

Q4 QUARTERLY REPORT



**FORTRESS
ENERGY INC.**

FOR THE TWELVE MONTHS ENDED DECEMBER 31, 2010

FINANCIAL AND OPERATING SUMMARY

	Three months ended December 31,				Year ended December 31,			
	2010		2009		2010		2009	
	(\$000's)	\$/Mcf	(\$000's)	\$/Mcf	(\$000's)	\$/Mcf	(\$000's)	\$/Mcf
Petroleum and natural gas sales	210	4.68	4,798	6.20	16,656	6.53	18,589	6.65
Royalties	(209)	(4.66)	71	0.09	(473)	(0.19)	(714)	(0.25)
Operating costs	(78)	(1.73)	(1,995)	(2.58)	(5,924)	(2.32)	(7,422)	(2.66)
Transportation	(51)	(1.14)	(223)	(0.29)	(987)	(0.39)	(915)	(0.33)
Operating netback ⁽¹⁾	(128)	(2.85)	2,651	3.42	9,272	3.63	9,538	3.41
Environmental remediation	-	-	(134)	(0.17)	-	-	(134)	(0.05)
General and administrative expenses	(244)	(5.45)	(821)	(1.06)	(3,252)	(1.27)	(2,908)	(1.04)
Professional fees	(130)	(2.90)	(73)	(0.10)	(516)	(0.20)	(675)	(0.24)
Bad debts recovery (expense)	(67)	(1.49)	(132)	(0.17)	4	-	(294)	(0.10)
Interest expense	(311)	(6.92)	(277)	(0.36)	(1,318)	(0.52)	(917)	(0.33)
Indemnification of flow-through share subscribers	(1,314)	(29.28)	-	-	(1,314)	(0.51)	-	-
Current income tax expense	-	-	(42)	(0.05)	(106)	(0.04)	(96)	(0.04)
Funds from operations before transaction costs	(2,194)	(48.89)	1,172	1.51	2,770	1.09	4,514	1.61
Transaction costs	-	-	-	-	(564)	(0.22)	-	-
Funds from operations ⁽¹⁾	(2,194)	(48.89)	1,172	1.51	(2,206)	0.87	4,514	1.61
Unrealized loss on commodity contracts	-	-	(808)	(1.04)	(1,321)	(0.52)	(1,166)	(0.42)
Stock-based compensation expense	-	-	(153)	(0.20)	(767)	(0.30)	(388)	(0.14)
Depletion, depreciation and accretion	(65)	(1.45)	(2,720)	(3.51)	(7,629)	(2.99)	(13,170)	(4.70)
Ceiling test impairment	-	-	(4,820)	(6.22)	(47,476)	(18.61)	(19,096)	(6.83)
Loss on sale of oil and gas properties	301	6.71	(304)	(0.39)	(1,000)	(0.39)	(304)	(0.11)
Write down of temporary investment	(183)	(4.08)	-	-	(293)	(0.11)	-	-
Loss before future income taxes	(2,141)	(47.71)	(7,633)	(9.85)	(56,280)	(22.05)	(29,610)	(10.59)
Future income tax	(724)	(16.13)	276	0.36	26	0.01	3,868	1.38
Net loss	(2,865)	(63.84)	(7,357)	(9.49)	(56,254)	(22.04)	(25,742)	(9.21)
Sales volumes (Mcf/d)	488		8,418		6,991		7,668	

⁽¹⁾ Non-GAAP measure. See discussion in the following MD&A.

MANAGEMENT'S DISCUSSION AND ANALYSIS

April 29, 2011

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") for the years ended December 31, 2010 and 2009. 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. Additional information is available on the Company's web site at www.fortressenergy.ca or under the Company's profile at www.sedar.com.

Non-GAAP Measurements

The terms "funds from operations" and "operating netback" used in the MD&A are not recognized measures under GAAP. Management believes that in addition to net income, funds from operations and operating netback are useful supplemental measures as they provide an indication of the results generated by the Company's principal business activities before the consideration of how those activities are financed. Investors are cautioned, however, that these measures should not be construed as alternatives to net income determined in accordance with GAAP.

The Company's method of calculating funds from operations may differ from that of other companies, and, accordingly, it may not be comparable to measures used by other companies. The Company calculates funds from operations by taking cash flow from operating activities as determined under GAAP before changes in non-cash operating working capital and abandonment expenditures. The consolidated statements of cash flows included in the consolidated financial statements present the reconciliation between net income (loss) and funds from operations. A summary of this reconciliation is as follows:

(\$000s)	Three months ended		Year ended	
	December 31,		December 31,	
	2010	2009	2010	2009
Cash provided by (used in) operating activities	(3,670)	640	1,556	2,720
Change in non-cash operating working capital	1,476	530	650	1,621
Abandonment expenditures	-	1	-	173
Funds from (used in) operations	(2,194)	1,171	2,206	4,514

Operating netback is calculated on a per boe basis taking the sale price and deducting royalties, operating costs and transportation costs, as follows:

	Three months ended December 31,				Year ended December 31,			
	2010		2009		2010		2009	
	(\$000s)	(\$/Mcf)	(\$000s)	(\$/Mcf)	(\$000s)	(\$/Mcf)	(\$000s)	(\$/Mcf)
Petroleum and natural gas sales	210	4.68	4,798	6.20	16,656	6.53	18,589	6.65
Royalties	(209)	(4.66)	71	0.09	(473)	(0.19)	(714)	(0.25)
Operating expenses	(78)	(1.73)	(1,995)	(2.58)	(5,924)	(2.32)	(7,422)	(2.66)
Transportation expenses	(51)	(1.14)	(223)	(0.29)	(987)	(0.39)	(915)	(0.33)
Operating netback	(128)	(2.85)	2,651	3.42	9,272	3.63	9,538	3.41

Natural Gas, Crude Oil and Natural Gas Liquids (NGL) Conversions

Certain crude oil and NGL volumes have been converted to million cubic feet equivalent (Mcf) on the basis of one barrel (bbl) to six thousand cubic feet (Mcf). Mcfe may be misleading, particularly if used in isolation. A conversion ratio of one bbl to six Mcf is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent value equivalency at the well head.

Forward-Looking Statements

Certain 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. Without limiting the generality of the foregoing, the Company has made materially forward-looking statements:

- (i) Under “Liquidity and Capital Resources” regarding the CCAA proceedings and the CRA reassessment;
- (ii) Under “Liquidity and Capital Resources” regarding the potential listing alternatives;
- (iii) Under “Liquidity and Capital Resources” regarding the ability to continue as a going concern;
- (iv) Under “Income Tax Refund” regarding potential refund;
- (v) Under “Income Tax Audit” regarding expected resolution of the matter; and

The reader is cautioned that assumptions used in the preparation of such information may prove to be incorrect. The Company cautions the reader that actual performance will be affected by a number of factors, including 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 (applicable to the forward-looking statements (i) through (iii) above), delays or changes in plans (applicable to the forward-looking statements identified in (i) through (v) above); 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 MD&A 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 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:

- (i) Risks that the CRA reassessment will be upheld;
- (ii) Risks associated with the oil and natural gas industry and regulatory bodies (e.g. operational risks in exploration, development and production, or changes in royalty rates);
- (iii) Delays or changes in plans with respect to exploration or development projects or capital expenditures;
- (iv) Uncertainty of estimates and projections relating to recoverable reserves, costs and expenses;
- (v) Health, safety and environmental risks;
- (vi) Commodity price and exchange rate fluctuations; and
- (vii) Liquidity risk and working capital requirements (refer to “Liquidity and Capital Resources”).

Forward-looking statements contained herein are made as of the date hereof subject to the requirements of applicable securities legislation and except as otherwise required by law, the Company assumes no obligation to update any forward-looking statements, whether as a result of new information, future events and results, or otherwise. There can be no assurance that forward-looking statements will prove to be

accurate, as actual results and future events could differ materially from those anticipated in such statements. Accordingly, the reader is cautioned not to place undue reliance on forward-looking statements.

DESCRIPTION OF THE BUSINESS

Fortress Energy Inc. ("Fortress" or the "Company") was incorporated on January 15, 2007 under the Business Corporations Act (Alberta). Fortress is a Calgary-based junior oil and natural gas exploration and development company. All activity is conducted in Western Canada and comprises a single operating segment.

On March 2, 2011, Fortress applied to the Court of Queen's Bench of Alberta for an Order under the *Companies' Creditors Arrangement Act* (Canada) ("CCAA") staying all claims and actions against the Company and its assets and allowing the Company to prepare a plan of arrangement for its creditors if necessary. The Order was granted and was in effect until March 31, 2011. The Order was subsequently extended to May 27, 2011, at which time the matter will be reviewed by the Court. While the Order is in effect the Company will work with a court-appointed monitor. For further details refer to the "Liquidity and Capital Resources" section of this MD&A.

SALE OF OIL AND GAS ASSETS

Effective August 31, 2010, the Company sold substantially all of its oil and gas properties, tangible equipment and undeveloped land, other than its interests at Buick Creek and Pine Creek, to Terra Energy Corp. ("Terra") for proceeds of \$30,437,000, consisting of cash of \$25,600,000 and 3,664,444 common shares of Terra valued at \$1.32 per share. The transaction costs were \$454,000. The Company has recorded a loss on the sale of oil and gas properties of \$1,000,000. The cash proceeds were used to repay bank indebtedness of \$21,457,000. The Terra shares trade on the Toronto Stock Exchange ("TSX") under the symbol "TT" and were subject to a four month hold period that expired on December 29, 2010.

DETAILED FINANCIAL ANALYSIS

Production

	Three months ended December 31,		Year ended December 31,	
	2010	2009	2010	2009
Sales volume:				
Natural gas (Mcf/d)	433	8,288	6,882	7,574
Oil and NGL (bbls/d)	9	19	18	15
Total (Mcf/d)	488	8,418	6,991	7,668

Sales volumes for the three months ended December 31, 2010 were 488 Mcfe/d compared to 8,418 Mcfe/d for the three months ended December 31, 2009 – a decrease of 94 percent. This decrease is attributed to the sale of substantially all of the Company's oil and gas properties on August 31, 2010. The Company retained its Buick Creek and Pine Creek properties. Sales volumes for the three months ended December 31, 2010 are attributed entirely to the Buick Creek property (three months ended December 31, 2009 - 282 Mcf/d).

Sales volumes for the year ended December 31, 2010 were 6,991 Mcfe/d compared to 7,668 Mcfe/d for the prior year - a decrease of 9 percent. The Company's share of sales volumes from its former Square Creek property increased in the fourth quarter of 2009 reflecting the Company's acquisition of its partner's 50 percent working interest on October 23, 2009. This increase in sales volumes was reduced by the effect of the sale of oil and gas properties on August 31, 2010. The sales volumes attributed to these sold properties for the year ended December 31, 2010 were 6,481 Mcfe/d compared to 7,231 Mcfe/d for the year ended December 31, 2009.

Revenue

	Three months ended December 31,		Year ended December 31,	
	2010	2009	2010	2009
Petroleum and natural gas sales (\$000s)	210	4,798	16,656	18,589
Average realized prices:				
Natural gas (\$/Mcf)	3.77	4.19	4.37	4.19
Realized gain on commodity contracts (\$/Mcf)	-	1.96	2.06	2.43
Realized natural gas price (\$/Mcf)	69.06	6.15	6.43	6.62
Oil and NGL (\$/bbl)	4.08	51.10	61.63	53.71
Total (\$/Mcf)		37.17	6.53	39.87
Benchmark prices:				
AECO average natural gas price (\$/Mcf)	3.61	4.55	3.99	3.97
Edmonton par crude oil (\$/bbl)	80.91	76.99	78.16	89.18

For the three months ended December 31, 2010, petroleum and natural gas sales were \$210,000 compared to \$4,798,000 (including realized gains on commodity contracts of \$1,498,000) for the three months ended December 31, 2009. This decrease is due to the sale of oil and gas properties on August 31, 2010, as previously noted. Also, with the then pending sale of the Company's oil and gas assets, on July 21, 2010, the Company sold its commodity contracts for all production periods beginning on or after September 1, 2010 for cash proceeds of \$2,009,000. The proceeds were used to reduce bank indebtedness.

For the year ended December 31, 2010 petroleum and natural gas sales were \$16,656,000 (including realized gains on commodity contracts of \$5,268,000) compared to \$18,589,000 (including realized gains on commodity contracts of \$6,722,000) for the year ended December 31, 2009 - a decrease of 10 percent. This decrease is consistent with the three months ended December 31, 2010, as previously noted.

The average realized natural gas price for the three months ended December 31, 2010 was \$3.77/Mcf compared to the average AECO natural gas price of \$3.61/Mcf. The average realized natural gas price in the three months ended December 31, 2009 was \$4.19 /Mcf and the average AECO natural gas price was \$4.55/mcf.

The average realized natural gas price for the year ended December 31, 2010 was \$4.37/Mcf compared to the average AECO natural gas price for the period of \$3.99/Mcf. This compares to the average realized natural gas price in the year ended December 31, 2009 of \$4.19/Mcf and an average AECO price of \$3.97/Mcf. The Company receives a slight premium to the AECO natural gas price of approximately 4 percent to 5 percent due to the higher heating value of its natural gas.

The Company sold its commodity contracts effective September 1, 2010 and accordingly did not record a gain or loss on commodity contracts in the three months ended December 31, 2010. For the three months ended December 31, 2009, the Company realized a gain on commodity contracts of \$1,498,000, or \$1.96/Mcf. For the three months ended December 31, 2009 the Company recognized an unrealized loss on commodity contracts of \$808,000.

For the year ended December 31, 2010, the Company realized a \$5,268,000 gain on commodity contracts, or \$2.06/Mcf, compared to a realized gain on commodity contracts of \$6,722,000 or \$2.43/Mcf for the year ended December 31, 2009. In addition, the unrealized loss on commodity contracts in the year ended December 31, 2010 was \$1,321,000 compared to \$1,166,000 for the year ended December 31, 2009.

Royalties

	Three months ended December 31,		Year ended December 31,	
	2010	2009	2010	2009
Royalties (\$000s)	209	(71)	473	714
\$/Mcf	4.66	(0.09)	0.19	0.25
Percentage of petroleum and natural gas sales (1)	99%	(2.1)%	4.2%	6.0%

(1) Before realized gains and losses on commodity contracts.

For the three months ended December 31, 2010, the Company recorded royalties expense of \$209,000 compared to a recovery of royalties for the three months ended December 31, 2009 of \$71,000. This increase is mainly due to adjustments for prior production periods of \$197,000 which includes \$99,000 of Alberta Royalty Tax Credits ("ARTCs") that are repayable as the result of an audit of the 2004 and 2005 amounts received by a predecessor company.

For the year ended December 31, 2010, royalties were \$473,000 compared to \$714,000 for the year ended December 31, 2009. This decrease is attributed to a decrease in the average natural gas sales volume in 2010. Royalties are not calculated or payable on realized gains and losses on commodity contracts. The effective royalty rate for the year ended December 31, 2010 was 4.2 percent compared to 6.0 percent for the prior year.

Operating Expenses

	Three months ended		Year ended	
	December 31,		December 31,	
	2010	2009	2010	2009
Operating expenses (\$000s)	78	1,995	5,924	7,422
\$/Mcf	1.73	2.58	2.32	2.66

For the three months ended December 31, 2010, operating expenses were \$78,000, or \$1.73/Mcfe, compared to \$1,995,000, or \$2.58/Mcfe, for the three months ended December 31, 2009. Operating expenses decreased in the three months ended December 31, 2010 as a result of the sale of oil and gas properties in August 2010.

For the year ended December 31, 2010, operating expenses were \$5,924,000 or \$2.32/Mcfe as compared to \$7,422,000 or \$2.66/Mcfe for the year ended December 31, 2009. Operating expenses on a per Mcfe basis are lower for the year ended December 31, 2010 due to the sale of higher cost properties.

Transportation Expenses

	Three months ended		Year ended	
	December 31,		December 31,	
	2010	2009	2010	2009
Transportation expenses (\$000s)	51	223	987	915
\$/Mcf	1.14	0.29	0.39	0.33

Transportation expenses include transportation and fuel costs associated with the usage of natural gas pipelines. For the three months ended December 31, 2010, transportation expenses were \$51,000 (\$1.14/Mcfe) compared to \$223,000 (\$0.29/Mcfe) for the three months ended December 31, 2009. The increased per Mcfe rate is due to the higher tariffs at Buick Creek. Transportation expenses for the year ended December 31, 2010 were \$987,000 (\$0.39/Mcfe) compared to \$915,000 (\$0.33/Mcfe) for the year ended December 31, 2009.

General and Administrative Expenses

	Three months ended December 31,				Year ended December 31,			
	2010		2009		2010		2009	
	(\$000s)	(\$/Mcf)	(\$000s)	(\$/Mcf)	(\$000s)	(\$/Mcf)	(\$000s)	(\$/Mcf)
General and administrative expenses, net of recoveries	244	5.45	821	1.06	3,252	1.27	2,908	1.04
Professional fees	130	2.90	73	(0.10)	516	0.20	675	0.24
Bad debts (recoveries)	67	1.49	132	0.17	(4)	-	294	0.10
Total	441	9.84	1,026	1.33	3,764	1.47	3,877	0.70

General and administrative expenses, net of recoveries, decreased to \$244,000 in the three months ended December 31, 2010 from \$821,000 in the three months ended December 31, 2009. This decrease is due to lower expenditures in the three months ended December 31, 2010 as a result of the downsizing of the Company's operations after the sale of oil and gas properties on August 31, 2010. For the year ended December 31, 2010, general and administrative expenses, net of recoveries, were \$3,252,000 compared to \$2,908,000 for the year ended December 31, 2009 and include severance and other costs relating to the asset sale.

Professional fees include fees for lawyers, auditors, income tax professionals, and independent reserves evaluators. Professional fees increased to \$130,000 in the three months ended December 31, 2010 from \$73,000 for the three months ended December 31, 2009. Professional fees for the year ended December 31, 2010 totaled \$516,000 compared to \$675,000 for the year ended December 31, 2009. This decrease is primarily due to a reduction in legal and advisory fees in 2010 from the prior year. The Company incurred additional costs in 2009 related to income tax compliance.

For the three months ended December 31, 2010 the Company recorded bad debts expense of \$67,000 compared to \$132,000 for the three months ended December 31, 2009. For the year ended December 31, 2010, the Company recorded a recovery of bad debts of \$4,000 compared to an expense of \$294,000 for the year ended December 31, 2009. Bad debts primarily reflect the accounts of former joint venture partners that are considered uncollectible; many of these accounts are related to companies that were acquired by the Company. With the closing of the sale of the majority of the Company's properties, recoveries of many accounts that had previously been written off were recognized.

Stock-based Compensation Expense

	Three months ended		Year ended	
	December 31,		December 31,	
	2010	2009	2010	2009
Stock-based compensation expense (\$000s):				
Stock options	-	154	718	303
Restricted stock units	-	(1)	49	85
Total	-	153	767	388
\$/Mcf	-	0.20	0.30	0.14

Stock-based compensation expense for the three months ended December 31, 2010 was \$nil compared to \$153,000 for the three months ended December 31, 2009. Stock-based compensation expense for the year ended December 31, 2010 was \$767,000 compared to \$388,000 for the year ended December 31, 2009. As a result of the sale of oil and gas properties in August 2010 and the substantial reduction in the Company's asset base, all stock options and restricted stock units outstanding on August 31, 2010 were immediately vested. The increase in stock-based compensation expense for the year ended December 31, 2010 reflects this accelerated vesting. All stock options expired unexercised on November 29, 2010.

Interest Expense

	Three months ended		Year ended	
	December 31,		December 31,	
	2010	2009	2010	2009
Interest expense (\$000s):	311	277	1,318	917
\$/Mcf	6.92	0.36	0.52	0.33

The Company recorded interest expense of \$311,000 for the three months ended December 31, 2010 compared to \$277,000 for the three months ended December 31, 2009. Interest expense for the three months ended December 31, 2010 reflects accrued interest on flow-through commitments. Interest expense for the three months ended December 31, 2009 reflects interest on bank indebtedness and accrued interest on flow-through commitments. Interest expense for the year ended December 31, 2010 was \$1,318,000 compared to \$917,000 for the year ended December 31, 2009. This increase is due to an increase in the interest rates that the Company was charged on its bank indebtedness, in addition to facility extension fees and interest on flow-through commitments. All of the Company's bank indebtedness was repaid on the closing of the sale of oil and gas assets on August 31, 2010.

Depletion, Depreciation and Accretion Expense

	Three months ended December 31,		Year ended December 31,	
	2010	2009	2010	2009
Depletion and depreciation expense (\$000s)	57	2,659	7,398	12,937
Accretion of asset retirement obligations (\$000s)	8	61	231	233
Depletion, depreciation and accretion expense (\$000s)	65	2,720	7,629	13,170
Ceiling test impairment (\$000s)	-	4,820	47,476	19,096
Depletion and depreciation expense (\$/Mcf)	1.27	3.43	2.90	4.62
Accretion of asset retirement obligations (\$/Mcf)	0.18	0.08	0.09	0.08
Depletion, depreciation and accretion expense (\$/Mcf)	1.45	3.51	2.99	4.70
Ceiling test impairment (\$/Mcf)	-	6.22	18.61	6.83

Depletion and depreciation expense is calculated based on capital expenditures, production rates, and proved reserves. Depletion and depreciation expense was \$57,000 for the three months ended December 31, 2010 compared to \$2,659,000 for the three months ended December 31, 2009. This decrease is due to the sale of oil and gas assets on August 31, 2010. On a per boe basis, depletion and depreciation expense for the three months ended December 31, 2010 was \$1.27/Mcfe compared to \$3.43/Mcfe for the three months ended December 31, 2009.

Depletion and depreciation expense for the year ended December 31, 2010 totaled \$7,398,000 compared to \$12,937,000 for the year ended December 31, 2009. On a per Mcfe basis, depletion and depreciation expense decreased to \$2.99/Mcfe for the year ended December 31, 2010 from \$4.62/Mcfe for the year ended December 31, 2009. The Company recorded a ceiling test impairment charge of \$47,476,000 in 2010, as compared to \$19,096,000 in 2009. These ceiling test impairment charges were the result of a significant decrease in natural gas prices.

Estimated future development costs for proved undeveloped properties included in the calculation of depletion expense at December 31, 2010 were \$nil compared to \$7,456,000 at December 31, 2009. Undeveloped land costs at December 31, 2010 decreased to \$170,000 from \$7,518,000 at December 31, 2009 and were excluded from assets subject to depletion. Undeveloped land costs decreased in 2010 due to the sale of oil and gas properties on August 31, 2010.

Accretion expense for the three months ended December 31, 2010 was \$8,000 compared to \$61,000 for the three months ended December 31, 2009. The accretion expense for the three months ended December 31, 2010 reflects changes to the assumptions used to calculate the Company's asset retirement obligations and an adjustment in the fourth quarter for accretion expense of prior periods. For the year ended December 31, 2010, accretion costs amounted to \$231,000 compared to \$233,000 for the year ended December 31, 2009.

Income Tax

(000's except \$/Mcf)	Three months ended December 31,		Year ended December 31,	
	2010	2009	2010	2009
Income tax expense	-	42	106	96
Future income tax expense (reduction)	724	(276)	(26)	(3,868)
Total, net	724	(234)	80	(3,772)
\$/Mcf	16.13	(0.36)	0.03	(1.38)

The Company recorded income tax expense for the three months ended December 31, 2010 of \$724,000 compared to a reduction of income tax expense of \$234,000 for the three months ended December 31, 2009. This expense was the result of the reversal of previous renunciations from the issuance of flow-through shares in September 2009 as the required capital expenditures were not made by the Company prior to December 31, 2010.

For the year ended December 31, 2010, the Company recorded income tax expense of \$80,000 compared to reduction of income tax expense of \$3,772,000 for the year ended December 31, 2009.

The estimated tax pools of the Company at December 31, 2010 are as follows:

	(\$000's)
Canadian Oil and Gas Property Expenses	39
Canadian Development Expenses	21,489
Canadian Exploration Expenses	12,585
Undepreciated Capital Cost	24,784
	<u>58,897</u>

Net Loss

	Three months ended December 31,		Year ended December 31,	
	2010	2009	2010	2009
Net loss (\$000s)	(2,865)	(7,357)	(56,254)	(25,742)
Net loss per share				
- basic and diluted (\$)	(0.05)	(0.13)	(1.02)	(0.76)
Net loss per \$/Mcf	(63.84)	(9.49)	(22.04)	(9.21)

The Company recorded a net loss of \$2,865,000 for the three months ended December 31, 2010 compared to a net loss of \$7,357,000 for the three months ended December 31, 2009. This translates into a net loss per basic and diluted share of \$0.05 for the three months ended December 31, 2010 compared to a loss per basic and diluted share of \$0.13 for the three months ended December 31, 2009. The net loss for the three months ended December 31, 2010 is the result of reduced sales volumes, royalty adjustments, the reversal of previously booked tax renunciations, and expenses for the indemnification of flow-through share subscribers.

The net loss for the year ended December 31, 2010 was \$56,254,000 compared to \$25,742,000 for the year ended December 31, 2009. Both years recorded reductions in natural gas prices from prior periods and substantial ceiling test impairment charges attributing to these losses.

Funds from Operations

	Three months ended December 31,		Year ended December 31,	
	2010	2009	2010	2009
Funds from (used in) operations (\$000s) ⁽¹⁾	(2,194)	1,172	2,206	4,514
Funds from operations (\$/Mcf)	(48.89)	1.51	0.87	1.61
Funds from (used in) operations per share				
- basic and diluted (\$)	(0.04)	0.02	0.04	0.13

⁽¹⁾ Non-GAAP measure as defined on page 2.

Funds used in operations for the three months ended December 31, 2010 were \$2,194,000 compared to funds from operations of \$1,172,000 for the three months December 31, 2009. This decrease is attributable to lower revenues recorded in the three months ended December 31, 2010 and the sale of the Company's commodity contracts effective September 1, 2010.

Funds from operations for the year ended December 31, 2010 were \$2,206,000 compared to \$2,731,000 for the year ended December 31, 2009. This increase is due to lower production levels, lower realized natural gas prices, higher general and administrative expenses and expenses for the indemnification of flow-through share subscribers.

Capital Expenditures

(\$000s)	Three months ended		Year ended	
	December 31,		December 31,	
	2010	2009	2010	2009
Land and seismic	(10)	119	361	530
Drilling and completions	-	447	498	4,678
Equipment and facilities	27	769	646	3,592
Acquisition	-	6,986	-	6,986
Disposition	47	-	(25,146)	-
Capitalized overhead costs	-	321	239	1,022
Other	-	16	3	43
	64	8,658	(23,399)	16,851

In the year ended December 31, 2010, the Company completed a fuel gas conversion at its Square Creek camp to reduce its operating costs, completed workover operations on two wells at Buick Creek, replaced coil tubing for two wells at Velma, completed pipeline header repairs at Mearon North to restore lost production and completed pipeline repairs at Ladyfern North. The disposition reflects the cash portion of the proceeds on the sale of oil and gas assets of \$25,600,000 net of transaction costs of \$454,000. The Company recorded a loss on the sale of oil and gas assets of \$1,000,000 in the year ended December 31, 2010.

Outstanding Securities

Outstanding securities	
Common shares	55,294,617
Warrants (exercise price \$2.00)	5,516,700
Warrants – A (exercise price \$0.55)	21,779,000
Stock options – expired on April 11, 2011	800
Total outstanding securities at December 31, 2010	82,591,117

On September 30, 2009, the Company closed a public offering of 21,779,000 units and 6,594,000 flow-through common shares for gross proceeds of \$11,385,185 (\$10,320,000 net of issuance costs). Each unit consists of one common share of the Company and one common share purchase warrant. The warrants are exercisable on or before December 31, 2011. Each warrant entitles the holder thereof to purchase one common share at an exercise price of \$0.55. The expenditure commitment resulting from the issuance of 6,594,000 flow-through common shares was \$3,000,270 and was renounced to subscribers effective December 31, 2009. Only a portion of these funds were expended and, accordingly, an additional liability for \$1,314,000 has been recorded representing the anticipated payments to investors required under indemnification agreements.

Options to purchase 800 (December 31, 2009 – 4,774,579) common shares and warrants to purchase 27,295,700 (December 31, 2009 – 27,295,700) common shares at December 31, 2010 were not included in the calculation of diluted common shares outstanding because they were anti-dilutive.

Liquidity and Capital Resources

The Company fully repaid its bank indebtedness on the closing of the sale of oil and gas properties on August 31, 2010. The facility was subsequently cancelled by the bank and the Company no longer has a borrowing facility. The Company has a letter of guarantee of \$107,000 outstanding as at December 31, 2010 (December 31, 2009 - \$1,007,000) which is secured by a cash deposit.

As at December 31, 2010, the Company has cash on hand of \$2,433,000 and 3,664,444 common shares of Terra with a carrying value of \$4,544,000. The Company anticipates that in 2011 it will be required to sell a portion of the Terra shares to allow it to continue ongoing operations and to continue its challenge of the CRA reassessment.

Cash used in operating activities for the three months ended December 31, 2010 was \$3,670,000 compared to cash generated from operating activities for the three months ended December 31, 2009 of \$641,000. This decrease is due to lower petroleum and natural gas sales in the three months ended December 31, 2010 and the sale of the Company's commodity contracts effective September 1, 2010 leaving it more vulnerable to fluctuations in natural gas prices. In addition, the Company recorded an expense for the indemnification of flow-through share subscribers of \$1,314,000. Cash provided by operating activities for the year ended December 31, 2010 was \$1,556,000 compared to \$2,720,000 for the year ended December 31, 2009. This increase is due to lower non-cash working capital balances.

Cash provided by financing activities for the three months ended December 31, 2010 was \$1,314,000 compared to \$2,135,000 for the three months ended December 31, 2009. Cash used in financing activities for the year ended December 31, 2010 was \$21,730,000 compared to the \$12,831,000 provided by financing activities for the year ended December 31, 2009. Cash used in financing activities for the year ended December 31, 2010 reflects the repayment of the Company's bank indebtedness of \$23,044,000 offset by the change in the liability for the indemnification of flow-through share subscribers of \$1,314,000. Cash provided by financing activities for the year ended December 31, 2009 reflects the net proceeds of an equity financing of \$10,320,000 and an increase in the amount drawn on the operating loan facility.

Cash provided by investing activities for the three months ended December 31, 2010 was \$1,304,000 compared to cash used in investing activities of \$9,775,000 for the three months ended December 31, 2009. The Company's capital expenditures in the three months ended December 31, 2010 were \$67,000 compared to \$1,672,000 plus \$6,986,000 for the Square Creek acquisition in the three months ended December 31, 2009. Cash provided by investing activities for the year ended December 31, 2010 was \$22,543,000 compared to cash used in investing activities of \$15,667,000 for the year ended December 31, 2009. For the year ended December 31, 2010, the Company incurred capital expenditures of \$1,747,000 and proceeds of \$25,146,000 on the disposition of oil and gas properties. This compares to capital expenditures of \$9,865,000 and the acquisition of its partner's interest at Square Creek for \$6,986,000 for the year ended December 31, 2009.

CCAA proceedings

On March 2, 2011, Fortress applied to the Court of Queen's Bench of Alberta for an Order under the *Companies' Creditors Arrangement Act* (Canada) ("CCAA") staying all claims and actions against the Company and its assets and allowing the Company to prepare a plan of arrangement for its creditors if necessary. The Order was granted and was in effect until March 31, 2011. The Order was subsequently extended to May 27, 2011, at which time the matter will be reviewed by the Court. While the Order is in effect the Company will work with a court-appointed monitor.

Fortress has taken this step to enable it to challenge a reassessment issued by the Canada Revenue Agency (the "CRA"), which reassessment is in the amount of approximately \$18,000,000 (in addition, the Company expects provincial reassessments based on the CRA reassessments of approximately \$10,000,000). As a result of the reassessment, if the Company took no action, it would be compelled to immediately remit \$9,000,000 to the CRA and the Company does not have the necessary funds to remit. Fortress believes that the CRA's position is not sustainable and is vigorously disputing the CRA's claim.

The reassessment denies the deduction of certain tax pools in SignalEnergy Inc.'s ("Signal") 2004, 2005 and 2006 taxation years on the basis that (i) those pools arose from expenses incurred prior to November of 2003 and (ii) that there was an acquisition of control of Signal (previously named SignalGene Inc.) in November of 2003. Signal was subsequently wound-up into Fortress.

Following the transactions that occurred in November of 2003, Signal was developed into an oil and gas company with over \$140,000,000 of oil and gas assets. On February 1, 2006, Signal received an unsolicited offer to acquire a substantial portion of its oil and gas assets for \$100,000,000 which transaction subsequently closed on March 10, 2006. Fortress used its available tax pools to reduce its taxable income from the proceeds of the disposition.

Management believes that no acquisition of control has occurred. Through a series of communications, including detailed written correspondence with the CRA, Fortress attempted to correct certain apparent factual misunderstandings that had led the CRA to determine that an acquisition of control had occurred. Unfortunately, notwithstanding the explanations by Fortress, the CRA issued the reassessments.

In addition to potential remedies that may be available under the CCAA, the Tax Act provides for at least two more levels at which this dispute can be considered. The first is at the appeals level with the CRA and, as a resolution at this level would resolve this matter most expeditiously; this is the avenue Fortress is pursuing at this time. If that process does not result in a successful resolution of this matter, Fortress can, and if necessary will, file an appeal to the Tax Court of Canada. While there is no certainty in the case of a CRA challenge, Fortress strongly believes that pursuit of this matter to a higher level should result in this matter being resolved in its favour.

As Fortress was a large corporation for purposes of the Tax Act in the taxation years that have been reassessed, under the relevant legislation the CRA is empowered to take action to collect 50 percent of the tax owing at any time during this dispute process (notwithstanding the ability of Fortress to challenge the reassessment and that no final legal determination of the matter has occurred). Due to the vast powers afforded to the CRA to collect this amount, and the severe adverse impact it would have on Fortress and its creditors if the CRA took any collection action without providing Fortress with reasonable notice, Fortress has taken action to protect stakeholders by voluntarily applying to the court for protection under CCAA.

TSX listing requirements

The Company announced that it had been advised on October 17, 2010 by the TSX that the Company substantially discontinued its business or materially changed the nature of its business by virtue of the closing of the sale of its oil and gas assets announced on September 1, 2010 and the Company was required to meet original listing requirements by February 18, 2011.

On February 23, 2011, Fortress announced that that it did not meet the listing requirements of the TSX by virtue of the sale of substantially all of its oil and gas assets on September 1, 2010. Fortress was notified by the TSX that its formal listing committee determined on February 25, 2011, that Fortress would be delisted from the TSX on March 30, 2011. As a result, Fortress then commenced the application process for listing on the TSX Venture Exchange and both exchanges at that time indicated a willingness to ensure a seamless transition to ensure no disruption of trading. Although application to the TSX Venture Exchange has started, Fortress is uncertain it will be accepted for listing until the CCAA Order is removed. Fortress was delisted from the TSX on March 30, 2011.

Fortress is considering a listing on the Canadian National Stock Exchange ("CNSX"). The CNSX has indicated its willingness to allow Fortress shares to be listed for trading on such exchange notwithstanding the CCAA Order.

Going concern uncertainty

The Company's consolidated financial statements have been prepared on a going concern basis, which assumes the realization of assets and discharge of liabilities in the normal course of business for the foreseeable future. The Company has experienced consecutive losses and has an accumulated deficit of \$154,993,000 as at December 31, 2010.

There is significant uncertainty regarding the Company's ability to continue as a going concern, which is dependent upon achieving on-going cash flow from operating activities and receiving additional support from its creditors and investors.

The Company is experiencing negative cash flow from operating activities. There is no certainty as to when the Company will have positive cash flow. The Company will be solely dependent upon outside sources and third party financings to obtain the necessary capital to implement a plan to explore and develop its properties or acquire further properties or restructure the Company and continue as a going concern. While the Company has repaid its outstanding bank indebtedness, it does not have access to short term bank financing. If the Company is unable to secure sufficient financing, delays or postponement of future development or production of the Company's properties may result. There can be no assurance that the additional capital required or other types of financing will be available if needed or even if available, the terms of such financing will be acceptable to the Company.

Therefore, failure to obtain suitable financing would, in all likelihood, lead to the liquidation of the Company's assets.

Should the stay period in the CCAA proceedings and any subsequent extensions thereof, if granted, not be sufficient to develop and present a plan ("Plan") under the CCAA, or allow a successful resolution of the dispute with CRA regarding the reassessment, or should the Plan not be accepted by affected creditors or confirmed by the Court and, in any such case, the Company loses the protection of the stay of proceedings, creditors including CRA may immediately enforce their rights and remedies against the Company and its properties which would in all likelihood lead to the liquidation of the Company's assets. Failure to implement a Plan and obtain sufficient exit financing within the time granted by the Court would in all likelihood also lead to the liquidation of the Company's assets.

There can be no assurance that a Plan proposed by the Company will be supported by the Company's creditors or confirmed by the Court, or that any such Plan or Plans will be consummated or successful. Without limiting the foregoing there can be no assurance that the Company will be successful in its dispute with CRA regarding the reassessment.

Considering a timely resolution of the CRA reassessment has not occurred and the timeline for a conclusion remains uncertain, it is not possible for the Company to invest in any new initiatives at this time and third party sources of financing may not be available to the Company.

The Company's financial statements do not contain any adjustments to the amounts and classification of assets and liabilities that might be necessary should the Company be unable to continue in business.

Related-Party Transactions

- a) In 2010 the Company was charged \$242,000 (2009 - \$321,000) by a law firm of which a director of the Company is a partner.
- b) In 2010, the Company was charged \$nil (2009 - \$125,000) by a director for consulting services of which \$nil is included in accounts payable and accrued liabilities at December 31, 2010 (\$9,000 – December 31, 2009).

All related party transactions are in the normal course of business and have been measured at the agreed to exchange amounts, which are the amounts of consideration established and agreed to by the related parties and which are similar to those negotiated with third parties.

Commitments and Contingencies

Office equipment

As at December 31, 2010 the Company is committed to minimum annual lease payments under operating leases for office equipment of \$9,000 in 2011.

Income Tax Refund

In September 2008, the Company re-filed its income tax returns for the 1997 to 1999 tax years to claim additional scientific research and experimental development (SR&ED) credits related to the bio-technology business of its predecessor company. These additional claims could result in a refund of approximately \$3,400,000 to the Company.

SUBSEQUENT EVENTS

(a) Income Tax Audit

In February 2011, the Company received a series of Notice of Assessments for the taxation years ended 2004 to 2007 from the Canada Revenue Agency ("CRA") pertaining to the conversion of SignalEnergy Inc., predecessor to the Company and formerly known as SignalGene Inc., into an oil and natural gas enterprise.

In these assessments, the CRA denied the use of tax pools existing at the time of the conversion. As a result, CRA now claims that the Company owes \$18,000,000 in taxes, interest and penalties.

The Company believes that these assessments will be resolved in the Company's favour. Accordingly, no provision for this amount has been included in these financial statements.

(b) Companies' Creditors Arrangement Act (the "CCA") filing

On March 2, 2011, the Company made an application for protection under the Companies' Creditors Arrangement Act and an order (the "Initial Order") was granted by the Court of Queen's Bench of Alberta (the "Court"). Hardie & Kelly Inc. was appointed by the Court as monitor of the Company (the "Monitor"). The Initial Order provides certain relief including the imposition of a Stay of Proceedings (the "Stay") against the Company and its assets through to March 31, 2011. The Order was subsequently extended to May 27, 2011, at which time the matter will be reviewed by the Court. While the Order is in effect the Company will work with a court-appointed monitor.

Income Tax Reassessment

Based on the results of an audit concluded in March 2009 by the Canada Revenue Agency (CRA) on the 2004 flow-through expenditures of a business acquired by the Company in 2006, the Company was reassessed by CRA for interest and penalties of \$300,000 on expenditures not qualifying for renunciation under the flow-through share program in the amount of \$1,916,000. The Company filed a Notice of Objection with CRA on July 31, 2009 after consultation with its tax advisors and legal counsel and is appealing this reassessment. The Company has indemnified the subscribers of this flow-through share offering from income taxes related to the offering. The amount of the potential indemnification is approximately \$765,000. The amounts of the interest and penalties and potential indemnification have not been recorded as the Company's position is that the more likely than not criteria for recognition have not been met.

SELECTED QUARTERLY INFORMATION

	2010				2009			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Production:								
Natural gas (Mcf/d)	433	7,084	9,903	10,212	8,288	8,733	8,690	7,391
Oil and NGL's (bbl/d)	9	17	20	27	19	23	15	33
Total (Mcf/d)	488	7,185	10,022	10,374	8,418	8,868	8,778	10,120
Average realized prices:								
Natural gas (\$/Mcf)	3.77	8.12	5.28	6.49	6.15	7.02	8.98	8.03
Oil and NGL (\$/bbl)	69.06	54.12	62.09	63.54	51.1	82.29	108.04	79.61
Combined average (\$/Mcf)	4.63	8.19	5.36	6.58	6.2	7.11	9.05	8.16
Benchmark prices:								
AECO average natural gas price (\$/Mcf)	3.61	3.53	3.89	4.94	4.55	7.76	9.82	7.9
Edmonton Par crude oil price (\$/bbl)	80.91	74.88	75.53	80.92	76.99	123.08	126.37	98.45
Financial (\$000's unless otherwise noted):								
Petroleum and natural gas sales	210	5,412	4,886	6,148	4,798	5,802	7,231	5,637
Net loss	(2,865)	(3,390)	(39,985)	(10,012)	(7,357)	1,070	(744)	(3,455)
Net loss per share – basic (\$)	(0.05)	(0.06)	(0.72)	(0.18)	(0.13)	0.04	(0.04)	(0.22)
Net loss per share – diluted (\$)	(0.05)	(0.06)	(0.72)	(0.18)	(0.13)	0.04	(0.04)	(0.22)
Funds from (used in) operations	(2,194)	2,199	997	1,205	1,172	1,193	2,627	2,025
Operating costs (\$/Mcf)	1.73	2.25	2.34	2.38	2.58	2.62	2.57	1.99
Weighted average shares outstanding – basic (000)	55,295	55,295	55,295	55,295	55,295	26,965	16,809	15,980
Weighted average shares outstanding – diluted (000)	55,295	55,295	55,295	55,295	55,295	27,004	16,809	15,980

Disclosure Controls and Procedures

The Company has established disclosure controls and procedures to ensure timely and accurate preparation of financial and other reports. Disclosure controls and procedures are designed to provide reasonable assurance that material information required to be disclosed is recorded, processed, summarized and reported within the periods specified by securities regulations and that information required to be disclosed is accumulated and communicated to the appropriate members of management and properly reflected in the Company's filings. The Chief Executive Officer and the Chief Financial Officer oversee this evaluation process and have concluded that the design and operation of these disclosure controls and procedures are adequate and effective in ensuring that the information required to be disclosed by the Company in reports filed with the Canadian Securities Administrators is accurate and complete and filed within the periods required. The Chief Executive Officer and Chief Financial Officer have individually signed certifications to this effect.

Internal Controls over Financial Reporting

Management has designed internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. The Company's management, under the direction and supervision of the Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the design and effectiveness of the internal controls over financial reporting as at December 31, 2010. Based on their assessment, management determined that the internal controls over financial reporting were effective as at December 31, 2010.

There was no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting. Management, including the Chief Executive Officer and the Chief Financial Officer, do not expect that the Company's disclosure controls or the Company's internal controls over financial reporting will prevent or detect all error or fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs.

Given the Company's limited staff level, certain duties within the accounting and finance department cannot be properly segregated. However, none of the segregation of duty deficiencies resulted in a misstatement to the financial statements as the Company relies on certain compensating controls, including substantive periodic review of the financial statements and other information by the Chief Executive Officer and Audit Committee. This weakness is considered to be a common area of deficiency for many smaller listed companies in Canada.

New Canadian Accounting Pronouncements

In December 2008, the CICA issued Section 1582, *Business Combinations*, which replaces the previous business combinations standard. The standard requires assets and liabilities acquired in a business combination, contingent consideration and certain acquired contingencies to be measured at their fair values as of the date of acquisition. In addition, acquisition-related and restructuring costs are to be recognized separately in the statement of operations. The Company's adoption of this standard on January 1, 2010 resulted in the expensing of certain acquisition-related costs in the three months and year ended December 31, 2010. This standard has been applied on a prospective basis with no restatement of prior periods.

International Financial Reporting Standards

The Canadian Accounting Standards Board (AcSB) has confirmed that the use of IFRS will be required in 2011 for publicly accountable profit-oriented enterprises. The official changeover date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The adoption date of January 1, 2011 will require the restatement, for comparative purposes, of amounts reported by the Company for the year ended December 31, 2010, including the opening balance sheet as at January 1, 2010.

The Company has started the process to transition from current Canadian GAAP to IFRS. The Company's IFRS conversion project is made up of three phases:

- Scoping and diagnostic phase – this phase involves performing a high-level impact analysis to identify areas that may be affected by the transition to IFRS. The results of this analysis were priority ranked according to complexity and the amount of time required to assess the impact of changes in transitioning to IFRS.
- Impact analysis and evaluation phase – during this phase, items identified in the scoping and diagnostic phase are addressed according to the priority levels assigned to them. This phase involved analysis of policy choices allowed under IFRS and their impact on the financial statements. In addition, certain potential differences are further investigated to assess whether there may be a broader impact to the Company's debt agreements, compensation arrangements or management reporting systems. The conclusion of the impact analysis and evaluation phase will require the Board of Directors to review and approve all accounting policy choices as proposed by management.
- Implementation phase – involves implementation of all changes approved in the impact analysis and evaluation phase and will include changes to information systems, business processes, modification of agreements and training of all staff who are impacted by the conversion.

The Company has completed the scoping and diagnostic phase of the project and has commenced the analysis of various accounting policy choices available under IFRS. The Company has not yet completed its accounting policies and is unable to quantify the impact of adopting IFRS on the financial statements. Due to the impact of low natural gas prices experienced and the resulting reallocation of staff resources, the Company is behind on its conversion schedule. The Company has recently hired consultants to assist with the project and expects that it will be able to meet the conversion timeline.

First-Time Adoption of IFRS

IFRS 1, "*First-Time Adoption of International Financial Reporting Standards*", provides entities adopting IFRS for the first time with a number of optional exemptions and mandatory exceptions in certain areas to the general requirement for full retrospective application of IFRS. The Company is analyzing the various accounting policy choices available and will implement those determined to be the most appropriate for the Company as summarized below:

- Business Combinations – IFRS 1 would allow the Company to use the IFRS rules for business combinations on a prospective basis rather than re-stating all business combinations. The IFRS business combination rules converge with the new CICA Handbook Section 1582 that is also effective for the Company on January 1, 2011; however, early adoption is permitted.
- Property, Plant and Equipment ("PP&E") – IFRS 1 provides the option to value the PP&E assets at their deemed cost being the Canadian GAAP net book value assigned to these assets as at the date of transition, January 1, 2010. This amendment is permissible for entities, such as Fortress, that currently follow the full cost accounting guideline under Canadian GAAP that accumulates all oil and gas assets into one cost centre. Under IFRS, the Company's PP&E assets must be divided into smaller cost centres. The net book value of the assets on the date of transition will be allocated to the new cost centres on the basis of reserve volumes or values at January 1, 2010.
- Share-Based Payments – IFRS 1 allows Fortress an exemption on IFRS 2, "*Share-Based Payments*" to equity instruments granted on or before November 2, 2002 or which are vested before the Company's transition date to IFRS.

The transition from Canadian GAAP to IFRS is a significant undertaking that may materially affect the Company's reported financial position and results of operations. At this time, the Company has identified key differences that will impact the financial statements as follows:

- Re-classification of Exploration and Evaluation (E&E) expenditures from PP&E – Upon transition to IFRS, Fortress will re-classify all E&E expenditures that are currently included in the PP&E balance on the Consolidated Balance Sheet. E&E assets will consist mainly of the book value for the Company's undeveloped land that relates to exploration properties. E&E assets will not be depleted and must be assessed for impairment when indicators suggest the possibility of impairment. In addition, IFRS requires that E&E expenditures incurred before the Company has acquired the legal right to explore an area be expensed. Under current Canadian GAAP these expenditures would be capitalized to PP&E. Once E&E assets have reached technical feasibility and commercial viability they are reclassified to production assets.
- Calculation of depletion expense for PP&E assets – Upon transition to IFRS, the Company has the option to calculate depletion using a reserve base of proved reserves or both proved and probable reserves, as compared to the Canadian GAAP method of calculating depletion using only proved reserves. The Company's policy will be to calculate depletion using a reserve base of proved and probable reserves.
- Impairment of PP&E assets – Under IFRS, impairment of PP&E must be calculated at a more granular level than what is currently required under Canadian GAAP. Impairment calculations will be performed at the cash-generating unit level using either total proved or proved plus probable reserves. IFRS requires an impairment test on the adoption of IFRS on January 1, 2010. The test for impairment under IFRS requires the use of a discounted cash flow model to determine fair value, whereas Canadian GAAP uses an undiscounted cash flow model and then discounted cash flow model to assess impairment. Market factors such as discount rates and the price of natural gas will affect the Company's assessment of impairment. Depending upon these factors, the Company may have an impairment loss on adoption of IFRS. Also, impairment charges may be more frequent under IFRS as individual E&E projects that do not reach technical feasibility or commercial viability will be written down to their recoverable amount, whereas under Canadian GAAP these projects may continue to remain part of the full cost pool subject only to a ceiling test.
- Decommissioning Liabilities (Asset Retirement Obligations) – Under Canadian GAAP the Company recognizes a liability for the estimated fair value of future retirement obligations related to PP&E. This liability is based on the estimated costs to abandon and reclaim the Company's net working interest in wells and facilities, including an estimate of when these costs will be incurred. These cash outflows are discounted using a credit-adjusted risk-free interest rate. Changes in net present value of the future retirement obligation are expensed through accretion expense. Under IFRS the liability is calculated at each reporting date using estimates of risk-adjusted cash outflows discounted using the risk-free rate. Changes in the net present value are expensed through accretion expense. As a result of the change in discount rate from a credit-adjusted risk-free rate to a risk-free rate, the Company expects that there may be an increase in the value of the decommissioning liability under IFRS compared to Canadian GAAP; however, the difference is not known at this time.
- Income Tax - In transitioning to IFRS, the carrying amount of the Company's tax balances will be directly impacted by the tax effects resulting from changes required by the above IFRS accounting policy differences. Therefore, at this time the income tax impacts of the differences are not reasonably determinable.

In addition to accounting policy differences, the Company's transition to IFRS will impact the internal controls over financial reporting, the disclosure controls and procedures, the Company's business activities and information technology systems as follows:

- Internal controls over financial reporting – As the review of the Company's accounting policies is completed, an assessment will be made to determine changes required for internal controls over financial reporting. As an example, additional controls will be implemented for the IFRS 1 changes such as the allocation of PP&E as well as the process for re-classifying E&E expenditures from PP&E. This will be an ongoing process to ensure that all changes in accounting policies include the appropriate additional controls and procedures for future IFRS reporting requirements.

- Disclosure controls and procedures – Throughout the transition process, the Company will be assessing stakeholders' information requirements and will ensure that adequate and timely information is provided so that all stakeholders are kept apprised.
- Business activities – The Company has been cognizant of the upcoming transition to IFRS and as such will work with counterparties and lenders to ensure that agreement references to Canadian GAAP statements are modified to allow for IFRS statements. Based on the expected changes to the Company's accounting policies, there are no foreseen issues with the existing wording of debt covenants and related agreements as a result of the conversion to IFRS.
- Information technology systems – The Company has identified several accounting system upgrades required for IFRS reporting and is working with its software provider to make the necessary changes. The modifications are not significant; however, they are critical in order to allow for reporting of both Canadian GAAP and IFRS statements in 2010 as well as the modifications required to track PP&E costs and E&E costs to a more granular level of detail for IFRS reporting. Additional system modifications may be required based on final policy choices.

CRITICAL ACCOUNTING ESTIMATES

The reader is advised that the critical accounting estimates, policies, and practices as described here 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 natural gas reserves are capitalized in a single Canadian cost centre. Such costs include lease acquisition, lease rentals on undeveloped properties, geological and geophysical costs, drilling 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 proved reserves that are believed to be recoverable from the Company's oil and natural 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 natural gas prices and costs change. The Company's 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 Fortress' accounting estimates, including:

- Calculating the Company's unit-of-production depletion and future site restoration rates. Proved reserve estimates are used to determine rates that are applied to each unit-of-production in calculating depletion expense; and
- Assessing when necessary, oil and natural gas assets for possible impairment. Estimated future undiscounted cash flows are determined using proved 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 Fortress makes every reasonable effort to ensure that its 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. Positive or negative revisions to the Company's reserve estimates can arise from changes in oil and natural gas prices, and reservoir performance.

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 plus 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, planned future development and sales impacts the amount and timing of impairment provisions.

Asset Retirement Obligations

The provision for asset retirement obligations recorded in the consolidated financial statements is based on an estimate of 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 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 would be reduced by a valuation allowance.

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 favour. If the outcomes of these claims are unfavourable, there could be 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 those which Fortress currently foresees.

BUSINESS RISKS and UNCERTAINTIES

Going Concern and CCAA Issues

There is substantial risk on the Company's ability to continue as a going concern. As the Company is experiencing negative cash flow with no certainty as to when it will have positive cash flow, the Company is dependent on outside sources for funding future capital expenditures. Failure to obtain such funding would, in all likelihood, lead to a liquidation of the Company's assets.

Similarly, if the Company cannot successfully implement a Plan under the CCAA or if the Plan is not accepted by affected Creditors or if the Company loses its protection of the stay of proceedings such would in all likelihood lead to the liquidation of the Company's assets.

Please refer to the discussion in the "*Liquidity and Capital Resources – Going Concern Uncertainty*" section of this MD&A.

CRA Reassessment

The Company obtained the Order under the CCAA staying all claims and actions against the Company and its assets. Fortress took such steps in order to enable it to challenge a reassessment by CRA. While the Company believes the reassessment is not sustainable, in the event the reassessment is upheld and the CRA enforces its rights such would, in all likelihood, lead to a liquidation of the Company's assets.

Delisting

The Common Shares have been delisted from trading on the TSX as a result of the sale of substantially all the assets of the Company. While the Company has applied to list the shares on an alternative Exchange, there can be no assurance that a listing will be obtained. Failure or delay in obtaining a listing on another stock exchange will drastically reduce the liquidity of the Common Shares.

Substantial Capital Requirements

The Company will be required to acquire additional assets in order to continue as a viable entity. In order to acquire additional assets the Company will need additional capital. There can be no assurance that debt or equity financing, or cash generated by operations, will be available or sufficient to meet these requirements or for other corporate purposes or, if debt or equity financing is available, that it will be on terms acceptable to the Company. The inability of the Company to access sufficient capital for its operations could have a material adverse effect on its business, financial condition, results of operations and prospects including its ability to continue in business.

There is no assurance that current cash on hand will be able to sustain the Company through the conclusion of the dispute with CRA. Should the dispute continue for an extended period, the Company will be required to identify alternative sources of financing. Given the reassessment and that the Company is under CCAA, it may be difficult to raise the required capital to fund ongoing operations.

General

Fortress' production and exploration activities are concentrated in the Western Canada 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 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 high-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 selected high-risk with high-reward opportunities.

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 natural 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.

Third-party Credit Risk

The Company may be exposed to third-party credit risk through its contractual arrangements with its current or future joint venture partners, marketers of its petroleum and natural gas production and other parties. In the event such entities fail to meet their contractual obligations to the Company, such failures may have a material adverse effect on Fortress' business, financial condition, results of operations and prospects.

Additional risk factors can be found under "Risk Factors Relating to the Oil and Gas Business" in the Company's 2010 Annual Information Form which can be found on the Company's website fortressenergy.ca or under the Company's profile on www.sedar.com. The risks should not be construed as exhaustive. There are numerous factors, both known and unknown, that could cause actual results or events to differ materially from forecast results.