first three months of 2006, the Company acquired \$0.2 million in office equipment and leasehold improvements where the obligation related to this acquisition is included in accounts payable.

During the first three months of 2006, the Company converted \$0.2 million compensation to subordinated debt.

The accompanying notes are an integral part  
of these 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 statement 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 unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes for the year ended December 31, 2005.

**2. Comprehensive Income**

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

**3. Earnings Per Common Share**

Basic earnings per share are computed based upon weighted-average shares outstanding. Dilutive earnings per share is computed consistently with basic while giving effect to all dilutive potential common shares that were outstanding during the period. The weighted-average shares outstanding were calculated as follows:

	Three Months Ended	
	March 31	
	2006	2005
Weighted average shares for basic earnings per share	15,377,662	13,256,692
Effect of dilutive common equivalent shares	-	-
Weighted average shares and dilutive common stock equivalents for dilutive earnings per share	15,377,662	13,256,692

For the three months ended March 31, 2006 and 2005, the Company excluded approximately 0.2 million and 0.9 million, respectively, of common stock equivalents in its computation of dilutive earnings per share because they were anti-dilutive.

**4. Receivables from and Payables to Brokers, Dealers and Clearing Agencies**

Amounts receivable from and payable to brokers, dealers and clearing agencies consists of the following:

	March 31	December 31
<i>(In thousands of dollars)</i>	2006	2005
Adjustment to record securities owned on a trade date basis, net	\$ 23,899	\$ 23,190
Securities borrowed	3,356	179
Securities failed-to-deliver	5,202	4,086
Commissions receivable	2,345	2,928
Receivable from clearing organizations	5,501	4,501
Good faith deposits	-	1,337
Total receivables	\$ 40,303	\$ 36,221
Payable to clearing organizations	\$ 4,023	\$ 45,959
Securities failed-to-receive	2,983	4,636
Total payables	\$ 7,006	\$ 50,595

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 unaudited Condensed Consolidated Statement of Financial Condition.

#### **5. *Receivables from and Payables to Customers***

At March 31, 2006, 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 clients.

The majority of the Company's non-institutional customers 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 indemnification. At March 31, 2006, 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.

**6. Securities Owned and Sold, but Not Yet Purchased**

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

<i>(In thousands of dollars)</i>	March 31, 2006		December 31, 2005	
	Owned	Sold, but not yet Purchased	Owned	Sold, but not yet Purchased
<b>Marketable Securities</b>				
U.S. Government and federal agency obligations	\$ 75,493	\$ 78,142	\$ 84,983	\$ 50,729
State and municipal bonds	133,381	3,808	124,388	128
Corporate obligations	40,064	122	41,954	760
Corporate stocks	13,659	54	11,542	828
Options	-	19	-	-
<b>Not Readily Marketable Securities</b>				
Securities with no publicly quoted market	1,397	-	909	-
Securities subject to restrictions	2,003	-	2,018	-
<b>Total</b>	<b>\$ 265,997</b>	<b>\$ 82,145</b>	<b>\$ 265,794</b>	<b>\$ 52,445</b>

Securities not readily marketable include investment 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.

**7. Intangible Assets**

<i>(In thousands of dollars)</i>	March 31	December 31
	2006	2005
<b>Intangible assets</b>		
<b>Customer related (amortizable):</b>		
Descap Securities, Inc. - Acquisition	\$ 641	\$ 641
Institutional convertible bond arbitrage group - Acquisition	1,017	1,017
Accumulated amortization	(433)	(395)
	1,225	1,263
<b>Goodwill (unamortizable):</b>		
Descap Securities, Inc. - Acquisition	23,763	23,763

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Institutional convertible bond arbitrage group - Acquisition		964		964
		24,727		24,727
Total Intangible Assets	\$	25,952	\$	25,990

Customer related intangible assets are being amortized over 10 to 12 years. Future amortization expense is estimated as follows:

Estimated Amortization Expense		
(year ended December 31)		
2006 - remainder	\$	117
2007		155
2008		155
2009		155
2010		155
2011		155
Thereafter		333
Total	\$	1,225

**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.

	March 31	December 31
<i>(In thousands of dollars)</i>	2006	2005
Carrying Value		
Public	\$ 31,081	\$ 40,375
Private	10,073	9,492
Consolidation of Employee Investment Funds, net of Company's ownership interest	2,409	2,630
Total carrying value	\$ 43,563	\$ 52,497

Investment gains (losses) were comprised of the following:

Three Months Ended

March 31

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<i>(In thousands of dollars)</i>	2006	2005
Public (net realized and unrealized gains and losses)	\$ (6,030)	\$ (4,666)
Private (net realized gains and losses)	83	(15)
Private (net unrealized gains and losses)	(196)	883
Investment gains (losses)	\$ (6,143)	\$ (3,798)

iRobot ( IRBT ) accounts for the majority of public investments owned by the Company. As of March 31, 2006, the Company owned approximately 1.1 million shares of IRBT worth approximately \$31.0 million. In the context of IRBT's initial public offering ( IPO ), the Company and certain other stockholders of IRBT entered into a lock-up agreement with the managing underwriters of the IPO in which it agreed not to sell IRBT until May 8, 2006. The lock-up is subject to extension through June 10, 2006 in specified circumstances generally related to IRBT's corporate announcements. In May 2006, the lock-up was extended until May 20, 2006. In addition, the Company has entered into an agreement to pledge the IRBT shares as collateral for various notes payable upon expiration of the lock-up agreement (see Notes Payable note in the unaudited Consolidated Financial Statements). During the three months ended March 31, 2006, the Company sold its remaining 1,116,040 shares of Mechanical Technology Incorporated ( MKTY ) for proceeds of approximately \$3.3 million.

Privately held investments include an investment of \$9.2 million in FA Technology Ventures L.P. (the Partnership ), which represented the Company's maximum exposure to loss in the Partnership at March 31, 2006. The Partnership's primary purpose is to provide investment returns consistent with the risk of investing in venture capital. At March 31, 2006 total Partnership capital for all investors in the Partnership equaled \$36.0 million. The Partnership is considered a variable interest entity. The Company is not the primary beneficiary, due to other investors' level of investment in the Partnership. Accordingly, the Company has not consolidated the Partnership in these financial statements but has only recorded the value of its investment. FA Technology Ventures Inc. ( FATV ) is the investment advisor for the Partnership. Revenues derived from the management of this investment and the Employee Investment Fund for the three month period ended March 31, 2006 were \$0.4 million in consolidation.

The Company has consolidated its Employee Investment Funds (EIF). The EIF are a 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., which has contracted with FATV to act as an investment advisor with respect to funds invested. The Company's carrying value of this EIF is \$0.5 million excluding the effects of consolidation. The Company has loaned \$1.3 million to the EIF and is also committed to loan an additional \$0.3 million to the EIF. The effect of consolidation was to increase Investments by \$2.4 million, decrease Receivable from Others by \$1.3 million and increased Payable to Others by \$1.1 million. The amounts in Payable to Others relates to the value of the EIF owned by employees.

## 9. Payables to Others

Amounts payable to others consisted of the following at:

<i>(In thousands of dollars)</i>	December 31	
	March 31 2006	2005
Drafts payable	\$ 6,682	\$ 9,963
Payable to Employees for the Employee Investment Funds (see Investments footnote)	1,150	1,371
Others	1,073	2,765
Total	\$ 8,905	\$ 14,099

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

### **10. Notes Payable**

The Company's notes payable include a \$15.0 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 ) (4.83% at March 31, 2006). Interest only was payable for first six months, and thereafter monthly payments of \$238 thousand in principal and interest over the life of the loan which matures on May 14, 2011. The \$15.0 million Term Loan agreement contains various covenants, as defined in the agreement. During 2005, the Company was not in compliance with certain covenants.

The lender modified the covenants and agreed to increase the maximum allowable modified total funded indebtedness to EBITDAR ratio from 1.75 to 2.00 through March 31, 2006. Thereafter the modified debt requirement will not exceed 1.75 to 1 (for the twelve month period ending March 31, 2006, modified total funded debt to EBITDAR ratio was 1.44 to 1). The financial covenants require operating cash flow to total fixed charge ratio (as defined) of not less than 1.15 to 1 (for the twelve month period ending March 31, 2006, the operating cash flow to total fixed charge ratio 1.43 to 1). EBITDAR is defined as earnings before interest, taxes, depreciation, amortization and lease expense plus pro forma adjustments as defined in the modified term loan agreement. The definition of operating cash flow includes the payment of cash dividends; therefore, the Company's ability to pay cash dividends in the future may be impacted by the covenant.

Notes payable include a \$4.9 million Term Loan with a current interest rate of 3.25% over the 30-day London Interbank Offered Rate ( LIBOR ) (4.83% at March 31, 2006). The interest rate may fluctuate based upon the Borrower's leverage ratio. Interest only is payable for the first four months; thereafter monthly payments of principal and interest are payable over the life of the loan, which originally matured on April 30, 2011, but has been modified to mature on June 15, 2006. The \$4.9 million Term Loan agreement contains various covenants consistent with the Company's \$15.0 million Term Loan. One additional covenant limits the Company's ability to incur additional indebtedness in excess of \$5 million in each calendar year. This limitation does not apply to short-term bank loans collateralized by Company-owned securities, refinancing of existing debt and certain other indebtedness.

Notes payable include an \$11.0 million Term Loan which was entered into in March 2006 for the purpose of repaying Senior Notes. The Company borrowed \$8.7 million under the \$11.0 million Term Loan, which is payable on June 15, 2006. Interest is 1% over the prime rate (7.75% at March 31, 2006) and is payable monthly. The \$11.0 million Term Loan contains various covenants consistent with the Company's \$15.0 Term Loan. Upon expiration of a lock-up agreement to which the Company is a party (refer to Investments note in the unaudited Consolidated Financial



Statements), the \$15.0 million Term Loan, \$4.9 million Term Loan and the \$11.0 million Term Loan will be collateralized by shares of iRobot Corporation common stock owned by the Company. If the daily market value of the iRobot common stock decreases to a level that causes the amount outstanding under the \$11 million Term Loan to exceed 30% of the collateral value, the Company must pledge additional collateral, either in cash or other specified securities.

Notes payable includes a note for \$0.2 million, which is payable \$37,096 per month through September 2006. The interest rate on this loan is 6.15% per annum.

Principal payments for all notes are due as follows:

*(In thousands of dollars)*

2006	\$	16,059
2007		2,857
2008		2,857
2009		2,857
2010		2,857
2011		1,239
Total principal payments remaining	\$	28,726

**11. Obligations Under Capitalized Leases**

The following is a schedule of future minimum lease payments under capital leases for office equipment together with the present value of the net minimum lease payments at March 31, 2006:

*(In thousands of dollars)*

2006 (remaining)	\$	1,551
2007		1,731
2008		1,124
2009		807
2010		581
2011		221
Thereafter		11
Total minimum lease payments		6,026
Less: amount representing interest		761
Present value of minimum lease payments	\$	5,265

## **12. Commitments and Contingencies**

**Commitments:** As of March 31, 2006, the Company had a commitment to invest up to \$6.7 million in FA Technology Ventures, LP (the Partnership). This commitment extends initially to the end of the Partnership's Commitment Period, which expires in July 2006; however, the General Partner may continue to make capital calls up through July 2011 for additional investments in portfolio companies and for the payment of management fees. 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 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 FATV to act as investment advisor to the General Partner.

As of March 31, 2006, the Company had an additional commitment to invest up to \$0.4 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). This commitment extends initially to the end of the Partnership's Commitment Period, which expires in July 2006; however, the General Partner may continue to make capital calls up through July 2011 for additional investments in portfolio companies and for the payment of management fees. 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. 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, which has contracted with FATV to act as an investment advisor with respect to funds invested in parallel with the Partnership.

**Contingent Consideration:** On May 14, 2004, the Company acquired 100 percent of the outstanding common shares of Descap, a New York-based broker-dealer and investment bank. Per the acquisition agreement, the Sellers can receive future contingent consideration (Earnout Payment) based on the following: for each of the years ending May 31, 2005 through May 31, 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. Each Earnout Payment shall be paid in cash, provided that Buyer shall have the right to pay up to seventy-five percent (75%) of each Earnout Payment in the form of shares of Company Stock. The amount of any Earnout Payment that the Company elects to pay in the form of Company Stock shall not exceed \$3.0 million for any Earnout Period and in no event shall such amounts exceed \$6.0 million in the aggregate for all Earnout Payments. Based upon Descap's Pre-Tax Net Income from June 1, 2005 through March 31, 2006, \$42 thousand 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.

**Retention:** First Albany Capital Inc. has committed to entering into retention agreements with certain of its employees in an amount aggregating \$6.7 million. These amounts are payable to the extent the employee continues to work for First Albany Capital Inc., subject to certain exceptions as defined. These retention amounts will be paid in July 2006.

**Leases:** The Company's headquarters and sales offices, and certain office and communication equipment, are leased under non-cancelable operating leases, certain of which contain renewal options and escalation clauses, and which expire at various times through 2014. To the extent the Company is provided tenant improvement allowances funded by the lessor, they are amortized over the initial lease period and serve to reduce rent expense. To the extent the Company is provided free rent periods, the Company recognizes the rent expense over the entire lease term on a straightline basis. In April 2006, the Company entered into a Surrender Agreement with its landlord related to a lease it had signed in 2005, for new office space in New York City (see Subsequent Events note to the unaudited Consolidated Financial Statements). Future minimum annual lease payments, adjusted for the Surrender Agreement and sublease rental income, are as follows:

<i>(In thousands of dollars)</i>	Future Minimum Lease Payments	Sublease Rental Income	Net Lease Payments
2006 remaining	\$ 5,840	\$ 1,059	\$ 4,781
2007	7,197	939	6,258
2008	6,427	704	5,723
2009	3,216	-	3,216
2010	2,782	-	2,782
2011	2,708	-	2,708
Thereafter	7,707	-	7,707
Total	\$ 35,877	\$ 2,702	\$ 33,175

**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 Inc. 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. Discovery is currently underway. 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 connection with the termination of Arthur Murphy's employment by First Albany Capital as Executive Managing Director, Mr. Murphy filed an arbitration claim against First Albany Capital, Alan Goldberg, President and Chief Executive Officer, and George McNamee, Chairman of First Albany Companies Inc. with the National Association of Securities Dealers on June 24, 2005. Mr. Murphy is a director of the Company. The claim alleges damages in the amount of \$8 million based on his assertions that he was fraudulently induced to remain in the employ of First Albany Capital. A hearing in the matter is scheduled to commence during the second quarter of 2006. The Company believes the claim lacks merit and intends to vigorously defend against such claim.

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 that 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, is that such litigation will not, in the aggregate, have a material adverse effect on the Company's liquidity, financial position or cash flow, although it could have a material effect on quarterly or annual operating results in the period in which it is resolved.

Collateral: The fair value of securities received as collateral, where the Company is permitted to sell or repledge the securities consisted of the following as of:

	March 31	December 31
<i>(In thousands of dollars)</i>	2006	2005
Securities purchased under agreements to resell	\$ 25,998	\$ 27,804
Securities borrowed	3,285	177
Total	\$ 29,283	\$ 27,981

Letters of Credit: The Company is contingently liable under bank stand-by letter of credit agreements, executed in connection with office leases, totaling \$2.1 million at March 31, 2006, and were collateralized by Company securities with a market value of \$2.3 million. Letters of credit in the amount of \$1.9 million were cancelled on April 28, 2006 (see Subsequent Events note to the unaudited Consolidated Financial Statements).

Other: In February of 2005, the Company was informed that the general partner of Ardent Research Partners LP (Ardent), an investment fund in which Company is a limited partner, was the subject of an SEC investigation. The complaint by the SEC alleges the general partner, Northshore Asset Management LLC, misappropriated fund assets in making illiquid, and potentially improper, investments. As of March 31, 2006 the value of the Company's investment

in Ardent is \$0.2 million and is classified as securities owned on the unaudited Statements of Financial Condition.

The Company enters into underwriting commitments to purchase securities as part of its investment banking business. Also, the Company may purchase and sell securities on a when-issued basis. As of March 31, 2006, the Company had no outstanding underwriting commitments and had purchased \$2.0 million and sold \$1.0 million securities on a when-issued basis.

### ***13. 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. If the put is not exercised by the time it expires, the Company will reclassify the temporary capital to stockholders' equity. The Company also has the right to purchase back these shares from the Sellers at a price of \$14.46. The put and call rights expire on May 31, 2007.

### ***14. Subordinated Debt***

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 New York Stock Exchange has approved the Company's subordinated debt agreements related to the Plan. Pursuant to these approvals, these amounts are allowable in the Company's computation of net capital. 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. Principal debt repayment requirements, which occur on about April 15<sup>th</sup> of each year, as of March 31, 2006, are as follows:

*(In thousands of dollars)*

2006	\$	1,288
2007		1,462
2008		1,299
2009		465
2010		287
2011 to 2016		910
Total	\$	5,711

### ***15. Stockholders Equity***

Deferred Compensation and Employee Stock Trust

The Company has adopted or may hereafter adopt 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 Plans 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 and generally accounted for in a manner similar to 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 equity under 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. Unearned compensation related to restricted common stock awarded under these plans was previously classified in Stockholders' Equity as unearned compensation. Upon the Company's adoption of FAS 123(R) (see Benefit Plans note to the unaudited Consolidated Financial Statements), this amount is now classified in Stockholders' Equity as a reduction of Additional Paid-In Capital.

#### **16. Income Taxes**

Income tax expense is recorded using the asset and liability method. Deferred tax assets and liabilities are recognized for the expected future tax consequences attributable to temporary differences between amounts reported for income tax purposes and financial statement purposes, using current tax rates. A valuation allowance is recognized if it is anticipated that some or all of a deferred tax asset will not be realized.

The Company must assess the likelihood that its deferred tax assets will be recovered from future taxable income and, to the extent that the Company believes that recovery is not likely, it must establish a valuation allowance. Significant management judgment is required in determining the provision for income taxes, deferred tax assets and liabilities and any valuation allowance recorded against net deferred tax assets. The Company has recorded a valuation allowance as a result of uncertainties related to the realization of its net deferred tax asset of approximately \$13.1 million at March 31, 2006, and \$9.2 million at December 31, 2005. The valuation allowance was established as a result of weighing all positive and negative evidence, including the Company's history of cumulative losses over at least the past two years and the difficulty of forecasting future taxable income. The valuation allowance reflects the conclusion of

management that it is more likely than not that the benefit of the deferred tax assets will not be realized.

In the event actual results differ from these estimates or these estimates are adjusted in future periods, the valuation allowance may require adjustment which could materially impact the Company's financial position and results of operations.

**17. Benefit Plans**

First Albany Companies Inc. has established several stock incentive plans through which employees of the Company may be awarded stock options, stock appreciation rights and restricted common stock, which expire at various times through April 30, 2015. The following is a recap of all plans as of March 31, 2006:

Share awards authorized for issuance	10,106,015
Share awards used:	
Stock options granted and outstanding	2,401,471
Restricted stock awards granted and unvested	1,343,162
Options exercised and restricted stock awards vested	5,111,576
Stock options expired and no longer available	190,327
Total share awards used	9,046,536
Share awards available for future awards	1,059,479

For the three month period ended March 31, 2006, total compensation expense for share based payment arrangements was \$1.9 million and the related tax benefit was \$0. There were no significant modifications or plan design changes made during the three month period ended March 31, 2006. At March 31, 2006, the total compensation expense related to non-vested awards not yet recognized is \$11.3 million, which is expected to be recognized over the remaining weighted average vesting period of 1.5 years. The amount of cash used to settle equity instruments granted under share based payment arrangements during the three month period ended March 31, 2006 was \$0.

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 for the three month period ended March 31, 2005:

<i>(In thousands of dollar except for per share amounts)</i>	Three Months Ended	
	March 31, 2005	
Net loss, as reported	\$	(6,895)

Add: Stock-based employee compensation expense included in reported net income, net of tax		72
Less: Total stock-based employee compensation expense determined under fair value based method for all stock options, net of tax		(329)
Pro forma net loss	\$	(7,152)
Earnings per share		
As reported		
Basic	\$	(0.52)
Diluted	\$	(0.52)
Pro forma		
Basic	\$	(0.54)
Diluted	\$	(0.54)

Options: Options granted under the plans have been granted at not less than fair market value, vest over a maximum of five years, and expire ten years after grant date. Unvested options are typically forfeited upon termination. Option transactions for the three month period ended March 31, 2006, under the plans were as follows:

	Shares Subject	Weighted Average Exercise Price
	to Option	
Balance at December 31, 2005	2,492,809	\$8.40
Options granted	-	-
Options exercised	(9,468)	\$5.77
Options terminated	(81,870)	\$8.06
Balance at March 31, 2006	2,401,471	\$8.42

Options are exercisable when they become fully vested. The intrinsic value of options exercised during the three month periods ending March 31, 2006 and 2005 was \$7 thousand and \$108 thousand, respectively. The amount of cash received from the exercise of stock options during the three month period ended March 31, 2006 was \$55 thousand. The tax benefit realized from the exercise of stock options during the three month period ended March 31, 2006 was \$0. Shares issued by the Company as a result of the exercise of stock options may be issued out of Treasury or authorized shares available. At March 31, 2006, 2,318,244 options were exercisable with an average exercise price of \$8.27, and a remaining average contractual term of 5.1 years. At March 31, 2006, 2,401,471 options outstanding had an intrinsic value of \$48 thousand.

The Black-Scholes option pricing model is used to determine the fair value of options granted. There were no options granted for the period ended March 31, 2006. Significant assumptions used to estimate the fair value of share based



compensation awards include the following:

	2005
Expected term-option	5.34
Expected volatility	41%
Expected dividends	2.97%
Risk-free interest rate	3.8%

Since no options were granted during the first quarter of 2006, the above assumptions have not been established for 2006.

Restricted Stock: Restricted stock awards under the plans have been valued at the market value of the Company's common stock as of the grant date and are amortized over the period in which the restrictions are outstanding, which is typically 3-4 years. Unvested restricted stock awards are typically forfeited upon termination although there are certain award agreements that may continue to vest subsequent to termination as long as other restrictions are followed. Restricted stock awards for the three month period ended March 31, 2006, under the plans were as follows:

	Unvested Restricted Stock Awards	Weighted Average Grant Date Fair Value
Balance at December 31, 2005	2,234,325	\$10.37
Granted	88,456	\$ 6.18
Vested	(803,620)	\$10.04
Forfeited	(175,999)	\$10.01
Balance at March 31, 2006	1,343,162	\$10.26

The total fair value of awards vested, based on the fair market value of the stock on the vest date, during the three month periods ending March 31, 2006 and 2005 was \$5.0 million and \$3.3 million, respectively. The weighted average grant date fair value of restricted stock awards granted during the three month period ended March 31, 2005 was \$9.30.

Adoption of FAS 123(R):

For options granted prior to December 31, 2002, the compensation expense was not required to be recognized in the consolidated financial statements. Effective January 1, 2003, the Company adopted FAS 123, using the prospective method of transition described in FAS 148. Under the fair value recognition provisions of FAS 123 and FAS 148,

stock based compensation cost was measured at the grant date based on the award and was recognized as expense over the vesting period for awards granted after December 31, 2002.

Effective January 1, 2006, the Company adopted FAS 123(R). In adopting FAS 123(R), the Company applied the modified prospective application transition method. Under the modified prospective application method, prior period financial statements are not adjusted. Instead, the Company will apply FAS 123(R) for new awards granted after December 31, 2005, any portion of awards that were granted after January 1, 1995 and have not vested by January 1, 2006 and any outstanding liability awards. The impact of applying the nominal vesting period approach for awards with vesting upon retirement eligibility and the non-substantive approach was immaterial. Upon adoption of FAS 123(R) on January 1, 2006, the Company recognized an after-tax gain of approximately \$0.4 million as the cumulative effect of a change in accounting principle, primarily attributable to the requirement to estimate forfeitures at the date of grant instead of recognizing them as incurred. The estimated forfeiture rate for 2006 and 2005 was 25%.

For the three month period ended March 31, 2006, the effect of adopting FAS 123(R) was to increase the loss from continuing operations by \$0.1 million, increase the loss before income taxes by \$0.1 million, increase the net loss by \$0.1 million, increase cash flow from operations by \$0, increase cash flow from financing activities by \$0, increase the basic loss per share by \$0.0 and increase the diluted loss per share by \$0.0.

#### **18. Net Capital Requirements**

First Albany Capital is subject to the Securities and Exchange Commission's Uniform Net Capital Rule, which requires the maintenance of a minimum net capital. First Albany Capital has elected to use the alternative method permitted by the rule, which requires it 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 March 31, 2006, First Albany Capital had aggregate net capital, as defined, of \$16.7 million, which equaled 149.5% of aggregate debit balances and \$15.7 million in excess of required minimum net capital.

Descap is subject to the Securities and Exchange Commission Uniform Net Capital Rule, 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. As of March 31, 2006, Descap had net capital of \$4.4 million, which was \$4.3 million in excess of its required net capital. Descap's ratio of Aggregate Indebtedness to Net Capital was .36 to 1.

#### **19. Segment Analysis**

The Company is organized around products and operates through the following six segments: Equities; Fixed Income, which is comprised of Taxable Fixed Income, Descap, Municipal Capital Markets and Fixed Income-Other; and Other. The Company evaluates the performance of its segments and allocates resources to them based on various factors, including prospects for growth, return on investment, and return on revenue.

The Company's Equities segment is comprised of equity sales and trading and equities investment banking services. Equities sales and trading provides equity trade execution to institutional investors and generates revenues primarily through commissions and sales credits earned on executing equity transactions. Equities investment banking generates revenues by providing financial advisory, capital raising, mergers and acquisitions, and restructuring services to small and mid-cap companies.

Included in the Company's Fixed Income business are the following segments: Taxable Fixed Income, Descap, Municipal Capital Markets and Fixed Income-Other. The Fixed Income business consists of fixed income sales and trading and fixed income investment banking. Fixed Income sales and trading provides trade execution to institutional investors and generates revenues primarily through commissions and sales credits earned on executing fixed income transactions in the following products:

- 

High Grade (Investment Grade and Government Bonds)

- 

High Yield (Below Investment Grade)

- 

Mortgage-Backed and Asset-Backed Securities

- 

Municipal Bonds (Tax-exempt and Taxable Municipal Securities)

These products can be sold through any of the Company's Fixed Income segments. Fixed Income investment banking generates revenues by providing financial advisory and capital raising services to municipalities, government agencies and other public institutions.

The Company's Other segment includes the results from the Company's investment portfolio, venture capital and asset management businesses, and costs related to corporate overhead and support. The Company's investment portfolio generates revenue from unrealized gains and losses as a result of changes in value of the firm's investments, and realized gains and losses as a result of sales of equity holdings. The Company's venture capital business generates revenue through the management of a private equity fund. This segment also includes results related to the Company's investment in these private equity funds and any gains or losses that might result from those investments. The Company's asset management business generates revenue through managing institutional investors' assets through its convertible arbitrage group.

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For presentation purposes, net revenue within each of the businesses is classified as sales and trading, investment banking, or net interest / other. Sales and trading net revenue includes commissions and principal transactions. Investment banking includes revenue related to underwritings and other investment banking transactions. Net interest/other includes interest income, interest expense, fees and other revenue. Net revenue presented within each category may differ from that presented in the financial statements as a result of differences in categorizing revenue within each of the revenue line items listed below for purposes of reviewing key business performance.

Intersegment revenue has been eliminated for purposes of presenting net revenue so that all 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 segment. Depreciation and amortization is allocated to each segment.

Information concerning operations in these segments is as follows:

	Three Months Ended	
	March 31	
<i>(In thousands of dollars)</i>	2006	2005
<i>Net revenue (including net interest income)</i>		
Equities	\$ 19,284	\$ 14,010
Fixed Income		
Taxable Fixed Income	2,605	4,853
Municipal Capital Markets	7,835	7,170
Fixed Income-Other	1,243	680
Descap Securities	3,195	4,482
Total Fixed Income	14,878	17,185
Other	(6,010)	(2,583)
Total Net Revenue	\$ 28,152	\$ 28,612
<i>Net interest income (included in total net revenue)</i>		
Equities	\$ (13)	\$ 9
Fixed Income		
Taxable Fixed Income	51	119
Municipal Capital Markets	(167)	83
Fixed Income-Other	(218)	(33)
Descap Securities	(155)	587
Total Fixed Income	(489)	756
Other	(703)	235
Total Net Interest Income (Expense)	\$ (1,205)	\$ 1,000
<i>Pre-tax Contribution (Income (loss) before income taxes, discontinued operations and</i>		

*cumulative effect of change in accounting principle)*

Equities	\$	2,079	\$	(1,923)
Fixed Income				
Taxable Fixed Income		(317)		(749)
Municipal Capital Markets		1,136		998
Fixed Income-Other		327		(122)
Descap Securities		(1,147)		350
Total Fixed Income		(1)		477
Other		(14,558)		(10,399)
Total Pre-tax Contribution	\$	(12,480)	\$	(11,845)

*Depreciation and amortization expense (charged to each segment in measuring the Pre-tax Contribution)*

Equities	\$	191	\$	259
Fixed Income				
Taxable Fixed Income		60		85
Municipal Capital Markets		69		97
Fixed Income-Other		6		9
Descap Securities		30		36
Total Fixed Income		165		227
Other		852		309
Total	\$	1,208	\$	795

For presentation purposes, net revenue within each of the businesses is classified as sales and trading, investment banking, investment gains (losses), or net interest/other. Sales and trading net revenue includes commissions and principal transactions. Investment banking includes revenue related to underwritings and other investment banking transactions. Investment gains (losses) reflects gains and losses on the Company's investment portfolio. Net interest/other includes interest income, interest expense, fees and other revenue. Net revenue presented within each category may differ from that presented in the financial statements as a result of differences in categorizing revenue within each of the revenue line items listed below for purposes of reviewing key business performance.

The following table reflects revenues for the Company's major products and services:

## Three Months Ended

March 31

*(In thousands of dollars)*

2006

2005

*Capital Markets (Fixed Income & Equities)**Net revenue*

*Institutional Sales & Trading*

Equities	\$ 11,119	\$ 10,853
Fixed Income	11,859	10,989
Total Institutional Sales & Trading	22,978	21,842

*Investment Banking*

Equities	8,173	3,130
Fixed Income	3,508	5,424
Total Investment Banking	11,681	8,554
Net Interest Income/Other	(497)	799
Total Net Revenues	\$ 34,162	\$ 31,195

The Company's segments financial policies are the same as those described in the Summary of Significant Accounting Policies note in the Company's Annual Report on Form 10-K December 31, 2005. 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. The Company also has an office in London, England, but the amount of assets held there are minimal.

**20. Discontinued Operations**

In February 2005, the Company sold its asset management operations, other than its institutional convertible arbitrage group, and, in 2000 sold its Private Client Group. The Company continues to report the receipt and settlement of pending contractual obligations related to both transactions as discontinued operations.

Amounts reflected in the unaudited Condensed Consolidated Statement of Operations are presented in the following table:

Three Months Ended

March 31

*(In thousands of dollars)*

2006

2005

Net revenues:

Asset management operations

\$

-

\$

179

Private Client Group

-

50

Total net revenues

-

229

Expenses:

31

Asset management operations

-

454

Private Client Group

165

44

Total expenses

165

498

Income (loss) before income taxes

(165)

(269)

Income tax benefit

-

(113)

Loss from discontinued operations, net of taxes

32



\$  
(165)  
\$  
(156)

The revenue and expenses of the Asset Management operations for the March 2005 period presented above reflect the activity of that operation through February 2005 when it was sold. The revenues and expenses of the Private Client Group for the periods presented above relate primarily to adjustments to impairment accruals for office space based upon subsequent utilization of the space by others in the Company and the resolution of certain legal matters, all of which related to the operations prior to its disposal.

**21. Subsequent Events**

The Company was a tenant under a sublease dated April 6, 2005, for space located at 1301 Avenue of the Americas, New York, New York ("Premises"). On April 28, 2006, the Company entered into transactions with various parties under which the Company surrendered the Premises and was released from future liability. As a result of the transactions, the Company was released from further liability for rent and other tenant expenses relating to the Premises, was reimbursed approximately \$5.0 million for construction costs and cancelled approximately \$1.9 million of letters of credit it had issued as security. As a result of these transactions, the Company estimates that it will incur an expense of approximately \$0.2 million in the quarter ended June 30, 2006.

On May 2, 2006, the Company announced it will be closing its taxable fixed-income corporate bond department. As a result, the Company estimates that it will incur an expense of approximately \$1.7 million and report the results of this business segment as discontinued operation in the quarter ending June 30, 2006.

**FIRST ALBANY COMPANIES INC.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

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

There are included or incorporated by reference in this document statements that may constitute forward-looking statements within the meaning of the safe harbor provisions of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements are usually preceded by words such as may, will, expect, anticipate, believe, estimate, and continue or similar words. statements other than historical information or current facts should be considered forward-looking statements.

Forward-looking statements may contain projections regarding revenues, earnings, operations, and other financial projections, and may include statements of future performance, strategies and objectives. However, there may be events in the future which the Company is not able to accurately predict or control which may cause actual results to differ, possibly materially, from the expectations set forth in the Company's forward-looking statements. All forward-looking statements involve risks and uncertainties, and actual results may differ materially from those discussed as a result of various factors. Such factors include, among others, market risk, credit risk and operating risk. These and other risks are set forth in greater detail throughout this document. The Company does not intend or assume any obligation to update any forward-looking information it makes.

## **Business Overview**

The Company is a full-service investment bank and institutional securities firm. The Company operates through three primary businesses: Equities, Fixed Income and Other.

The Company's Equities segment is comprised of equity sales and trading and equities investment banking services. Equities sales and trading provides equity trade execution to institutional investors and generates revenues primarily through commissions and sales credits earned on executing equity transactions. Equities investment banking generates revenues by providing financial advisory, capital raising, mergers and acquisitions, and restructuring services to small and mid-cap companies.

Included in the Fixed Income business are the following segments: Taxable Fixed Income, Descap, Municipal Capital Markets, and Fixed Income-Other. The Company's Fixed Income business consists of fixed income sales and trading and fixed income investment banking. Fixed Income sales and trading provides trade execution to institutional investors and generates revenues primarily through commissions and sales credits earned on executing fixed income transactions in the following products:

- 

High Grade (Investment Grade and Government Bonds)

- 

High Yield (Below Investment Grade)

- 

Mortgage-Backed and Asset-Backed Securities

- 

Municipal Bonds (Tax-exempt and Taxable Municipal Securities)

These products can be sold through any of the Company's Fixed Income segments. Fixed Income investment banking generates revenues by providing financial advisory and capital raising services to municipalities, government agencies and other public institutions.

The Company's Other segment includes the results from the Company's investment portfolio, venture capital and asset management businesses, and costs related to corporate overhead and support. The Company's investment portfolio generates revenue from unrealized gains and losses as a result of changes in value of the firm's investments and realized gains and losses as a result of sales of equity holdings. The Company's venture capital business generates revenue through the management of a private equity fund. This segment also includes results related to the Company's investment in these private equity funds and any gains or losses that might result from those investments. The Company's asset management business generates revenue through managing institutional investors' assets through its convertible arbitrage group.

The Company believes it has an opportunity to become one of the premier investment banking boutiques serving the middle market, which the Company believes is largely an under-served market. The Company has focused on growing its middle market position by broadening its product line through acquisition and investments in key personnel and shedding non-core businesses.

## **Business Environment**

NYSE daily trading volume was up 23.3 percent while the NASDAQ composite daily trading volume fell 7.8 percent. Public offering activity showed strong improvement over year ago levels with public follow-on activity up 24.6 percent in terms of dollar volume while the number of transactions increased 29.7 percent. Initial public offering transactions were up 12.5 percent year-over-year and dollar volume increased 93.1 percent compared to the first quarter of 2005. (Source: Factset and Commscan)

In the fixed income markets, increasing short-term rates, coupled with a flattening yield curve have negatively impacted secondary market activity across in the both the corporate and asset backed products. In addition, price transparency in the secondary corporate bond market and price and coupon compression in the mortgage-backed market continue to negatively impact spreads.

**Financial Overview**Three Months Ended March 31, 2006

For the quarter ended March 31, 2006, net revenues from continuing operations were \$28.2 million, compared to \$28.6 million for the first quarter of 2005. Excluding investment gains and losses, net revenues from continuing operations were \$34.3 million, up 5.8 percent compared to the first quarter of 2005. For the first quarter of 2006, the Company reported a loss from continuing operations before income taxes of \$12.5 million compared to a loss of \$11.8 million for the first quarter of 2005. The Company reported a net loss of \$12.2 million, or \$0.79 per diluted share, for the first quarter of 2006, compared to a net loss of \$6.9 million, or \$0.52 per diluted share, for the first quarter of 2005.

<i>(In thousands of dollars)</i>	Three Months Ended	
	2006	2005
<i>Revenues:</i>		
Commissions	\$ 3,598	\$ 4,587
Principal transactions	19,770	17,625
Investment banking	11,513	8,462
Investment gains (losses)	(6,143)	(3,798)
Interest	3,100	3,385
Fees and other	619	736
Total revenues	32,457	30,997
Interest expense	4,305	2,385
Net revenues	28,152	28,612
<i>Expenses (excluding interest):</i>		
Compensation and benefits	29,036	28,945
Clearing, settlement and brokerage costs	1,748	1,734
Communications and data processing	3,348	3,659
Occupancy and depreciation	3,100	2,732
Selling	1,539	1,733
Other	1,861	1,654
Total expenses (excluding interest)	40,632	40,457
Income (loss) before income taxes	(12,480)	(11,845)
Income tax (benefit) expense	-	(5,106)
Income (loss) from continuing operations	(12,480)	(6,739)
Income (loss) from discontinued operations, (net of taxes \$0 in 2006, \$(113) in 2005)	(165)	(156)
Income (loss) before cumulative effect of change in accounting principles	(12,645)	(6,895)

Cumulative effect of accounting change, (net of taxes \$0 in 2006)		427		-
Net income (loss)	\$	(12,218)	\$	(6,895)
Net interest income:				
Interest income	\$	3,100	\$	3,385
Interest expense		4,305		2,385
Net interest income/(loss)	\$	(1,205)	\$	1,000

### Net Revenue

Net revenue fell \$0.5 million, or 1.6 percent, in the first quarter 2006 to \$28.2 million. Excluding the investment loss related to the Company's investment portfolio, net revenue increased 5.8 percent. Strong revenue growth in Equities was offset by net revenue declines in both Fixed Income investment banking, and taxable fixed income corporate bonds. A decrease in equity listed commission revenue resulted in a 21.6 percent decrease in commission revenue. Principal transaction revenue was up 12.2 percent compared to the first quarter 2005 as a result of an increase in both NASDAQ and Municipal sales and trading customer activity. Fees and other revenue decreased 15.9 percent primarily as a result of a decline in fee revenue in the convertible arbitrage group. Net interest income of a negative \$1.2 million represented a 220.5 percent decrease compared to the first quarter of 2005. Rising short-term inventory financing rates and \$0.9 million in costs associated with refinancing the Company's senior debt negatively impacted net interest income.

### Non-Interest Expense

Non-interest expense increased \$0.2 million, or 0.4 percent, to \$40.6 million in the first quarter 2006.

Compensation and benefits expense increased \$0.1 million or 0.3 percent to \$29.0 million. An increase in incentive compensation expense of \$1.9 million primarily as a result of higher net revenues in equities and retention compensation of \$1.5 million were offset by decreases in sales related compensation of \$1.4 million as a result of lower principal transactions in the taxable fixed income corporate bond group, restricted stock amortization of \$0.6 million and salary expense of \$1.4 million. The decline in salary expense was the result of a 16 percent decline in headcount.

Clearing, settlement, and brokerage costs of \$1.7 million represented an increase of 0.8 percent compared to the prior year. An increase in electronic communications network (ECN) expense in Equities drove the variance.

Communications and data processing costs decreased \$0.3 million or 8.5 percent. A \$0.1 million decrease in data processing expense and a \$0.2 million decrease in market data services expense drove the variance. Data processing expense was down due to lower trading volumes in Equities and Fixed Income corporate bonds. A decrease in trading communications costs in Equities accounted for the decrease in market data services.

Occupancy and depreciation expense increased 13.4 percent or \$0.4 million. Costs associated with offices in New York City and the closing of the Greenwich, CT office accounted for \$0.7 million of the increase, which were offset by other decreases.

Selling expense was down 11.2 percent, or \$0.2 million, in the first quarter 2006 as a result of a decrease in travel and entertainment expense and dues, fees and assessment costs.

Other expense increased \$0.2 million, or 12.5 percent, in the first quarter 2006. The increase was driven by \$0.1 million increase in miscellaneous expenses and a \$0.1 million loss on the sale of assets as a result of the Company's decision to close its Greenwich CT office.

The Company did not recognize any income tax benefit in the first quarter of 2006 due to the valuation allowance recorded related to the Company's deferred tax asset. The valuation allowance was recorded as a result of uncertainties as to the realization of the deferred tax asset and after weighing all positive and negative evidence, including the Company's history of cumulative losses over at least the past two years and the difficulty of forecasting future taxable income. Income tax benefit for the 2005 first quarter was \$5.1 million. Refer to the Income Tax note of the unaudited Consolidated Financial Statements for more detail.

## Product Highlights

For presentation purposes, net revenue within each of the businesses is classified as sales and trading, investment banking, investment gains (losses), or net interest / other. Sales and trading net revenue includes commissions and principal transactions. Investment banking includes revenue related to underwritings and other investment banking transactions. Investment gains (losses) reflects gains and losses on the Company's investment portfolio. Net interest/other includes interest income, interest expense, fees and other revenue. Net revenue presented within each category may differ from that presented in the financial statements as a result of differences in categorizing revenue within each of the revenue line items listed below for purposes of reviewing key business performance.

<i>Equities</i> (In thousands of dollars)	Three Months Ended March 31,		
	2006	2005	2006 V 2005
<i>Net revenue</i>			
Sales and Trading	\$ 11,119	\$ 10,853	2.5%
Investment Banking	8,173	3,130	161.1%

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Net Interest / Other		(8)	27	-129.6%
Total Net Revenue	\$	19,284	\$ 14,010	37.6%
Pre-Tax Contribution	\$	2,079	\$ (1,923)	208.1%

Q1 2006 vs. Q1 2005

Net revenues in Equities increased \$5.3 million, or 37.6 percent, to \$19.3 million in the first quarter 2006. In the first quarter 2006 Equities represented 56.2 percent of consolidated net revenue excluding the impact of investment losses, compared to 43.2 percent in the same period 2005. In Equity Sales and Trading, NASDAQ net revenue was up 13.7 percent to \$8.0 million. The increase was driven by a nine percent increase in customer activity along with lower trading losses related to market making activities. Listed net revenue of \$3.1 million was down 18.4 percent relative to the same period in 2005 primarily as a result of a decline in customer volume. Investment Banking net revenues increased 161.1 percent versus the same period in the prior year. Public offering related revenue was up \$0.4 million to \$3.4 million and advisory and private placement revenue increased \$3.6 million to \$4.3 million. In terms of volume, Investment Banking completed eleven transactions in the first quarter 2006 compared to seven in the first quarter of 2005. Profitability was favorably impacted by an increase in net revenues, an improvement in compensation margins and a reduction in non-compensation expenses of 2.3 percent.

<i>Fixed Income</i> (In thousands of dollars)	Three Months Ended March 31,		
	2006	2005	2006 V 2005
<i>Net revenue</i>			
Sales and Trading	\$ 11,859	\$ 10,989	7.9%
Investment Banking	3,508	5,424	-35.3%
Net Interest / Other	(489)	772	-163.3%
Total Net Revenue	\$ 14,878	\$ 17,185	-13.4%
Pre-Tax Contribution	\$ (1)	\$ 477	-100.2%

Q1 2006 vs. Q1 2005

Fixed Income net revenue declined 13.4 percent in the first quarter of 2006. Fixed Income Investment Banking net revenue of \$3.5 million represented a 35.3 percent decrease compared to the same period in the prior year.

Contributing to the decline in Fixed Income Investment Banking, Public Finance net revenue was down as a result of a decline in underwriting activity. Underwriting related revenue was down \$1.1 million or 31.3 percent and public finance advisory fees were down \$0.2 million or 32.6 percent when compared to the first quarter of 2005. Fixed Income sales and trading revenue was up 7.9 percent or \$0.9 million compared to the same period in the prior year primarily due to continuing strength in the municipal sales and trading group. Increases in net revenue from municipal sales and trading of \$2.6 million and Fixed Income Middle Markets of \$0.8 million were mitigated by a decline in net revenue from mortgage backed securities / asset backed securities of \$1.1 million and continued deterioration in corporate bond net revenue of \$1.7 million. The margin impact from the decline in net revenues was offset to some extent by a decrease in compensation expense due to lower net revenues and a decrease in

non-compensation expense of 5.7 percent.

After substantial review of the significant capital and investment of personnel that would be necessary to maintain and develop the business, the Company recently determined that it would be in the best interests of the Company and the shareholders to exit the Taxable Fixed Income corporate bond business in the second quarter of 2006. Excluding the Taxable Fixed Income Group, which will be reflected in Discontinued Operations beginning in the second quarter of 2006, Fixed Income net revenue was \$12.3 million, or unchanged versus the year-ago period, and pre-tax contribution declined \$0.9 million to \$0.3 million. The decline in pre-tax contribution was the result of a decline in profitability at Descap.

<i>Other</i> <i>(In thousands of dollars)</i>	Three Months Ended March 31,		
	2006	2005	2006 V 2005
<i>Net revenue</i>			
Investment Gains / (Losses)	\$ (6,143)	\$ (3,798)	-61.7%
Net Interest / Other	133	1,215	-89.1%
Total Net Revenue	\$ (6,010)	\$ (2,583)	-132.7%
Pre-Tax Contribution	\$ (14,558)	\$ (10,399)	-40.0%

#### Q1 2006 vs. Q1 2005

Net revenue was down \$3.4 million compared to the first quarter of 2005 as a result of a \$2.3 million decrease in investment gains and losses related to the Company's investment portfolio. Net Interest/Other were down due to a \$0.9 million charge related to refinancing the Company's senior debt. Profitability was negatively impacted primarily by the decrease in net revenues, a \$1.5 million increase in compensation expense due to the retention compensation program and a \$0.7 million increase in non-compensation expense due to the consolidation of the Greenwich CT and New York City Offices. Excluding the retention compensation program and office consolidation, compensation expense and non-compensation expense for Other would have decreased 22.2 percent and 10.6 percent respectively.

#### Liquidity and Capital Resources

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. The Company anticipates that it will be able to finance its operations and commitments through available lines of credit, the sale of investments, additional financing that may be available by using investments as collateral as well as \$5.0 million received as a result of a recent transaction which will be used to retire



notes payable maturing in June 2006 (see Subsequent Events note to the unaudited Consolidated Financial Statements).

#### *Short-term Bank Loans and Notes Payable*

Short-term bank loans are made under a variety of bank lines of credit totaling \$250 million of which approximately \$181 million is outstanding at March 31, 2006. These bank lines of credits consist of credit lines that the Company has been advised are available but for which no contractual lending obligation exist and are repayable on demand.

These loans are collateralized by eligible securities, including Company-owned securities, subject to certain regulatory formulas. At March 31, 2006, short-term bank loans were collateralized by Company-owned securities, which are classified as securities owned and receivables from brokers, dealers and clearing agencies, of \$209.2 million.

The Company's notes payable include a \$15.0 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 ) (4.83% at March 31, 2006). Interest only was payable for first six months, and thereafter monthly payments of \$238 thousand in principal and interest over the life of loan which matures on May 14, 2011. The Term Loan agreement contains various covenants, as defined in the agreement. During 2005, the Company was not in compliance with certain covenants. The lender modified the covenants and agreed to increase the maximum allowable modified total funded indebtedness to EBITDAR ratio from 1.75 to 2.00 through March 31, 2006. Thereafter the modified debt requirement will not exceed 1.75 to 1 (for the twelve month period ending March 31, 2006, modified total funded debt to EBITDAR ratio was 1.44 to 1). The financial covenants require operating cash flow to total fixed charge ratio (as defined) of not less than 1.15 to 1 (for the twelve month period ending March 31, 2006, the operating cash flow to total fixed charge ratio 1.43 to 1). EBITDAR is defined as earnings before interest, taxes, depreciation, amortization and lease expense plus pro forma adjustments as defined in the modified term loan agreement. The definition of operating cash flow includes the payment of cash dividends; therefore, the Company's ability to pay cash dividends in the future may be impacted by the covenant.

Notes payable include a \$4.9 million Term Loan with a current interest rate of 3.25% over the 30-day London Interbank Offered Rate ( LIBOR ) (4.83% at March 31, 2006). The interest rate may fluctuate based upon the Borrower's leverage ratio. Interest only is payable for the first four months; thereafter monthly payments of principal and interest are payable over the life of the loan, which originally matured on April 30, 2011, but has been modified to mature on June 15, 2006. The term loan agreement contains various covenants consistent with the Company's \$15.0 million Term Loan. One additional covenant limits the Company's ability to incur additional indebtedness in excess of \$5 million in each calendar year. This limitation does not apply to short-term bank loans collateralized by Company-owned securities, refinancing of existing debt and certain other indebtedness.

Notes payable include an \$11 million Term Loan which was entered into in March 2006 for the purpose of repaying Senior Notes. The Company borrowed \$8.7 million under the Term Loan, which is payable on June 15, 2006. Interest is 1% over the prime rate (7.75% at March 31, 2006) and is payable monthly. The term loan contains various covenants consistent with the Company's \$15.0 Term Loan. Upon expiration of a lock-up agreement to which we are a party (refer to Investments note in the unaudited Consolidated Financial Statements), the \$11 million Term Loan, \$4.9 million Term Loan and the \$15.0 Term Loan will be collateralized by shares of iRobot Corporation common

stock owned by the Company. If the daily market value of the iRobot common stock decreases to a level that causes the outstanding loan amount of the \$11 million Term Loan to exceed 30% of the collateral value, the Company must pledge additional collateral, either in cash or other specified securities.

Notes payable includes a note for \$0.2 million, which is payable \$37,096 per month through September 2006. The interest rate on this loan is 6.15% per annum.

Principal payments for all notes are due as follows:

(In thousands of dollars)

2006	\$	16,059
2007		2,857
2008		2,857
2009		2,857
2010		2,857
2011		1,239
Total principal payments remaining	\$	28,726

### *Regulatory*

As of March 31, 2006, 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 March 31, 2006, First Albany Capital Inc. had net capital of \$16.7 million, which exceeded minimum net capital requirements by \$15.7 million, while Descap Securities, Inc. had net capital of \$4.4 million, which exceeded minimum net capital requirements by \$4.3 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 March 31, 2006, the Company had no outstanding underwriting commitments, and had purchased \$2.0 million and sold \$1.0 million securities on a when-issued basis.

### *Investments and Commitments*

In February of 2005, the Company was informed that the general partner of Ardent Research Partners LP (Ardent), an investment fund in which the Company is a limited partner, was the subject of an SEC investigation. The complaint

by the SEC alleges the general partner, Northshore Asset Management LLC, misappropriated fund assets in making illiquid, and potentially improper, investments. As of March 31, 2006 the value of the Company's investment in Ardent is \$0.2 million and is classified as securities owned on the unaudited Condensed Consolidated Statement of Financial Condition.

Publicly held investments include approximately 1.1 million shares of iRobot ( IRBT ) worth approximately \$31 million. For the three months ended March 31, 2006, the Company sold its remaining 1,116,040 shares of Mechanical Technology Incorporated ( MKTY ). Net proceeds from this sale were approximately \$3.3 million.

As of March 31, 2006, the Company had a commitment to invest up to \$6.7 million in FA Technology Ventures, LP (the Partnership ). This commitment extends initially to the end of the Partnership's Commitment Period, which expires in July 2006; however, the General Partner may continue to make capital calls up through July 2011 for additional investments in portfolio companies and for the payment of management fees. 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 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 FATV to act as investment advisor to the General Partner.

As of March 31, 2006, the Company had an additional commitment to invest up to \$0.4 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). This commitment extends initially to the end of the Partnership's Commitment Period, which expires in July 2006; however, the General Partner may continue to make capital calls up through July 2011 for additional investments in portfolio companies and for the payment of management fees. 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. 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, which has contracted with FATV to act as an investment advisor with respect to funds invested in parallel with the Partnership.

*Letters of Credit*

The Company is contingently liable under bank stand-by letter of credit agreements, executed in connection with office leases, totaling \$2.1 million at March 31, 2006, and were collateralized by Company securities with a market value of \$2.3 million. Letters of credit in the amount of \$1.9 million were cancelled on April 28, 2006

### *Retention*

First Albany Capital Inc. has committed to entering into retention agreements with certain of its employees in an amount aggregating \$6.7 million. These amounts are payable to the extent the employee continues to work for the First Albany Capital Inc., subject to certain exceptions as defined. These retention amounts will be paid in July 2006.

### *Tax Valuation Allowance*

At March 31, 2006, the Company had a valuation allowance of \$13.1 million compared to \$9.2 million at December 31, 2005. The valuation allowance was established as a result of weighing all positive and negative evidence, including the Company's history of cumulative losses over at least the past two years and the difficulty of forecasting future taxable income. The Company does not anticipate that the payment of future taxes will have a significant negative impact on its liquidity and capital resources.

### *Contingent Consideration*

On May 14, 2004, the Company acquired 100 percent of the outstanding common shares of Descap, a New York-based broker-dealer and investment bank. Per the acquisition agreement, the Sellers can receive future contingent consideration ( Earnout Payment ) based on the following: for each of the years ending May 31, 2005 through May 31, 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. Each Earnout Payment shall be paid in cash, provided that Buyer shall have the right to pay up to seventy-five percent (75%) of each Earnout Payment in the form of shares of Company Stock. The amount of any Earnout Payment that the Company elects to pay in the form of Company Stock shall not exceed \$3.0 million for any Earnout Period and in no event shall such amounts exceed \$6.0 million in the aggregate for all Earnout Payments. Based upon Descap's Pre-Tax Net Income from June 1, 2005 through March 31, 2006, \$42 thousand 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.

## **CONTRACTUAL OBLIGATIONS**

First Albany Companies Inc. has obligations and commitments to make future payments in connection with our debt, leases, compensation and retention programs and investments. See Notes to unaudited Condensed 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>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>Thereafter</b>	<b>Total</b>
Short-term bank loans	\$ 180,740	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 180,740
Long term debt (1)	16,059	2,857	2,857	2,857	2,857	1,239	28,726
Purchase obligations	-	-	-	-	-	-	-
Capital lease obligations (including interest)	1,551	1,731	1,124	807	581	232	6,026
Operating leases (net of sublease rental income)(2)	4,781	6,258	5,723	3,216	2,782	10,415	33,175
Guaranteed compensation payments (3)	11,317	5,290	740	698	-	-	18,045
Partnership and employee investment funds commitments (4)	7,100	-	-	-	-	-	7,100
Subordinated debt	1,288	1,462	1,299	465	287	910	5,711
<b>Total</b>	<b>\$ 222,836</b>	<b>\$ 17,598</b>	<b>\$ 11,743</b>	<b>\$ 8,043</b>	<b>\$ 6,507</b>	<b>\$ 12,796</b>	<b>\$ 279,523</b>

(1)

The Company has several notes payable which have principal payments associated with each. See Notes to the unaudited Condensed 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 2014. See Notes to the unaudited Condensed Consolidated Financial Statements.

(3)

Guaranteed compensation payments include the Company's commitment related to the \$6.7 million in retention agreements along with various other compensation arrangements.

(4)

The Company has a commitment to invest in FA Technology Ventures LP (the Partnership) and an additional commitment to invest in funds that invest in parallel with the Partnership. See Notes to the unaudited Condensed Consolidated Financial Statements.

## **NEW ACCOUNTING STANDARDS**

Effective January 1, 2006, the Company adopted FAS 123(R). In adopting FAS 123(R), the Company applied the modified prospective application transition method. Under the modified prospective application method, prior period financial statements are not adjusted. Instead, the Company will apply FAS 123(R) for new awards granted after December 31, 2005, any portion of awards that were granted after January 1, 1995 and have not vested by January 1, 2006 and any outstanding liability awards. The impact of applying the nominal vesting period approach for awards with vesting upon retirement eligibility and the non-substantive approach was immaterial. Upon adoption of FAS 123(R) on January 1, 2006, the Company recognized an after-tax gain of approximately \$0.4 million as the cumulative effect of a change in accounting principle, primarily attributable to the requirement to estimate forfeitures at the date of grant instead of recognizing them as incurred. The estimated forfeiture rate for 2006 and 2005 was 25%.

For options granted prior to December 31, 2002, the compensation expense was not required to be recognized in the consolidated financial statements. Effective January 1, 2003, the Company adopted FAS 123, using the prospective method of transition described in FAS 148. Under the fair value recognition provisions of FAS 123 and FAS 148, stock based compensation cost was measured at the grant date based on the award and was recognized as expense over the vesting period for awards granted after December 31, 2002.

For the three month period ended March 31, 2006, total compensation expense for share based payment arrangements was \$1.9 million and the related tax benefit was \$0. There were no significant modifications or plan design changes made during the three month period ended March 31, 2006. At March 31, 2006, the total compensation expense related to non-vested awards not yet recognized is \$11.3 million, which is expected to be recognized over the remaining weighted average vesting period of 1.5 years.

## 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 and federal agency 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>	2006	2007	2008	2009	2010	2011	Thereafter	Total
Fair value of securities								
Corporate bonds	\$ 711	\$ 2,119	\$ 3,339	\$ 1,362	\$ 374	\$ 2,113	\$ 29,924	\$ 39,942
State and municipal bonds	10	9,914	9,383	3,169	6,147	2,043	98,907	129,573

## US Government and federal

agency obligations	7	(483)	(14,598)	(352)	1,514	(1,524)	14,990	(446)
Subtotal	728	11,550	(1,876)	4,179	8,035	2,632	143,821	169,069
Equity securities	14,783	-	-	-	-	-	-	14,783
Investments	41,154	-	-	-	-	-	-	41,154
Fair value of securities	\$ 56,665	\$ 11,550	\$ (1,876)	\$ 4,179	\$ 8,035	\$ 2,632	\$ 143,821	\$ 225,006

Following is a discussion of the Company's primary market risk exposures as of March 31, 2006, 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 March 31, 2006 was \$130.5 million and \$183.0 million at December 31, 2005 (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 March 31, 2006, the potential change in fair value using a yield to maturity calculation and assuming this hypothetical change, was \$5.7 million and at year-end 2005 was \$6.8 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 \$14.8 million in securities owned at March 31, 2006 and \$11.6 million in securities owned at December 31, 2005, and 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 \$1.5 million at March 31, 2006 and \$1.2 million at year-end 2005. The Company's investment portfolio, excluding the consolidation of Employee Investment Fund (see Investments note to the unaudited Consolidated Financial Statements), at March 31, 2006 and December 31, 2005, had a fair market value of \$41.2 million and \$49.9 million, respectively. This equity price risk is also estimated as the potential loss in fair value resulting from a hypothetical 10% adverse change in equity security prices or valuations, and amounts to \$4.1 million at March 31, 2006 and \$5.0 million at December 31, 2005. 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, 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.

**Item 4. Controls and Procedures**

As of the end of the period covered by this Form 10Q, the Company's management, with the participation of the Chief Executive Officer and the Principal Financial Officer, evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). 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 as of the end of the period covered by this report. In addition, no changes in the Company's internal control over financial reporting occurred during the March 31, 2006 quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**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 Inc. 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. Discovery is currently underway. 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 connection with the termination of Arthur Murphy's employment by First Albany Capital as Executive Managing Director, Mr. Murphy filed an arbitration claim against First Albany Capital, Alan Goldberg, President and Chief Executive Officer, and George McNamee, Chairman of First Albany Companies Inc. with the National Association of Securities Dealers on June 24, 2005. Mr. Murphy is a director of the Company. The claim alleges damages in the

amount of \$8 million based on his assertions that he was fraudulently induced to remain in the employ of First Albany Capital. A hearing in the matter is scheduled to commence during the second quarter of 2006. The Company believes the claim lacks merit and intends to vigorously defend against such claim.

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, 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**

(a) Exhibits

Item

Number    Item

10.40    Agreement dated April 28, 2006 between First Albany Companies Inc. and Lehman Brothers Holdings Inc. (filed as exhibit herewith)

10.41    Surrender of Sublease Agreement dated April 28, 2006 between First Albany Companies Inc. and Deutsche Bank AG. (filed as exhibit herewith)

10.42    Form of Restricted Stock Agreement pursuant to First Albany Companies Inc. 1999 Long-Term Incentive Plan (filed herewith)

31.1    Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer, furnished herewith

31.2    Rule 13-a-14(a)/15d-14(a) Certification of Chief Financial Officer, furnished herewith

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: May 10, 2006

/S/ALAN P. GOLDBERG  
Alan P. Goldberg  
Chief Executive Officer

Date: May 10, 2006

/S/PAUL W. KUTEY  
Paul W. Kutey  
Chief Financial Officer  
(Principal Accounting Officer)

**Certification on Form 10-Q**

EXHIBIT 31.1

I, Alan P. Goldberg, certify that:

1. I have reviewed this quarterly report on Form 10-Q of First Albany Companies Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 10, 2006

/S/ALAN P. GOLDBERG

Alan P. Goldberg  
Chief Executive Officer

**Certification on Form 10-Q**

EXHIBIT 31.2

I, Paul W. Kutey, certify that:

1. I have reviewed this quarterly report on Form 10-Q of First Albany Companies Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's

- b) ability to record, process, summarize and report financial information; and any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 10, 2006

/S/PAUL W. KUTEY  
Paul W. Kutey  
Chief Financial Officer

(Exhibit 32)

### **Certification**

#### **Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

**(Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code)**

Each of the undersigned officers of First Albany Companies Inc., a New York corporation (the Company), does hereby certify to such officer's knowledge that:

The Quarterly Report on Form 10-Q for the quarter ended March 31, 2006 (the Form 10-Q) of the Company fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 and information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 10, 2006

/S/ALAN P. GOLDBERG  
Alan P. Goldberg  
Chief Executive Officer

Date: May 10, 2006

/S/PAUL W. KUTEY  
Paul W. Kutey  
Chief Financial Officer