



2006 ANNUAL REPORT

TSX:FEI

Annual General Meeting

The Annual General Meeting of Shareholders
of Fortress Energy Inc. will be held:

May 29, 2007 at 10:00am MT

Bow Valley Conference Centre

Suite 300 (North Cote Room)

205 - 5th Avenue SW, Calgary, AB

T2P 2V7

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's discussion and analysis ("MD&A") should be read in conjunction with the consolidated financial statements of Fortress Energy Inc. ("Fortress" or the "Company", formerly known as SignalEnergy Inc.) for the years ended December 31, 2006 and 2005. The consolidated financial statements have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"). All tabular amounts in the following discussion are in thousands of Canadian dollars unless otherwise noted.

This MD&A provides management's analysis of Fortress' historical financial and operating performance based on information currently available. Actual results will vary from estimates and variances may be significant. Historical results are not indicative of future performance. This MD&A is dated April 2, 2007.

Non-GAAP Measurements

Management uses the term "funds from operations" to analyze operating performance and leverage, determined as cash flow from operating activities adjusted for changes in non-cash working capital balances. While widely used in the oil and gas industry, funds from operations does not have any standardized meaning prescribed by GAAP and therefore it may not be comparable to the calculation of similar measures for other entities. The Company considers funds from operations to be a key measure since it demonstrates the Company's ability to generate the cash necessary to fund future growth and repay debt. Funds from operations as presented is not intended to represent operating cash flow or operating profits for the period, nor should it be viewed as an alternative to cash flow from operating activities, net income (loss), or other measures of financial performance calculated in accordance with GAAP.

Management also uses certain key performance indicators ("KPI's") and industry benchmarks such as "operating netbacks" and funds from operations/boe to analyze financial and operating performance. These KPI's and benchmarks as presented do not have any standard meaning prescribed by GAAP and therefore may not be comparable with the calculation of similar measures for other entities.

BOE Presentation

Natural gas reserves and volumes recorded in thousand cubic feet are converted to barrels of oil equivalent ("boe") on the basis of six thousand cubic feet ("mcf") of gas to one barrel ("bbl") of oil. The term "barrels of oil equivalent" may be misleading, particularly if used in isolation. A boe conversion ratio of 6 mcf to 1 bbl is based on an energy equivalent conversion method primarily applicable at the burner tip and does not represent a value equivalent at the wellhead.

Forward Looking Statements

Statements in this MD&A may contain forward looking information including expectations of future production, components of cash flow and earnings, expected future events and/or financial results that are forward looking in nature and subject to substantial risks and uncertainties. The reader is cautioned that assumptions used in the preparation of such information may prove to be incorrect. The Company cautions the readers that actual performance will be affected by a number of factors, as many may respond to changes in economic and political circumstances throughout the world. Events or circumstances may cause actual results to differ materially from those predicted, a result of numerous known and unknown risks, uncertainties, and other factors, many of which are beyond the control of the Company. These risks include, but are not limited to: the risks associated with the oil and gas industry, commodity prices and exchange rate changes; industry related risks could include, but are not limited to, operational risks in exploration, development and production, delays or changes in plans; risks associated with the uncertainty of reserve estimates, health and safety risks and the uncertainty of estimates and projections of production, costs and expenses. These external factors beyond the Company's control may affect the marketability of oil and natural gas produced, industry conditions including changes in laws and regulations, changes in income tax regulations, increased competition, fluctuations in commodity prices, interest rates, and variations in the Canadian/United States dollar exchange rate. The reader is cautioned not to place undue reliance on this forward looking information.

Statements throughout this annual report that are not historical facts may be considered "forward looking statements." These forward looking statements sometimes include words to the effect that management believes or expects a stated condition or result. All estimates and statements that describe the Company's objectives, goals or future plans are forward looking statements. Since forward looking statements address future events and conditions, by their very nature they involve inherent risks and uncertainties. Actual results could differ materially from those currently anticipated due to any number of risks including, but not limited to:

- a. Risks associated with the oil and gas industry and regulatory bodies (e.g. operational risks in exploration, development and production);
- b. Delays or changes in plans with respect to exploration or development projects or capital expenditures;
- c. Uncertainty of estimates and projections relating to recoverable reserves, costs and expenses;
- d. Health, safety and environmental risks; and
- e. Commodity price and exchange rate fluctuations.

HIGHLIGHTS

	2006	2005
Sales volume:		
Natural gas (<i>mcf/d</i>)	2,744	5,585
Oil and NGLs (<i>bbl/d</i>)	95	245
Equivalence at 6:1 (<i>boe/d</i>)	553	1,176
Sales price:		
Natural gas (<i>\$/mcf</i>)	6.95	8.93
Oil and NGLs (<i>\$/bbl</i>)	59.94	61.15
Equivalence at 6:1 (<i>\$/boe</i>)	44.92	55.16
Financial: (000's)		
Petroleum and natural gas sales	9,090	23,670
Net income	8,088	2,086
Net income per share – basic and diluted	0.11	0.04
Funds from operations	2,614	10,933
Total assets	115,654	118,639
Capital expenditures	4,986	11,373
Net working capital (deficiency)	37,712	(29,480)
Weighted average shares outstanding – basic	74,494	55,077
Weighted average shares outstanding – diluted	74,494	55,370
Wells drilled:		
Gross	2	32
Net	0.7	20
Success rate (%)	100	97

CORPORATE OVERVIEW

In February 2006, the Company sold its Ferrier, Carrot Creek, Kaybob and Redwater properties for net cash proceeds of approximately \$91.2 million, after adjustments. The Company retained its assets in the Chigwell, Bashaw and Buick Creek areas. After the completion of the sale, the Company announced its intention to distribute the net proceeds (after repayment of existing indebtedness) to shareholders.

On March 27, 2006, Pearl Exploration and Production Ltd. announced its intention to make an offer (the "Offer") to acquire all of the issued and outstanding shares of Fortress. The Offer was withdrawn on June 22, 2006 due to a lack of support by Fortress shareholders.

In consideration of its fiduciary obligations to maximize shareholder value, the Company's Board of Directors decided to defer the decision of a distribution so that it could consider other strategic alternatives. In this regard, the Company engaged FirstEnergy Capital Corporation ("FirstEnergy") as its independent financial advisors to consider alternative transactions which could return greater value to shareholders than the proposed distribution and the retention or future sale of the remaining operating entity or properties.

On November 8, 2006, the Company announced that it had entered into an agreement to acquire Marauder Resources West Coast Inc. ("Marauder") and proposed to proceed with a plan of arrangement to reorganize its share capital. The consideration for the acquisition of Marauder was \$15.0 million cash, 16.3 million common shares of Fortress and the assumption of approximately \$8.2 million of indebtedness. Marauder's production at the time

of the acquisition was approximately 440 boe/d with an additional 200 boe/d behind pipe. In addition, Marauder held 14,000 net acres of undeveloped land with an average working interest of 54% and options to earn an additional 52,800 gross acres of undeveloped lands with up to 40 development drilling locations with access to production facilities. Marauder's lands are all located in the Ladyfern area straddling the borders of Alberta and British Columbia.

In conjunction with the acquisition of Marauder, the Company proposed an arrangement with its shareholders whereby existing shareholders could elect to receive one share of Fortress (a newly formed Alberta company) for every five shares of Signal held, \$1.30 cash for each Signal share or a combination thereof provided that the maximum amount of cash to be paid out to shareholders was \$30 million.

Following the completion of the arrangement and the acquisition of Marauder, Fortress has approximately 13.3 million common shares outstanding. The Company's 2007 capital budget is \$15 million which will fund the drilling of 10 infill development wells and 5 exploration wells in the Ladyfern area, all expected to be drilled by the end of the first quarter of 2007.

QUARTERLY HIGHLIGHTS

	2006				2005			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Sales volume:								
Natural gas (mcf/d)	3,010	1,777	1,833	4,366	6,253	5,990	5,100	4,929
Oil and NGLs (bbl/d)	20	35	69	263	430	242	170	145
Equivalence at 6:1 (boe/d)	522	331	375	991	1,472	1,240	1,020	966
Sales price:								
Natural gas (\$/mcf)	7.19	5.31	6.04	7.86	11.48	9.22	7.25	6.93
Oil and NGLs (\$/bbl)	57.19	65.43	57.08	59.62	65.95	62.88	56.59	47.86
Equivalence at 6:1 (\$/boe)	44.13	35.46	40.08	50.45	68.31	56.82	45.67	42.53
Benchmark prices:								
AECO bench (\$/gj)	6.53	5.39	5.71	7.19	10.84	8.76	6.98	6.49
Edmonton Par (\$/bbl)	65.24	80.26	80.43	68.90	72.18	77.80	65.80	61.07
Financial (\$000's):								
Petroleum and natural gas sales	2,149	1,079	1,362	4,500	9,250	6,483	4,238	3,699
Net income (loss)	(5,635)	(13)	270	13,440	952	536	85	513
Net income (loss) per share – basic and diluted (\$)	(0.08)	(0.00)	0.00	0.19	0.02	0.01	–	0.01
Funds from operations	1,089	821	17	687	4,223	3,141	2,208	1,361
Operating costs (\$/boe)	5.73	8.51	13.13	13.07	12.81	7.20	7.78	7.25

In February 2006, the Company sold its interest in certain oil and gas assets. The sale resulted in substantially lower sales volumes in the first three quarters of 2006 when compared to the same period in 2005. Effective November 15, 2006, the Company acquired Marauder Resources West Coast Inc. ("Marauder") which was producing at a rate of 440 boe/d at the time of acquisition. Significant increases in sales volumes were realized in the first and third quarters of 2005 with the acquisitions of Predator Exploration Ltd. ("Predator") and a private oil and gas company in January, and with the acquisition of Goose River Resources Ltd. ("Goose River") in August. These three acquisitions added production gains of approximately 750 boe/d at the time of acquisition. In addition to improved sales volumes throughout 2005, the Company benefited from significantly increased commodity prices in the third and fourth quarters of 2005.

The Company recorded a net loss of \$13,000 and a net loss of \$5,635,000 in the third and fourth quarters of 2006, respectively, compared to net income in the previous six calendar quarters. The net loss recorded in the fourth quarter of 2006 was attributed to a goodwill impairment charge of \$4,548,000 and additional costs incurred to fulfill the Company's commitments to the purchaser of the oil and gas properties that were sold in the first quarter of 2006. The net loss realized in the third quarter was mainly the result of decreased natural gas prices realized by the Company. Net income for the second quarter of 2006 is attributed to a future income tax recovery of \$1,068,000 recorded in that period. Net income for the first quarter of 2006 included a gain on the sale of oil and gas properties of \$20,087,000, before adjustments. Net income for the first quarter of 2005 is attributable to the recognition of a portion of previously unrecognized tax assets as a result of a 2004 flow-through share renunciation for which the income tax effects were recorded in March 2005. Net income in the fourth quarter of 2005 improved over the previous quarter due to record commodity prices and increased sales volumes resulting from the Goose River acquisition and the Company's drilling program which included the drilling of 31 gross wells (19 net wells) in the last half of 2005.

The Company recorded funds from operations in the fourth quarter of 2006 of \$1,089,000 compared to \$821,000 for the prior quarter. These increases from the funds provided from operations for the second quarter of 2006 of \$17,000 reflects decreases in royalties, operating expenses, and general and administrative expenses in the third and fourth quarters of 2006. Funds from operations in the second quarter of 2006 reflects substantially lower operating netbacks and certain one-off charges related to the sale of oil and gas properties and the failed Pearl offer. Funds from operations in the first quarter of 2006 decreased from the prior quarter due to the sale of oil and gas properties and substantially lower natural gas prices realized. Funds from operations improved throughout 2005 as a result of production increases and record commodity prices realized by the Company.

FOURTH QUARTER HIGHLIGHTS

	Three months ended December 31, 2006		Three months ended December 31, 2005	
	(\$000's)	\$/boe	(\$000's)	\$/boe
Petroleum and natural gas sales	2,149	44.13	9,250	68.31
Royalties (net of ARTC)	(24)	(0.49)	(2,036)	(15.03)
Operating expenses	(279)	(5.73)	(1,733)	(12.80)
	1,846	37.91	5,481	40.48
Funds from operations	1,089	22.36	4,223	31.18

The Company's sales volume decreased in the fourth quarter of 2006 to 522 boe/d from 1,472 boe/d for the fourth quarter of 2005. This decrease is primarily due to the sale of oil and gas properties in the first quarter of 2006. Marauder added sales volumes of 460 boe/d for 46 days from the closing of this acquisition - or 230 boe/d of additional production in the fourth quarter of 2006.

Petroleum and natural gas sales decreased to \$2,149,000 for the fourth quarter of 2006 from \$9,250,000 for the comparable period in 2005. This decrease is due to substantially lower commodity prices and the sale of oil and gas properties, as previously noted.

Royalties decreased substantially in the fourth quarter of 2006 due to previously unrecorded Alberta Royalty Tax Credits of approximately \$426,000. When adding back this previously unrecorded amount, royalties as a percentage of sales is 20.9% for the fourth quarter of 2006 which is consistent with 22.2% recorded for the fourth quarter of 2005. In addition, the Redwater property, which was sold in the first quarter of 2006, had a substantially higher royalty rate due to substantial freehold and overriding royalties charged on this property, which typically carry a higher charge than crown royalties. The majority of the properties retained from the sale are on crown lands.

Operating expenses decreased to \$279,000 for the fourth quarter of 2006, or \$5.73/boe, compared to \$1,733,000, or \$12.80/boe for the fourth quarter of 2005. This decrease is due to the sale of oil and gas properties in the first quarter of 2006. Particularly, the Redwater property, posted higher than average operating costs due to additional costs incurred for compressor and pump jack rentals, trucking, salt water disposal, and oil treating fees at third party facilities.

Funds from operations, decreased to \$1,089,000 for the fourth quarter of 2006 compared to \$4,223,000 for the fourth quarter of 2005 as a result of lower commodity prices and the sale of oil and gas assets in the first quarter of 2006. In addition, the Company incurred significant severance and retention costs and legal and advisory fees related to the downsizing of the Company as a result of the sale of oil and gas properties and an unsuccessful takeover bid for the Company in the first quarter of 2006.

RESULTS OF OPERATIONS

Sales

	December 31,	
	2006	2005
Sales volume:		
Natural gas (<i>mcf/d</i>)	2,744	5,585
Oil and NGLs (<i>bb/d</i>)	95	245
Equivalence at 6:1 (<i>boe/d</i>)	553	1,176
Sales price:		
Natural gas (<i>\$/mcf</i>)	6.95	8.93
Oil and NGLs (<i>\$/bbl</i>)	59.94	61.15
Equivalence at 6:1 (<i>\$/boe</i>)	44.92	55.16

Revenues from petroleum and natural gas sales decreased substantially from 2005 levels, as a result of the sale of oil and gas assets in the first quarter of 2006 and lower natural gas prices realized by the Company. Sales improved in the fourth quarter of 2006 over the prior two quarters due to the acquisition of Marauder which added gas sales of 450 boe/d from the closing.

Average sales volumes for 2006 were 553 boe/d compared to 1,176 boe/d for 2005. This decrease is a result of the sale of oil and gas properties in the first quarter of 2006 which was producing at a rate of approximately 1,100 boe/d at the time of sale.

Natural gas accounted for 83% of sales volumes for 2006 compared to 79% for 2005. This increase is due to the change in sales mix resulting from the sale of oil and gas properties in the first quarter of 2006 and the acquisition of Marauder in November 2006. As a result of the acquisition of Marauder, the Company's production is now weighted 95% to natural gas. The natural gas price realized by the Company in 2006 decreased to \$6.95/mcf from \$8.93/mcf a year earlier. The average sales price per mcf realized by the Company is consistent with the AECO spot price, adjusted for heat content and transportation costs.

The average price realized by the Company for oil and natural gas liquids sales for 2006 was \$59.94/bbl – a slight decrease from \$61.15/bbl for 2005. The price realized by the Company is slightly lower than the average Edmonton Par posting as a result of quality differentials and transportation costs.

All of the Company's production is marketed in the Alberta spot market and is unhedged.

Royalties

	December 31,	
	2006	2005
Royalties (net of Alberta Royalty Tax Credit) (\$000's)	1,398	5,262
\$/boe	6.93	12.26
Percentage of petroleum and natural gas sales	15.4	22.2

Royalties, consisting of crown, gross-override and freehold royalties were \$1,398,000 for 2006 – a decrease of \$3,864,000 from 2005, reflecting the sale of oil and gas properties and substantially lower sales. Alberta Royalty Tax Credits of \$426,000 recorded in 2006 reduced the overall crown royalty rate by 4.7%. In addition, in July of 2006, the Company was advised of an adjustment to its Capital Cost and Custom Processing Fee Adjustments (formerly "Gas Cost Allowance") that resulted from an under estimation of these amounts in 2005, resulting in a further reduction to the crown royalty rate of 1.8%.

Operating Expenses

	December 31,	
	2006	2005
Operating (\$000's)	2,161	3,908
\$/boe	10.71	9.10

The Company's operating expenses decreased to \$2,161,000 for 2006 from \$3,908,000 for 2005. This decrease can be attributed to the sale of oil and gas assets. On a per boe basis, operating expenses have increased in 2006 to \$10.71/boe, compared to \$9.10/boe in 2005. A substantial portion of this increase is due to the acquisition of the Redwater property in August 2005 which posted higher than average operating costs due to additional costs incurred for compressor and pump jack rentals, trucking, salt water disposal, and oil treating fees at third party facilities. Operating costs have trended downward in the third and fourth quarters of 2006.

General and Administrative Expenses

(\$000's)	December 31,	
	2006	2005
General and administrative expense	4,760	3,817
General and administrative costs capitalized	(410)	(979)
General and administrative expenses (net)	4,350	2,838
\$/boe	21.57	6.61

General and administrative expenses increased to \$4,760,000 in 2006 compared to \$3,817,000 in 2005. This increase is attributed to severance and retention costs of approximately \$959,000 recorded in the period due to the downsizing that occurred as a result of the sale of oil and gas properties in February 2006. Also, advisory and legal costs of approximately \$360,000 related to the failed Pearl offer were incurred in the second quarter of 2006. These one-time charges amount to \$6.53/boe. The Company's strategy has been to acquire oil and gas companies and to exploit the acquired assets, which results in higher levels of administrative and support staff to integrate the systems and operations of the acquired business than what might otherwise be required.

The Company capitalized general and administrative costs of \$410,000 in 2006 compared to \$979,000 in 2005. This decrease is due to a reduction in exploration and development activities conducted in the first three quarters of 2006 due to the sale of oil and gas properties in the first quarter of 2006 and the Board initiated process to review strategic alternatives.

Stock-based Compensation Expense

	December 31,	
	2006	2005
Stock-based compensation expense (\$000's)	822	1,080
Stock-based compensation expense capitalized	-	(170)
Stock-based compensation expense, net	822	910
\$/boe	4.08	2.12

Stock-based compensation expense reflects the value attributed to stock options granted to employees, officers, directors and consultants to the Company. Stock-based compensation expense for 2006 was \$822,000 compared to \$1,080,000 for 2005. As a result of the sale of oil and gas properties in February 2006 and the substantial reduction in the Company's asset base, all stock options outstanding that had not previously vested were vested on March 1, 2006. Stock-based compensation expense reflects the early vesting of these options.

Interest Expense

	December 31,	
	2006	2005
Interest expense (\$000's)	498	693
\$/boe	2.47	1.62

Interest expense decreased to \$498,000 for 2006 from \$693,000 for 2005. The Company repaid its operating loan on February 28, 2006 with the proceeds from the sale of oil and gas assets. Interest expense for the second, third, and fourth quarters of 2006 represents accrued interest on unspent flow-through funds that were raised in December 2005. Interest expense incurred in prior periods represents interest on the Company's operating loan, the proceeds of which were used to fund the cash portion of three corporate acquisitions and the Company's capital program.

Depletion and Depreciation Expense

	December 31,	
	2006	2005
Depletion and depreciation expense (\$000's)	4,865	8,879
\$/boe	24.12	20.69

Depletion and depreciation expense was \$4,865,000 for 2006 compared to \$8,879,000 for 2005. This decrease results from the sale of oil and gas assets in the first quarter of 2006. The depletion and depreciation expense rate for 2006 increased to \$24.12/boe from \$20.69/boe for 2005. This increase is a result of a reduction in proven reserves for the Bashaw 10-7 and Buick Creek B-22-C/94wells. These reductions were partially offset by new reserves related to 2 gross (0.7 net) wells in the Bashaw area that were brought onto production in the third quarter of 2006. The increase in the depletion and depreciation expense rate for 2006 reflects the mix of the properties sold and retained, reserve adjustments, and estimated future development costs of approximately \$15.6 million relating to the Marauder properties, which significantly increases the depletion and depreciation rate.

Accretion of Asset Retirement Obligations

	December 31,	
	2006	2005
Accretion of asset retirement obligations (<i>\$000's</i>)	90	253
\$/boe	0.45	0.59

Accretion expense was \$90,000 for 2006 compared to \$253,000 for 2005. The sale of oil and gas properties in February 2006 resulted in a reduction in asset retirement obligations by \$3,387,000 which has been assumed by the purchaser.

Income Tax

The Company recorded future income tax expense of \$36,000 for 2006 compared to a future income tax recovery for 2005 of \$1,100,000. The Company intends to apply its available tax pools to the sale proceeds to minimize the overall tax liability. In addition, the Company recorded the income tax effect of the 2005 flow-through share issuance in the first quarter of 2006 amounting to \$1,022,000. In the first quarter of 2005 the Company recorded a future income tax recovery of \$1,195,000 which reflects the income tax effect of a 2004 flow-through share issuance.

Operating Netback

	December 31,	
<i>(\$/per boe)</i>	2006	2005
Petroleum and natural gas sales	44.92	55.16
Less: Royalties (net of ARTC)	(6.93)	(12.26)
Operating expenses	(10.71)	(9.10)
Operating netback	27.28	33.80
Funds from operations	12.96	25.48

The operating netback for 2006 decreased to \$27.28/boe from \$33.80/boe for 2005, due to lower commodity prices realized in 2006.

Funds from operations for 2006 were \$12.95/boe compared to \$25.48/boe for 2005. This decrease is a result of lower operating netbacks and substantially higher general and administrative costs incurred in 2006, as previously noted in this MD&A.

Net Income

	December 31,	
<i>(\$000's except per share amounts)</i>	2006	2005
Net income	8,088	2,086
Net income per share – basic and diluted	0.11	0.04

The Company recorded net income of \$8,088,000 for 2006 compared to net income of \$2,086,000 for 2005. Net income for 2006 is attributed to the gain on sale of oil and gas assets of \$15,835,000. The effect of this gain was reduced by a goodwill impairment charge of \$4,548,000 which resulted from the Company's assessment of goodwill, based on the latest available information including the market capitalization of the Company as indicated by the Company's share price.

Capital Expenditures

(\$000's)	December 31,	
	2006	2005
Land and rentals	76	2,317
Seismic	18	320
Drilling and completions	1,343	13,525
Equipment and tie-ins	2,293	7,013
Property acquisitions	720	840
Capitalized overhead costs	410	1,149
Other	126	199
	4,986	25,363

In 2006, the Company recompleted 2 gross (0.7 net) wells and upgraded its gas gathering systems in the Bashaw area. In addition, the Company conducted 4 workover operations on wells in the Chigwell, Bashaw, and Buick Creek areas. This reflects a substantial reduction in activity levels compared to the previous year when the Company drilled 32 gross wells (20 net), mainly in the last two quarters. This reduction in activity level was facilitated by the Board initiated process announced in March 2006 to review strategic alternatives to maximize shareholder value.

LIQUIDITY AND CAPITAL RESOURCES

Cash provided by operating activities was \$741,000 for 2006 compared to \$4,323,000 for 2005. This decrease in cash provided by operating activities is due to decreased activity in the field due to the sale of oil and gas assets in the first quarter to 2006, lower operating netbacks and substantially higher general and administrative expenses realized.

Cash used in financing activities for 2006 was \$19,776,000 compared to cash provided by financing activities of \$25,314,000 for 2005. Cash provided by financing activities for 2005 represented an increase to the Company's operating loan to fund three corporate acquisitions and the 2005 drilling program. In the first quarter of 2006, the Company used the proceeds from the sale of oil and gas properties to repay its revolving operating loan which had \$28,550,000 drawn at the time of repayment. The exercise of stock options resulted in cash proceeds to the Company of \$3,199,000 in 2006.

Cash provided by investing activities for 2006 was \$55,730,000 compared to cash used in investing activities of \$32,294,000 in 2005. Cash provided by investing activities for 2006 reflects capital expenditures, a reduction in non-cash working capital balances as a result of the substantial decrease in the field activity levels, the proceeds from the sale of oil and gas properties, and the cash component of the acquisition of Marauder in November. The cash component of the Marauder acquisition was \$23,208,000, consisting of cash of \$15,000,000, transaction and severance costs of \$1,660,000, and the assumption of Marauder's operating line of credit which had \$6,548,000 drawn at the time of acquisition. The line was subsequently repaid by the Company. Cash used in financing activities for 2005 reflects property and equipment expenditures, the proceeds of sale on the Company's Twining property for proceeds of \$13,250,000 in the second quarter of 2005, and the cash component of the purchase price for three companies acquired in 2005. In 2005, the Company drilled 32 gross (20 net) wells compared to only 2 gross and 0.7 net wells in 2006. As noted previously in this MD&A, this decrease was the result of the Board initiated process to review strategic alternatives.

Securities Outstanding

Securities outstanding as of the date of this MD&A consist of 13,307,815 issued and outstanding common shares and 970,000 stock options. These figures reflect the reorganization of Signal on February 20, 2007, which resulted

in the redemption of 23,076,923 common shares for \$30 million of cash based on a redemption price of \$1.30 per share. This redemption left 66,539,059 common shares of Signal which were exchanged for 13,307,815 common shares of Fortress, based on a conversion factor of one share of Fortress for every five shares of Signal held. 4,850,000 options of Signal outstanding at the time of this reorganization were exchanged on a five for one basis resulting in the issuance of 970,000 options of Fortress. As a result of this reorganization, Fortress now holds all of the assets formerly held by Signal.

Off-balance Sheet Arrangements

The Company has no off-balance sheet arrangements.

Related Party Transactions

The Company has no related party transactions.

Commitments and Contingencies

The Company has no commodity price, interest rate swaps or fixed price contracts in place as of December 31, 2006.

The Company is committed to minimum annual lease payments under operating leases for office premises and office equipment to March, 2013, as follows:

	(\$000's)
2007	395
2008	431
2009	430
2010	435
2011	439
Thereafter	549
	2,679

Subsequent Events

A Reorganization (the "Reorganization") of SignalEnergy Inc. ("Signal"), including an arrangement (the "Arrangement") under the Companies Act (Quebec), was approved by the shareholders at a Special General Meeting of Shareholders held on February 15, 2007 and was effective on February 20, 2007.

Under the Arrangement, shareholders of Signal could elect to receive cash, common shares of Fortress, or a combination of both, subject to total cash available of \$30 million. Shareholders representing 63,400,000 common shares of Signal elected to receive cash which resulted in a cash distribution to shareholders of \$30 million to redeem 23,076,923 common shares of Signal at \$1.30 per share. The remaining 66,539,059 common shares of Signal were exchanged for common shares of Fortress on a basis of one common share of Fortress for every five common shares of Signal, resulting in the issuance of 13,307,815 common shares of Fortress.

On January 15, 2007, after giving effect to the Reorganization, the Company granted options to acquire 948,000 common shares of the Company at an exercise price of \$4.75 per share, expiring January 15, 2012.

Upon completion of the Reorganization, Fortress holds all of the assets formerly held by Signal.

New Canadian Accounting Pronouncements

The Canadian Institute of Chartered Accountants (CICA) has issued a number of accounting pronouncements, some of which may impact the Company's reported results and financial position in future periods.

Comprehensive Income/Financial Instruments/Hedges

The CICA issued new standards in early 2006 for Comprehensive Income (CICA 1530), Financial Instruments (CICA 3855) and Hedges (CICA 3865), which will be effective for the reporting year-end 2007. The new standards will bring Canadian rules in line with current rules in the US. The standards will introduce the concept of "Comprehensive Income" to Canadian GAAP and will require that an enterprise (a) classify items of comprehensive income by their nature in a financial statement and (b) display the accumulated balance of comprehensive income separately from retained earnings and additional paid-in capital in the equity section of a statement of financial position. Derivative contracts will be carried on the balance sheet at their mark-to-market value, with the change in value flowing to either net income or comprehensive income. Gains and losses on instruments that are identified as hedges will flow initially to comprehensive income and be brought into net income at the time the underlying hedged item is settled. It is expected that this standard will be effective for Fortress' 2007 reporting. Any instruments that do not qualify for hedge accounting will be marked-to-market with the adjustment (tax effected) flowing through the income statement.

Fortress does not currently have any hedges in place so the impact of these recommendations would not be significant.

Changes in Accounting Policies and Estimates, and Errors

In July 2006, the CICA issued a new standard for Changes in Accounting Policies and Estimates, and Errors (CICA 1300). The new standard applies to interim and annual financial statements for fiscal years beginning on or after January 1, 2007. The standard permits changes to accounting policies only when it is required by a primary source of GAAP, or when the change results in a reliable and more relevant presentation in the financial statements. The standard requires expanded disclosure about the effects of changes in accounting policy, estimates and errors on financial statements, and disclosure of new primary sources of GAAP that have been issued but have not yet come into effect and have not been adopted by the Company. Management expects that this new standard will not have a significant impact on future financial statements of the Company.

Disclosure Controls and Procedures

Disclosure controls and procedures have been designed to ensure that information required to be disclosed by the Company is accumulated and communicated to the Company's management as appropriate to allow timely decisions regarding required disclosure. The Company's Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of the end of the period covered by the annual filings, that the Company's disclosure controls and procedures as of the end of such period are effective to provide reasonable assurance that material information related to the Company, including its consolidated subsidiaries, is made known to them by others within those entities. It should be noted that while the Company's Chief Executive Officer and Chief Financial Officer believe that the Company's disclosure controls and procedures provide a reasonable level of assurance that they are effective, they do not expect that the disclosure controls and procedures will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

Internal Controls over Financial Reporting

Internal controls over financial reporting are defined in MI 52-109 as "... a process designed by, or under the supervision of, the issuer's chief executive officer and chief financial officer, or persons performing similar functions, and effected by the issuer's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the issuer's GAAP and includes those policies and procedures that:

- (a) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the acquisitions and dispositions of the assets of the issuer;
- (b) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with the issuer's GAAP, and that receipts and expenditures of the issuer are being made only in accordance with authorizations of management and directors of the issuer; and
- (c) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the issuer's assets that could have a material effect on the annual financial statements or interim financial statements."

The Company has conducted a review of the design of its internal controls over financial reporting, with the conclusion that as at December 31, 2006, the Company's system of internal controls over financial reporting as defined under MI 52-109 is sufficiently designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the Company's GAAP. In its assessment, the Company identified certain material weaknesses in the design of its internal controls over financial reporting:

- a) due to the small number of staff, it is not feasible to achieve the complete segregation of incompatible duties;
- b) due to the small number of staff, the Company relies upon third parties as participants in the Company's internal controls over financial reporting and accounting for income taxes; and
- c) due to the small number of staff, weaknesses may be caused by the number of corporate acquisitions and restructuring activities conducted in 2005 and 2006.

The Company believes these weakness are mitigated by: the active involvement of senior management and the board of directors in all the affairs of the Company; open lines of communication within the Company; the present levels of activities and transactions within the Company being readily transparent; the thorough review of the Company's financial statements by management, the board of directors and by the Company's auditors. In addition, the Company is increasing the size of its finance team. However, these mitigating factors will not necessarily prevent the likelihood that a material misstatement will not occur as a result of the aforesaid weaknesses in the Company's internal controls over financial reporting. A system of internal controls over financial reporting, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the internal controls over financial reporting are met.

BUSINESS RISKS AND UNCERTAINTIES

Fortress' production and exploration activities are concentrated in the Western Canadian Sedimentary Basin, where activity is highly competitive and includes a variety of different sized companies ranging from smaller junior producers to the much larger integrated petroleum companies. Fortress is subject to the various types of business risks and uncertainties including:

- finding and developing oil and natural gas reserves at economic costs;
- production of oil and natural gas in commercial quantities; and
- marketability of oil and natural gas produced.

In order to reduce exploration risk, the Company strives to employ highly qualified and motivated professional employees with a demonstrated ability to generate quality proprietary geological and geophysical prospects.

To help maximize drilling success, Fortress combines exploration in areas that afford multi-zone prospect potential, targeting a range of low to moderate risk prospects with some exposure to select high-risk with high-reward opportunities. The Company explores in areas where the Company has drilling experience.

The Company mitigates its risk related to producing hydrocarbons through the utilization of the most appropriate technology and information systems. In addition, the Company seeks to maintain operational control of its prospects.

Oil and gas exploration and production can involve environmental risks such as pollution of the environment and destruction of natural habitat, as well as safety risks such as personal injury. In order to mitigate such risks, Fortress conducts its operations at high standards and follows safety procedures intended to reduce the potential for personal injury to employees, contractors and the public at large. The Company maintains current insurance coverage for general and comprehensive liability as well as limited pollution liability. The amount and terms of this insurance are reviewed on an ongoing basis and adjusted as necessary to reflect changing corporate requirements, as well as industry standards and government regulations. Fortress may periodically use financial or physical delivery hedges to reduce its exposure against the potential adverse impact of commodity price volatility, as governed by formal policies approved by senior management subject to controls established by the Board of Directors.

CRITICAL ACCOUNTING ESTIMATES

The reader is advised that the critical accounting estimates, policies, and practices as described in this MD&A and report continue to be critical in determining Fortress' financial results.

The reader is further cautioned that the preparation of financial statements in accordance with GAAP requires management to make certain judgments and estimates that affect the reported amounts of assets, liabilities, revenues and expenses. Estimating reserves is also critical to several accounting estimates and requires judgments and decisions based upon available geological, geophysical, engineering and economic data. These estimates may change, having either a negative or positive effect on net earnings as further information becomes available, and as the economic environment changes. Changes in these judgments and estimates could have a material impact on the financial results and financial condition. The following discussion outlines accounting policies and practices that are critical to determining the Company's financial results:

Accounting for Petroleum and Natural Gas Operations

The Company follows the full cost method of accounting whereby all costs relating to the acquisition of, exploration for and development of oil and gas reserves are capitalized in a single Canadian cost center. Such costs include lease acquisition, lease rentals on undeveloped properties, geological and geophysical costs, drilling both productive and non-productive wells, production equipment and overhead charges directly related to acquisition, exploration and development activities.

The application of the full cost method of accounting requires management's judgment to determine the proper designation of wells as either developmental or exploratory, which will ultimately determine the proper income tax treatment of the costs incurred.

Full cost accounting depends on the estimated proven reserves that are believed to be recoverable from the Company's oil and gas properties. The process of estimating reserves is complex. It requires significant judgments and decisions based on available geological, geophysical, engineering, and economic data. These estimates may change substantially as additional data from ongoing development activities and production performance becomes available and as economic conditions impacting oil and gas prices and costs change. Our reserve estimates are based on current production forecasts, prices and economic conditions. Fortress' reserves were evaluated by the independent engineering firm Sproule Associates Ltd.

Reserve estimates are critical to many of our accounting estimates, including:

- Calculating our unit-of-production depletion and future site restoration rates. Proven reserve estimates are used to determine rates that are applied to each unit-of-production in calculating depletion expense.
- Assessing when necessary, oil and gas assets for possible impairment. Estimated future undiscounted cash flows are determined using proven reserves. The criteria used to assess impairment, including the impact of changes in reserve estimates, are discussed below.

As circumstances change and additional data becomes available, reserve estimates also change, possibly materially impacting net income. Estimates made are reviewed and revised, either upward or downward, as warranted by the new information. Revisions are often required due to changes in well performance, prices, economic conditions and governmental restrictions.

Although we make every reasonable effort to ensure that our reserve estimates are accurate, reserve estimation is an inferential science. As a result, the subjective decisions, new geological or production information and a changing environment may impact these estimates. Revisions to our reserve estimates can arise from changes in oil and gas prices, and reservoir performance. Such revisions can be either positive or negative.

It would take a very significant decrease in our proven reserves to limit our ability to borrow money under our credit facility.

Impairment of Petroleum and Natural Gas Properties

The Company reviews its full cost pool for impairment annually. An impairment provision is recorded whenever events or circumstances indicate that the carrying value of the Company's properties may not be recoverable. The impairment provision is based on the excess of carrying value over fair value. Fair value is defined as the present value of the estimated future net revenues from production of total proved and probable petroleum and natural gas reserves, as estimated by the Company on the balance sheet date. Reserve estimates, as well as estimates for petroleum and natural gas prices and production costs may change, and there can be no assurance that impairment provisions will not be required in the future.

Management's assessment of, among other things, the results of exploration activities, commodity price outlooks, and planned future development and sales, impacts the amount and timing of impairment provisions.

Asset Retirement Obligations

The asset retirement obligations provision recorded in the consolidated financial statements is based on an estimate for total costs for future site restoration and abandonment of the Company's petroleum and natural gas properties. This estimate is based on management's analysis of production structure, reservoir characteristics and depth, market demand for equipment, currently available procedures, and discussions with construction and engineering consultants. Estimating these future costs requires management to make estimates and judgments that are subject to future revisions based on numerous factors, including changing technology, political and regulatory environments.

Income Taxes

The Company records future tax assets and liabilities to account for the expected future tax consequences of events that have been recorded in its consolidated financial statements and its tax returns. These amounts are estimates; the actual tax consequences may differ from the estimates due to changing tax rates and regimes, as well as changing estimates of cash flows and capital expenditures in current and future periods. The Company periodically assesses its ability to realize on its future tax assets. If Fortress concluded that it is more likely than not that some portion

or all of the deferred tax assets will not be realized under accounting standards, the tax asset will be reduced by a valuation allowance.

Goodwill

The Company recognizes goodwill on corporate acquisitions when the total purchase price exceeds the fair value of the net identifiable assets and liabilities of the acquired entity. Goodwill is tested annually at year-end for impairment or as events occur that could result in impairment. Impairment is recognized based on the fair value of the Company compared to the book value of the Company. If the fair value of the Company is less than the book value, impairment is measured allocating the fair value to the identifiable assets and liabilities as if the Company had been acquired in a business combination for its fair value. The excess of the fair value over the amounts assigned to the identifiable assets and liabilities is the fair value of goodwill. Any excess of the book value over this implied fair value of goodwill is the impairment amount. Impairment is charged to the statement of operations in the period which it occurs. Goodwill is stated at cost less impairment and is not amortized.

Claims and Litigation

The Company is involved in various claims and litigation arising in the normal course of business. The outcome of these matters is uncertain and there can be no assurance that such matters will be resolved in the Company's favor. If the outcome is unfavorable, it could have a materially adverse impact on the Company's financial position or results of operations.

With the above risks and uncertainties, the reader is cautioned that future events and results may vary significantly from that which Fortress currently foresees.

MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The accompanying consolidated financial statements and all information in this report are the responsibility of management. The consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. Financial statements are not precise since they include certain amounts based upon estimates and judgments. When alternative accounting methods exist, management has chosen those it deems to be the most appropriate to ensure fair and consistent presentation. The financial information presented elsewhere in this report is consistent with that in the financial statements.

Management maintains financial and operating systems that include appropriate and effective internal controls. Such systems are designed to provide reasonable assurance that the financial information is reliable and relevant, and the Company's assets are appropriately accounted for and adequately safeguarded.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the financial statements. The Board of Directors carries out this responsibility principally through its Audit Committee.

The Audit Committee, with all of its members being outside directors, is appointed by the Board of Directors and reviews the financial statements and Management's Discussion and Analysis; assesses the adequacy of the internal controls of the Company; considers the report of the external auditors; examines the fees and expenses for audit services; and recommends to the Board of Directors the independent auditors for appointment by the shareholders. The Audit Committee reports its findings to the Board of Directors for consideration when approving the annual financial statements for issuance to the shareholders.

These consolidated financial statements have been audited by Ernst & Young LLP, the external auditors, in accordance with Canadian generally accepted auditing standards, on behalf of the shareholders. Ernst & Young LLP have full and free access to, and meet periodically with, the Audit Committee.



J. Cameron Bailey
President & CEO



Jamie Jeffs, CA
Chief Financial Officer

AUDITORS' REPORT

To the Shareholders of Fortress Energy Inc.

We have audited the consolidated balance sheets of Fortress Energy Inc. (formerly SignalEnergy Inc.) as at December 31, 2006 and 2005 and the consolidated statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



Calgary, Canada
April 2, 2007

Chartered Accountants

CONSOLIDATED BALANCE SHEETS

As at December 31

[in thousands]

	2006	2005
ASSETS		
Current		
Cash and cash equivalents (note 3)	\$ 36,756	\$ 61
Accounts receivable	7,951	11,269
Prepaid expenses	368	258
	45,075	11,588
Property and equipment (note 6)	70,579	102,503
Goodwill (note 7)	–	4,548
	\$ 115,654	\$ 118,639

LIABILITIES AND SHAREHOLDERS' EQUITY

Current

Accounts payable and accrued liabilities	\$ 7,080	\$ 17,810
Income taxes payable	283	283
Revolving operating loans (note 8)	–	22,975
	7,363	41,068
Future income tax liability (note 9)	5,052	–
Asset retirement obligations (note 10)	1,678	4,428
	14,093	45,496

Commitments and contingencies (notes 11 and 14)

Shareholders' Equity

Share capital (note 11)	157,508	136,817
Contributed surplus (note 11)	1,779	2,140
Deficit	(57,726)	(65,814)
	101,561	73,143
	\$ 115,654	\$ 18,639

Subsequent events (note 16)

See accompanying notes to the consolidated financial statements

On Behalf of the Board of Directors:



J. Cameron Bailey
Director



Barry Giovanetto
Director

CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT

For the years ended December 31

[in thousands, except per share amounts]

	2006	2005
REVENUE		
Petroleum and natural gas sales	\$ 9,090	\$ 23,670
Royalties (net of Alberta Royalty Tax Credit)	(1,398)	(5,262)
	7,692	18,408
Interest income	1,931	59
	9,623	18,467
EXPENSES		
Operating	2,161	3,908
General and administrative	4,350	2,838
Stock-based compensation (note 12)	822	910
Interest	498	693
Depletion and depreciation	4,865	8,879
Accretion of asset retirement obligations (note 10)	90	253
	12,786	17,481
Income (loss) from operations before the following	(3,163)	986
OTHER ITEMS		
Gain on sale of oil and gas properties and equipment (note 5)	15,835	–
Goodwill impairment (note 7)	(4,548)	–
	11,287	–
Income before income taxes	8,124	986
Income tax expense (recovery) (note 9)		
Current	–	95
Future	36	(1,195)
	36	(1,100)
Net income for the year	8,088	2,086
Deficit, beginning of year	(65,814)	(67,616)
Distribution to shareholders (note 4 (b))	–	(284)
Deficit, end of year	\$ (57,726)	\$ (65,814)
Net income per share (note 11)		
Basic	\$ 0.11	\$ 0.04
Diluted	\$ 0.11	\$ 0.04

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended December 31

[in thousands]

	2006	2005
OPERATING ACTIVITIES		
Net income for the year	\$ 8,088	\$ 2,086
Items not affecting cash flows:		
Stock-based compensation	822	910
Depletion and depreciation	4,865	8,879
Accretion of asset retirement obligations	90	253
Gain on sale of oil and gas properties and equipment	(15,835)	–
Goodwill impairment	4,548	–
Future income tax expense (recovery)	36	(1,195)
	2,614	10,933
Change in non-cash operating working capital <i>(note 15)</i>	(1,873)	(6,610)
Cash provided by operating activities	741	4,323
FINANCING ACTIVITIES		
Change in revolving operating loan	(22,975)	22,975
Share buy back <i>(note 11)</i>	–	(579)
Issuance of common shares on exercise of stock options	3,199	–
Issuance of flow-through common shares	–	3,040
Share issuance costs	–	(122)
Cash provided by (used in) financing activities	(19,776)	25,314
INVESTING ACTIVITIES		
Property and equipment expenditures	(4,986)	(25,363)
Sale of property and equipment, net of transaction costs <i>(note 5)</i>	91,223	13,990
Acquisition of businesses <i>(note 4)</i>	(23,208)	(15,907)
Change in non-cash investing working capital <i>(note 15)</i>	(7,299)	(5,014)
Cash provided by (used in) investing activities	55,730	(32,294)
Net change in cash	36,695	(2,657)
Cash and cash equivalents – beginning of year	61	2,718
Cash and cash equivalents – end of year	\$ 36,756	\$ 61
Supplemental cash flow information:		
Interest paid	\$ 498	\$ 693
Income taxes paid	–	–

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2006 and 2005 (Tabular figures are in thousands of dollars unless otherwise indicated)

1. NATURE OF OPERATIONS

Fortress Energy Inc. ("Fortress" or the "Company" formerly SignalEnergy Inc.) is a Calgary-based junior oil and gas exploration and development company. All activity is conducted in Western Canada and comprises a single operating segment.

Effective February 20, 2007, SignalEnergy Inc. ("Signal") completed a reorganization whereby all of its assets were transferred to Fortress and a significant number of Signal shares were redeemed for cash (refer to note 16).

2. SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of presentation

The consolidated financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles and include the accounts of the Company and its wholly-owned subsidiary. All inter-company transactions have been eliminated.

The timely preparation of financial statements requires that management make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from estimates.

In the opinion of management, these consolidated financial statements have been properly prepared within reasonable limits of materiality and within the framework of the significant accounting policies summarized below.

(b) Joint operations

Substantially all of the Company's exploration, development and production activities are conducted jointly with others and, accordingly, these consolidated financial statements reflect only the Company's proportionate interest in such activities.

(c) Cash and cash equivalents

Cash and cash equivalents include short-term investments with an original maturity of three months or less from the date of purchase. Cash and cash equivalents are stated at cost, which approximates market value.

(d) Property and equipment

The Company follows the full cost method of accounting whereby all costs relating to the acquisition of, exploration for and development of oil and gas reserves are capitalized and accumulated in a single Canadian cost center. Such costs include lease acquisition, lease rentals on undeveloped properties, geological and geophysical, drilling of both productive and non-productive wells, production equipment and overhead charges directly related to acquisition, exploration and development activities.

Proceeds from the disposition of oil and gas properties are accounted for as a reduction of capitalized costs, with no gain or loss recognized unless such disposition would alter the depletion and depreciation rate by 20% or more.

Other capital assets include furniture and fixtures and are recorded at cost.

(e) Depletion and depreciation

All costs of acquisition, exploration and development of oil and gas reserves, associated with plant and equipment costs (net of salvage value), and estimated costs of future development of proven undeveloped reserves are depleted using the unit-of-production method based on estimated gross proven reserves as determined by the Company's independent reserve engineers.

Costs of unproved properties and seismic costs on undeveloped land are initially excluded from oil and gas properties for the purpose of calculating depletion. When proven reserves are assigned or the property or seismic costs are considered impaired, the cost of the property or the amount of the impairment is added to costs subject to depletion.

The relative volume of oil and natural gas reserves and production are converted to equivalent barrels of oil based on the relative energy content of one barrel of oil being equal to six thousand cubic feet of natural gas.

Capital assets not related to oil and gas properties are depreciated over their estimated useful lives using the straight-line method at annual rates of 20% to 100%.

(f) Impairment of property and equipment

A ceiling test is performed to recognize and measure impairment, if any, of the carrying amount of oil and gas properties and equipment by comparing the carrying amount of property and equipment to the sum of undiscounted cash flows

December 31, 2006 and 2005 (Tabular figures are in thousands of dollars unless otherwise indicated)

expected to result from the future production of proved reserves and the cost of unproved properties less any impairment. Cash flows are based on a forecast of prices and costs, adjusted for transportation and quality, as provided by the Company's independent reserve engineers. Should this result in an excess of carrying value, the Company would then measure the amount of impairment by comparing the carrying amounts of property and equipment to the sum of the estimated net present value of future cash flows from proved plus probable reserves and the cost of unproved properties less any impairment. A risk-free interest rate is used to arrive at the net present value of the future cash flows. Any excess is recorded as additional depletion in the period the impairment is identified.

The carrying value of undeveloped properties (land and seismic data) is reviewed periodically and written down to net realizable value if impairment is determined.

(g) Asset retirement obligations

Asset retirement obligations includes the costs of abandonment of oil and gas wells, dismantling and removing tangible equipment, and returning land to its original condition.

The fair value of estimated asset retirement obligations is recognized in the consolidated financial statements in the period in which they are identified and when a reasonable estimate of the fair value can be made. The fair value is determined through a review of engineering studies, industry guidelines, and management's estimate on a site-by-site basis. The asset retirement cost, equal to the estimated fair value of the asset retirement obligation, is capitalized as part of the cost of the related long-lived asset.

The liability is subsequently adjusted for the passage of time, which is recognized as accretion of asset retirement obligations expense in the consolidated statement of operations. The liability is also adjusted due to revisions in either the timing or the amount of the original estimated cash flows associated with the liability. The increase in the carrying value of the asset is amortized using the unit of production method based on estimated gross proven reserves, as determined by independent engineers. Actual costs incurred upon settlement of the asset retirement obligations are charged against the asset retirement obligation to the extent of the liability recorded. Any difference between the actual costs incurred upon settlement of the asset retirement obligation and the recorded liability is charged to the property and equipment in the period in which the settlement occurs unless the settlement represents abandonment of the last well in the cost centre, in which case the difference is charged to the consolidated statement of operations.

(h) Goodwill

Goodwill, at the time of acquisition, represents the excess of purchase price of a business over the fair value of net identifiable assets acquired in the business combination. The Company assesses the carrying amount of goodwill for impairment on an annual basis, or more frequently when changes in circumstances indicate that impairment may exist. The amount of impairment loss, if any, is charged to the consolidated statement of operations in the period the impairment is identified.

(i) Flow-through shares

A portion of the Company's exploration and development activities is financed through proceeds received from the issuance of flow-through shares. Under the terms of the flow-through share issues, the tax attributes of the related expenditures are renounced to the share subscribers. To recognize the foregone tax benefits to the Company, the carrying value of the shares issued is reduced by the tax effect of the tax benefits renounced to the subscribers. The tax effect of the renouncement is recorded when the required documents are filed with the tax authorities and the corresponding exploration and development expenditures are incurred or are reasonably likely to be incurred within the permitted time frame.

(j) Stock-based compensation

The Company has a stock based compensation plan, which is described in note 12. The Company accounts for stock-based compensation using the fair value method whereby compensation expense is recognized over the vesting period based on the fair value of stock options at the date of grant. The fair value of stock options granted is determined using the Black-Scholes option-pricing model and is recorded as compensation expense and contributed surplus. Contributed surplus is reduced as stock options are exercised and credited to share capital.

(k) Revenue recognition

Petroleum and natural gas sales are recognized as revenue when the commodities are delivered to purchasers.

December 31, 2006 and 2005 (Tabular figures are in thousands of dollars unless otherwise indicated)

(l) Hedging and forward sales contracts

In certain circumstances, fixed price commodity contracts or commodity derivatives contracts may be used to reduce the Company's exposure to adverse fluctuations in commodity prices to protect future cash flows used to finance the Company's capital expenditure program. Gains and losses relating to commodity derivative contracts which settle via net cash payment and that meet hedge criteria are recognized as part of petroleum and natural gas sales concurrent with the hedged transaction. The Company does not enter into financial instruments for trading or speculative purposes.

The hedging requirements as amended by Accounting Guideline 13, consist of the designation of the instrument as a hedge, the identification of the nature of the risk exposure being hedged and that there is reasonable assurance that the instrument is expected to be an effective hedge throughout its term. In addition, in the case of anticipated transactions, it must also be probable that the transaction designated as being hedged will occur. Should the Company elect to follow hedge accounting, it assesses both at the hedge's inception and on an ongoing basis, whether the derivative financial instruments that have been designated as hedges are highly effective in offsetting changes in fair value or cash flows of the hedged items.

Realized and unrealized gains and losses associated with commodity derivative contracts which have been terminated or cease to be effective prior to maturity, are deferred as other current or non-current assets or liabilities on the consolidated balance sheet, as appropriate, and recognized in the consolidated statement of operations in the period in which the underlying hedged transaction is recognized. In the event a designated hedged item is sold, extinguished or matures prior to the termination of the related derivative instrument, any realized or unrealized gain or loss on such derivative instrument is recognized in the consolidated statement of operations.

Financial instruments not designated as hedges are marked to market at the end of each period with any gain/loss recognized into income in that period.

(m) Future income taxes

The Company follows the liability method of accounting for income taxes. Under this method, future tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. The effect on future income tax assets and liabilities of a change in tax rates is recognized in net income in the period in which the change is substantively enacted. Income tax expense for the period is the tax payable for the period and any change during the period in future income tax assets and liabilities. A valuation allowance is recorded to the extent that the realization of future tax assets is not more likely than not.

(n) Measurement uncertainty

The amount recorded for depletion and depreciation of oil and gas properties and the ceiling test calculation are based on estimates of gross proven reserves, production rates, commodity prices, future costs and other relevant assumptions. Accruals for revenue, royalties and operating costs are prepared based on estimates when actual amounts are not known. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future years could be significant.

Inherent in the fair value calculation of asset retirement obligations, are numerous assumptions and judgments including the ultimate settlement amounts, inflation factors, credit adjusted discount rates, timing of settlement, and changes in legal and regulatory environments. To the extent future revisions to these assumptions impact the fair value of the existing asset retirement obligation liability, a corresponding adjustment is made to the property and equipment balance.

(o) Per share amounts

The treasury stock method is used in the determination of diluted earnings per share. Under this method, the diluted weighted average number of shares is calculated assuming the proceeds that arise from the exercise of outstanding in-the-money options are used to purchase common shares of the Company at their average market price for the applicable period.

(p) Investment tax credits

Investment tax credits are applied against expenses or the related capital assets when it is reasonably certain that they will be realized. Ultimate realization will depend on the review and approval by the tax authorities concerned.

(q) Comparative figures

Certain comparative figures have been reclassified to conform to the presentation adopted in the current year.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2006 and 2005 (Tabular figures are in thousands of dollars unless otherwise indicated)

3. CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of cash on hand and a short-term investment as follows:

	2006	2005
	\$	\$
Cash on hand	1,708	61
Short-term investment	35,048	-
	36,756	61

Short-term investments at December 31, 2006 consist of commercial paper, yielding 4.3% per annum, with a term of less than 3 months from initiation, and maturing January 15, 2007.

4. BUSINESS ACQUISITIONS

(a) Effective November 15, 2006, the Company acquired all of the issued and outstanding common shares of Marauder Resources West Coast Inc. ("Marauder") for consideration of \$33,990,716, consisting of \$15,000,000 of cash, 16,349,534 common shares of the Company valued at \$17,330,506, and transaction and severance costs of \$1,660,210. The common shares issued were valued at \$1.06 per share based on the Company's trading price for the five-day period prior to and the five-day period immediately following the announcement of this transaction.

The acquisition has been accounted for using the purchase method and the results of operations are included in the consolidated statement of operations from the effective date of November 15, 2006. The purchase price was allocated to the assets and liabilities, on a preliminary basis, as follows:

	\$
Property and equipment	46,794
Non-cash working capital deficiency	(1,651)
Future income tax liability	(3,994)
Asset retirement obligations	(610)
Bank indebtedness	(6,548)
	33,991
Consideration:	
Cash	15,000
16,349,534 common shares	17,331
Transaction costs	1,660
	33,991

(b) Effective August 9, 2005, the Company acquired all of the issued and outstanding common shares of Goose River Resources Ltd. ("Goose River") for consideration of \$35,366,190, consisting of 21,250,000 common shares of the Company valued at \$23,594,700, cash consideration of \$9,930,678, additional cash of \$953,400 paid on the buy-out of Goose River stock options, and transaction costs of \$887,412. The common shares issued were valued at \$1.11 per share based on the Company's trading price for the five-day period prior to the announcement of this transaction.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2006 and 2005 (Tabular figures are in thousands of dollars unless otherwise indicated)

The acquisition has been accounted for using the purchase method and the results of operations are included in the consolidated statement of operations from the effective date. The fair values of the net assets acquired are as follows:

	\$
Property and equipment	42,870
Non-cash working capital deficiency	(6,829)
Asset retirement obligations	(795)
Cash	120
	35,366
Consideration:	
21,250,000 common shares	23,595
Cash	10,884
Transaction costs	887
	35,366

The acquisition resulted in the shareholders of Goose River becoming shareholders of two companies: Fortress and G2 Resources Ltd. ("G2"), a newly created company. Fortress contributed cash of \$179,000 and its Sylvan Lake and Foam Lake properties with an estimated fair market value of \$105,000 to G2 in exchange for common shares of G2. These shares of G2 were distributed to the shareholders of Fortress in August 2005 with each shareholder receiving 0.037537 of a G2 share for each share of Fortress held.

(c) Effective January 26, 2005, the Company acquired all of the issued and outstanding common shares of a private oil and gas company for consideration of \$5,310,519, consisting of 1,000,000 common shares of the Company valued at \$1,250,000, cash consideration of \$3,970,380, and transaction costs of \$90,139. The common shares issued were valued at \$1.25 per share based on the Company's trading price for the five-day period prior to the announcement of this transaction.

The acquisition has been accounted for using the purchase method and the results of operations are included in the consolidated statement of operations from the effective date of acquisition. The fair values of the net assets acquired are as follows:

	\$
Property and equipment	6,027
Non-cash working capital deficiency	(398)
Asset retirement obligations	(318)
	5,311
Consideration:	
1,000,000 common shares	1,250
Cash	3,971
Transaction costs	90
	5,311

(d) Effective January 20, 2005, the Company acquired all of the issued and outstanding common shares of Predator Exploration Ltd. ("Predator") for consideration of \$13,468,443, consisting of 10,424,097 common shares of the Company valued at \$13,030,121 and transaction costs of \$438,322. The common shares issued were valued at \$1.25 per share based on the Company's trading price for the five-day period prior to the announcement of this transaction.

The acquisition has been accounted for using the purchase method and the results of operations are included in the consolidated statement of operations from the effective date. The fair values of the net assets acquired are as follows:

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2006 and 2005 (Tabular figures are in thousands of dollars unless otherwise indicated)

	\$
Property and equipment	27,070
Non-cash working capital deficiency	(12,461)
Asset retirement obligations	(1,563)
Cash	422
	13,468
Consideration:	
10,424,097 common shares	13,030
Transaction costs	438
	13,468

5. PROPERTY DISPOSITION

Effective February 27, 2006, the Company sold certain oil and gas properties, tangible equipment and undeveloped land for cash proceeds of \$96,446,000. The transaction involved the sale of the Company's Ferrier, Carrot Creek, Kaybob, Redwater and certain other minor properties (the "Sold Properties"). The Company retained its Chigwell, Bashaw and Buick Creek properties (the "Retained Properties"). The transaction closed in two stages on February 27 and March 9, 2006. The transaction costs associated with this transaction were \$1,163,000. The Company incurred additional costs of \$4,060,000 to complete its capital commitments to the purchaser.

The carrying amount of the Sold Properties at the time of sale was \$82,835,000 and the related asset retirement obligation was \$3,387,000. The Company recorded a gain on sale of oil and gas properties and equipment of \$15,835,000.

6. PROPERTY AND EQUIPMENT

	Cost	Accumulated Depletion and Depreciation	Net Book Value
	\$	\$	\$
December 31, 2006			
Oil and gas properties	77,194	6,708	70,486
Other	146	53	93
	77,340	6,761	70,579

	Cost	Accumulated Depletion and Depreciation	Net Book Value
	\$	\$	\$
December 31, 2005			
Oil and gas properties	114,170	11,730	102,440
Other	110	47	63
	114,280	11,777	102,503

In 2006 the Company capitalized general and administrative expenses of \$410,000 (2005 – \$1,148,584) which includes stock-based compensation expenses of \$nil (2005 – \$170,000) directly attributable to exploration and development activities.

Estimated future development costs of \$15.6 million (December 31, 2005 – \$3.7 million) were included in the calculation of depletion expense for the year ended December 31, 2006. As at December 31, 2006, undeveloped land costs of \$3.8 million (December 31, 2005 – \$10 million) were excluded from assets subject to depletion.

The Company performed a ceiling test calculation at December 31, 2006 in which the estimated undiscounted future cash flows associated with the Company's proved reserves exceeded the carrying amount of the Company's property and equipment. The oil and natural gas prices used in the ceiling test calculation are based on the January 1, 2007 commodity price forecast of our independent reserve evaluators and are as follows:

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2006 and 2005 (Tabular figures are in thousands of dollars unless otherwise indicated)

Year	Edmonton Light Crude Oil <i>(Cdn\$/lbb)</i>	AECO Gas <i>(Cdn\$/MMbtu)</i>
2007	74.10	7.85
2008	77.62	8.39
2009	70.25	7.65
2010	65.56	7.48
2011	61.90	7.63

Prices increase at a rate of 1.5% per year after 2011. The benchmark prices were adjusted for quality and transportation.

Based on these assumptions, the undiscounted value of net revenues from the Company's proved reserves exceeds the carrying value of property and equipment at December 31, 2006 and, accordingly, no impairment write down was recorded.

7. GOODWILL IMPAIRMENT

The Company assesses the carrying amount of goodwill for impairment on an annual basis, or more frequently when changes in circumstances indicate that impairment may exist. As part of this assessment, the Company considers the latest available information including the Company's market capitalization as indicated by the Company's share price. As a result of this assessment, the Company has recorded a goodwill impairment of \$4,548,000 as of December 31, 2006 which has been reflected as a non-cash charge to the statement of operations.

8. BANK FACILITIES

On February 28, 2006, the Company used the proceeds from the sale of oil and gas properties (note 5) to repay the revolving operating loan from its bank, which had \$28,550,000 drawn at the time of repayment.

As at November 15, 2006, the Company's subsidiary, Marauder, had an operating loan to maximum of \$7 million. The loan was repaid on December 15, 2006.

9. INCOME TAXES

The provision for income tax expense (recovery) recorded in the consolidated statement of operations differs from the amount that would be obtained by applying the statutory income tax rate to the income (loss) before tax as follows:

	2006 \$	2005 \$
Net income before tax	8,124	986
Expected tax expense at 34.50% (2005 – 33.62%)	2,803	331
Add (deduct) income tax effect of:		
Non-deductible crown charges	167	823
Resource allowance	(66)	(921)
Stock based compensation	284	305
Non-taxable ARTC	(145)	–
Non-taxable portion of capital gain	(1,800)	–
Flow-through share renouncement	(1,022)	(1,195)
Non-deductible expenses and other permanent differences	20	30
Large Corporations Tax	–	95
Rate adjustments	(205)	–
Change in valuation allowance on unrecognized benefit of tax assets	–	(568)
Income tax expense (recovery)	36	(1,100)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2006 and 2005 (Tabular figures are in thousands of dollars unless otherwise indicated)

Future tax assets and liabilities are comprised of:

	2006	2005
	\$	\$
Net book value of property and equipment in excess of tax pools	6,929	16,529
Scientific research and experimental development expenditures	–	(10,330)
Non-capital losses carried forward	(854)	(4,468)
Asset retirement obligations	(513)	(1,489)
Attributed Canadian royalty income	(88)	–
Share issue costs	(422)	(242)
Net future income tax liability	5,052	–

The Company has non-capital losses for income tax purposes of approximately \$3.3 million (2005 – \$13.3 million) which are available for application against future taxable income and which expire in the following years:

	\$
2010	2,708
2011	630
	3,338

The Company has approximately \$2.7 million (2005 – \$2.8 million) of unclaimed investment tax credits available to reduce the future years' income tax payable. These credits will expire in the following years:

	\$
2007	300
2008	267
2009	74
2010	279
2011	1,013
2012	734
	2,667

At December 31, 2006, the Company has approximately \$47.8 million of available resource pools and undepreciated capital cost pools, as follows:

	\$
Canadian Oil and Gas Property Expenses	5,197
Canadian Development Expenses	12,777
Canadian Exploration Expenses	14,450
Undepreciated Capital Cost	15,358
	47,782

10. ASSET RETIREMENT OBLIGATIONS

The Company's asset retirement obligations result from net ownership interests in oil and gas assets including well sites, gathering systems and processing facilities. The Company estimates the net present value of its total asset retirement obligations at December 31, 2006 to be \$1.7 million (December 31, 2005 – \$4.4 million) based on a total future liability of \$3.1 million (December 31, 2005 – \$8.9 million) which will be primarily incurred between 2007 and 2029. An inflation rate of 2.0% (2005 – 3.0%) and a credit-adjusted risk-free rate of 6.5% (2005 – 6.0%) were used to calculate the fair value of the asset retirement obligations.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2006 and 2005 (Tabular figures are in thousands of dollars unless otherwise indicated)

Asset Retirement Obligations	\$
Balance, December 31, 2004	1,633
Obligations incurred	928
Obligations acquired (note 4)	2,676
Obligations disposed	(1,062)
Accretion expense	253
Balance, December 31, 2005	4,428
Adjustments to assumptions	(92)
Obligations incurred	29
Obligations acquired (note 4)	610
Obligations disposed (note 5)	(3,387)
Accretion expense	90
Balance, December 31, 2006	1,678

11. SHARE CAPITAL

(a) Authorized:

Unlimited number of voting common shares without par value.

Unlimited number of class A, non-voting common shares without par value.

Unlimited number of non-voting, non-retractable, non-redeemable preferred shares without par value to be issued in series as determined by the Company.

Share capital is comprised of:	December 31, 2006	December 31, 2005
	\$	\$
Common shares	156,788	136,097
Additional paid-in capital	720	720
	157,508	136,817

(b) Common shares issued and outstanding:

	Number of Class A Voting Common Shares	Number of Common Shares	\$
Balance, December 31, 2004	5,240,754	30,665,772	97,194
Issued on business acquisitions (note 4)		32,674,097	37,876
Issued on land acquisition (i)		453,022	634
Tax effect of flow-through share renoucement (ii)		-	(1,195)
Normal course issuer bid (iii)		(512,700)	(1,330)
Conversion to common shares (iv)	(5,240,754)	5,240,757	-
Issued on flow-through offering (v)		2,000,000	3,040
Share issuance costs			(122)
Balance, December 31, 2005	-	70,520,948	136,097
Issued on business acquisitions (note 4)		16,349,534	17,331
Tax effect of flow-through share renoucement (v)			(1,022)
Issued on exercise of stock options (note 11 (f))		2,745,500	4,382
Balance, December 31, 2006		89,615,982	156,788

(i) On September 27, 2005, the Company issued 453,022 common shares at \$1.40 per share, being the market value, to acquire land interests.

(ii) On June 16, 2004, the Company closed a private placement of 4,485,000 common shares and 1,615,000 flow-through common shares, raising gross proceeds of \$7,848,750 and \$3,553,000, respectively. The tax effect of the flow-through

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2006 and 2005 (Tabular figures are in thousands of dollars unless otherwise indicated)

shares was renounced at March 31, 2005 at a rate of 33.62% and \$1,194,519 was recorded as a reduction to share capital with a corresponding increase in future income tax liability.

- (iii) On April 27, 2005, the Company initiated the normal course issuer bid process whereby a maximum of 2,104,493 common shares could be repurchased beginning April 21, 2005 and terminating April 20, 2006. As of the expiry date, the Company had purchased 512,700 common shares of the Company at an average price of \$1.13 per share or \$578,721. The historical value of these shares of \$1,330,000 was removed from share capital and the excess over the purchase price was recorded as an increase in contributed surplus of \$751,279.
- (iv) On August 4, 2005, the Company converted the Class A, non-voting common shares to common shares on a one-for-for basis.
- (v) On December 1, 2005, the Company closed a private placement of 2,000,000 flow-through common shares at \$1.52 per share for total gross proceeds of \$3,040,000 (\$2,935,000 net of share issuance costs). The full expenditure commitment was renounced to subscribers effective December 31, 2005. The tax effect related to this flow-through offering of \$1,022,048 was recorded at March 31, 2006 using a tax rate of 33.62%. As at December 31, 2006, the Company had incurred expenditures of approximately \$1.9 million with the remaining expenses incurred in the first quarter of 2007.
- (vi) On December 13, 2006, the Company initiated a normal course issuer bid process whereby a maximum of 4,480,799 common shares could be repurchased beginning December 15, 2006 and terminating December 14, 2007. As at December 31, 2006, the Company had not made any purchases under this normal course issuer bid. Subsequent to December 31, 2006, the Company purchased 407,000 common shares of the Company at an average price of \$0.75 per share or \$305,705.

(e) Contributed surplus:

	\$
Balance, December 31, 2004	309
Normal course issuer bid	751
Stock-based compensation expense	1,080
Balance, December 31, 2005	2,140
Stock-based compensation expense	822
Reclassification to share capital for stock options exercised	(1,183)
Balance, December 31, 2006	1,779

(f) Stock option plan:

The Company grants stock options to employees, officers, directors and consultants of the Company pursuant to an incentive plan (the "Plan"). Under the Plan, the exercise price of options granted cannot be less than the closing market price for the Company's common shares on the date of grant. Options typically vest over a four-year period and expire five years from the date of grant.

The following table summarizes stock option transactions:

		2006		2005
	Number	Weighted average exercise price \$		Weighted average exercise price \$
Outstanding, beginning of year	4,385,500	2.01	2,412,500	2.01
Granted	(1,530,000)	1.49	2,474,500	1.10
Exercised	(2,745,500)	1.17	(501,500)	3.28
Outstanding, end of year	110,000	4.15	4,385,500	1.35
Exercisable, end of year	110,000	4.15	1,011,250	1.90

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2006 and 2005 (Tabular figures are in thousands of dollars unless otherwise indicated)

The Company has the following stock options outstanding:

Exercise Price \$	Number	Outstanding at December 31, 2006		Exercisable at December 31, 2006	
		Weighted average years to expiry	Exercise Price \$	Number exercisable	Exercise Price \$
3.00 – 4.00	102,000	2.5	3.91	102,000	3.91
4.00 – 5.00	4,000	4.5	4.40	4,000	4.40
10.00	4,000	3.1	10.00	4,000	10.00
Outstanding, December 31, 2006	110,000	2.6	4.15	110,000	4.15

Exercise Price \$	Number	Outstanding at December 31, 2005		Exercisable at December 31, 2005	
		Weighted average years to expiry	Exercise Price \$	Number exercisable	Exercise Price \$
1.00 – 1.20	1,910,500	1.4	1.03	–	–
1.21 – 2.00	2,310,000	3.9	1.39	846,250	1.40
3.00 – 4.00	102,000	3.3	3.91	102,000	3.91
4.01 – 5.00	59,000	0.7	4.96	59,000	4.96
10.00	4,000	4.9	10.00	4,000	10.00
Outstanding, December 31, 2005	4,385,500	2.8	1.35	1,011,250	1.90

(g) **Per share amounts:**

The weighted average number of common shares and Class A, non-voting common shares outstanding for the years ended December 31, 2006 and 2005 are as follows:

	2006	2005
Weighted average – basic	74,494,047	55,076,751
Weighted average – diluted	74,494,047	55,369,854

The dilutive effect of the Company's issuable securities at December 31, 2006, which consist of 110,000 (December 31, 2005 – 4,385,500) stock options to issue common shares, was nil shares (2005 – 293,103 shares). The remaining 110,000 options are available for dilution in future periods.

12. STOCK-BASED COMPENSATION

The Company records compensation costs on the granting of stock options using the fair value method. Compensation expense is calculated using the Black-Scholes option pricing model with the following weighted average assumptions:

	2006	2005
Risk-free interest rate (%)	3.51	3.51
Expected life (years)	5.0	5.0
Expected volatility (%)	60.0	60.0
Expected dividend yield (%)	–	–

The estimated fair value of stock options of \$0.71 per share (December 31, 2005 – \$0.71) is amortized to expense over the vesting period on a straight-line basis. In 2006, the Company recorded compensation expense of \$822,000 related to stock options (2005 – \$1,080,000) of which \$nil was capitalized (2005 – \$170,000).

December 31, 2006 and 2005 (Tabular figures are in thousands of dollars unless otherwise indicated)

13. FINANCIAL INSTRUMENTS

Fair value of financial instruments

The Company has financial instruments consisting of cash and cash equivalents, accounts receivable, accounts payable, and revolving operating loan. The carrying value of these instruments approximate fair value due to their short-term maturity.

Credit risk

A substantial portion of the Company's accounts receivable are with customers and joint venture partners in the petroleum and natural gas industry and are subject to normal industry credit risk. The Company will generally extend unsecured credit to these companies, and therefore, the collection of accounts receivable may be affected by changes in economic or other conditions and may accordingly impact the Company's overall credit risk. Management believes the risk will be mitigated by the size, reputation and diversified nature of the companies to which they extend credit.

Commodity price risk management

At December 31, 2006, the Company had no fixed price contracts associated with future production (December 31, 2005 – nil).

Foreign currency risk

The Company is exposed to foreign currency fluctuations as crude oil and natural gas prices received are referenced to U.S. dollar dominated prices.

14. COMMITMENTS AND CONTINGENCIES

Royalties

The Company will pay to various university research centers royalties amounting to two – five percent on sales of licensed products related to a research contract and acquired technology rights and 15% of sublicense revenues from products related to the acquired technology rights. At December 31, 2006 and 2005, there were no royalties payable under these agreements.

Office space and equipment

The Company is committed to minimum annual lease payments under operating leases for office premises and office equipment to March, 2013, as follows:

	\$
2007	395
2008	431
2009	430
2010	435
2011	439
Thereafter	549
	2,679

Guarantees

The Company maintains liability insurance for its directors and officers and indemnifies its directors and officers against any and all claims or losses reasonably incurred in the performance of their service to the Company to the extent permitted by law.

Claims and Litigation

The Company is involved in various claims and litigation arising in the normal course of business. The outcome of these matters is uncertain and there can be no assurance that such matters will be resolved in the Company's favor. If the outcome is unfavorable, it could have a materially adverse impact on the Company's financial position or results of operations.

December 31, 2006 and 2005 (Tabular figures are in thousands of dollars unless otherwise indicated)

15. CHANGE IN NON-CASH WORKING CAPITAL

Changes in non-cash working capital balances are comprised of the following:

	2006	2005
	\$	\$
Accounts receivable	3,318	(7,126)
Prepaid expenses	(110)	(67)
Accounts payable and accrued liabilities	(10,729)	14,974
Income taxes payable	–	283
	(7,521)	8,064
Less: working capital deficiency acquired on acquisitions	(1,651)	(19,688)
	(9,172)	(11,624)
Attributable to investing activities	(7,299)	(5,014)
Attributable to operating activities	(1,873)	(6,610)

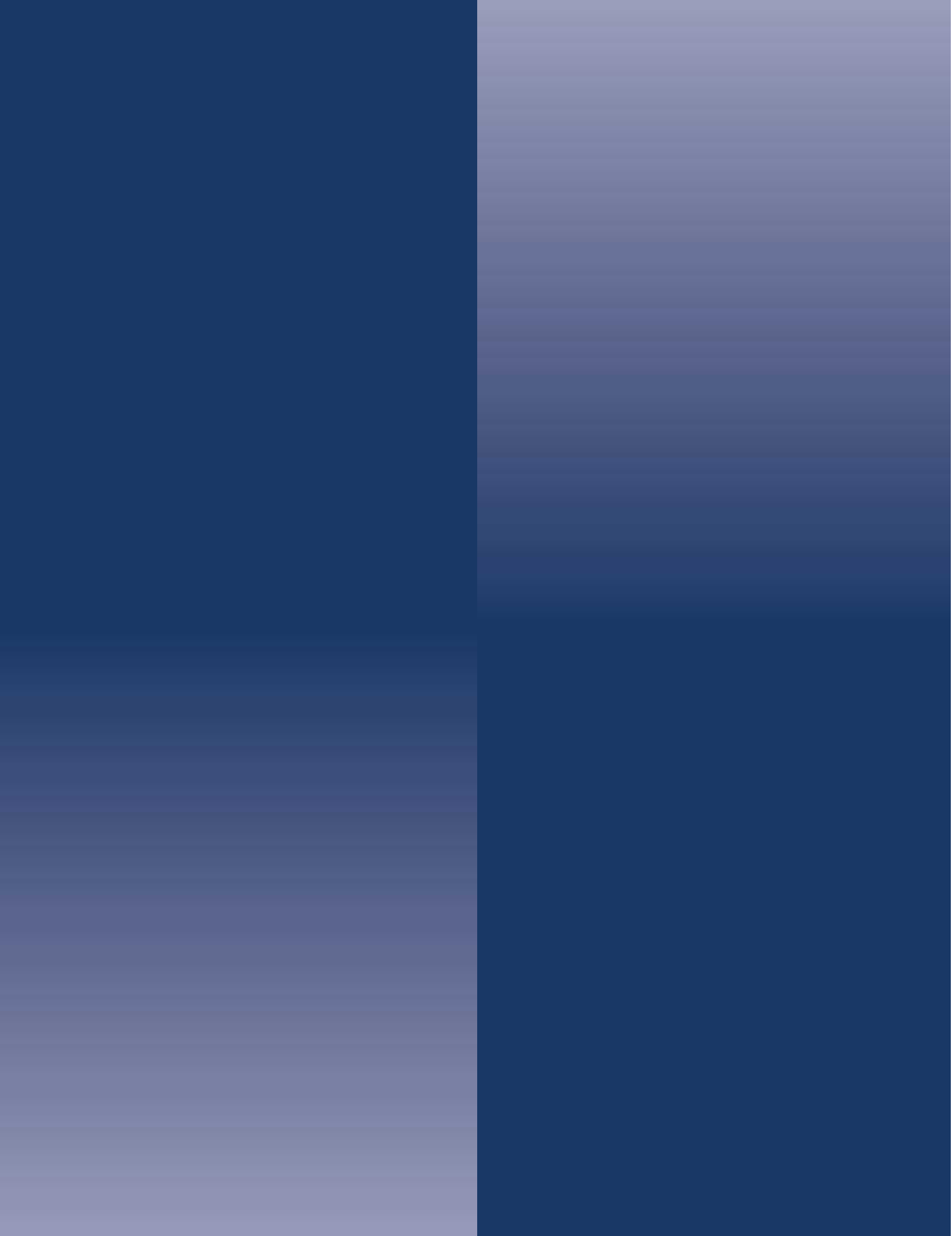
16. SUBSEQUENT EVENTS

(a) A Reorganization (the “Reorganization”) of SignalEnergy Inc. (“Signal”), including an arrangement (the “Arrangement”) under the Companies Act (Quebec), was approved by the shareholders at a Special General Meeting of Shareholders held on February 15, 2007 and was effective on February 20, 2007.

Under the Arrangement, shareholders of Signal could elect to receive cash, common shares of Fortress, or a combination of both, subject to total cash available of \$30 million. Shareholders representing 63,400,000 common shares of Signal elected to receive cash which resulted in a cash distribution to shareholders of \$30 million to redeem 23,076,923 common shares of Signal at \$1.30 per share. The remaining 66,539,059 common shares of Signal were exchanged for common shares of Fortress on a basis of one common share of Fortress for every five common shares of Signal, resulting in the issuance of 13,307,815 common shares of Fortress.

Fortress was a shell company that was formed for the purposes of completing the Reorganization of Signal. Upon completion of the Reorganization, Fortress holds all of the assets formerly held by Signal.

(b) After giving effect to the Reorganization, on January 15, 2007 the Company granted options to acquire 948,000 common shares of the Company at an exercise price of \$4.75 per share, expiring January 15, 2012.





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