



MESSAGE TO SHAREHOLDERS

Fortress Energy Inc. ("Fortress" or the "Company") is pleased to announce its financial and operating results for the second quarter of 2007.

SECOND QUARTER HIGHLIGHTS

- Completed a \$13.25 million asset acquisition in the Ladyfern, Mearon and Velma areas. The acquisition included approximately 290 boe/d of natural gas production with additional production behind pipe, estimated reserves of 1.0 million boe on a proven basis and 1.5 million on a proven plus probable basis, and over 50,000 net acres of undeveloped land.
- Increased average sales volumes for the second quarter to 876 boe/d from 805 boe/d in the previous quarter, representing an 8.8% increase.
- Decreased operating expenses for the second quarter to \$8.23/boe from \$8.82/boe in the prior quarter.
- Incurred capital expenditures of \$4.3 million for the installation of a refrigeration plant at Ladyfern and for the tie-in of wells at Velma. The plant is expected to provide greater reliability of processing capabilities and additional natural gas liquids recoveries as well as generate additional processing revenues for the Company.
- Increased borrowing facility to \$26.5 million from \$7 million, with an initial borrowing capacity of \$24 million.

UPDATE OF OPERATIONS

Fortress recently completed an acquisition of natural gas assets in its core operating areas of Ladyfern, Mearon and Velma providing additional production of approximately 290 boe/d with additional behind pipe production expected by mid-August 2007. The acquisition consolidates the Company's interests in these areas, increasing the Company's overall working interest to 74% from 60%.

The Company's average sales volumes for the second quarter were 876 boe/d. Fortress continued to experience production disruptions at Mearon North due to constraints at a third party facility. To help alleviate this constraint, the Company recently completed the installation of a refrigeration plant at the Ladyfern gas processing facility to lower the dew point of its gas entering the third-party facility, reducing the need, at various times, to shut-in these wells. The refrigeration plant is currently being tested and is anticipated to be on production by mid-August 2007 and bring additional gas processing revenues to the Company. The Company also completed the tie-in of its wells at Velma which are expected to be on production by mid-August 2007.

OUTLOOK

The Company continued to execute on its plan to "Acquire and Exploit" in the second quarter. The recent strategic acquisition in the Company's core Ladyfern, Mearon and Velma areas is one example of how the Company is positioning itself for future growth. Fortress will continue to analyze and evaluate acquisition opportunities, seeking strategic assets at attractive valuation levels to add to the Company's existing asset base.

J. Cameron Bailey, President and Chief Executive Officer

On Behalf of the Board of Directors

MANAGEMENT'S DISCUSSION AND ANALYSIS

August 10, 2007

Management's discussion and analysis ("MD&A") should be read in conjunction with the unaudited interim consolidated financial statements of Fortress Energy Inc. ("Fortress" or the "Company", formerly known as SignalEnergy Inc.) for the three and six months ended June 30, 2007 and the audited consolidated financial statements of Fortress Energy Inc. for the year ended December 31, 2006. The interim 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. Additional information is available on the Company's web site at www.fortressenergy.ca or under the Company's profile at www.sedar.com.

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.

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 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.

SELECTED QUARTERLY INFORMATION

	2007		2006				2005	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Sales volume:								
Natural gas (mcf/d)	5,082	4,699	3,010	1,777	1,833	4,366	6,253	5,990
Oil and NGLs (bbl/d)	29	22	20	35	69	263	430	242
Barrels of oil equivalent (boe)	876	805	522	331	375	991	1,472	1,240
Sales price:								
Natural gas (mcf/d)	7.07	7.47	7.19	5.31	6.04	7.86	11.48	9.22
Oil and NGLs (\$/bbl)	52.14	60.56	57.19	65.43	57.08	59.62	65.95	62.88
Barrels of oil equivalent (boe)	42.75	45.48	44.13	35.46	40.08	50.45	68.31	56.82
Benchmark prices:								
AECO bench (\$/GJ)	6.74	6.99	6.53	5.39	5.71	7.19	10.84	8.76
Edmonton Par (\$/bbl)	72.65	67.86	65.24	80.26	80.43	68.90	72.18	77.80
Financial (\$000's unless otherwise noted):								
Petroleum and natural gas sales	3,407	3,296	2,149	1,079	1,362	4,500	9,250	6,483
Net income (loss)	(617)	(308)	(5,635)	(13)	270	13,440	952	536
Net income (loss) per share – basic (\$)	(0.05)	(0.02)	(0.07)	(0.00)	0.00	0.19	0.02	0.01
Net income (loss) per share – diluted (\$)	(0.05)	(0.02)	(0.07)	(0.00)	0.00	0.19	0.02	0.01
Funds from operations	1,147	1,558	1,089	821	17	687	4,223	3,141
Operating costs (\$/boe)	8.23	8.82	5.73	8.51	13.13	13.07	12.81	7.20
Weighted average shares outstanding								
– basic ('000)	13,258	13,262	81,439	73,266	72,595	70,598	69,195	59,086
Weighted average shares outstanding								
– diluted ('000)	13,258	13,262	81,439	73,266	73,316	71,239	69,525	61,240

Q2 - 2007

Sales volumes in the second quarter of 2007 were 876 boe/d compared to 805 boe/d in the previous quarter reflecting the first full quarter of sales volumes from wells drilled and tied to production facilities in March 2007. Major capital projects in the quarter were the installation of a refrigeration plant located at Ladyfern to improve the recovery of natural gas liquids and pipeline costs to tie wells in the Velma area to production facilities. The net loss for the second quarter of \$617,000 reflects a decrease in funds from operations to \$1,147,000 from \$1,558,000 in the prior quarter resulting from a reduction in natural gas prices realized and higher interest and general and administrative expenses incurred.

Q1 - 2007

Sales volumes increased to 805 boe/d in the first quarter - an increase of 283 boe/d from the prior quarter - reflecting the first full quarter of results from the acquisition of Marauder Resources West Coast Inc. ("Marauder") on November 15, 2006. The Company drilled 14 gross (8 net) wells, tied 8 wells to production facilities (of which 1 well was from the 2006 program), and conducted 7 recompletions of existing well bores, resulting in incremental sales volumes of 200 boe/d in the first quarter of 2007. The Company recorded a net loss of \$308,000 in the quarter compared to a net loss of \$5,635,000 in the prior quarter. The net loss for the fourth quarter of 2006 is the result of a write off of goodwill of \$4.5 million and adjustments to the gain on sale of oil and gas properties to reflect additional capital commitments incurred. Funds from operations for the quarter were \$1,558,000 compared to \$1,089,000 in the prior quarter, reflecting production gains noted and improved operating netbacks.

Q4 - 2006

Sales volumes increased in the quarter to 522 boe/d from 331 boe/d for the prior quarter as a result of the acquisition of Marauder which added additional sales volumes of 450 boe/d from the effective date. Funds from

operations increased to \$1,089,000 in the fourth quarter from \$821,000 in the prior quarter, due to the Marauder acquisition and improved natural gas prices realized by the Company which increased by 35.4% to \$7.19/mcf. The Company recorded a net loss of \$5,635,000 in the quarter, as noted previously in this MD&A.

Q3 - 2006

Sales decreased from the prior quarter due to declining commodity prices and sales volumes to \$1,079,000 from \$1,362,000 in the prior quarter. The Company completed workover operations on two wells in the Buick Creek and Bashaw areas in the third quarter of 2006 but was unable to restore production for these wells. Funds from operations improved to \$821,000 in the quarter from \$17,000 in the previous quarter, reflecting lower royalties, operating and general and administrative costs. The Company recorded a net loss of \$13,000 in the quarter primarily as a result of higher depletion and depreciation charges that reflect reserve adjustments for the two wells noted.

Q2 - 2006

Sales volumes declined in the second quarter as a result of the sale of the Company's Redwater, Ferrier, and Carrot Creek properties in the first quarter. A reduction in natural gas prices realized in the quarter of 20.5% contributed to reduced sales revenues. Funds from operations for the second quarter were \$17,000 reflecting lower sales volumes and commodity prices and an increase in operating costs due to an under estimation relating to Redwater in the prior quarter. Incremental legal and advisory costs related to a failed takeover bid for the shares of the Company were recorded in the second quarter. Net income for the quarter was \$270,000 – a significant reduction from the prior quarter which reflects the gain on the sale of oil and gas assets.

Q1 - 2006

In the first quarter of 2006 the Company sold its interest in certain oil and gas assets, as noted previously in this MD&A, for \$91.2 million. The Company used the proceeds to repay its operating loan which had \$28,550,000 drawn at the time of repayment. These oil and gas assets contributed sales volumes of 674 boe/d in the first quarter. Funds from operations declined substantially from the previous quarter due to a 26.1% decline in commodity prices realized by the Company, and an increase in operating costs due to the addition of several wells in the Redwater area that had been tied into production facilities in the first quarter. Net income for the quarter of \$13,440,000 reflects a gain on the sale of oil and gas assets of \$20,087,000.

Q4 - 2005

Sales volumes increased to 1,472 boe/d as a result of the addition of Goose River Resources Ltd. ("Goose River") in August and the Company's capital program which included the drilling of 31 gross (19 net) wells in the last six months of 2005 with a 97% success rate. Funds from operations were \$4,223,000 for the quarter compared to \$3,141,000 in the prior quarter reflecting a 24.5% increase in natural gas prices realized. Net income for the fourth quarter was \$952,000 reflecting substantially improved commodity prices and sales volumes.

Q3 - 2005

In August of 2005, the Company acquired Goose River which contributed sales volumes of 454 boe/d for the quarter from the effective date. The acquisition of Goose River provided a large prospect inventory of drill ready locations which became the focus of the Company's drilling program for the balance of 2005. Funds from operations for the third quarter were \$3,141,000 - an increase of 42.3% from the prior quarter – reflecting a 24.4% increase in commodity prices realized by the Company and increased sales volumes of 220 boe/d over the prior quarter, primarily as a result of the Goose River acquisition. Net income increased to \$536,000 for the quarter from \$85,000 for the second quarter, reflecting improved commodity pricing and higher sales volumes.

REORGANIZATION

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 \$30,000,000 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 13,307,815 common shares of Fortress, which was a shell company that was formed for the purposes of completing the Reorganization.

The economic substance of the Reorganization is a transaction whereby the resulting entity is governed under the laws of the Province of Alberta, and not Quebec. Signal was dissolved into Fortress on April 19, 2007.

The balance sheet and share capital presented are of Fortress as a legal entity. The assets, liabilities, and dollar amounts attributed to share capital are those of Signal. The financial position, results of operations and cash flow for all periods prior to the Reorganization are those of Signal.

RESULTS OF OPERATIONS

Sales

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Petroleum and natural gas sales (\$000's)	3,407	1,362	6,703	5,862
Sales volume:				
Natural gas (mcf/d)	5,082	1,833	4,890	3,092
Oil and NGLs (bbl/d)	29	69	26	166
Barrels of oil equivalent (boe/d)	876	375	841	681
Sales price:				
Natural gas (\$/mcf)	7.07	6.04	7.28	7.32
Oil and NGLs (\$/bbl)	52.14	57.08	46.55	59.09
Barrels of oil equivalent (\$/boe)	42.75	40.08	44.05	47.58

Petroleum and natural gas sales were \$3,407,000 for the three months ended June 30, 2007 compared to \$1,362,000 for the three months ended June 30, 2006. This increase is the result of higher volumes resulting from the acquisition of Marauder in the fourth quarter of 2006 and additional wells drilled and brought onto production in the first quarter of 2007. The Company realized average sales volumes of 876 boe/d in the second quarter of 2007 compared to 375 boe/d in the second quarter of 2006. The Company sold various oil and gas assets in the first quarter of 2006 which recorded sales volumes of 674 boe/d in that quarter. The Company recorded petroleum and natural gas sales of \$6,703,000 in the first six months of 2007 on average sales volumes of 841 boe/d compared to sales of \$5,862,000 and sales volumes of 681 boe/d in the first six months of 2006.

Natural gas accounted for 97% of sales volumes for the first six months of 2007 compared to 76% for the first six months of 2006. This change results from the sale of oil and gas properties in the first quarter of 2006 where the Company sold substantially all of its oil producing assets and from the acquisition of Marauder in fourth quarter of 2006 which held natural gas assets. The natural gas price realized by the Company in the three months ended June 30, 2007 increased to \$7.07/mcf from \$6.04/mcf a year earlier. The average AECO prices were \$6.74/GJ and \$5.71/GJ for the second quarter of 2007 and 2006, respectively (approximately \$7.11/mcf and \$6.02/mcf). The average

natural gas price realized by the Company in the second quarter of 2007 also includes a realized gain on a natural gas collar of \$97,000 or \$0.21/mcf. The average sales price for the six months ended June 30, 2007 was \$7.28/mcf compared to \$7.32/mcf in the first six months of 2006. The average sales price per mcf realized by the Company is consistent with the AECO spot price, adjusted for heat content and transportation costs.

Royalties

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Royalties (net of Alberta Royalty Tax Credit) (\$000's)	484	280	991	1,231
\$/boe	6.07	8.22	6.51	9.99
Percentage of petroleum and natural gas sales	14.2	20.6	14.8	21.6

Royalties, consisting of crown, gross-overriding and freehold royalties were \$484,000 for the three months ended June 30, 2007, reflecting an increase of \$204,000 from the three months ended June 30, 2006. This increase in royalties reflects an increase in sales volumes during the second quarter of 2007. In addition, there were two significant adjustments recorded in the second quarter of 2007. The first pertains to a \$206,000 charge resulting from the audit and reassessment of Alberta Royalty Tax Credits ("ARTC") claimed. The second adjustment relates to a reduction in royalties for the 2006 fiscal year, in the amount of \$309,000, resulting from the Ultra-Marginal Royalty Program in BC. Both adjustments relate to subsidiary companies for periods that were prior to ownership by Fortress. As a percentage of sales, the royalty rate decreased to 14.2% in the second quarter of 2007 from 20.6% for the second quarter of 2006. For the six months ended June 30, 2007, royalties decreased to \$991,000 from \$1,231,000 for the six months ended June 30, 2006. As a percentage of sales, royalties for the six months ended June 30, 2007 decreased to 14.8% from 21.6% due to the sale of oil and gas properties in the first quarter of 2006 which carried substantial freehold and gross override royalty components and a reduction in royalty rate for low producing wells attributed to the Ultra-Marginal Royalty Program, as noted.

Operating Expenses

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Operating expenses (\$000's)	656	447	1,295	1,617
\$/boe	8.23	13.13	8.51	13.12

The Company's operating expenses increased to \$656,000 for the second quarter of 2007 from \$447,000 for the second quarter of 2006. On a per boe basis, operating expenses decreased in the second quarter of 2007 to \$8.23/boe compared to \$13.13/boe in the second quarter of 2006. The Company recorded additional operating expenses of \$238,000 or \$6.99/boe in the second quarter of 2006 due to an under estimation of operating expenses in the prior quarter resulting from inexperience with several new wells drilled in the Redwater area. Operating expenses for the six months ended June 30, 2007 were \$1,295,000 or \$8.51/boe, compared to \$1,617,000 or \$13.12/boe for the same six month period in 2006. This decrease is due to the sale of oil and gas properties in the first quarter of 2006 which carried substantially higher costs related to compressor and pump jack rentals, trucking, salt water disposal, and oil treating fees at third party facilities.

General and Administrative Expenses

(\$000's)	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
General and administrative expense	1,240	1,176	2,438	2,863
General and administrative costs capitalized	(295)	–	(703)	(110)
General and administrative expenses (net)	945	1,176	1,735	2,753
\$/boe	11.86	34.53	11.40	22.34

General and administrative expenses increased to \$1,240,000 in the second quarter of 2007 compared to \$1,176,000 in the second quarter of 2006. This increase is the result of increased field activity levels and an increase in staffing levels in 2007. General and administrative expenses for the six months ended June 30, 2007 were \$2,438,000 compared to \$2,863,000. This decrease is attributed to severance and retention costs due to the sale of oil and gas properties and downsizing of the Company's operations in March of 2006 and additional legal and advisory expenses incurred in the first six months of 2006 related to a failed take-over bid for the Company.

The Company capitalized general and administrative expenses of \$295,000 in the second quarter of 2007 compared to \$nil in the first quarter of 2006. This increase is the result of increased exploration and development activities in 2007. In the first quarter of 2006, the Company substantially curtailed its exploration and development activities due to the sale of oil and gas properties which included most of its prospect inventory.

Stock-based Compensation Expense (Recovery)

(\$000's)	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Stock-based compensation expense (recovery)	169	(30)	279	822
\$/boe	2.12	(0.88)	1.83	6.67

Stock-based compensation expense for the three months ended June 30, 2007 was \$169,000 compare to a recovery of \$30,000 for the three months ended June 30, 2006. Stock-based compensation expense reflects the value attributed to stock options granted to employees, officers, directors and consultants to the Company. During the second quarter of 2007, the Company granted 215,000 stock options. The recovery recorded in the second quarter of 2006 reflects an adjustment for stock options that were cancelled in the prior quarter. Stock-based compensation expense for the first six months of 2007 was \$279,000 compared to \$822,000 for the first six months of 2006. As a result of the sale of oil and gas properties in the first quarter of 2006, all unvested stock options outstanding were vested on March 1, 2006 resulting in an increase in stock-based compensation expense for the six months ended June 30, 2006 to reflect this early vesting accelerating the recognition of stock-based compensation expense.

Interest Expense

(\$000's)	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Interest expense	175	70	193	304
\$/boe	2.20	2.06	1.27	2.47

Interest expense for the second quarter of 2007 was \$175,000 compared to \$70,000 for the second quarter of 2006 – an increase of \$105,000 which includes interest and penalties of \$69,000 related to the audit and reassessment of ARTC and interest of \$36,000 related to the audit of a 2003 flow-through share issuance by a subsidiary company. Interest expense recorded in the second quarter of 2006 pertains to interest charged on unspent flow-through obligations. Interest expense for the six months ended June 30, 2007 was \$193,000 compared to \$304,000 for the six

months ended June 30, 2006. This decrease results from the sale of oil and gas properties in the first quarter of 2006 and the interest charged on the Company's bank operating line which had \$28,550,000 drawn at the time of the sale.

Depletion and Depreciation Expense

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Depletion and depreciation expense (\$000's)	2,183	697	3,999	2,629
\$/boe	27.39	20.47	26.27	21.33

Depletion and depreciation expense was \$2,183,000 for the second quarter of 2007 compared to \$697,000 for the second quarter of 2006 which results from an increase in sales volumes and an increase in the depletion and depreciation rate in 2007. The increase in the depletion and depreciation rate is the result of changes in property mix due to the sale of oil and gas properties in the first quarter of 2006 and the acquisition of Marauder in the fourth quarter of 2006. In addition, the Company incurred capital costs in the second quarter of 2007 related to the refrigeration plant at Ladyfern and pipeline costs at Velma for which no incremental reserves have been assigned. Depletion and depreciation expense for the six months ended June 30, 2007 was \$3,999,000 compared to \$2,629,000 for the six months ended June 30, 2006 – an increase of \$1,370,000 reflecting the sale of oil and gas properties in the first quarter of 2006. Estimated future development costs for proved undeveloped properties of \$21.3 million (June 30, 2006 - \$nil) were included in the calculation of depletion and depreciation expense for the six months ended June 30, 2007. Undeveloped land costs of \$4.3 million (June 30, 2006 - \$1.2 million) were excluded from assets subject to depletion for the six months ended June 30, 2007.

Accretion of Asset Retirement Obligations

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Accretion of asset retirement obligations (\$000's)	26	16	50	59
\$/boe	0.33	0.47	0.33	0.48

Accretion expense was \$26,000 for the second quarter of 2007 compared to \$16,000 for the second quarter of 2006. This increase is the result of an increase in the asset retirement obligation in 2007. The sale of oil and gas properties in the first quarter of 2006 resulted in the assumption of asset retirement obligations of \$3,387,000 by the purchaser. Accretion expense was \$50,000 for the six months ended June 30, 2007 compared to \$59,000 for the six months ended June 30, 2006. The accretion rate decreased to \$0.33/boe as a result of increased sales volumes in 2007. Also this rate is affected by the change in property mix as the Marauder properties are muskeg and require minimal surface reclamation resulting in a lower retirement obligation per well.

Income Tax

The Company recorded a future income tax recovery of \$506,000 for the first quarter of 2007 compared to \$1,068,000 for the second quarter of 2006. Future income tax reflects the difference between the underlying tax value and carrying value of the Company's assets and liabilities. The Company recorded a future income tax recovery of \$590,000 for the first six months of 2007 compared to a future income tax expense of \$3,439,000 for the six months ended June 30, 2006. This change reflects the sale of oil and gas assets in the first quarter of 2006 and the application of available tax pools to minimize the tax liability to the Company.

Operating Netback

<i>(\$/per boe)</i>	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Petroleum and natural gas sales	42.75	40.08	44.05	47.58
Less: Royalties (net of ARTC)	(6.07)	(8.22)	(6.51)	(9.99)
Operating expenses	(8.23)	(13.13)	(8.51)	(13.12)
Operating netback	28.45	18.73	29.03	24.47
Funds from operations	14.39	0.50	17.78	5.71

The Company's operating netback for the second quarter of 2007 was \$28.45/boe compared to \$18.73/boe for the second quarter of 2006. This increase is the result of higher oil and natural gas prices realized and lower royalties and operating costs. The operating netback for the six months ended June 30, 2007 was \$29.03/boe compared to \$24.47/boe for the six months ended June 30, 2006. This increase is the result of a reduction in royalties and operating expenses.

Funds from operations for the second quarter of 2007 were \$14.39/boe compared to \$0.50/boe for the second quarter of 2006 – an increase of \$13.89/boe. This increase is attributed to an improved operating netback and reduced general and administrative costs in the second quarter of 2007. Funds from operations for the six months ended June 30, 2007 was \$17.78/boe – an increase of \$12.07/boe from the six months ended June 30, 2006. This increase is attributed to a higher operating netback and lower general and administrative expenses.

Net Income/(Loss)

<i>(\$000's except per share amounts)</i>	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Net income/(loss)	(617)	270	(925)	13,710
Net income/(loss) per share – basic	(0.05)	–	(0.07)	0.19
Net income/(loss) per share – diluted	(0.05)	–	(0.07)	0.19

The Company recorded a net loss of \$617,000 for the second quarter of 2007 compared to net income of \$270,000 for the second quarter of 2006. This translates to a basic and diluted loss per share of \$0.05 for the second quarter of 2007 and a basic and diluted income per share of \$nil for 2006. The Company's net loss for the six months ended June 30, 2007 was \$925,000 compared to net income of \$13,710,000 for the six months ended June 30, 2006. Net income for the first six months of 2006 is attributed to the gain on sale of oil and gas assets of \$19,955,000. The basic and diluted loss per share for the six months ended June 30, 2007 was \$0.07 compared to basic and diluted income per share of \$0.19 for the six months ended June 30, 2006.

Capital Expenditures

<i>(\$000's)</i>	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Land and lease retention	33	–	65	104
Geological and geophysical	12	–	12	56
Drilling and completions	405	–	9,573	908
Facilities and equipment	2,129	603	4,294	2,165
Property acquisitions	357	–	357	465
Capitalized overhead costs	295	–	703	110
Other	1,089	161	1,166	161
	4,320	764	16,170	3,969

In the second quarter of 2007, the Company began the installation of a refrigeration plant at the Ladyfern gas processing facility to improve the recovery of natural gas liquids and to lower the dew point of the gas entering this third-party facility. The plant is expected to provide greater reliability of processing capabilities and as well as generate additional processing revenues for the Company. The Company also completed the tie-in of the Company's wells at Velma which are expected to be on production by mid-August 2007.

In the first quarter of 2007, the Company's drilling program focused exclusively on the Company's lands in the Ladyfern, Mearon, Square Creek, and Drake areas. The Company drilled a total of 14 gross (8 net) wells of which 11 gross (6.5 net) were considered to be development wells and 3 gross (1.5 net) were exploratory. In addition, the Company completed 7 recompletion operations existing wells. A total of 8 gross (4.5 net) wells were tied into production facilities in the first quarter of which 1 gross (0.5 net) wells were from Marauder's 2006 drilling program. The wells that were tied to production facilities in the first quarter of 2007 added incremental production of 200 boe/d. The 2007 drilling program also set up an additional 20 development and 6-8 exploratory drilling opportunities for 2008. In the first six months of 2006, the Company was not actively engaged in exploration or development opportunities due to the sale of oil and gas assets.

LIQUIDITY AND CAPITAL RESOURCES

Cash provided by operating activities was \$1,669,000 for the second quarter of 2007 compared to cash used in operating activities of \$3,747,000 for the second quarter of 2006. This increase in cash provided by operating activities is due to an increase in funds from operations realized in the second quarter of 2007 of \$1,130,000 and an increase in non-cash working capital balances of \$4,286,000. For the six months ended June 30, 2007, cash provided by operating activities was \$3,784,000 compared to cash used in operating activities of \$1,664,000 for the six months ended June 30, 2006. This increase is due to an increase in funds from operations for the six months ended June 30, 2007 to \$2,705,000 from \$704,000 for the six months ended June 30, 2006, resulting from higher operating netbacks realized, and changes in non-cash working capital balances.

Cash provided by financing activities for the second quarter of 2007 was \$3,061,000 compared to \$1,624,000 for the second quarter of 2006. This increase represents additional funds drawn on the Company's bank lending facilities in the second quarter of 2007. In the second quarter of 2006, the Company raised additional equity of \$1,624,000 from the issuance of common shares on exercise of employee stock options. For the six months ended June 30, 2007, cash used in financing activities was \$23,846,000 compared to \$19,787,000 for the six months ended June 30, 2006. In the first six months of 2007 the Company redeemed 23 million common shares as part of the reorganization of Signal for \$30.4 million and was advanced \$6.8 million on its operating line. In the first six months of 2006, the Company used the proceeds from the sale of oil and gas assets of \$91.2 million to repay the Company's operating line of credit which had \$28.6 million drawn. In addition, the Company received proceeds of \$3.2 million for the exercise of employee stock options.

Cash used in investing activities for the second quarter of 2007 was \$6,087,000 compared to cash used in investing activities of \$243,000 in the second quarter of 2006. Cash provided by investing activities for the first quarter of 2006 reflects capital expenditures, a reduction in non-cash working capital balances as a result of a substantial decrease in the field activity levels, and proceeds from the sale of oil and gas properties. Capital expenditures for the second quarter of 2007 relate to the installation of the refrigeration plant at Ladyfern and pipeline and tie-in costs at Velma. Cash used in investing activities for the six months ended June 30, 2007 was \$16,634,000 compared to cash provided by investing activities of \$82,664,000 for the six months ended June 30, 2006. Cash used in investing activities for the six months ended June 30, 2007 reflects capital expenditures for the Company's drilling program and new infrastructure and facilities of \$16,170,000. By comparison, in 2006 the Company incurred capital expenditures of \$3,969,000 due to the downsizing of operations following the sale of oil and gas properties in the first quarter.

Securities Outstanding

Securities outstanding as of the date of this MD&A consist of 13,261,823 issued and outstanding common shares and 1,200,000 stock options.

Off-balance Sheet Arrangements

The Company has no off-balance sheet arrangements.

Related Party Transactions

The Company has no related party transactions.

Subsequent Events

On July 18, 2007, the Company announced that it had closed the acquisition of certain strategic natural gas assets located within the Company's core operating areas, principally in the Ladyfern and Velma areas in British Columbia, and the Mearon area in Alberta, for cash consideration of \$13.25 million, subject to final adjustments. The Company used its revolving credit facility to finance this acquisition.

Commitments and Contingencies

The Company is committed under the terms of a natural gas costless collar to deliver 2,500 GJ/d of natural gas through to October 31, 2007 with a floor price of \$6.00/GJ and a ceiling of \$8.30/GJ.

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)
Balance of 2007	247
2008	431
2009	430
2010	435
2011	439
2012	439
Thereafter	110
	2,531

The Company is involved in various claims arising in the normal course of business. In the opinion of management, all such claims are not expected to materially affect the Company's financial position.

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

The discussion and conclusion with respect to the Company's internal controls over financial reporting included in the December 31, 2006 MD&A remain unchanged as at June 30, 2007.

NEW CANADIAN ACCOUNTING PRONOUNCEMENTS

Effective January 1, 2007, the Company adopted five new accounting standards issued by the Canadian Institute of Chartered Accountants ("CICA"): Handbook Section 3855 "Financial Instruments – Recognition and Measurement", Section 3861 "Financial Instruments – Disclosure and Presentation", Section 3865 "Hedges", Section 1506 "Accounting Changes", Section 1530 "Comprehensive Income" and Section 3251 "Equity".

Financial instruments - recognition and measurement

Section 3855 establishes standards for recognizing and measuring financial assets, financial liabilities, and non-financial derivatives. It requires that financial assets and financial liabilities, including derivatives, be recognized on the balance sheet when the Company becomes a party to the contractual provisions of the financial instrument or non-financial derivative contract. Under this standard, all financial instruments are required to be measured at fair value upon initial recognition except for certain related party transactions. Measurement in subsequent periods depends on whether the financial instrument has been classified as held-for-trading, available-for sale, held-to-maturity, loans or receivables, or other financial liabilities. Financial assets and financial liabilities held for-trading are measured at fair value with changes in those fair values recognized in net earnings. Financial assets held-to-maturity, loans and receivables, and other financial liabilities are measured at amortized cost using the effective interest method of amortization. Investments in equity instruments classified as available-for-sale that do not have a quoted market price in an active market are measured at cost.

Derivative instruments are recorded on the balance sheet at fair value, including those derivatives that are embedded in financial or non-financial contracts that are not closely related to the host contracts. Changes in the fair values of derivative instruments are recognized in net earnings, with the exception of derivatives designated as effective cash flow hedges and hedges of the foreign currency exposure of a net investment in a self-sustaining foreign operation, which are recognized in other comprehensive income. In addition, Section 3855 requires that an entity must select an accounting policy of either expensing debt issue costs as incurred or applying them against the carrying value of the related asset or liability.

Hedges

Section 3865 provides alternative treatments to Section 3855 for entities which choose to designate qualifying transactions as hedges for accounting purposes. It replaces and expands on Accounting Guideline 13 "Hedging Relationships", and the hedging guidance in Section 1650 "Foreign Currency Translation" by specifying how hedge accounting is applied and what disclosures are necessary when it is applied. The Company does not currently have any hedges in place and therefore the adoption of Section 3865 "Hedges" did not have any impact on the Company's financial statements.

Accounting changes

Section 1506 provides expanded disclosures for changes in accounting policies, accounting estimates and corrections of errors. Under the new standard, accounting changes should be applied retrospectively unless otherwise permitted or where impracticable to determine. As well, voluntary changes in an accounting policy are to be made only when required by a primary source of GAAP or the change results in more relevant and reliable information.

Comprehensive income (loss) and accumulated other comprehensive income (loss)

Section 1530 introduces comprehensive income, which consists of net earnings and other comprehensive income ("OCI"). OCI represents changes in shareholder's equity during a period arising from transactions and changes in

prices, markets, interest rates, and exchange rates. OCI includes unrealized gains and losses on financial assets classified as available-for-sale, unrealized translation gains and losses arising from self-sustaining foreign operations net of hedging activities and changes in the fair value of the effective portion of cash flow hedging instruments.

Future accounting changes

On December 1, 2006, the CICA issued three new accounting standards: Handbook Section 1535, *Capital Disclosures*, Handbook Section 3862, *Financial Instruments – Disclosures*, and Handbook Section 3863, *Financial Instruments – Presentation*. These new standards are effective January 1, 2008. Section 1535 specifies the disclosure of (i) an entity's objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; (iii) whether the entity has complied with any capital requirements; and (iv) if it has not complied, the consequences of such non-compliance. The new Sections 3862 and 3863 replace Handbook Section 3861, *Financial Instruments – Disclosure and Presentation*, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks. We are currently assessing the impact of these new standards on our financial statements.

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.

CONSOLIDATED BALANCE SHEETS

As at (in thousands) (unaudited)	June 30, 2007	December 31, 2006
ASSETS <i>(note 2)</i>		
Current		
Cash and cash equivalents	\$ 60	\$ 36,756
Accounts receivable	11,584	7,951
Prepaid expenses	383	368
Risk management asset <i>(note 11)</i>	131	-
	12,158	45,075
Property, plant and equipment <i>(note 4)</i>	83,044	70,579
	\$ 95,202	\$ 115,654
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities	\$ 11,626	\$ 7,080
Income taxes payable	-	283
Revolving operating loan <i>(note 5)</i>	6,780	-
Risk management liability <i>(note 11)</i>	23	-
	18,429	7,363
Asset retirement obligations <i>(note 6)</i>	2,022	1,678
Future income tax liability	4,462	5,052
	24,913	14,093
Contingencies <i>(note 12)</i>		
Shareholders' Equity		
Share capital <i>(note 8)</i>	116,709	157,508
Contributed surplus <i>(note 8)</i>	12,231	1,779
Deficit	(58,651)	(57,726)
	70,289	101,561
	\$ 95,202	\$ 115,654

Subsequent events (notes 5 and 13)

See accompanying notes to the consolidated financial statements

CONSOLIDATED STATEMENTS OF OPERATIONS, COMPREHENSIVE INCOME (LOSS) AND DEFICIT

(in thousands, except per share amounts) (unaudited)	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
REVENUE				
Petroleum and natural gas	\$ 3,407	\$ 1,362	\$ 6,703	\$ 5,862
Royalties (net of Alberta Royalty Tax Credit)	(484)	(280)	(991)	(1,231)
Interest income	–	608	216	747
Unrealized gain on financial instruments <i>(note 11)</i>	108	–	108	–
	3,031	1,690	6,036	5,378
EXPENSES				
Operating	656	447	1,295	1,617
General and administrative	945	1,176	1,735	2,753
Stock-based compensation <i>(note 9)</i>	169	(30)	279	822
Interest	175	70	193	304
Depletion and depreciation	2,183	697	3,999	2,629
Accretion of asset retirement obligations <i>(note 6)</i>	26	16	50	59
	4,154	2,376	7,551	8,184
Loss before the following	(1,123)	(686)	(1,515)	(2,806)
OTHER				
Gain (loss) on sale of oil and gas property, plant and equipment	–	(132)	–	19,955
Income (loss) before income taxes	(1,123)	(818)	(1,515)	17,149
Income tax expense (recovery) <i>(note 7)</i>				
Current	–	(20)	–	–
Future	(506)	(1,068)	(590)	3,439
	(506)	(1,088)	(590)	3,439
Net income (loss) and comprehensive income (loss) for the period	(617)	270	(925)	13,710
Deficit, beginning of period	(58,034)	(52,374)	(57,726)	(65,814)
Deficit, end of period	\$ (58,651)	\$ (52,104)	\$ (58,651)	\$ (52,104)
Net income (loss) and comprehensive income (loss) per share <i>(note 8)</i>				
Basic	\$ (0.05)	\$ 0.00	\$ (0.07)	\$ 0.19
Diluted	\$ (0.05)	\$ 0.00	\$ (0.07)	\$ 0.19

See accompanying notes to the consolidated financial statements

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands) (unaudited)	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
CASH PROVIDED BY (USED IN):				
OPERATING ACTIVITIES				
Net income (loss) for the period	\$ (617)	\$ 270	\$ (925)	\$ 13,710
Items not affecting cash flows:				
Unrealized gain on financial instruments	(108)	-	(108)	-
Stock-based compensation	169	(30)	279	822
Depletion and depreciation	2,183	697	3,999	2,629
Accretion of asset retirement obligations	26	16	50	59
Loss (gain) on sale of oil and gas property, plant and equipment	-	132	-	(19,955)
Future income tax expense (recovery)	(506)	(1,068)	(590)	3,439
Funds from operations	1,147	17	2,705	704
Change in non-cash operating working capital (note 10)	522	(3,764)	1,079	(2,368)
	1,669	(3,747)	3,784	(1,664)
FINANCING ACTIVITIES				
Change in revolving operating loan	3,030	-	6,780	(22,975)
Issuance of common shares on exercise of stock options	-	1,624	-	3,188
Redemption of common shares (note 8)	31	-	(30,440)	-
Purchase of common shares (note 8)	-	-	(186)	-
	3,061	1,624	(23,846)	(19,787)
INVESTING ACTIVITIES				
Property, plant and equipment expenditures	(4,320)	(764)	(16,170)	(3,969)
Sale of property and equipment, net of transaction costs	-	(132)	-	95,345
Deferred costs	-	175	-	-
Change in non-cash investing working capital (note 10)	(1,767)	478	(464)	(8,712)
	(6,087)	(243)	(16,634)	82,664
Net change in cash	(1,357)	(2,366)	(36,696)	61,213
Cash and cash equivalents - beginning of period	1,417	63,640	36,756	61
Cash and cash equivalents - end of period	\$ 60	\$ 61,274	\$ 60	\$ 61,274
Supplemental cash flow information:				
Interest paid	72	-	90	234
Income taxes paid	-	-	-	-

See accompanying notes to the consolidated financial statements

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2007 (Tabular figures are in thousands of dollars unless otherwise indicated) (unaudited)

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. This transaction is further described in notes 2 and 8.

2. SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of presentation

Except as noted below, the unaudited interim consolidated financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles using the same accounting policies as set out in note 2 to the audited consolidated financial statements of the Company for the year ended December 31, 2006. Certain information or disclosures normally required to be included in notes to annual audited financial statements have been condensed or omitted. The unaudited interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2006.

On February 20, 2007, Signal and Fortress reorganized, as follows (refer to note 8 for a continuity of Fortress' and Signal's share capital):

- (i) Signal redeemed 23,076,923 common shares for cash at a price of \$1.30 per share;
- (ii) Fortress issued 13,307,815 common shares from treasury to Signal's shareholders in exchange for all of Signal's outstanding shares;
- (iii) Out-of-pocket transaction costs of \$440,000.

The economic substance of the Reorganization is a transaction whereby the resulting entity is governed under the laws of the Province of Alberta, and not Quebec. Signal was dissolved into Fortress on April 19, 2007.

The balance sheet and share capital as presented are of Fortress as a legal entity. The assets, liabilities, and dollar amounts attributed to share capital are those of Signal. The financial position, results of operations and cash flow for all periods prior to the Reorganization are those of Signal.

(b) Comparative figures

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

3. CHANGES IN ACCOUNTING POLICIES

Effective January 1, 2007, the Company adopted five new accounting standards issued by the Canadian Institute of Chartered Accountants ("CICA"): Handbook Section 3855 "Financial Instruments – Recognition and Measurement", Section 3861 "Financial Instruments – Disclosure and Presentation", Section 3865 "Hedges", Section 1506 "Accounting Changes", Section 1530 "Comprehensive Income" and Section 3251 "Equity".

The adoption of these standards did not impact January 1, 2007 opening balances.

Financial instruments – recognition and measurement

Section 3855 establishes standards for recognizing and measuring financial assets, financial liabilities, and non-financial derivatives. It requires that financial assets and financial liabilities, including derivatives, be recognized on the balance sheet when the Company becomes a party to the contractual provisions of the financial instrument or non-financial derivative contract. Under this standard, all financial instruments are required to be measured at fair value upon initial recognition except for certain related party transactions. Measurement in subsequent periods depends on whether the financial instrument has been classified as held-for-trading, available-for sale, held-to-maturity, loans or receivables, or other financial liabilities. Financial assets and financial liabilities held-for-trading are measured at fair value with changes in those fair values recognized in net earnings. Financial assets held-to-maturity, loans and receivables, and other financial liabilities are measured at amortized cost using the effective interest method of amortization. Investments in equity instruments classified as available-for-sale that do not have a quoted market price in an active market are measured at cost.

Derivative instruments are recorded on the balance sheet at fair value, including those derivatives that are embedded in financial or non-financial contracts that are not closely related to the host contracts. Changes in the fair values of derivative

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

June 30, 2007 (Tabular figures are in thousands of dollars unless otherwise indicated) (unaudited)

instruments are recognized in net earnings, with the exception of derivatives designated as effective cash flow hedges and hedges of the foreign currency exposure of a net investment in a self-sustaining foreign operation, which are recognized in other comprehensive income. In addition, Section 3855 requires that an entity must select an accounting policy of either expensing debt issue costs as incurred or applying them against the carrying value of the related asset or liability.

Hedges

Section 3865 provides alternative treatments to Section 3855 for entities which choose to designate qualifying transactions as hedges for accounting purposes. It replaces and expands on Accounting Guideline 13 "Hedging Relationships", and the hedging guidance in Section 1650 "Foreign Currency Translation" by specifying how hedge accounting is applied and what disclosures are necessary when it is applied.

Accounting changes

Section 1506 provides expanded disclosures for changes in accounting policies, accounting estimates and corrections of errors. Under the new standard, accounting changes should be applied retrospectively unless otherwise permitted or where impracticable to determine. As well, voluntary changes in an accounting policy are to be made only when required by a primary source of GAAP or the change results in more relevant and reliable information.

Comprehensive income (loss) and accumulated other comprehensive income (loss)

Section 1530 introduces comprehensive income, which consists of net earnings and other comprehensive income ("OCI"). OCI represents changes in shareholder's equity during a period arising from transactions and changes in prices, markets, interest rates, and exchange rates. OCI includes unrealized gains and losses on financial assets classified as available-for-sale, unrealized translation gains and losses arising from self-sustaining foreign operations net of hedging activities and changes in the fair value of the effective portion of cash flow hedging instruments.

Future accounting changes

On December 1, 2006, the CICA issued three new accounting standards: Handbook Section 1535, *Capital Disclosures*, Handbook Section 3862, *Financial Instruments – Disclosures*, and Handbook Section 3863, *Financial Instruments – Presentation*. These new standards are effective January 1, 2008. Section 1535 specifies the disclosure of (i) an entity's objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; (iii) whether the entity has complied with any capital requirements; and (iv) if it has not complied, the consequences of such non-compliance. The new Sections 3862 and 3863 replace Handbook Section 3861, *Financial Instruments – Disclosure and Presentation*, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks. We are currently assessing the impact of these new standards on our financial statements.

4. PROPERTY, PLANT AND EQUIPMENT

	June 30, 2007	December 31, 2006
	\$	\$
Oil and gas properties	93,618	77,194
Other	186	146
	93,804	77,340
Accumulated depletion and depreciation	(10,760)	(6,761)
Net book value	83,044	70,579

For the six months ended June 30, 2007, the Company capitalized general and administrative expenses directly attributable to exploration and development activities of \$703,000 (June 30, 2006 - \$110,000).

Estimated future development costs for proved undeveloped reserves of \$21.3 million (June 30, 2006 - \$nil) were included in the calculation of depletion expense for the six months ended June 30, 2007. As at June 30, 2007, undeveloped land costs of \$4.3 million (June 30, 2006 - \$1.2 million) were excluded from assets subject to depletion.

5. BANK FACILITIES

As of June 30, 2007, the Company had a revolving credit facility with its bank (the "Bank") of \$7 million, bearing interest at the Bank's prime lending rate plus 0.25% (effective interest rate for the six months ended June 30, 2007 of 6.5%) and secured by an interest over all present and after acquired property and a floating charge on all lands of a subsidiary company.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

June 30, 2007 (Tabular figures are in thousands of dollars unless otherwise indicated) (unaudited)

On July 17, 2007, the Company increased its revolving credit facility from \$7 million to \$26.5 million, subject to an initial borrowing capacity of \$24 million. The facility bears interest at the Bank's prime lending rate plus 0.25% and is secured by an interest over all present and after acquired property and a floating charge on all lands of the Company.

6. 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 June 30, 2007 to be \$2.0 million based on a total future liability of \$3.5 million which will be primarily incurred between 2007 and 2029. An inflation rate of 2.0% (2006 – 3.0%) and a credit-adjusted risk-free rate of 6.5% were used to calculate the fair value of the asset retirement obligations.

Asset Retirement Obligations	\$
Balance, December 31, 2006	1,678
Liabilities incurred	294
Accretion expense	50
Balance, June 30, 2007	2,022

7. 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 income taxes as follows:

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
	\$	\$	\$	\$
Income (loss) before income taxes	(1,123)	(818)	(1,515)	17,149
Expected tax expense (recovery) at 32.12% (2006 – 34.50%)	(361)	(283)	(487)	5,916
Add (deduct) income tax effect of:				
Non-deductible crown charges	–	33	–	110
Resource allowance	–	7	–	(39)
Stock-based compensation	54	(10)	90	284
Flow-through share renouncement	–	–	–	(1,022)
Non-deductible expenses and other permanent differences	94	9	100	18
Large Corporations Tax	–	(20)	–	–
Rate adjustments	(293)	(824)	(293)	(1,828)
Income tax expense (recovery)	(506)	(1,088)	(590)	3,439

8. SHARE CAPITAL

(a) Authorized:

Unlimited number of 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.

(b) Common shares issued and outstanding:

(i) SignalEnergy Inc.

	Number of Common Shares	\$
Balance, December 31, 2006	89,615,982	157,508
Redemption of common shares (iii)	(23,076,923)	(40,374)
Exchanged for common shares of Fortress (iii)	(66,539,059)	(117,134)
Balance, June 30, 2007	–	–

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

June 30, 2007 (Tabular figures are in thousands of dollars unless otherwise indicated) (unaudited)

(ii) Fortress Energy Inc.

	Number of Common Shares	\$
Balance, December 31, 2006	-	-
Issued in exchange for shares of Signal (iii)	13,307,815	117,134
Normal course issuer bid (iv)	(50,000)	(438)
Issued in exchange for employment services (v)	4,008	13
Balance, June 30, 2007	13,261,823	116,709

(iii) 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 \$30,000,000 to redeem 23,076,923 common shares of Signal at \$1.30 per share. The historical value of these shares of \$40,374,000 was removed from share capital and the excess over the redemption price and reorganization costs of \$9,935,000 was recorded as an increase in contributed surplus. 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.

(iv) On December 13, 2006, the Company initiated a normal course issuer bid process whereby a maximum of 896,160 common shares (as adjusted for the Reorganization) could be repurchased beginning December 15, 2006 and terminating December 14, 2007. As at June 30, 2007, the Company had purchased 50,000 common shares at an average price of \$3.71 per share or \$186,000. The historical value of these shares of \$438,000 was removed from share capital and the excess over the purchase price of \$252,000 was recorded as an increase in contributed surplus.

(v) As part of an agreement with a new employee, the Company agreed to grant shares with a total market value of \$50,000 to the employee, to be paid on June 30, August 31, October 31, and December 31, 2007. The actual number of shares issuable on each of these dates is based on the volume weighted-average trading price of the Company's shares for the 30-day period prior to issuance. A total of 4,008 common shares with a market value of \$12,500 were issued to the employee on June 30, 2007 which is reflected in the consolidated statement of operations as stock-based compensation expense for the three and six months ended June 30, 2007. As at June 30, 2007, the remaining obligation to the employee of \$37,500 has been reflected in accounts payable and accrued liabilities with an offsetting amount in prepaid expenses.

(c) **Contributed surplus:**

	\$
Balance, December 31, 2006	1,779
Share redemption (note 8 (b)(iii))	9,935
Normal course issuer bid (note 8 (b)(iv))	252
Stock-based compensation expense (note 9)	265
Balance, June 30, 2007	12,231

(d) **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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

June 30, 2007 (Tabular figures are in thousands of dollars unless otherwise indicated) (unaudited)

The following table summarizes stock option transactions:

	Number	Weighted average exercise price \$
Outstanding, beginning of period	22,000	20.75
Granted	1,193,000	4.51
Cancelled	(15,000)	4.75
Outstanding, June 30, 2007	1,200,000	4.76
Exercisable, June 30, 2007	22,000	20.75

The Company has the following stock options outstanding at June 30, 2007:

Range of exercise prices \$	Outstanding			Exercisable	
	Number	Weighted average years to expiry	Weighted average exercise price \$	Number exercisable	Weighted average exercise price \$
3.00 - 4.00	215,000	4.8	3.17	-	-
4.00 - 5.00	963,000	4.5	4.75	-	-
19.50 - 50.00	22,000	1.9	20.75	22,000	20.75
Outstanding, June 30, 2007	1,200,000	4.5	4.76	22,000	20.75

(e) Per share amounts:

The weighted average number of common shares outstanding for the three and six months ended June 30, 2007 and 2006 are as follows:

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Weighted average - basic	13,257,860	72,594,859	13,260,828	72,299,545
Weighted average - diluted	13,257,860	73,316,247	13,260,828	72,994,542

The weighted average number of common shares outstanding reflects the effects of the Reorganization on February 20, 2007. The dilutive effect of the Company's issuable securities for the three and six months ended June 30, 2007 was nil shares (three and six months ended June 30, 2006 - 721,388 and 694,997 shares, respectively).

9. 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:

	June 30, 2007	June 30, 2006
Risk-free interest rate (%)	3.75	3.51
Expected life (years)	5.0	3.3
Expected volatility (%)	50.0	60.0
Expected dividend yield (%)	-	-

The estimated fair value of stock options of \$2.09 per share (June 30, 2006 - \$3.55) is amortized to expense over the vesting period on a straight-line basis. For the three months and six months ended June 30, 2007, the Company recorded compensation expense (recovery) of \$169,000 and \$279,000, respectively, related to stock options (three and six months ended June 30, 2006 - (\$30,000) and \$822,000, respectively). The total stock-based compensation expense for the three and six months ended June 30, 2007 also includes \$12,500 described in note 8 (b)(v).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

June 30, 2007 (Tabular figures are in thousands of dollars unless otherwise indicated) (unaudited)

10. CHANGE IN NON-CASH WORKING CAPITAL

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

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
	\$	\$	\$	\$
Accounts receivable	(1,370)	910	(3,633)	4,272
Prepaid expenses	30	(5)	(15)	55
Accounts payable and accrued liabilities	95	(4,171)	4,546	(15,407)
Income taxes payable	-	(20)	(283)	-
	(1,245)	(3,286)	615	(11,080)
Attributable to operating activities	522	(3,764)	1,079	(2,368)
Attributable to investing activities	(1,767)	478	(464)	(8,712)

11. FINANCIAL INSTRUMENTS

The Company entered into a derivative contract to manage its exposure to fluctuations in the price of natural gas, as follows:

Type	Period	Volume	Price Floor	Price Ceiling	Index
Natural gas collar	April 1, 2007 to October 31, 2007	2,500 GJ/d	\$6.00/GJ	\$8.30/GJ	AECO-CGPR

This derivative contract has not been designated as a hedge and, accordingly, has been recorded on the balance sheet as an asset and a liability based on its fair value.

The following table reconciles the movement in the value of this contract:

	\$
Risk management asset, December 31, 2006	-
Unrealized mark-to-market gain	131
Risk management asset, June 30, 2007	131
Risk management liability, December 31, 2006	-
Unrealized mark-to-market loss	(23)
Risk management liability, June 30, 2007	(23)

Realized gains and losses are recorded in petroleum and natural gas revenue in the period in which they occur. The Company realized a gain of \$97,000 in the three and six month periods ended June 30, 2007 representing actual cash settlements paid on this contract.

12. CONTINGENCIES

The Company is involved in various claims arising in the normal course of business. In the opinion of management, all such claims are not expected to materially affect the Company's financial position.

13. SUBSEQUENT EVENT

On July 18, 2007, the Company announced that it had closed the acquisition of certain strategic natural gas assets located within the Company's core operating areas, principally in the Ladyfern and Velma areas in British Columbia, and the Mearon area in Alberta, for cash consideration of \$13.25 million, subject to final adjustments. The Company used its revolving credit facility to finance this acquisition.

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