FIRST ALBANY COMPANIES INC
Form 10-K
March 14, 2007

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2006

- or -

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission file number 014140
FIRST ALBANY COMPANIES INC.
(Exact name of registrant as specified in its charter)

New York	**22-2655804**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
677 Broadway, Albany, New York	**12207**
(Address of principal executive offices)	*(Zip Code)*

Registrant s telephone number, including area code: (518) 447-8500

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	**Name of Each Exchange on Which Registered**
Common stock par value $.01 per share	Nasdaq Global Market

Securities registered pursuant to Section 12(g) of the Act:
None
(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. Yes o No þ

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

90 days. Yes þ   No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

Large Accelerated Filer o   Accelerated Filer þ   Non-accelerated Filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o   No þ

The aggregate market value of the shares of common stock of the Registrant held by non-affiliates based upon the closing price of Registrant s shares as reported on the NASDAQ system on June 30, 2006 which was $4.50 was $59,017,536.

As of February 22, 2007, 16,337,054 shares, par value $0.01 per share, were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant s definitive proxy statement to be filed with the Securities and Exchange Commission are incorporated by reference into Part III.

The Exhibit Index is included on page 84 through 87
The total number of pages in this document is 94.

PART I

Item 1. ***Business***

First Albany Companies Inc. and its subsidiaries (the Company) operate a full-service investment bank and institutional securities firm focused on the corporate middle market as well as government agencies and public institutions. The Company offers financial advisory and capital raising services to small and mid-cap companies and government agencies and provides trade execution in equity, mortgage-backed, convertible, high grade, tax-exempt and taxable municipal securities. The Company is traded on NASDAQ under the symbol FACT.

First Albany Capital Inc. (First Albany Capital), a subsidiary of First Albany Companies Inc., is a broker-dealer and investment banking firm serving the corporate middle market, as well as government agencies and public institutions. Through its Equities and Fixed Income businesses, the firm offers a diverse range of products and advisory services in the areas of corporate and public finance and fixed income and equity sales and trading. First Albany Capital was founded in 1953.

Descap Securities Inc. (Descap), a subsidiary of First Albany Companies Inc., is a specialized broker-dealer and boutique investment banking firm specializing in secondary trading of mortgage and asset-backed securities as well as the primary issuance of debt financing. The Company acquired Descap in May of 2004.

FA Technology Ventures Corporation (FATV), a subsidiary of First Albany Companies Inc., manages FA Technology Ventures L.P. and certain other employee investment funds, providing management and guidance for portfolio companies, which are principally involved in the emerging growth sectors of information and energy technology.

Effective as of January 2006, First Albany Capital Limited (FACL), a subsidiary of First Albany Companies Inc., commenced providing securities brokerage to institutional investors in the United Kingdom and Europe.

Through its subsidiaries, the Company is a member of the New York Stock Exchange, Inc. (NYSE), the National Association of Securities Dealers, Inc. (NASD), the American Stock Exchange, Inc. (ASE), the Boston Stock Exchange, Inc. (BSE) and various other exchanges and is registered as a broker-dealer with the Securities and Exchange Commission (SEC).

In the third quarter of 2006, the Company determined that it would dispose of its convertible arbitrage advisory group due to a continued decline of assets under management. The operating results of the convertible arbitrage advisory group are reported as discontinued operations.

In the second quarter of 2006, the Company ceased operations in the Taxable Fixed Income division due to a changing business climate and continued revenue declines. The operating results of the Taxable Fixed Income division are reported as discontinued operations.

On December 31, 2004, the Company ceased asset management operations in Sarasota, FL and on February 5, 2005 sold its asset management operations in Albany, NY, and these operating results are reported as discontinued operations.

In August 2000, First Albany Capital divested its retail brokerage operation (the Private Client Group). The operating results of the Private Client Group are reported as discontinued operations.

In March 2007, the Company and First Albany Capital agreed to sell First Albany Capital s Municipal Capital Markets Group (the Municipal Capital Markets Group) which consists primarily of the Company s Municipal Capital Markets segment (see Segment Analysis note to the Consolidated Financial Statements) to DEPFA BANK plc (DEPFA). This group is engaged in the business of underwriting, advisory services, sales and trading of U.S. municipal bonds and other similar instruments and securities. Completion of this sale is subject to a variety of conditions. See Part II Item 9b. Other Information.

Additional information about First Albany Companies Inc. is available on our website at http://www.firstalbany.com. We make available, free of charge, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and our proxy statements. Investors can find this information under the Investor Relations section of our website. These reports are available through our website as soon as reasonably practicable after we electronically file the material with, or furnish it to, the SEC. The information on our website is not incorporated by reference into this Report.

Also, the public may read and copy any materials the Company files with the SEC at the SEC s Public Reference Room at 450 Fifth Street, NW, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330.

The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC, at http://www.sec.gov.

Sources of Revenues

A breakdown of the amount and percentage of revenues from each principal source for the periods indicated follows (excludes discontinued operations):

	For the Years Ended December 31,					
	2006		2005		2004	
	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)					
Commissions	$ 11,799	9.0%	$ 17,513	10.7%	$ 19,799	12.9%
Principal transactions	63,708	48.8%	59,037	36.0%	66,171	43.0%
Investment banking	47,418	36.3%	47,441	28.9%	45,932	29.8%
Investment gains (losses)	(7,602)	(5.8)%	21,591	13.2%	10,070	6.5%
Fees and others	1,871	1.4%	3,391	2.1%	1,938	1.3%
Total operating revenues	117,194	89.7%	148,973	90.8%	143,910	93.4%
Interest income	13,499	10.3%	15,141	9.2%	10,100	6.6%
Total revenues	$ 130,693	100.0%	$ 164,114	100.0%	$ 154,010	100.0%

For information regarding the Company s reportable segment information, refer to Segment Analysis note of the Consolidated Financial Statements.

Commissions

A portion of the Company s revenue is derived from customer commissions on brokerage transactions for the Company s institutional clients, such as investment advisors, mutual funds, hedge funds, and pension and profit sharing plans, for which the Company is not acting as a market maker. The majority of the commission revenue is related to brokerage transactions in our listed equity trading group.

Principal Transactions

The Company specializes in trading and making markets in equity and debt securities. In the ordinary course of business the Company maintains securities positions as a market maker to facilitate customer transactions and, to a lesser extent, for investment purposes.

The Equities sales and trading group makes markets in 496 NASDAQ and over-the-counter stocks to facilitate customer transactions. In addition to trading profits and losses, included in principal transactions are commission-equivalents charged on certain principal trades for NASDAQ and over-the-counter securities.

The Company s Fixed Income business segments maintain inventories of municipal debt (tax-exempt and taxable), corporate debt, mortgage-backed and asset-backed securities, convertible securities, government securities and government agency securities.

The Company s trading activities require the commitment of capital, and the majority of the Company s inventory positions are for the purpose of generating sales credits by the institutional sales force. As a result, the Company exposes its own capital to the risk of fluctuations in market value. All inventory positions are marked to their market or fair value price on at least a weekly basis. The Company also hedges certain inventory positions with highly liquid future contracts and U.S. Government Securities. The following table sets forth the highest, lowest, and average month-end inventories (the net of securities owned and securities sold, but not yet purchased, less securities not readily marketable) for calendar year 2006, by securities category, where the Company acted in a principal capacity.

	Highest Inventory	Lowest Inventory (In thousands)	Average Inventory
State and municipal bonds	$ 166,402	$ 118,644	$ 140,797
Corporate obligations	58,137	26,358	35,593
Corporate stocks	29,763	9,398	16,694
U.S. Government and federal agencies obligations	44,574	(2,649)	22,935
Options	109	(19)	48

Investment Banking

The Company manages, co-manages, and participates in corporate securities offerings through its Equities and Fixed Income businesses. Participation in an underwriting syndicate or selling group involves both economic and regulatory risks. An underwriter or selling group member may incur losses if it is forced to resell the securities it has committed to purchase at less than the agreed-upon purchase price.

For the periods indicated, the table below highlights the number and dollar amount of corporate stock and bond offerings managed or co-managed by the Company and underwriting syndicate participations, including those managed or co-managed by the Company.

Corporate Stock and Bond Offerings

	Managed or Co-Managed		Syndicate Participations	
Year Ended	**Number of Issues**	**Amount of Offering**	**Number of Participations**	**Amount of Participation**
		(Dollars in thousands)		
December 2006	24	$ 3,671,851	28	$ 339,965
December 2005	18	1,637,381	21	195,166
December 2004	27	2,497,273	36	297,952

For the periods indicated, the table below highlights the number and dollar amount of municipal bond offerings managed or co-managed by the Company and underwriting participations, including those managed or co-managed by the Company.

Municipal Bond Offerings

	Managed or Co-Managed	Syndicate Participations
	Number of	**Number of**

Year Ended	Issues	Dollar Amount	Participations	Dollar Amount
		(Dollars in thousands)		
December 2006	329	$ 48,062,855	363	$ 4,660,377
December 2005	280	47,127,792	305	6,131,850
December 2004	266	61,845,138	293	11,308,895

Investment gains (losses)

The Company s investment portfolio includes interests in publicly and privately held companies. Investment gains (losses) are comprised of both unrealized and realized gains and losses from the Company s investment portfolio (see Investments note of the Consolidated Financial Statements).

Fees and Others

Fees and Others relate primarily to investment management fees earned by FATV.

Other Business Information

Operations

The Company s operations activities include: execution of orders; processing of transactions; receipt, identification, and delivery of funds and securities; custody of customers securities; internal control; and compliance with regulatory and legal requirements. The Company clears the majority of its own securities transactions.

The volume of transactions handled by the operations staff fluctuates substantially. The monthly numbers of purchase and sale transactions processed for the periods indicated were as follows:

	Number of Monthly Transactions		
Year Ended	**High**	**Low**	**Average**
December 2006	424,174	288,948	353,417
December 2005	648,768	309,614	462,898
December 2004	486,504	379,288	428,390

The Company has established internal controls and safeguards to help prevent securities theft, including the use of depositories and periodic securities counts. Operations, compliance, internal audit, and legal personnel monitor compliance with applicable laws, rules, and regulations. As required by the NYSE and other regulatory authorities, the Company s broker-dealer subsidiaries carry fidelity bonds covering loss or theft of securities as well as embezzlement and forgery.

Research

First Albany Capital maintains a professional staff of equity research analysts. Research is focused on several industry sectors, including healthcare, energy and technology. First Albany Capital employs 12 publishing analysts who support the Equities segment.

The Company s research analysts review and analyze the economy, general market conditions, technology trends, industries and specific companies through fundamental and technical analyses; make recommendations of specific action with regard to industries and specific companies; and respond to inquiries from customers.

Employees

At February 23, 2007, the Company s continuing operations had 284 full-time employees, of which 92 were institutional salespeople and institutional traders, 30 were investment bankers, 12 were research analysts, 80 were in other revenue support positions, and 70 were in corporate support and overhead. The Company considers its employee relations to be good and believes that its compensation and employee benefits are competitive with those offered by other securities firms. None of the Company s employees are covered by a collective bargaining agreement.

Regulation

The securities industry in the United States is subject to extensive regulation under federal and state laws. The SEC is the federal agency charged with administration of the federal securities laws. Much of the regulation of broker-dealers, however, has been delegated to self-regulatory organizations, principally the NASD and the national securities exchanges. These self-regulatory organizations adopt rules (subject to approval by the SEC), which govern the industry and conduct periodic examinations of member broker-dealers. Securities firms are also subject to regulation by state securities commissions in the states in which they are registered. First Albany Capital is currently registered as a broker-dealer in 50 states, the District of Columbia and Puerto Rico.

The regulations to which broker-dealers are subject cover all aspects of the securities business, including sales methods, trade practices among broker-dealers, capital structure of securities firms, recordkeeping, and conduct of directors, officers, and employees. Salespeople, traders, investment bankers and others are required to take examinations given by the NASD and approved by the NYSE and all principal exchanges as well as state securities authorities to both obtain and maintain their securities license registrations. Registered employees are also required to participate annually in the firm s continuing education program.

Additional legislation, changes in rules promulgated by the SEC and by self-regulatory organizations, or changes in the interpretation or enforcement of existing laws and rules often directly affect the method of operation and profitability of broker-dealers. The SEC, self-regulatory organizations, and state security regulators may conduct administrative proceedings which can result in censure, fine, suspension, or expulsion of a broker-dealer, its officers, or employees. The principal purpose of regulation and discipline of broker-dealers is the protection of customers and the securities markets rather than protection of creditors and stockholders of broker-dealers.

Net Capital Requirements

The Company s subsidiaries, First Albany Capital and Descap, as broker-dealers, are subject to the Uniform Net Capital Rule promulgated by the SEC. The Rule is designed to measure the general financial condition and liquidity of a broker-dealer, and it imposes a required minimum amount of net capital deemed necessary to meet a broker-dealer s continuing commitments to its customers.

Compliance with the Net Capital Rule may limit those operations which require the use of a firm s capital for purposes, such as maintaining the inventory required for trading in securities, underwriting securities, and financing customer margin account balances. Net capital, aggregate indebtedness and aggregate debit balances change from day to day, primarily based in part on a firm s inventory positions, and the portion of the inventory value the Net Capital Rule requires the firm to exclude from its capital.

At December 31, 2006, the Company s broker-dealer subsidiaries net capital and excess net capital were as follows:

	Net Capital	Excess Net Capital
	(In thousands)	
First Albany Capital	$ 19,517	$ 18,517
Descap	$ 2,070	$ 1,775

Item 1A. *Risk Factors*

This document includes statements that may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements often address our expected future business and financial performance, and often contain words such as may , will , expect , anticipate , believe , estimate , and or similar words. You should consider all statements other than historical information or current facts to be forward-looking statements. Our forward-looking statements may contain projections regarding our revenues, earnings, operations, and other financial projections, and may include statements of our future performance, strategies and objectives. However, there may be events in the future that we are not able to accurately predict or control that may cause our actual results to differ, possibly materially, from the expectations expressed in our forward-looking statements. All forward-looking statements involve risks and uncertainties, and actual results may differ materially from those discussed as a result of various factors. Such factors include, among others, market risk, credit risk and operating risk. These and other risks are set forth in greater detail below and elsewhere in this document. We caution you not to place undue reliance on these forward-looking statements. We do not undertake to update any of our forward-looking statements.

You should carefully consider the risk factors described below in addition to the other information set forth or incorporated by reference in this 2006 Annual Report on Form 10-K. If any of the following risks actually occur, our financial condition or results of operations could be materially adversely affected. These risk factors are intended to highlight some factors that may affect our financial condition and results of operations and are not meant to be an exhaustive discussion. Additional risks and uncertainties that we do not presently know or that we currently believe to be immaterial may also adversely affect us.

Company Risks

We have incurred losses in recent periods and may incur losses in the future. We have incurred losses in recent periods. We recorded a net loss of $44.0 million for the year ended December 31, 2006 and a net loss of $10.2 million for the year ended December 31, 2005. We have experienced declines in revenues generated by several of our key segments, including equities sales and trading, equity investment banking and fixed income sales and trading. We may incur losses and further declines in revenue in future periods. Historically, we have financed most of our losses through asset sales and the incurrence of debt. If we continue to incur losses and we are unable to raise funds to finance those losses, they could have a significant effect on our liquidity as well as our ability to operate.

In addition, we may incur significant expenses if we expand our underwriting and trading businesses or engage in strategic acquisitions and investments. Accordingly, we will need to increase our revenues at a rate greater than our expenses to achieve and maintain profitability. If our revenues do not increase sufficiently, or we are unable to manage our expenses, we will not achieve and maintain profitability in future periods.

Our current long-term notes payable contain certain covenants that require us to achieve specified financial results. These financial covenants are described under Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources . If we continue to incur losses in future periods, it will impede our ability to maintain these financial covenants which would put the loan in default. In the event of a default, the Company cannot be certain that it would be able to obtain additional financing on acceptable terms which could have a material adverse effect on our results of operations.

Our ability to retain our senior professionals and hire new senior management is critical to the success of our business. In order to operate our business successfully, we rely heavily on our senior professionals. Their personal reputation, judgment, business generation capabilities and project execution skills are a critical element in obtaining and executing client engagements. We encounter intense competition for qualified employees from other companies in the investment banking industry as well as from businesses outside the investment banking industry, such as hedge funds, private equity funds and venture capital funds. In the past, we have lost investment banking, brokerage, research, other professionals and, more recently, we lost several senior professionals. We could lose more in the future. Any loss of professionals, particularly key senior professionals or groups of related professionals, could impair our ability to secure or successfully complete engagements, materially and adversely affect our revenues and make it more difficult to return to profitability. In the future, we may need to hire additional personnel. At that time, there could be a shortage of qualified and, in some cases, licensed personnel whom we could hire. This could hinder our ability to expand or cause a backlog in our ability to conduct our business, including the handling of investment banking transactions and the processing of brokerage orders. These personnel challenges could harm our business, financial condition and operating results.

In addition, in the past year we have had several changes in our senior management, including the replacement of our Chief Executive Officer and acting Chief Financial Officer and the departure of another executive officer.

Limitations on our access to capital could impair our liquidity and our ability to conduct our businesses. Liquidity, or ready access to funds, is essential to financial services firms. Failures of financial institutions have often been attributable in large part to insufficient liquidity. Liquidity is of particular importance to our trading business and perceived liquidity issues may affect our clients and counterparties willingness to engage in brokerage transactions with us. Our liquidity could be impaired due to circumstances that we may be unable to control, such as a general market disruption or an operational problem that affects our trading clients, third parties or us. Further, our ability to sell assets may be impaired if other market participants are seeking to sell similar assets at the same time.

Our current borrowing capacity consists of $210 million in short-term borrowing arrangements. These bank lines of credit are available to us only for our securities trading operations and are repayable on demand. Typically, these lines of credit will allow the Company to borrow up to 85% to 90% of the market value of the collateral (see Short-Term Bank Loans and Notes Payable note of the Consolidated Financial Statements). If we need additional funding for other aspects of our business, we may seek to raise capital through issuance and sale of our common stock or the incurrence of additional debt. The sale of equity, or securities convertible into equity, would result in dilution to our stockholders. The incurrence of debt may subject us to covenants restricting our business activities. Additional funding may not be available to us on acceptable terms, or at all.

Our private equity business and investment portfolio may also create liquidity risk due to increased levels of investments in high-risk, illiquid assets. We have made substantial principal investments in our private equity funds and may make additional investments in future funds, which are typically made in securities that are not publicly traded. There is a significant risk that we may be unable to realize our investment objectives by sale or other disposition at attractive prices or may otherwise be unable to complete any exit strategy. In particular, these risks could arise from changes in the financial condition or prospects of the portfolio companies in which investments are made, changes in national or international economic conditions or changes in laws, regulations, fiscal policies or political conditions of countries in which investments are made. It takes a substantial period of time to identify attractive investment opportunities and then to realize the cash value of our investments through resale. Even if a private equity investment proves to be profitable, it may be several years or longer before any profits can be realized in cash. At December 31, 2006, $12.2 million of our total assets consisted of relatively illiquid private equity investments (see Investments note of the Consolidated Financial Statements).

First Albany Capital and Descap, our broker-dealer subsidiaries, are subject to the net capital requirements of the SEC and various self-regulatory organizations of which they are members. These requirements typically specify the minimum level of net capital a broker-dealer must maintain and also mandate that a significant part of its assets be kept in relatively liquid form. Any failure to comply with these net capital requirements could impair our ability to conduct our core business as a brokerage firm. Furthermore, First Albany Capital and Descap are subject to laws that authorize regulatory bodies to block or reduce the flow of funds from it to First Albany Companies Inc. As a holding company, First Albany Companies Inc. depends on dividends and other payments from its subsidiaries to support the funding of dividend payments to shareholders and debt obligations. As a result, regulatory actions could impede First Albany Companies Inc. s access to funds. In addition, because First Albany Companies Inc. holds equity interests in the firm s subsidiaries, its rights may be subordinated to the claims of the creditors of these subsidiaries.

Pricing and other competitive pressures may impair the revenues and profitability of our brokerage business. In recent years, we have experienced significant pricing pressures on trading margins and commissions in debt and equity trading. In the fixed income market, regulatory requirements have resulted in greater price transparency, leading to increased price competition and decreased trading margins. In the equity market, we have experienced increased pricing pressure from institutional clients to reduce commissions, and this pressure has been augmented by the increased use of electronic, algorithmic and direct market access trading, which has created additional competitive downward pressure on trading margins. The trend toward using alternative trading systems is continuing to grow, which may result in decreased commission and trading revenue, reduce our participation in the trading markets and our ability to access market information, and lead to the creation of new and stronger competitors. As a result of pressure from institutional clients to alter soft dollar practices and SEC rulemaking in the soft dollar area, some institutions are entering into arrangements that separate (or unbundle) payments for research products or services from sales commissions. These arrangements, both in the form of lower commission rates and commission sharing agreements, have increased the competitive pressures on sales commissions and have affected the value our clients place on high-quality research. Beginning in June 2006, one of our largest institutional brokerage clients in terms of commission revenue, Fidelity Management and Research Company, began to separate payments for research services and services for sales commissions for brokerage services, instead of compensating research services through sales commissions. Additional pressure on sales and trading revenue may impair the profitability of our brokerage business. Moreover, our inability to reach agreement regarding the terms of unbundling arrangements with institutional clients who are actively seeking such arrangements could result in the loss of those clients, which would likely reduce our institutional commissions. We believe that price competition and pricing pressures in these and other areas will continue as institutional investors continue to reduce the amounts they are willing to pay, including by reducing the number of brokerage firms they use, and some of our competitors seek to obtain market share by reducing fees, commissions or margins.

We focus principally on specific sectors of the economy, and a deterioration in the business environment in these sectors generally or decline in the market for securities of companies within these sectors could materially adversely affect our businesses. For example, our equity business focuses principally on the healthcare, energy and technology sectors of the economy. Therefore, volatility in the business environment in these sectors generally, or in the market for securities of companies within these sectors particularly, could substantially affect our financial results and the market value of our common stock. The market for securities in each of our target sectors may also be subject to industry-specific risks. Underwriting transactions, strategic advisory engagements and related trading activities in our target sectors represent a significant portion of our businesses. This concentration exposes us to the risk of substantial declines in revenues in the event of downturns in these sectors of the economy and any future downturns in our target sectors could materially adversely affect our business and results of operations.

Increase in capital commitments in our trading, underwriting and other businesses increases the potential for significant losses. The trend in capital markets is toward larger and more frequent commitments of capital by financial services firms in many of their activities. For example, in order to win business, investment banks are increasingly committing to purchase large blocks of stock from publicly-traded issuers or their significant shareholders, instead of the more traditional marketed underwriting process, in which marketing was typically completed before an investment bank committed to purchase securities for resale. As a result, we may be subject to increased risk as we commit greater amounts of capital to facilitate primarily client-driven business. Furthermore, we may suffer losses even when economic and market conditions are generally favorable for others in the industry.

We may enter into large transactions in which we commit our own capital as part of our trading business. The number and size of these large transactions may materially affect our results of operations in a given period. We may also incur significant losses from our trading activities due to market fluctuations and volatility from quarter to quarter. We maintain trading positions in the fixed income and equity markets to facilitate client-trading activities. To the extent that we own security positions, in any of those markets, a downturn in the value of those securities or in those markets could result in losses from a decline in value. Conversely, to the extent that we have sold securities we do not own in any of those markets, an upturn in those markets could expose us to potentially unlimited losses as we attempt to acquire the securities in a rising market.

Our principal trading and investments expose us to risk of loss. A significant portion of our revenues is derived from trading in which we act as principal. Although the majority of our principal trading is riskless principal in nature, we may incur trading losses relating to the purchase, sale or short sale of municipal, corporate, asset-backed and equity securities for our own account and from other principal trading. In any period, we may experience losses as a result of price declines, lack of trading volume, and illiquidity. From time to time, we may engage in a large block trade in a single security or maintain large position concentrations in a single security, securities of a single issuer, or securities of issuers engaged in a specific industry. In general, because our inventory is marked to market on a weekly basis, any downward price movement in these securities could result in a reduction of our revenues and profits.

In addition, we may engage in hedging transactions and strategies that may not properly mitigate losses in our principal positions. If the transactions and strategies are not successful, we could suffer significant losses.

Our financial results may fluctuate substantially from period to period, which may impact our stock price. We have experienced, and expect to experience in the future, significant periodic variations in our revenues and results of operations. These variations may be attributed in part to fluctuations in the value of our investment portfolio and the fact that our investment banking revenues are typically earned upon the successful completion of a transaction, the timing of which is uncertain and beyond our control. In most cases, we receive little or no payment for investment banking engagements that do not result in the successful completion of a transaction. We may nevertheless incur significant direct and indirect expenses in connection with such transactions. As a result, our business is highly dependent on market conditions as well as the decisions and actions of our clients and interested third parties. If the parties fail to complete a transaction on which we are advising or an offering in which we are participating, we will earn little or no revenue from the transaction. This risk may be intensified by our focus on growth companies in the healthcare, energy and technology sectors, as the market for securities of these companies has experienced significant variations in the number and size of equity offerings as well as the after-market trading volume and prices of newly issued securities. Recently, more companies initiating the process of an initial public offering are simultaneously exploring merger and acquisition exit opportunities. If we are not engaged as a strategic advisor in any such dual-tracked process, our investment banking revenues would be adversely affected in the event that an initial public offering is not consummated. In addition, our investments in our private equity funds are adjusted for accounting purposes to fair value at the end of each quarter and our allocable share of these gains or losses will affect our revenues even when these market fluctuations have no cash impact, which could increase the volatility of our quarterly earnings.

As a result, we are unlikely to achieve steady and predictable earnings on a quarterly basis, which could in turn adversely affect our stock price. For more information, see Management s Discussion and Analysis of Financial Condition and Results of Operations.

If we violate the listing requirements of The NASDAQ Global Market, our common stock may be delisted. To maintain our listing on The NASDAQ Global Market, we must meet certain financial and liquidity criteria. One of these criteria requires that we maintain a minimum bid price per share of $1.00. We currently meet the listing standards for continued listing on The NASDAQ Global Market. The last reported sale price of our common stock on February 23, 2007 was $1.8699 per share. The market price of our common stock has been and may continue to be subject to significant fluctuation as a result of periodic variations in our revenues and results of operations. If we violate The NASDAQ Global Market listing requirements, we may be delisted.

Difficult market conditions could adversely affect our business in many ways. Difficult market and economic conditions and geopolitical uncertainties have in the past adversely affected and may in the future adversely affect our business and profitability in many ways. Weakness in equity markets and diminished trading volume of securities could adversely impact our brokerage business. Industry-wide declines in the size and number of underwritings and mergers and acquisitions also would likely have an adverse effect on our revenues. In addition, reductions in the trading prices for equity securities also tend to reduce the deal value of investment banking transactions, such as underwriting and mergers and acquisitions transactions, which in turn may reduce the fees we earn from these transactions. As we may be unable to reduce expenses correspondingly, our profits and profit margins may decline.

We face strong competition from larger firms. The brokerage and investment banking industries are intensely competitive and we expect them to remain so. We compete on the basis of a number of factors, including client relationships, reputation, the abilities of our professionals, market focus and the relative quality and price of our services and products. We have experienced intense price competition in some of our businesses, in particular discounts in large block trades and trading commissions and spreads. In addition, pricing and other competitive pressures in investment banking, including the trends toward multiple book runners, co-managers and multiple financial advisors handling transactions, have continued and could adversely affect our revenues, even as the volume and number of investment banking transactions have started to increase. We believe we may experience competitive pressures in these and other areas in the future, as some of our competitors seek to obtain market share by competing on the basis of price.

We are a small investment bank with 284 employees and net revenues of $114.8 million in 2006. Many of our competitors in the brokerage and investment banking industries have a broader range of products and services, greater financial and marketing resources, larger customer bases, greater name recognition, more professionals to serve their clients needs, greater global reach and more established relationships with clients than we have. These larger and better-capitalized competitors may be better able to respond to changes in the brokerage and investment banking industries, to compete for skilled professionals, to finance acquisitions, to fund internal growth and to compete for market share generally.

The scale of our competitors has increased in recent years as a result of substantial consolidation among companies in the brokerage and investment banking industries. In addition, a number of large commercial banks, insurance companies and other broad-based financial services firms have established or acquired underwriting or financial advisory practices and broker-dealers or have merged with other financial institutions. These firms have the ability to offer a wider range of products than we do, which may enhance their competitive position. They also have the ability to support investment banking with commercial banking, insurance and other financial services in an effort to gain market share, which has resulted, and could further result, in pricing pressure in our businesses. In particular, the ability to provide financing has become an important advantage for some of our larger competitors and, because we do not provide such financing, we may be unable to compete as effectively for clients in a significant part of the brokerage and investment banking market. Additionally, these broader, more robust investment banking and financial services platforms may be more appealing to investment banking professionals than our business, making it more difficult for us to attract new employees and retain those we have.

If we are unable to compete effectively with our competitors, our business, financial condition and results of operations will be adversely affected.

Our risk management policies and procedures may leave us exposed to unidentified or unanticipated risk. Our risk management strategies and techniques may not be fully effective in mitigating our risk exposure in all market environments or against all types of risk.