

FIRST ALBANY COMPANIES INC  
Form 10-Q  
May 15, 2003

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-Q**

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

**For Quarter Ended March 31, 2003**

Commission file number 0-14140

**First Albany Companies Inc.**

(Exact name of registrant as specified in its charter)

New York 22 - 2655804

(State or other jurisdiction of

(I.R.S. Employer

incorporation or organization)

Identification No.)

30 South Pearl St., Albany, NY 12207

(Address of principal executive offices)

(Zip Code)

(518) 447-8500

(Registrant's telephone number, including area code)

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

Yes  (1) No

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

10,837,595 shares of Common Stock were outstanding as of the close of business on April 23, 2003.

**FIRST ALBANY COMPANIES INC. AND SUBSIDIARIES**

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## Item 1. Financial Statements

| <i>(In thousands of dollars)</i>                         | March 31, 2003<br>(Unaudited) | December 31, 2002 |
|----------------------------------------------------------|-------------------------------|-------------------|
| <i>Assets</i>                                            |                               |                   |
| Cash                                                     | \$ 880                        | \$ 176            |
| Cash and securities segregated under federal regulations | 8,100                         | 9,900             |
| Securities purchased under agreement to resell           | 29,949                        | 52,674            |
| Securities borrowed                                      | 1,378                         | 2,278             |
| Receivables from:                                        |                               |                   |
| Brokers, dealers and clearing agencies                   | 10,291                        | 5,297             |
| Customers                                                | 24,325                        | 6,836             |
| Others                                                   | 6,277                         | 32,096            |
| Securities owned                                         | 180,754                       | 275,289           |
| Investments                                              | 34,328                        | 29,643            |
| Office equipment and leasehold improvements, net         | 5,642                         | 5,470             |
| Other assets                                             | 21,672                        | 20,513            |
| <b>Total Assets</b>                                      | <b>\$ 323,596</b>             | <b>\$ 440,172</b> |
| <i>Liabilities and Stockholders' Equity</i>              |                               |                   |
| <i>Liabilities</i>                                       |                               |                   |
| Short-term bank loans                                    | \$ 135,125                    | \$ 215,100        |
| Securities loaned                                        | 163                           | 21                |
| Payables to:                                             |                               |                   |
| Brokers, dealers and clearing agencies                   | 7,099                         | 1,630             |
| Customers                                                | 22,224                        | 8,316             |
| Others                                                   | 12,635                        | 15,822            |
| Securities sold but not yet purchased                    | 33,526                        | 51,492            |
| Accounts payable                                         | 3,233                         | 2,929             |
| Accrued compensation                                     | 16,392                        | 49,941            |
| Accrued expenses                                         | 11,668                        | 12,446            |
| Income tax payable                                       | 288                           | 3,068             |
| Notes payable                                            | 7,553                         | 8,298             |
| Obligations under capitalized leases                     | 2,253                         | 2,708             |
| <b>Total liabilities</b>                                 | <b>252,159</b>                | <b>371,771</b>    |
| <i>Commitments and Contingencies</i>                     |                               |                   |
| Subordinated debt                                        | 1,760                         | 1,760             |
| <i>Stockholders' Equity</i>                              |                               |                   |
| Common stock                                             | 114                           | 109               |
| Additional paid-in capital                               | 102,916                       | 100,134           |
| Deferred compensation                                    | 2,220                         | 1,748             |
| Unearned compensation                                    | (4,975)                       | (3,454)           |
| Retained (deficit)                                       | (26,788)                      | (28,384)          |
| Treasury stock, at cost                                  | (3,810)                       | (3,512)           |

|                                            |            |            |
|--------------------------------------------|------------|------------|
| -----                                      |            |            |
| Total stockholders' equity                 | 69,677     | 66,641     |
| -----                                      |            |            |
| Total liabilities and stockholders' equity | \$ 323,596 | \$ 440,172 |
| =====                                      |            |            |

See notes to the condensed consolidated financial statements.

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| <i>(In thousands of dollars except for per share amounts and shares outstanding)</i> | Three Months Ended |                   |
|--------------------------------------------------------------------------------------|--------------------|-------------------|
|                                                                                      | 2003               | March 31,<br>2002 |
| <i>Revenues</i>                                                                      |                    |                   |
| Commissions                                                                          | \$ 4,187           | \$ 2,764          |
| Principal transactions                                                               | 28,408             | 27,460            |
| Investment banking                                                                   | 5,250              | 5,768             |
| Investment gains (losses)                                                            | 4,847              | (158)             |
| Interest                                                                             | 1,822              | 4,276             |
| Fees and other                                                                       | 1,954              | 1,245             |
| <b>Total revenues</b>                                                                | <b>46,468</b>      | <b>41,355</b>     |
| Interest expense                                                                     | 760                | 3,104             |
| <b>Net revenues</b>                                                                  | <b>45,708</b>      | <b>38,251</b>     |
| <i>Expenses (excluding interest):</i>                                                |                    |                   |
| Compensation and benefits                                                            | 31,561             | 29,116            |
| Clearing, settlement and brokerage costs                                             | 1,064              | 820               |
| Communications and data processing                                                   | 3,482              | 2,576             |
| Occupancy and depreciation                                                           | 2,268              | 2,055             |
| Selling                                                                              | 1,670              | 1,487             |
| Other                                                                                | 2,144              | 1,675             |
| <b>Total expenses (excluding interest)</b>                                           | <b>42,189</b>      | <b>37,729</b>     |
| Operating income (loss)                                                              | 3,519              | 522               |
| Equity in income (loss) of affiliate                                                 | -                  | (4,500)           |
| Gains on sale of equity holdings                                                     | -                  | 598               |
| <b>Income (loss) before income taxes</b>                                             | <b>3,519</b>       | <b>(3,380)</b>    |
| Income tax expense (benefit)                                                         | 1,296              | (1,372)           |
| <b>Net income (loss)</b>                                                             | <b>\$ 2,223</b>    | <b>\$ (2,008)</b> |
| <i>Net income (loss) per common share:</i>                                           |                    |                   |
| Basic                                                                                | \$ 0.22            | \$ (0.21)         |
| Diluted                                                                              | \$ 0.21            | \$ (0.21)         |
| <i>Weighted average common and common equivalent shares outstanding:</i>             |                    |                   |
| Basic                                                                                | 10,238,404         | 9,482,803         |
| Diluted                                                                              | 10,575,664         | 9,482,803         |
| <b>Dividend per common share outstanding</b>                                         | <b>\$ 0.05</b>     | <b>\$ 0.05</b>    |



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| <i>(In thousands of dollars)</i>                                                                | Three Months Ended |                   |
|-------------------------------------------------------------------------------------------------|--------------------|-------------------|
|                                                                                                 | March 31,<br>2003  | March 31,<br>2002 |
| <i>Cash flows from operating activities:</i>                                                    |                    |                   |
| Net income (loss)                                                                               | \$2,223            | \$(2,008)         |
| <i>Adjustments to reconcile net income (loss) to net cash provided by operating activities:</i> |                    |                   |
| Depreciation and amortization                                                                   | 747                | 653               |
| Deferred compensation                                                                           | 508                | 313               |
| Deferred income taxes                                                                           | 1,799              | (1,511)           |
| Equity in loss of affiliate                                                                     | -                  | 4,500             |
| Unrealized investment (gain) loss                                                               | (4,908)            | (42)              |
| Realized (gain) loss on sale of investments                                                     | 61                 | 200               |
| Gain on sales of equity holdings                                                                | -                  | (598)             |
| Services provided in exchange for common stock                                                  | 377                | 3                 |
| <i>(Increase) decrease in operating assets:</i>                                                 |                    |                   |
| Cash and securities segregated under federal regulations                                        | 1,800              | 800               |
| Securities purchased under agreement to resell                                                  | 22,725             | (13,302)          |
| Securities borrowed, net                                                                        | 1,042              | (1,126)           |
| Net receivable from broker, dealers and clearing agencies                                       | 475                | (2,555)           |
| Net receivables from customers                                                                  | (3,581)            | (3,843)           |
| Securities owned, net                                                                           | 76,569             | 66,562            |
| Other assets                                                                                    | (3,315)            | (2,115)           |
| <i>Increase (decrease) in operating liabilities:</i>                                            |                    |                   |
| Net payables to others                                                                          | 25,334             | 70,642            |
| Accounts payable and accrued expenses                                                           | (34,023)           | (22,602)          |
| Income taxes payable, net                                                                       | (2,780)            | -                 |
| <b>Net cash provided by operating activities</b>                                                | <b>85,053</b>      | <b>93,971</b>     |
| <i>Cash flows from investing activities:</i>                                                    |                    |                   |
| Purchase of furniture, equipment, and leaseholds, net                                           | (897)              | (587)             |
| Disbursements for purchase of investments                                                       | (49)               | (14)              |
| Proceeds from sale of investments                                                               | 13                 | 1,078             |
| <b>Net cash (used in) provided by investing activities</b>                                      | <b>(933)</b>       | <b>477</b>        |
| <i>Cash flows from financing activities:</i>                                                    |                    |                   |
| Net (payment) proceeds of short-term bank loans                                                 | (79,975)           | (91,400)          |
| Payments on notes payable                                                                       | (745)              | (745)             |
| Payments of obligations under capitalized leases                                                | (455)              | (425)             |
| Payments for purchases of common stock for treasury                                             | (102)              | (741)             |
| Proceeds from issuance of common stock                                                          | 589                | 505               |
| Net decrease from borrowing under line-of-credit agreements                                     | (2,169)            | (866)             |
| Dividends paid                                                                                  | (559)              | (430)             |
| <b>Net cash used in financing activities</b>                                                    | <b>(83,416)</b>    | <b>(94,102)</b>   |

Dividend per common share outstanding

|                               |       |         |
|-------------------------------|-------|---------|
| Increase in cash              | 704   | 346     |
| Cash at beginning of the year | 176   | 1,710   |
| -----                         |       |         |
| Cash at end of period         | \$880 | \$2,056 |
| =====                         |       |         |

See notes to the condensed consolidated financial statements

### **1. Basis of Presentation**

In the opinion of management, the accompanying unaudited consolidated financial statements contain all normal, recurring adjustments necessary for a fair presentation of results for such periods. The results for any interim period are not necessarily indicative of those for the full year. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes for the year ended December 31, 2002.

### **2. Reclassification**

Certain 2002 amounts have been reclassified to conform to the 2003 presentation.

### **3. Comprehensive Income**

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

### **4. Earnings Per Common Share**

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

|                                                                                                             |            |           |
|-------------------------------------------------------------------------------------------------------------|------------|-----------|
| For the three months ending:                                                                                | March 31   |           |
|                                                                                                             | 2003       | 2002      |
| <i>(In thousands)</i>                                                                                       |            |           |
| Weighted average shares for basic earnings per share                                                        | 10,238,404 | 9,482,803 |
| Effect of dilutive common stock equivalents (stock options and stock issuable under employee benefit plans) | 337,260    | -         |
| -----                                                                                                       |            |           |
| Weighted average shares and dilutive common stock equivalents for dilutive earnings per share               | 10,575,664 | 9,482,803 |
| =====                                                                                                       |            |           |

For the three months ended March 31, 2002, the Company excluded approximately 0.1 million common stock equivalents, in its computation of dilutive earnings per share because they were anti-dilutive.

### **5. 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.

Dividend per common share outstanding



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| (In thousands of dollars)                                                               | March 31,<br>2003 | December 31,<br>2002 |
|-----------------------------------------------------------------------------------------|-------------------|----------------------|
| Carrying Value                                                                          |                   |                      |
| Public                                                                                  | \$22,744          | \$19,003             |
| Private                                                                                 | 9,431             | 8,423                |
| Consolidation of Variable Interest Entities,<br><br>net of Company's ownership interest | 2,153             | 2,217                |
| <b>Total carrying value</b>                                                             | <b>\$34,328</b>   | <b>\$29,643</b>      |

| For the three months period ending:        | March 31,<br>2003 | March 31,<br>2002 |
|--------------------------------------------|-------------------|-------------------|
| Net realized gains (losses)                |                   |                   |
| Public                                     | \$14              | \$-               |
| Private                                    | (75)              | (200)             |
| <b>Total net realized gains (losses)</b>   | <b>(61)</b>       | <b>(200)</b>      |
| Net unrealized gains (losses)              |                   |                   |
| Public                                     | 3,741             | 42                |
| Private                                    | 1,167             | -                 |
| <b>Total net unrealized gains (losses)</b> | <b>4,908</b>      | <b>42</b>         |
| <b>Investment gains (losses)</b>           | <b>\$4,847</b>    | <b>\$(158)</b>    |

Publicly held investments include 853,924 shares of META Group Inc. ("META") with a market value of \$3.2 million. The Company is restricted in the sales of these shares under Securities and Exchange Commission Rule 144. Under Rule 144 the Company's sales of META for a three month period may not exceed the greater of one percent of the outstanding shares of META or the average weekly volume of trading in META during the four calendar weeks preceding the sale. META currently has 13.2 million shares outstanding and had an average weekly volume for the four calendar weeks ended March 28, 2003 of approximately 90,000 shares. Also included in publicly held investments are 2,721,088 shares of Plug Power ("PLUG") with a market value of \$13.8 million which can not be sold until after December 23, 2003 and 2,991,040 shares of Mechanical Technology Incorporated ("MKTY") with a market value of \$5.7 million which can not be sold until after December 23, 2004. PLUG and MKTY are also subject to Rule 144 restrictions after the expiration of the time during which they can not be sold.

In January 2003, the FASB issued FIN No. 46, "Consolidation of Variable Interest Entities". Under FIN No. 46, the Company is required to consolidate one of its Employee Investment Funds (EIF). The EIF is a limited liability company, 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 FA Technology Ventures Corporation, a subsidiary of the Company, to act as an investment advisor with respect to funds invested. The carrying value on the Company's books related to this EIF is \$1.6 million excluding the effects of consolidation. The Company is also committed to loan approximately \$1.7 million to the EIF of which \$1.1 million was provided in April 2003. The Company's maximum exposure to loss from the EIF is the carrying value of \$1.6 million and the loan commitment of \$1.7 million. The effect of consolidation, as of March 31, 2003, is to increase Investments by \$2.2 million, decrease Receivable from Others by \$1.0 million and increase Payable to Others by \$1.2 million. The Payable to Others amounts relates to the value of the EIF owned by employees.

#### 6. *Receivables from Customers*

Receivables from customers include amounts due on cash and margin transactions. Securities owned by customers are held as collateral for receivables. Such collateral is not reflected in the financial statements. Included in receivables from customers are accounts of officers, directors, employees and related individuals mainly under margin loans which as of March 31, 2003, approximated \$1.6 million and as of December 31, 2002 approximated \$3.4 million.

#### 7. *Receivables from Others*

Amounts receivable from others consisted of the following at:

| <i>(In thousands of dollars)</i>                                 | March 31, 2003 | December 31, 2002 |
|------------------------------------------------------------------|----------------|-------------------|
| Adjustment to record securities owned on a trade date basis, net | \$ 1,455       | \$ 26,195         |
| Others                                                           | 4,822          | 5,901             |
| Total                                                            | \$ 6,277       | \$ 32,096         |

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 Others on the Statement of Financial Condition.

#### 8. *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, 2003 |                                   | December 31, 2002 |                                   |
|------------------------------------------------|----------------|-----------------------------------|-------------------|-----------------------------------|
|                                                | Owned          | Sold, but<br>not yet<br>purchased | Owned             | Sold, but<br>not yet<br>purchased |
| Marketable Securities                          |                |                                   |                   |                                   |
| U.S. Government and federal agency obligations | \$ 14,373      | \$ 31,937                         | \$ 11,738         | \$ 50,725                         |
| State and municipal bonds                      | 129,354        | 102                               | 191,569           | 209                               |
| Corporate obligations                          | 27,245         | 903                               | 60,722            | 520                               |
| Corporate stocks                               | 7,075          | 584                               | 6,235             | 38                                |
| Options                                        | 144            | -                                 | 20                | -                                 |

Dividend per common share outstanding

## Not Readily Marketable Securities

|                                                      |            |           |            |           |
|------------------------------------------------------|------------|-----------|------------|-----------|
| Investment securities with no publicly quoted market | 189        | -         | 220        | -         |
| Investment securities subject to restrictions        | 2,374      | -         | 4,785      | -         |
| -----                                                |            |           |            |           |
| Total                                                | \$ 180,754 | \$ 33,526 | \$ 275,289 | \$ 51,492 |
| =====                                                |            |           |            |           |

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.

**9. Payables to Others**

Amounts payable to others consisted of the following at:

|                                           |           |              |
|-------------------------------------------|-----------|--------------|
|                                           | March 31, | December 31, |
| <i>(In thousands of dollars)</i>          | 2003      | 2002         |
| -----                                     |           |              |
| Borrowing under line-of-credit agreements | \$ 9,837  | \$ 12,006    |
| Others                                    | 1,634     | 2,252        |
| Payable to employees                      | 1,164     | 1,564        |
| -----                                     |           |              |
| Total                                     | \$ 12,635 | \$ 15,822    |
| =====                                     |           |              |

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 Others on the Statement of Financial Condition.

**10. Intangible Assets**

|                                  |                |              |
|----------------------------------|----------------|--------------|
|                                  | March 31, 2003 | December 31, |
| <i>(In thousands of dollars)</i> |                | 2002         |
| -----                            |                |              |
| Amortized intangible assets:     |                |              |
| Customer related                 | \$ 984         | \$ 984       |
| Accumulated amortization         | (22)           | -            |
| -----                            |                |              |
|                                  | \$ 962         | \$ 984       |
| =====                            |                |              |
| Unamortized intangible assets:   |                |              |
| Goodwill                         | \$ 246         | \$ 246       |
| =====                            |                |              |

Aggregate amortization expense for the three month period ending March 31, 2003 and 2002 was \$22,000 and 0, respectively.

Customer related intangible assets are being amortized over 10 years.

Estimated Amortization Expense

(year ended December 31)

|      |    |    |
|------|----|----|
| 2003 | \$ | 98 |
| 2004 |    | 98 |
| 2005 |    | 98 |
| 2006 |    | 98 |
| 2007 |    | 98 |

The changes in the carrying amount of goodwill for the period ended March 31, 2003, are as follows:

|                                     |    |     |
|-------------------------------------|----|-----|
| Balance as of January 1, 2003       | \$ | 246 |
| Goodwill acquired during the period |    | -   |
| Impairment losses                   |    | -   |
| Balance as of March 31, 2003        | \$ | 246 |

The intangible assets are related to the First Albany Asset Management Segment and will be tested annually for impairment in the quarter ending December 31 of each fiscal year.

### **11. Notes Payable**

Notes payable consist of a note for \$1.0 million which is payable in monthly principal payments of \$73,333 plus interest. The interest rate is 1.5% over the 30-day London InterBank Offered Rate ("LIBOR") (1.30% plus 1.50% at March 31, 2003) This note matures on April 1, 2004.

A note for \$6.6 million collateralized by 2,991,040 shares of Mechanical Technology Inc. (MKTY), 2,000,000 shares of Plug Power Inc. (PLUG) and 853,924 shares of META Group Inc. (METG) is payable in quarterly principal payments of \$525,000 plus interest. The interest rate is fixed at 7% for the term of the loan. This loan matures September 1, 2006.

### **12. Commitments and Contingencies**

**Commitments:** As of March 31, 2003, the Company had a commitment through July 2006 to invest up to \$16.3 million in FA Technology Ventures, L.P. (the "Partnership"). The Company intends to fund this commitment from the sale of other investments and operating cash flow. The Partnership's primary purpose is to provide a source of venture capital to enable privately owned businesses to expand, while providing market-rate 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 FA Technology Ventures Corporation (FATV), a wholly owned subsidiary of the Company, to act as an investment advisor to the General Partner.

As of March 31, 2003, the Company had an additional commitment through July 2006 to invest up to \$12.2 million in funds that invest in parallel with the Partnership, which it intends to fund through current and future Employee Investment Funds (EIF). EIF are limited liability companies, established by the Company for the purpose of having select employees invest in private equity placements. The EIF are managed by FAC Management Corp., which has contracted with FATV to act as an investment advisor with respect to funds invested in parallel with the Partnership. The Company anticipates that the commitment related to EIF will be funded primarily by employees; however, the Company must fund any amount, which is not. Some individuals who are members of the General Partnership have established their own fund to invest at least \$2.6 million in parallel with the Partnership. This fund is managed by FATV GP LLC. The fund is not charged a management fee by FATV GP LLC.

**Litigation:** In mid-2002, First Albany Corporation received a subpoena from the Attorney General's Office of the State of New York in connection with the industry-wide probe of research analyst activities. Management does not believe that this proceeding will have a material adverse effect on the Company's liquidity or financial position. There can be no assurance, however, that such proceeding will not have a material adverse effect on quarterly or annual operating results in the period in which it is resolved. An industry-wide settlement of these matters has been announced and could result in structural changes in certain aspects of our business. The outcome of these negotiations and the impact

of such possible changes on the business of the Company or its results of operations remain uncertain.

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

The Company believes that it has strong defenses to and intends to vigorously defend itself against the plaintiffs' claims, and believes that the claims lack merit.

In 1999, the Company acted as a placement agent for a \$7.5 million bond issue. In July 2002, as a result of a dispute between the Company and the buyer of the bonds, the Company entered into an agreement, which expires on January 4, 2004, that indemnified the buyer for up to \$3.7 million of potential realized losses which might be incurred on the outstanding principal amount of the bonds and up to \$0.5 million for related legal fees and \$0.5 million for unpaid debt service. These bonds are collateralized by a first security interest in certain rights, titles and interests of the company for whom the bonds were issued. As of March 31, 2003, management has estimated the probable amount of the loss expected to be incurred based upon current conditions and has accordingly accrued a \$2.4 million expense related to this agreement of which \$0.9 million of this liability has been paid. In entering into this agreement, the Company and the buyer of the bonds did not admit or concede to any liability, wrongdoing, misconduct or damages of any kind.

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

#### Contingent Consideration:

Under the terms of the Noddings purchase agreement, the Company may be required to pay up to \$750,000 of additional cash consideration contingent upon the amount of assets under management on various dates through 2004.

Other: 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, 2003, the Company had no outstanding underwriting commitments and had purchased securities on a when-issued basis with a market value of \$1.8 million.

### ***13. Stockholders' Equity***

In April 2003, the Board of Directors declared the regular quarterly dividend of \$0.05 per share for the first quarter ended March 31, 2003, payable on May 28, 2003 to stockholders of record on May 14, 2003.

***14. Benefit Plans***

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



The Company has elected to follow Accounting Principals Board No. 25 "Accounting for Stock Issued to Employees" ("APB 25") in accounting for the stock incentive plans. The Company, under APB 25, has not recognized any compensation cost for the quarters ended March 31, 2003 and 2002.

The following table reflects pro forma results as if the Company had elected and recognized compensation costs for the stock incentive plans to follow Financial Accounting Standard No. 123 (FAS 123) "Accounting for Stock-Based Compensation".

*(In thousands of dollars except per share amounts)*

| For the three months ended                                                                                                            | March 31, 2003 | March 31, 2002 |
|---------------------------------------------------------------------------------------------------------------------------------------|----------------|----------------|
| Net Income (loss) as reported                                                                                                         | \$2,223        | \$(2,008)      |
| Deduct: Total stock-based employee compensation expense determined under fair value method for all awards, net of related tax effects | 300            | 165            |
| Pro forma net income (loss)                                                                                                           | \$1,923        | \$(2,173)      |
| Earnings per share                                                                                                                    |                |                |
| Basic - as reported                                                                                                                   | 0.22           | (0.21)         |
| Basic - pro forma                                                                                                                     | 0.19           | (0.23)         |
| Diluted - as reported                                                                                                                 | 0.21           | (0.21)         |
| Diluted - pro forma                                                                                                                   | 0.18           | (0.23)         |

#### **15. Net Capital Requirements**

The Company's broker-dealer subsidiary, First Albany Corporation (the "Corporation"), is subject to the Securities and Exchange Commission's Uniform Net Capital Rule, which requires the maintenance of a minimum net capital. The Corporation has elected to use the alternative method permitted by the rule, which requires the Corporation to maintain a minimum net capital of 2% of

aggregate debit balances arising from customer transactions as defined or \$1 million, whichever is greater. As of March 31, 2003, the Corporation had aggregate net capital, as defined, of \$22.7 million, which equaled 76.7% of aggregate debit balances and \$21.7 million in excess of required minimum net capital.

#### **16. Segment Analysis**

Due to the acquisition of Noddings on December 31, 2002 the Company has expanded its segments to break out First Albany Asset Management from Parent and Affiliates. The Company's reportable segments include Taxable Fixed Income, Municipal Capital Markets, Equity Capital Markets, Fixed Income-Other and Corporate-Other which collectively comprise First Albany Corporation, the Company's brokerage operations; Parent and Affiliates, First Albany Asset Management and Investments. The Company evaluates the performance of its segments and allocates resources to them based on various factors, including prospects for growth, return on investment, and return on revenue.

The Taxable Fixed Income segment includes institutional sales and trading of corporate, federal government and agency securities. The Municipal Capital Markets segment includes underwriting and institutional sales and trading of municipal securities. The Equity Capital Markets segment includes institutional sales and trading of equity securities, corporate finance advisory services and underwritings. The Fixed Income-Other segment includes institutional sales and trading of fixed income middle markets and taxable municipal securities. The Corporate-Other segment includes stock loan/borrow operations and other unallocated revenues and expenses.

The Parent and Affiliates segment, includes the Parent company, excluding its investment portfolio, and the asset management services of FA Technology. The First Albany Asset Management segment includes Noddings Investments. The Investment segment includes realized gains and losses, unrealized gains and losses and the equity in income and loss of affiliate from the Company's investment portfolio including gains on sale of equity holdings.

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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 business segment. Depreciation and amortization is allocated to the business segments. Total Net Revenue presented below differs from that presented in the financial statements as a result of the inclusion of the equity in income and loss of affiliate and sale of equity holdings as a component of the segment financial information.

Information concerning operations in these segments is as follows for the three months ending March 31:

| <i>(In thousands of dollars)</i>                   | 2003     | 2002     |
|----------------------------------------------------|----------|----------|
| <i>Net revenue (including net interest income)</i> |          |          |
| Taxable Fixed Income                               | \$15,731 | \$16,621 |
| Municipal Capital Markets                          | 9,021    | 10,164   |
| Equity Capital Markets                             | 9,741    | 5,092    |
| Fixed Income-Other                                 | 4,144    | 5,014    |
| Corporate-Other                                    | 652      | 625      |
| First Albany Corporation                           | 39,289   | 37,516   |
| Parent & Affiliates                                | 217      | 291      |
| First Albany Asset Management Investments          | 1,355    | 602      |
|                                                    | 4,847    | (4,060)  |
| Total Net Revenue                                  | 45,708   | 34,349   |

*Net interest income (included in total net revenue)*

|                               |         |         |
|-------------------------------|---------|---------|
| Taxable Fixed Income          | \$198   | \$90    |
| Municipal Capital Markets     | 367     | 257     |
| Equity Capital Markets        | 7       | 8       |
| Fixed Income-Other            | 22      | 211     |
| Corporate-Other               | 671     | 761     |
| First Albany Corporation      | 1,265   | 1,327   |
| Parents & Affiliates          | (199)   | (156)   |
| First Albany Asset Management | (4)     | 1       |
| Total Net Interest Income     | \$1,062 | \$1,172 |

*Pre-tax Contribution:*

|                                           |         |         |
|-------------------------------------------|---------|---------|
| Taxable Fixed Income                      | \$3,319 | \$3,622 |
| Municipal Capital Markets                 | 1,612   | 2,586   |
| Equity Capital Markets                    | (1,115) | (2,776) |
| Fixed Income-Other                        | 2,294   | 2,756   |
| Corporate-Other                           | (4,609) | (4,933) |
| First Albany Corporation                  | 1,501   | 1,255   |
| Parent & Affiliates                       | (2,779) | (462)   |
| First Albany Asset Management Investments | (50)    | (113)   |
|                                           | 4,847   | (4,060) |

Dividend per common share outstanding

|                                   |         |           |
|-----------------------------------|---------|-----------|
| Income (loss) before income taxes | \$3,519 | \$(3,380) |
|-----------------------------------|---------|-----------|

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*(In thousands of dollars)*

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

|                               |       |       |
|-------------------------------|-------|-------|
| Taxable Fixed Income          | \$71  | \$73  |
| Municipal Capital Markets     | 96    | 104   |
| Equity Capital Markets        | 294   | 210   |
| Fixed Income-Other            | 13    | 15    |
| Corporate-Other               | 224   | 230   |
| <hr/>                         |       |       |
| First Albany Corporation      | 698   | 632   |
| Parent & Affiliates           | 8     | 8     |
| First Albany Asset Management | 41    | 13    |
| <hr/>                         |       |       |
| Total                         | \$747 | \$653 |

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

### **17. New Accounting Standards**

In August 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143, which is effective for fiscal years beginning after June 15, 2002, requires the fair value of a liability for an asset retirement obligation to be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. SFAS No. 143 was adopted January 1, 2003 and it did not have a material impact on the Company's financial statements.

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections as of April 2002", which is effective for fiscal years beginning after May 15, 2002. This Standard addresses a number of items related to leases and other matters. SFAS No. 145 was adopted January 1, 2003 and it did not have a material impact on the Company's financial statements.

In June 2002, the FASB issued SFAS 146, "Accounting for Costs Associated with Exit or Disposal Activities", which is effective for exit or disposal activities that are initiated after December 31, 2002. This Standard addresses the recognition, measurement and reporting costs that are associated with exit or disposal activities. SFAS No. 146 was adopted January 1, 2003 and it did not have a material impact on the Company's financial statements.

In December 2002, the FASB issued SFAS No. 148 " Accounting for Stock Based Compensation - Transition and Disclosure - an amendment of FAS 123." This Statement amends FASB Statement No. 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure

requirements of Statement 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Statement has varying effective dates. The Company has fully adopted this statement and it did not have a material effect on the Company's financial statements.

In November 2002, the FASB issued FASB Interpretation No. 45 (FIN 45), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others". FIN 45 requires that upon issuance of a guarantee, the guarantor must recognize a liability for the fair value of the obligation it assumes under the guarantee. The interpretation's provisions for initial recognition and measurement must be applied on a prospective basis to guarantees issued or modified after December 31, 2002. FIN 45 was adopted January 1, 2003 and it did not have a material effect on the Company's financial statements.

In January 2003, the FASB issued FIN No. 46, "Consolidation of Variable Interest Entities". FIN No. 46 requires a company to consolidate a variable interest entity (VIE) if the company has variable interests that give it a majority of the expected losses or a majority of the expected residual returns of the entity. FIN No. 46 was fully adopted and applied to all of the Company's VIEs as of December 31, 2002. The adoption of FIN No. 46 did not have a material effect on the Company's financial statements.

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

|                                            | Three Months Ended |                   |
|--------------------------------------------|--------------------|-------------------|
| <i>(In thousands of dollars)</i>           | 2003               | March 31,<br>2002 |
| <i>Revenues :</i>                          |                    |                   |
| Commissions                                | \$ 4,187           | \$ 2,764          |
| Principal transactions                     | 28,408             | 27,460            |
| Investment banking                         | 5,250              | 5,768             |
| Investment gain (loss)                     | 4,847              | (158)             |
| Interest income                            | 1,822              | 4,276             |
| Fees and others                            | 1,954              | 1,245             |
| <b>Total revenues</b>                      | <b>46,468</b>      | <b>41,355</b>     |
| Interest expense                           | 760                | 3,104             |
| <b>Net revenues</b>                        | <b>45,708</b>      | <b>38,251</b>     |
| <i>Expenses (excluding interest):</i>      |                    |                   |
| Compensation and benefits                  | 31,561             | 29,116            |
| Clearing, settlement and brokerage costs   | 1,064              | 820               |
| Communications and data processing         | 3,482              | 2,576             |
| Occupancy and depreciation                 | 2,268              | 2,055             |
| Selling                                    | 1,670              | 1,487             |
| Other                                      | 2,144              | 1,675             |
| <b>Total expenses (excluding interest)</b> | <b>42,189</b>      | <b>37,729</b>     |
| <b>Operating income (loss)</b>             | <b>3,519</b>       | <b>522</b>        |
| Equity in income (losses) of affiliate     | -                  | (4,500)           |
| Gains on sale of equity holdings           | -                  | 598               |
| <b>Income (loss) before income taxes</b>   | <b>3,519</b>       | <b>(3,380)</b>    |
| Income tax expense (benefit)               | 1,296              | (1,372)           |
| <b>Net income (loss)</b>                   | <b>\$ 2,223</b>    | <b>\$ (2,008)</b> |
| <i>Net interest income</i>                 |                    |                   |
| Interest income                            | \$ 1,822           | \$ 4,276          |
| Interest expense                           | 760                | 3,104             |
| <b>Net interest income</b>                 | <b>\$ 1,062</b>    | <b>\$ 1,172</b>   |

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

## Business Environment

First Albany Companies Inc. (the "Company") is the parent company whose principal subsidiaries include First Albany Corporation, First Albany Asset Management Corporation and FA Technology Ventures Corporation. First Albany Corporation provides investment banking services to corporate and public clients, and engages in market making and trading of corporate, government and municipal securities. FA Technology Ventures Corporation provides venture capital and merchant banking to the investment and corporate communities, and First Albany Asset Management Corporation provides asset management services to individuals and institutions.

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

## Results of Operations

For the quarter, consolidated net revenues for First Albany Companies were \$45.7 million, compared to \$38.3 million for the same period in 2002, an increase of 19%. The Company reported consolidated net income of \$2.2 million for the first quarter 2003, compared to a net loss of (\$2.0) million for the same period in 2002. First quarter 2003 net income was \$0.21 per diluted share compared to a net loss of (\$0.21) per diluted share in the first quarter of 2002.

Net revenues from the Company's brokerage operations, First Albany Corporation, was \$39.3 million for the first quarter ended March 31, 2003, compared to \$37.5 million for the same period in 2002, an increase of 5%. First Albany Corporation had income of \$1.0 million for the first quarter 2003, compared to \$0.8 million for the same period in 2002.

### Major Segment Operating Results

#### *First Albany Corporation*

First Albany Corporation is the brokerage operations of the Company.

Taxable Fixed Income net revenues were \$15.7 million for the first quarter of 2003, down 5% from the \$16.6million for the comparable prior year quarter. The decrease in net revenues in the Taxable Fixed Income division was due to lower revenues from principal transactions compared to the prior period.

Municipal Capital Markets net revenues were \$9.0 million, down 11% from \$10.2million reported for the quarter ended March 31, 2002. The decreased net revenues in the Municipal Capital Markets division were due to lower revenues from principal transactions compared to the prior period.

Equity Capital Markets net revenues were \$9.7 million for the first quarter of 2003, up 91% from the \$5.1million for the first quarter of 2002. The increase in net revenue was primarily due to significantly higher trading volume and activity, slightly offset by lower investment banking revenues as the capital markets continue to operate in a very challenging environment.

#### *Parent & Affiliates*

First Albany Asset Management net revenues were \$1.4 million for the quarter ended March 31, 2003, up 125% from the comparable quarter last year. The increase in net revenues was due in large part to the acquisition of

Noddings Investments, a convertible bond arbitrage manager, which contributed approximately \$300 million in assets under management and \$0.7million in net revenues in the quarter.

Investment gains for the quarter ended March 31, 2003 were \$4.8 million due to an increase in fair market value of the investment portfolio held by First Albany Companies. As previously announced, as of December 31, 2002, First Albany Companies Inc. changed its method of accounting for its investment in Mechanical Technology Inc. (NASDAQ: MKTY) from the equity method of accounting to the fair value method. As a result, the Company no longer recognizes equity income or loss from its proportionate share of Mechanical Technology's financial results. For the quarter ended March 31, 2002, the Company recognized a \$4.5 million equity loss related to its investment in Mechanical Technology.

### **Three-Month Period Ended March 31, 2003**

## **Commissions**

Commissions revenue increased \$1.4 million or 51% primarily due to increases in listed agency transactions by the Equity Capital Markets Segment.

## **Principal Transactions**

Principal transactions increased \$0.9 million or 3%. This amount was comprised primarily of an increase of \$4.6 million by the Equity Capital Markets Segment, a decrease of \$2.2 million in Municipal Capital Markets, a decrease of \$0.9 in Taxable Fixed Income and a decrease of \$0.6 million in Fixed Income -Other.

## **Investment Banking**

Investment banking revenues decreased \$0.5 million or 9%. The decrease was comprised of an increase in municipal investment banking of \$0.9 million, in the Municipal Capital Markets Segment, and a decrease of \$1.4 million within the Equity Capital Markets Segment. Market conditions had a material impact on both of these changes.

## **Investment Gains**

Investment gains increased by \$5.0 million due to an increase in fair market value of the investment portfolio held by the Parent Company (see note 5 of the Condensed Consolidated Financial Statements).

## **Interest Income**

Interest income decreased \$2.4 million or 57% primarily due to the Company discontinuing its securities borrow/securities loan conduit business in 2002.

## **Fees and Other**

Fees and other increased \$0.7 million or 57% primarily due to increased revenues generated by the First Albany Asset Management Segment as a result of the Noddings acquisition in December 2002.

### **Interest Expense**

Interest expense decreased \$2.3 million or 76% primarily due to the Company discontinuing its securities borrow/securities loan conduit business in 2002.



### Compensation and Benefits

Compensation and benefits increased \$2.4 million or 8% due primarily to an increase in net revenues in the Parent and Affiliates Segment and increase in personnel in the First Albany Asset Management Segment due to the Acquisition of Noddings Investments.

## **Communications and Data Processing**

Communications and data processing expense increased \$0.9 million or 35% due primarily to an increase in the number of equity securities transactions and market data related services in the Equity Capital Markets Segment.

### Other

Other expense increased \$0.5 million or 28% due primarily to an increase in legal costs, professional fees and insurance costs, relating to the Parent and Affiliates Segment.

### Equity in income (losses) of affiliate

As of December 31, 2002, First Albany Companies Inc. changed its method of accounting for its investment in Mechanical Technology Inc. (NASDAQ: MKTY) from the equity method of accounting to the fair value method. As a result, the Company no longer recognizes equity income or loss from its proportionate share of Mechanical Technology's financial results. For the quarter ended March 31, 2002, the Company recognized a \$4.5 million equity loss related to its investment in Mechanical Technology.

### Gain on Sale of Equity Holdings

As of December 31, 2002, First Albany Companies, Inc. changed its method of accounting for its investment in Mechanical Technology Inc. (NASDAQ: MKTY) from the equity method of accounting to the fair value method. For the quarter ended March 31, 2002, the Company recognized \$0.6 million gain related to the sale of its investment in Mechanical Technology.

### Income Tax (Expense)

Income tax expense increased \$2.7 million due mainly to an increase in income before income tax.

## **Liquidity and Capital Resource**

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

As of March 31, 2003, First Albany Corporation, a registered broker-dealer subsidiary of First Albany Companies Inc., was in compliance with the net capital requirements of the Securities and Exchange Commission. The amount of the broker-dealer's net assets that may be distributed is subject to restrictions under applicable net capital rules. Also, a significant operating loss or extraordinary charge against net capital may adversely affect the ability of the Company's broker-dealer subsidiary 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, 2003, the Corporation had net capital of \$22.7 million, which exceeded minimum net capital requirements by \$21.7 million.

As of March 31, 2003, the Company had a commitment through July 2006 to invest up to \$16.3 million in FA Technology Ventures, L.P. (the "Partnership"). The Company intends to fund this commitment from the sale of other investments and operating cash flow. The Partnership's primary purpose is to provide a source of venture capital to enable privately owned businesses to expand, while providing market-rate 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.

As of March 31, 2003, the Company had an additional commitment through July 2006 to invest up to \$12.2 million in funds that invest in parallel with the Partnership, which it intends to fund through current and future Employee Investment Funds (EIF). EIF are limited liability companies, established by the Company for the purpose of having select employees invest in private equity placements. The EIF are managed by FAC Management Corp., which has contracted with FATV to act as an investment advisor with respect to funds invested in parallel with the Partnership. The Company anticipates that the commitment related to EIF will be funded primarily by employees; however, the Company must fund any amount, which is not.

The Company has net deferred tax assets of \$7.9 million and deferred tax liabilities of \$2.8 million as of March 31, 2003. The Company expects that it will realize the benefit of the deferred tax assets through the combination of future taxable income and income available in years in which the reversal of the asset can be carried back.

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, 2003, the Company had no outstanding underwriting commitments and had purchased securities on a when-issued basis with a market value of \$1.8 million.

Management believes that funds provided by operations and a variety of bank lines of credit totaling \$300 million, of which approximately \$165 million were unused as of March 31, 2003, will provide sufficient resources to meet present and reasonably foreseeable short-term and long-term financial needs. These bank lines of credits consist of credit lines that the Company has been advised are available but for which no contractual lending obligations exist and are repayable on demand. These bank lines of credit are limited to financing securities eligible for collateralization including Company owned securities and certain customer-owned securities purchased on margin, subject to certain regulatory formulas.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

## **MARKET RISK**

Market risk generally represents the risk of loss that may result from the potential change in the value of a financial instrument as a result of fluctuations in interest rates and equity prices, changes in the implied volatility of interest rates and equity prices and also changes in the credit ratings of either the issuer or its related country of origin. Market risk is inherent to both derivative and non-derivative financial instruments, and accordingly, the scope of the Company's market risk management procedures extends beyond derivatives to include all market-risk-sensitive financial instruments. The Company's exposure to market risk is directly related to its role as a financial intermediary in customer-related transactions and to its proprietary trading.

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

U.S. Government securities.

Following is a discussion of the Company's primary market risk exposures as of March 31, 2003, 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, 2003 was \$122.3 million and \$186.8 million at December 31, 2002. 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, 2003, the potential change in fair value using a yield to maturity calculation and assuming this hypothetical change, was \$4.5 million and at year-end 2002 was \$6.6 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 \$6.6 million at March 31, 2003 and \$6.5 million at December 31, 2002, have exposure to equity price risk. This risk is estimated as the potential loss in fair value resulting from a hypothetical 10% adverse change in prices quoted by stock exchanges and amounts to \$0.7 million at March 31, 2003 and \$0.7 million at year-end 2002.

The Company's investment portfolio excluding the consolidation of Variable Interest Entities (see Note 5 of the Consolidated Financial Statement) at March 31, 2003 and December 31, 2002, had a fair market value of \$32.2 million and \$27.4 million, respectively. This equity price risk is also estimated as the potential loss in fair value resulting from a hypothetical 10% adverse change in prices quoted by stock exchanges and amounts to \$3.2 million at March 31, 2003 and \$2.7 million at year-end 2002. The actual risks and results of such adverse effects may differ substantially.

## **CREDIT RISK**

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

The Company purchases debt securities and may have significant positions in its inventory subject to market and credit risk. In order to control these risks, security positions are monitored on at least a daily basis. Should the

Company find it necessary to sell such a security, it may not be able to realize the full carrying value of the security due to the size of the position sold. The Company attempts to reduce its exposure to changes in municipal securities valuation with the use as hedges of highly liquid municipal bond index futures contracts.

## **OPERATING RISK**

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

## **OTHER RISKS**

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

### **Item 4. Controls and Procedures**

As of a date within 90 days of the filing of this Form 10Q, the Company's management, including the Chief Executive Officer and the Principal Financial Officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on that evaluation, the Company's management, including the Chief Executive Officer and the Principal Financial Officer, concluded that the Company's disclosure controls and procedures were effective in timely alerting management, including the Chief Executive Officer and the Principal Financial Officer, of material information about the Company required to be included in periodic Securities and Exchange Commission filings. However, in evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. There have been no significant changes in the Company's internal controls or in other factors that could significantly affect its internal controls subsequent to the date of the evaluation.

## **Part II-Other Information**

### ***Item 1. Legal Proceedings***

In mid-2002, First Albany Corporation received a subpoena from the Attorney General's Office of the State of New York in connection with the industry-wide probe of research analyst activities. Management does not believe that this proceeding will have a material adverse effect on the Company's liquidity or financial position. There can be no assurance, however, that such proceeding will not have a material adverse effect on quarterly or annual operating results in the period in which it is resolved. An industry-wide settlement of these matters has been announced and could result in structural changes in certain aspects of our business. The outcome of these negotiations and the impact of such possible changes on the business of the Company or its results of operations remain uncertain.

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

In 1999, the Company acted as a placement agent for a \$7.5 million bond issue. In July 2002, as a result of a dispute between the Company and the buyer of the bonds, the Company entered into an agreement, which expires on January 4, 2004, that indemnified the buyer for up to \$3.7 million of potential realized losses which might be incurred on the outstanding principal amount of the bonds and up to \$0.5 million for related legal fees and \$0.5 million for unpaid debt service. These bonds are collateralized by a first security interest in certain rights, titles and interests of the company for whom the bonds were issued. As of March 31, 2003, management has estimated the probable amount of the loss expected to be incurred based upon current conditions and has accordingly accrued a \$2.4 million expense related to this agreement of which \$0.9 million of this liability has been paid. In entering into this agreement, the Company and the buyer of the bonds did not admit or concede to any liability, wrongdoing, misconduct or damages of any kind.

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

**Item 6. Exhibits and Reports on Form 8-K**

(a) Exhibits

Item No. Item

(10.17) Employment Agreement with Rob Gales, an executive officer of the Company, dated 3/20/03 (filed herewith)

(10.18) Employment Agreement with Theodore L. Gillman, an executive officer of the Company, dated 2/18/03 (filed herewith)

(11) Statement Re: Computation of Per Share Earnings (filed herewith)

(99.1) Certification of CEO and CFO pursuant to Section 906 of the Sarbanes-Oxley Act

(b) Reports on Form 8-K

The following report on Form 8K was filed during the quarter ended March 31, 2003:

1. Form 8-K filed March 19, 2003 announcing the resignation of Registrant's Directors.

4238:

| <i>(In thousands, except per share amounts)</i>                     | Three Months Ended<br>March 31, |           |
|---------------------------------------------------------------------|---------------------------------|-----------|
|                                                                     | 2003                            | 2002      |
| <b>Basic:</b>                                                       |                                 |           |
| Net income (loss)                                                   | \$2,223                         | \$(2,008) |
| Weighted average number of shares<br>outstanding during the period  | 10,238                          | 9,482     |
| Net income (loss) per share                                         | \$0.22                          | \$(0.21)  |
| <b>Dilutive:</b>                                                    |                                 |           |
| Net income (loss)                                                   | \$2,223                         | \$(2,008) |
| Weighted average number of shares<br>outstanding during the period  | 10,238                          | 9,482     |
| Effect of dilutive common equivalent shares                         | 337                             | -         |
| Weighted average shares and common<br>equivalent shares outstanding | 10,575                          | 9,482     |
| Net income (loss)                                                   | \$0.21                          | \$(0.21)  |

4381:

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: 05/14/2003

/s/ Alan P. Goldberg

Alan P. Goldberg

President/Co-Chief Executive Officer

Date: 05/14/2003

/s/ Steven R. Jenkins

Steven R. Jenkins

Chief Financial Officer

(Principal Accounting Officer)

**Certification on Form 10-Q**

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-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures 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) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and



c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: 05/14/2003

/s/ Alan P. Goldberg

Alan P. Goldberg

Co-Chief Executive Officer

### **Certification on Form 10-Q**

I, Steven R. Jenkins, 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-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures 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) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: 05/14/2003

Steven R. Jenkins

/s/ Steven R. Jenkins

Chief Financial Officer

### **Certification on Form 10-Q**

I, George C. McNamee, 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-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures 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) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: 05/14/2003

/s/ George C. McNamee

George C. McNamee

Co-Chief Executive Officer