

**FIRST ALBANY CAPITAL INC.**  
(A wholly owned subsidiary of First Albany Companies Inc.)

STATEMENT OF FINANCIAL CONDITION

As of December 31, 2006

Report of Independent Auditors

To the Board of Directors and Stockholder of  
First Albany Capital Inc.

In our opinion, the accompanying statement of financial condition presents fairly, in all material respects, the financial position of First Albany Capital Inc. (the "Company") at December 31, 2006 in conformity with accounting principles generally accepted in the United States of America. This financial statement is the responsibility of the Company's management. Our responsibility is to express an opinion on this financial statement based on our audit. We conducted our audit of this statement in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the statement of financial condition is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the statement of financial condition, assessing the accounting principles used and significant estimates made by management, and evaluating the overall statement of financial condition presentation. We believe that our audit of the statement of financial condition provides a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP  
February 16, 2007

**STATEMENT OF FINANCIAL CONDITION**  
**(In thousands of dollars)**

	December 31 2006
<b>ASSETS</b>	
Cash	\$ 1,566
Cash and securities segregated under federal regulations	5,200
Securities purchased under agreements to resell	14,083
Receivables from:	
Brokers, dealers and clearing agencies	10,401
Customers	2,898
Affiliates	156
Others	5,792
Securities owned, at market value	187,774
Other assets	1,846
<b>Total assets</b>	<b>\$ 229,716</b>
<b>LIABILITIES AND STOCKHOLDER'S EQUITY</b>	
<b>Liabilities</b>	
Short-term bank loans	\$ 128,525
Payables to:	
Brokers, dealers and clearing agencies	5,258
Customers	1,153
Affiliates	3,524
Others	6,871
Securities sold, but not yet purchased, at market value	15,989
Accounts payable	2,689
Accrued compensation	26,960
Accrued expenses	2,979
<b>Total liabilities</b>	<b>193,948</b>
Subordinated debt	4,424
<b>COMMITMENTS AND CONTINGENCIES</b>	
<b>Stockholder's equity</b>	
Preferred, voting, 6% cumulative, \$10 par value; authorized 20,000 shares; none issued	
Common, voting, \$.01 par value; authorized 5,000,000 shares; 100 issued and outstanding	
Additional paid-in capital	32,731
Accumulated deficit	(1,387)
<b>Total stockholder's equity</b>	<b>31,344</b>
<b>Total liabilities and stockholder's equity</b>	<b>\$ 229,716</b>

The accompanying notes are an integral  
part of this financial statement

## NOTES TO THE FINANCIAL STATEMENT

### **Significant Accounting Policies**

First Albany Capital Inc. (the Company) is a wholly owned subsidiary of First Albany Companies Inc. (the Parent). The Company is a broker-dealer registered with the Securities and Exchange Commission (SEC) and is a member of the National Association of Securities Dealers, Inc., the New York Stock Exchange and various other exchanges. The Company's primary businesses include securities brokerage for institutional customers and investment banking services to corporate and public clients primarily in the United States. Additionally, the Company engages in market-making and trading of corporate, government and municipal securities primarily in the United States.

### Liquidity and Net Capital

The Company has experienced recurring losses. Continuing losses will impact the Company's liquidity and net capital. Management's plans in this regard include increasing revenue and reducing cash compensation and benefit costs by restructuring incentive compensation. Based upon management's plans, management believes it will have adequate resources and regulatory capital to continue operations for at least the next twelve months. However, there can be no assurance that management's plans will be achieved and accordingly continued losses could adversely affect the Company's liquidity and net capital.

### Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates.

### Resale and Repurchase Agreements

Transactions involving purchases of securities under agreements to resell or sales of securities under agreements to repurchase are accounted for as collateralized financing transactions and are recorded at their contracted resale or repurchase amounts plus accrued interest. It is the policy of the Company to obtain possession of collateral with a market value equal to or in excess of the principal amount loaned under resale agreements. Collateral is valued daily and the Company may require counter parties to deposit additional collateral or return collateral pledged when appropriate.

At December 31, 2006, the Company had entered into a number of resale agreements with Mizuho Securities USA and First Tennessee valued at \$14.1 million. The collateral held by the Company consists of government bonds and was equal to the approximate principal amount loaned to Mizuho Securities USA and First Tennessee. These resale agreements may be cancelled or renewed on a daily basis by either the Company or the counter party.

### Securities-Borrowing Activities

Securities borrowed are generally reported as collateralized financings and are recorded at the amount of cash collateral advanced. Securities borrowed transactions require the Company to deposit cash or other collateral with the lender. The Company monitors the market value of securities borrowed on a daily basis, with additional collateral obtained or refunded as necessary. The Company no longer engages in securities lending transactions.

### Collateral

The Company receives collateral in connection with resale agreements and securities borrowed transactions. Under many agreements, the Company is permitted to sell or repledge these securities held as

collateral and use the securities to secure repurchase agreements or to deliver to counter parties to cover short positions. The Company continues to report assets it has pledged as collateral in secured borrowing transactions and other arrangements when the secured party cannot sell or repledge the assets and does not report assets received as collateral in secured lending transactions and other arrangements because the debtor typically has the right to redeem the collateral on short notice.

#### Exchange Memberships

Exchange memberships are recorded at cost or, if an other than temporary impairment in value has occurred, at a value that reflects management's estimate of the impairment.

#### Drafts Payable

The Company maintains a group of "zero-balance" bank accounts which are included in payables to others on the Statement of Financial Condition. The balances in the "zero-balance" accounts represent outstanding checks that have not yet been presented for payment at the bank. The Company has sufficient funds on deposit to clear these checks, and these funds will be transferred to the "zero-balance" accounts upon presentation. The Company maintains one "zero-balance" account which is used as a cash management technique, permitted under Rule 15c3-3 of the Securities and Exchange Commission, to obtain federal funds for a fee, which is lower than prevailing interest rates, in amounts equivalent to amounts in customers' segregated funds accounts with a bank ( See "Cash and Securities Segregated Under Federal Regulations" Note).

#### Income Taxes

The Company files a consolidated federal and various combined state and local income tax returns with its Parent and separate tax returns with certain other states and localities. The income tax provision or benefit is computed on a separate return basis as a member of a controlled group and is allocated to the Company by its Parent.

Under the asset and liability method, deferred income taxes are recognized for the tax consequences of "temporary differences" by applying enacted statutory tax rates applicable for future years to differences between financial statement basis and tax basis of existing assets and liabilities. The effect of tax rate changes on deferred taxes is recognized in the income tax provision in the period that includes the enactment date.

#### Fair Value of Financial Instruments

The financial instruments of the Company are reported on the Statement of Financial Condition at market or fair value, or at carrying amounts that approximate fair values, because of the short maturity of the instruments except subordinated debt. The estimated fair value of subordinated debt at December 31, 2006, approximates its carrying value based on current rates available.

#### **Cash and Securities Segregated Under Federal Regulations**

At December 31, 2006, the Company segregated cash of \$5.2 million in a special reserve bank account for the benefit of customers under Rule 15c3-3 of the Securities and Exchange Commission.

**Receivables From and Payables To Brokers, Dealers and Clearing Agencies**

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

<i>(In thousands of dollars)</i>	December 31, 2006
Securities borrowed	\$ 445
Securities fail-to-deliver	3,841
Commissions receivable	2,146
Deposits with clearing organizations	3,959
<b>Total</b>	<b>\$ 10,401</b>

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

<i>(In thousands of dollars)</i>	December 31, 2006
Adjustment to record securities owned on a trade date basis, net	2,173
Securities fail-to-receive	\$ 3,085
<b>Total</b>	<b>\$ 5,258</b>

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

**Receivables from Customers**

At December 31, 2006, receivables from customers are mainly comprised of the purchase of securities by institutional clients. Delivery of these securities is made only when the Company is in receipt of the funds from the institutional clients.

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

If the clearing agent incurs a loss, it has the right to pass the loss through to the Company which exposes the Company to off-balance-sheet risk. The Company has retained the right to pursue collection or performance from customers who do not perform under their contractual obligations and monitors customer balances on a daily basis along with the credit standing of the clearing agent. As the potential amount of losses during the term of this contract has no maximum, the Company believes there is no maximum amount assignable to this indemnification. At December 31, 2006, substantially all customer obligations were fully collateralized and the Company has not recorded a liability related to the clearing agent's right to pass losses through to the Company.

**Securities Owned and Sold, But Not Yet Purchased**

Securities owned and sold, but not yet purchased, consisted of the following at December 31:

<i>(In thousands of dollars)</i>	2006	
	Owned	Sold, But Not Yet Purchased
<b>Marketable Securities</b>		
U.S. Government and federal agency obligations	\$ 10,134	\$ 15,262
State and municipal bonds	139,811	26
Corporate obligations	23,659	84
Equity securities	12,989	456
Options	258	161
<b>Not Readily Marketable Securities</b>		
Investment securities with no publicly quoted market	620	-
Investment securities subject to restrictions	303	-
<b>Total</b>	<b>\$ 187,774</b>	<b>\$ 15,989</b>

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

**Short-Term Bank Loans**

Short-term bank loans are made under a variety of bank lines of credit totaling \$210.0 million of which \$128.5 million is outstanding at December 31, 2006. These bank lines of credit consist of credit lines that the Company has been advised are available solely for financing securities inventory, but for which no contractual lending obligation exists and are repayable on demand. These loans are collateralized by eligible securities, including Company owned securities, subject to certain regulatory formulas. Typically, these lines of credit will allow the Company to borrow up to 85% to 90% of the market value of the collateral. These loans bear interest at variable rates based primarily on the Federal Funds interest rate. The weighted average interest rates on these loans are 5.74% at December 31, 2006. At December 31, 2006, short-term bank loans are collateralized by Company owned securities, which are classified as securities owned, of \$145.1 million.

The Company is contingently liable under bank stand-by letter of credit agreements, executed in connection with office lease activities, totaling \$0.2 million at December 31, 2006. The letter of credit agreements were collateralized by Company owned securities with a market value of \$0.2 million at December 31, 2006.

**Payables To Others**

Amounts payable to others consisted of the following at December 31:

<i>(In thousands of dollars)</i>	2006	
Draft payables	\$	5,942
Others		929
<b>Total</b>	<b>\$</b>	<b>6,871</b>

The Company maintains a group of “zero-balance” bank accounts which are included in payables to others on the Statement of Financial Condition. Drafts payable represents the balances in these accounts related to outstanding checks that have not yet been presented for payment at the bank. The Company has sufficient funds on deposit to clear these checks, and these funds will be transferred to the “zero-balance” accounts upon presentment. The Company maintains one “zero-balance” account which is used as a cash management technique, permitted under Rule 15c3-3 of the Securities and Exchange Commission, to obtain federal funds for a fee, which is lower than prevailing interest rates, in amounts equivalent to amounts in customers’ segregated funds accounts with a bank ( See “Cash and Securities Segregated Under Federal Regulations” Note).

## **Commitments and Contingencies**

### Litigation:

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

In the ordinary course of business, the Company is called upon from time to time to answer inquiries and subpoenas on a number of different issues by self-regulatory organizations, the SEC and various state securities regulators. In recent years, there has been an increased incidence of regulatory enforcement in the United States involving organizations in the financial services industry, and the Company is no exception. We are not always aware of the subject matter of the particular inquiry or the ongoing status of a particular inquiry. As a result of some of these inquiries, the Company has been cited for technical operational deficiencies. Although there can be no assurance as to the eventual outcome of these proceedings, none of these inquiries has to date had a material effect upon the business or operations of the Company.

Without admitting or denying any wrongdoing or liability, on December 28, 2006, the Company’s wholly owned subsidiary, First Albany Capital Inc. (“First Albany”), entered into a settlement agreement with Arthur Murphy, a former member of the Board of Directors and an Executive Managing Director of the Company in connection with an arbitration claim that he had filed against First Albany. In connection with his termination of employment by First Albany as Executive Managing Director, Mr. Murphy filed an arbitration claim against First Albany, Alan Goldberg, former President and Chief Executive Officer, and George McNamee, Chairman of First Albany Companies Inc. with the National Association of Securities Dealers on June 24, 2005. The claim alleged damages in the amount of \$8 million based on his assertions that he was fraudulently induced to remain in the employ of First Albany.

### Collateral:

The Company receives collateral in connection with resale agreements and securities borrowed transactions. Under many agreements, the Company is permitted to sell or repledge these securities held as collateral and use the securities to secure repurchase agreements or to deliver to counter parties to cover short positions. The Company continues to report assets it has pledged as collateral in secured borrowing transactions and other arrangements when the secured party cannot sell or repledge the assets and does not report assets received as collateral in secured lending transactions and other arrangements because the debtor typically has the right to redeem the collateral on short notice.

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The fair value of securities received as collateral, where the Company is permitted to sell or repledge the securities consisted of the following as of December 31:

<u>(In thousands of dollars)</u>	<u>2006</u>
Securities purchased under agreements to resell	\$ 13,990
Securities borrowed	442
<b>Total</b>	<b>\$ 14,432</b>

As of December 31, 2006, no collateral had been sold or repledged.

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 December 31, 2006, the Company had \$0.4 million in outstanding underwriting commitments and had purchased or sold no securities on a when-issued basis.

As of December 31, 2006, the Company has guaranteed compensation payments of \$10.8 million payable over the next four years related to various compensation arrangements with its employees.

### **Related Party Transactions**

#### Securities transactions

The Company clears securities transactions for its Parent and affiliates, and certain of the Parent's investments are managed by an affiliate. Revenues and expenses associated with these transactions are nominal.

#### Advances

The Company periodically provides advances to its Parent and affiliates or receives advances from its Parent and affiliates. Typically, advances are to fund certain operating expenses, tax payments and capital purchases. These advances are included in Receivables from and Payable to Parent and affiliates on the Statement of Financial Condition.

During 2006, the Parent sold to the Company certain publicly traded investments, valued at market value on the trade date, to reduce its liability to the Company and to contribute additional capital to the Company.

#### Other

To the extent that employees of the Company participate in certain stock based benefit plans sponsored by the Company's Parent, the expense associated with these plans is recognized by the Company and either a liability to the Parent or capital contribution by the Parent is recognized. Any tax benefits related to these benefit plans are also recognized by the Company.

#### Leases

The Company's headquarters and sales offices, and certain office and communication equipment are leased by the Parent under noncancellable operating leases, certain of which contain escalation clauses that expire at various times through 2015. Certain leases also contain renewal options. The Company is charged by the Parent for the use of such offices.

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The Parent's future minimum annual lease payments, net of sublease rental income related to offices used by the Company are as follows:

<i>(In thousands of dollars)</i>	Future Minimum Lease Payments	Sublease Rental Income	Net Lease Payments
2007	\$ 6,763	\$ 1,126	\$ 5,637
2008	5,310	809	4,501
2009	2,462	100	2,362
2010	2,361	100	2,261
2011	2,366	100	2,266
Thereafter to 2015	6,607	191	6,416
<b>Total</b>	<b>\$ 25,869</b>	<b>\$ 2,426</b>	<b>\$ 23,443</b>

### Subordinated Debt

A select group of management and highly compensated employees are eligible to participate in the First Albany Companies Inc. Deferred Compensation Plan for Key Employees (the "Plan"). The employees enter into subordinate loans with the Company to provide for the deferral of compensation and employer allocations under the Plan. The accounts of the participants of the Plan are credited with earnings and/or losses based on the performance of various investment benchmarks selected by the participants. Maturities of the subordinated debt are based on the distribution election made by each participant, which may be deferred to a later date by the participant. The amount of subordinate loans under the Plan at December 31, 2006 was \$4.4 million.

Principal debt repayment requirement as of December 31, 2006, are as follows:

<i>(In thousands of dollars)</i>	
2007	\$ 1,462
2008	1,299
2009	465
2010	287
2011	108
2012 to 2016	803
	<b>\$ 4,424</b>

The New York Stock Exchange has approved the Company's subordinated debt agreements disclosed above. Pursuant to these approvals, these amounts are allowable in the Company's computation of net capital.

### Income Taxes

The Company files a consolidated federal and various combined state and local income tax returns with its Parent and separate tax returns with certain other states and localities. The income tax provision or benefit is computed on a separate return basis as a member of a controlled group and is allocated to the Company by its Parent.

Under the asset and liability method, deferred income taxes are recognized for the tax consequences of "temporary differences" by applying enacted statutory tax rates applicable for future years to differences between financial statement basis and tax basis of existing assets and liabilities. The effect of tax rate changes on deferred taxes is recognized in the income tax provision in the period that includes the enactment date.

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The temporary differences that give rise to significant portions of deferred tax assets and liabilities consisted of the following at December 31:

<i>(In thousands of dollars)</i>	2006
Investments	\$ 13
Deferred compensation	7,970
Deferred revenues	(442)
Accrued liabilities	555
Other	183
Capital loss carryforwards	1,652
Net operating loss carryforward	12,385
Total deferred tax asset	22,316
Less valuation allowance	(22,316)
Net deferred tax asset	\$ -

The Company has recorded a valuation allowance at December 31, 2006 as a result of uncertainties related to the realization of its net deferred tax asset. The valuation allowance was established as a result of weighing all positive and negative evidence, including the Company's history of cumulative losses over the past three years and the difficulty of forecasting future taxable income. The valuation allowance reflects the conclusion of management that it is more likely than not that the benefit of the deferred tax assets will not be realized. The Company recorded a net change in its deferred tax valuation allowance in 2006 of \$4.2 million.

At December 31, 2006, the Company had federal net operating loss carryforwards of \$31.8 million, which will expire between 2024 and 2026. At December 31, 2006, the Company had state operating loss carryforwards for tax purposes approximating \$23.9 million, which will expire between 2009 and 2026.

The Company applies the "with and without" intra-period tax allocation approach described in the Emerging Issues Task Force (EITF) release Topic D-32 in determining the order in which tax attributes are considered. Under this approach a windfall benefit is recognized in additional paid in capital only if an incremental benefit is provided after considering all other tax attributes presently available to the Company. The Company measures windfall tax benefits considering only the direct effects of the stock option deduction. In the current year, there were no windfall tax benefits, only tax shortfalls, the tax impact of which was offset by the change in the valuation allowance.

The company has elected to apply the alternative transition method to calculate the historical pool of windfall tax benefits available as of the date of adoption of FAS 123(R) as described in FASB Staff Position No. FAS 123(R)-3.

### Net Capital Requirements

The Company is subject to the SEC's Uniform Net Capital Rule (Rule 15c3-1) which requires the maintenance of minimum net capital. The Company has elected to use the alternative method, permitted by the Rule, which requires that the Company maintain minimum net capital equal to 2% of aggregate debit balances arising from customer transactions, as defined, or \$1 million, whichever is greater. At December 31, 2006, the Company had net capital of \$19.5 million, which was 536.41% of aggregate debit balances and \$18.5 million in excess of required minimum net capital.

### NOTE 13. Trading Activities

As part of its trading activities, the Company provides to institutional clients, brokerage and underwriting services. While trading activities are primarily generated by client order flow, the Company also takes selective proprietary positions based on expectations of future market movements and conditions and to facilitate institutional client transactions. Interest revenue and expense are integral components of trading

activities. In assessing the profitability of trading activities, the Company views net interest and principal transactions revenues in the aggregate. Certain trading activities expose the Company to market and credit risks.

### Market Risk

Market risk is the potential change in an instrument's value caused by fluctuations in interest rates, equity prices, or other risks. The level of market risk is influenced by the volatility and the liquidity in the markets in which financial instruments are traded.

As of December 31, 2006, the Company had approximately \$1.5 million of securities owned which were considered non-investment grade. Non-investment grade securities are defined as debt and preferred equity securities rated as BB+ or lower or equivalent ratings by recognized credit rating agencies. These securities have different risks than investment grade rated investments because the companies are typically more highly leveraged and therefore more sensitive to adverse economic conditions and the securities may be more thinly traded or not traded at all.

The Company seeks to mitigate market risk associated with trading inventories by employing hedging strategies that correlate interest rate, price, and spread movements of trading inventories and hedging activities. The Company uses a combination of cash instruments and derivatives to hedge its market exposures. The following discussion describes the types of market risk faced by the Company:

*Interest Rate Risk:* Interest rate risk arises from the possibility that changes in interest rates will affect the value of financial instruments. The decision to manage interest rate risk using futures or options as opposed to buying or selling short U.S. Treasury or other securities depends on current market conditions and funding considerations.

*Equity Price Risk:* Equity price risk arises from the possibility that equity security prices will fluctuate, affecting the value of equity securities.

The Company also has sold securities that it does not currently own and will therefore be obligated to purchase such securities at a future date. The Company has recorded these obligations in the financial statements at December 31, 2006 at market values of the related securities and will incur a loss if the market value of the securities increase subsequent to December 31, 2006.

### Credit Risk

The Company is exposed to risk of loss if an issuer or counterparty fails to perform its obligations under contractual terms ("default risk"). Both cash instruments and derivatives expose the Company to default risk. The Company has established policies and procedures for mitigating credit risks on principal transactions, including reviewing and establishing limits for credit exposure, requiring collateral to be pledged, and assessing the creditworthiness of counter parties.

In the normal course of business, the Company executes, settles, and finances various customer securities transactions. Execution of these transactions includes the purchase and sale of securities by the Company. These activities may expose the Company to default risk arising from the potential that customers or counter parties may fail to satisfy their obligations. In these situations, the Company may be required to purchase or sell financial instruments at unfavorable market prices to satisfy obligations to other customers or counter parties. In addition, the Company seeks to control the risks associated with its customer margin activities by requiring customers to maintain collateral in compliance with regulatory and internal guidelines.

Liabilities to other brokers and dealers related to unsettled transactions (i.e., securities failed-to-receive) are recorded at the amount for which the securities were acquired, and are paid upon receipt of the securities from other brokers or dealers. In the case of aged securities failed-to-receive, the Company may purchase the underlying security in the market and seek reimbursement for losses from the counter party.

### Concentrations of Credit Risk

The Company's exposure to credit risk associated with its trading and other activities is measured on an individual counter party basis, as well as by groups of counter parties that share similar attributes. Concentrations of credit risk can be affected by changes in political, industry, or economic factors. The Company's most significant industry credit concentration is with financial institutions. Financial institutions include other brokers and dealers, commercial banks, finance companies, insurance companies and investment companies. This concentration arises in the normal course of the Company's brokerage, trading, financing, and underwriting activities. To reduce the potential for concentration risk, credit limits are established and monitored in light of changing counter party and market conditions. The Company also purchases securities and may have significant positions in its inventory subject to market and credit risk. 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 significance of the position sold. In order to control these risks, securities positions are monitored on at least a daily basis along with hedging strategies that are employed by the Company.

### **NOTE 14. Derivative Financial Instruments**

The Company does not engage in the proprietary trading of derivative securities with the exception of highly liquid treasury and municipal index futures contracts and options. These index futures contracts and options are used primarily to hedge securities positions in the Company's inventory.

The contractual or notional amounts related to the index futures contracts were as follows at December 31:

<i>(In thousands of dollars)</i>	2006
Average notional or contract market value	\$ (56,018)
Year end notional or contract market value	\$ (56,798)

The contractual or notional amounts related to these financial instruments reflect the volume and activity and do not reflect the amounts at risk. The amounts at risk are generally limited to the unrealized market valuation gains on the instruments and will vary based on changes in market value. Futures contracts are executed on an exchange, and cash settlement is made on a daily basis for market movements. Open equity in the futures contracts in the amount of \$2.4 million at December 31, 2006, are recorded as other assets. The settlements of the aforementioned transactions are not expected to have a material adverse effect on the financial condition of the Company.

### **NOTE 15. Discontinued Operations**

In May 2006, the Company closed its Taxable Fixed Income corporate bond division. For the year ended December 31, 2006, \$1.7 million of costs related to the closing of this division was paid, as well as other various residual activity.

### **NOTE 16. New Accounting Standards**

#### SFAS No. 157, Fair Value Measurements

In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 157, *Fair Value Measurements*. This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles in the United States of America, and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. Therefore, SFAS No. 157 will be effective for our fiscal year beginning January 1, 2008. The Company is currently evaluating the impacts of SFAS No. 157.

SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115

In February 2007, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115*. This Statement permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This Statement is expected to expand the use of fair value measurement, which is consistent with the Board’s long-term measurement objectives for accounting for financial instruments. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. Therefore, SFAS No. 159 will be effective for our fiscal year beginning January 1, 2008. The Company is currently evaluating the impacts of SFAS No. 159.

FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes

In July 2006, the Financial Accounting Standards Board (“FASB”) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (“FIN No. 48”). FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN No. 48 prescribes a recognition threshold and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN No. 48 establishes a two-step process for evaluation of tax positions. The first step is recognition, under which the enterprise determines whether it is more-likely-than-not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. The enterprise is required to presume the position will be examined by the appropriate taxing authority that has full knowledge of all relevant information. The second step is measurement, under which a tax position that meets the more-likely-than-not recognition threshold is measured to determine the amount of benefit to recognize in the financial statements. The tax position is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. Therefore, FIN No. 48 is effective for our fiscal year beginning January 1, 2007. The cumulative effect of adopting FIN No. 48 is required to be reported as an adjustment to the opening balance of retained earnings (or other appropriate components of equity) for that fiscal year, presented separately. The Company is currently analyzing the impact of adopting FIN No. 48. At this time the Company does not anticipate that FIN No. 48 will have a significant impact on the financial statements.

**NOTE 17. Subsequent Events**

Stock Based Compensation Awards

On January 26, 2007, the Company’s Parent announced that the Board of Directors of the Company’s Parent approved a Program designed to incentivize employees and better align their interest with those of the Company’s shareholders. The Program covers selected current employees of the Company and is comprised of two components. First, the employees will be allowed to rescind outstanding restricted share awards and the Company will grant them stock appreciation rights. Second, the Company will reprice outstanding out-of-the-money stock options held by the employees. Stock appreciation rights granted, and stock options repriced, pursuant to the closing market price of Parent’s stock following the completion of the offers to the employees.

The reprice component is subject to shareholder approval. In addition, the Parent intends to seek shareholder approval for the increase in the number of shares that may be issued upon exercise of stock appreciation rights, although such approval is not necessary for the issuance or exercise of the stock

appreciation rights. The Parent intends to seek such approvals at its next regular annual shareholders meeting.

The rescission of outstanding restricted share awards and the grants of stock appreciation rights will be affected pursuant to an offer expected to commence in the first quarter of 2007. The repricing will be effected pursuant to an offer expected to commence following shareholder approval. The financial impact of the Program on the Company will depend on the rate of employee participation, the value of the Parent's common stock in the future and the shareholder approvals referred to above. The Program could result in the issuance of up to an additional 4.8 million shares of the Parent's common stock.

Other

On February 16, 2007, Gordon J. Fox voluntarily resigned his employment with First Albany Capital Inc. as Executive Managing Director and Chief Operations Officer. Mr. Fox also served as Executive Managing Director of the Company's Parent, First Albany Companies Inc. The Company does not currently intend to replace Mr. Fox, but instead has distributed his duties and responsibilities among other employees.

Net Capital Requirements

At January 31, 2007, the Company had net capital of \$16.5 million, which was 615.47% of aggregate debit balances and \$15.5 million in excess of minimum net capital.