Q3 QUARTERLY REPORT

FORTRESS ENERGY INC.

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2010

FINANCIAL AND OPERATING SUMMARY

	Three months ended September 30,				Nine months ended September 30,			
	2010		2009		2010		2009	
	($000s)	$/Mcfe	($000s)	$/Mcfe	($000s)	$/Mcfe	($000s)	$/Mcfe
Petroleum and natural gas sales	5,412	8.19	4,240	6.76	16,446	6.56	13,791	6.82
Royalties	441	0.67	135	0.22	(264)	(0.11)	(785)	(0.39)
Operating costs	(1,487)	(2.25)	(1,757)	(2.80)	(5,846)	(2.33)	(5,427)	(2.68)
Transportation	(243)	(0.37)	(197)	(0.31)	(936)	(0.37)	(692)	(0.34)
Operating netback [1]	4,123	6.24	2,421	3.87	9,400	3.75	6,887	3.41
General and administrative expenses	(1,595)	(2.41)	(726)	(1.16)	(3,008)	(1.20)	(2,087)	(1.03)
Professional fees	(89)	(0.13)	(114)	(0.18)	(386)	(0.15)	(602)	(0.30)
Bad debts recovery (expense)	78	0.12	17	0.03	71	0.03	(162)	(0.08)
Interest expense	(314)	(0.47)	(187)	(0.30)	(1,006)	(0.40)	(640)	(0.32)
Current income tax recovery (expense)	7	(0.01)	(18)	(0.03)	(106)	(0.04)	(54)	(0.03)
Funds from operations before transaction costs	2,210	3.34	1,393	2.23	4,965	1.99	3,342	1.65
Transaction costs	(11)	(0.02)	-	-	(564)	(0.23)	-	-
Funds from operations [1]	2,199	3.32	1,393	2.23	4,401	1.76	3,342	1.65
Unrealized loss on commodity contracts	(2,407)	(3.64)	(1,855)	(2.96)	(1,321)	(0.53)	(358)	(0.18)
Stock-based compensation expense	(623)	(0.94)	(108)	(0.17)	(767)	(0.31)	(235)	(0.12)
Depletion, depreciation and accretion	(1,148)	(1.74)	(2,942)	(4.69)	(7,564)	(3.02)	(10,450)	(5.16)
Ceiling test impairment	-	-	-	-	(47,476)	(18.93)	(14,276)	(7.06)
Loss on sale of oil and gas properties	(1,301)	(1.97)	-	-	(1,301)	(0.52)	-	-
Write down of temporary investment	(110)	(0.17)	-	-	(110)	(0.04)	-	-
Loss before future income taxes	(3,390)	(5.14)	(3,512)	(5.59)	(54,138)	(21.59)	(21,977)	(10.87)
Future income tax reduction	-	-	(275)	(0.44)	750	0.30	3,592	1.78
Net loss	(3,390)	(5.14)	(3,787)	(6.03)	(53,388)	(21.29)	(18,385)	(9.09)
Sales volume (Mcfe/d)	7,185		6,822		9,182		7,410	

[1] Non-GAAP measure. See discussion in the following MD&A.

MANAGEMENT'S DISCUSSION AND ANALYSIS

November 12, 2010

This 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") as at and for the three and nine months ended September 30, 2010 and the audited consolidated financial statements for the year ended December 31, 2009. 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.

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 September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Cash provided by (used in) operating activities	3,625	(396)	5,228	2,079
Change in non-cash operating working capital	(1,426)	1,789	(827)	1,091
Abandonment expenditures	-	-	-	172
Funds from operations	2,199	1,393	4,401	3,342

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

	Three months ended September 30,				Nine months ended September 30,			
	2010		2009		2010		2009	
	($000s)	($/Mcfe)	($000s)	($/Mcfe)	($000s)	($/Mcfe)	($000s)	($/Mcfe)
Petroleum and natural gas sales	5,412	8.19	4,240	6.76	16,446	6.56	13,791	6.82
Royalties	441	0.67	135	0.22	(264)	(0.11)	(785)	(0.39)
Operating expenses	(1,487)	(2.25)	(1,757)	(2.80)	(5,846)	(2.33)	(5,427)	(2.68)
Transportation expenses	(243)	(0.37)	(197)	(0.31)	(936)	(0.37)	(692)	(0.34)
Operating netback	4,123	6.24	2,421	3.87	9,400	3.75	6,887	3.41

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

Certain crude oil and NGL volumes have been converted to cubic feet equivalent (cfe) on the basis of one barrel (bbl) to six thousand cubic feet (Mcf). Cfe 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 ability to continue as a going concern;

(ii) Under “Income Tax Refund” regarding potential refund;

(iii) Under “Income Tax Audit” regarding expected resolution of the matter; and

(iv) Under “Outstanding Securities” regarding plans to incur flow-through expenditures.

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 (iii) 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 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);

(ii) Delays or changes in plans with respect to exploration or development projects or capital expenditures;

(iii) Uncertainty of estimates and projections relating to recoverable reserves, costs and expenses;

(iv) Health, safety and environmental risks;

(v) Commodity price and exchange rate fluctuations; and

(vi) 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.

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 $407,000. The Company has recorded a loss on the sale oil and gas properties of $1,301,000. 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 are subject to a four month hold period that expires on December 29, 2010.

TSX LISTING REQUIREMENTS

As a result of the sale of oil and gas assets on August 31, 2010, the Company was given notice by the TSX that it will be commencing a formal review of the Company's TSX listing and its ability to meet the minimum listing requirements in mid-January 2011.

DETAILED FINANCIAL ANALYSIS

Production

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Sales volume:				
Natural gas (Mcf/d)	7,084	6,741	9,055	7,333
Oil and NGL (bbls/d)	17	13	21	13
Total (Mcfe/d)	7,185	6,822	9,182	7,410

Sales volumes for the three months ended September 30, 2010 were 7,185 Mcfe/d compared to 6,822 Mcfe/d for the three months ended September 30, 2009. The Company sold substantially all of its oil and gas properties on August 31, 2010, with the exception of its Buick Creek and Pine Creek assets. The sales volumes associated with the sold properties for the three months ended September 30, 2010 were 6,632 Mcfe/d. At the time of the sale, the Company's sales volumes were approximately 10,200 Mcfe/d.

Sales volumes for the nine months ended September 30, 2010 were 9,182 Mcfe/d compared to 7,410 Mcfe/d for the nine months ended September 30, 2009, an increase of 24 percent. The Company's share of sales volumes from Square Creek increased to 5,812 Mcfe/d for the nine months ended September 30, 2010 from 2,951 Mcfe/d for the nine months ended September 30, 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 nine months ended September 30, 2010 were 8,669 Mcfe/d compared to 6,920 Mcfe/d for the nine months ended September 30, 2009.

Revenue

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Petroleum and natural gas sales ($000s)	5,412	4,240	16,446	13,791
Average realized prices:				
Natural gas ($/Mcf)	3.81	3.41	4.38	4.18
Realized gain on commodity contracts ($/Mcf)	4.31	3.24	2.10	2.58
Realized natural gas price ($/Mcf)	8.12	6.65	6.48	6.76
Oil and NGL ($/bbl)	54.12	82.45	60.56	55.18
Total ($/Mcfe)	8.19	6.76	6.56	6.82
Benchmark prices:				
AECO average natural gas price ($/Mcf)	3.53	3.00	4.12	3.78
Edmonton par crude oil ($/bbl)	74.88	71.65	77.09	63.23

For the three months ended September 30, 2010, petroleum and natural gas sales were $5,412,000 (including realized gains on commodity contracts of $2,846,000) compared to $4,240,000 (including realized gains on commodity contracts of $1,733,000) for the three months ended September 30, 2009. 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 nine months ended September 30, 2010, petroleum and natural gas sales were $16,446,000 (including realized gains on commodity contracts of $5,268,000) compared to $13,791,000 (including realized gains on commodity contracts of $5,224,000) for the nine months ended September 30, 2009. This increase is consistent with the three months ended September 30, 2010, as previously noted.

The average realized natural gas price for the three months ended September 30, 2010 was $3.81/Mcf compared to the average AECO natural gas price of $3.53/Mcf. The average realized natural gas price in the three months ended September 30, 2009 was $3.41/Mcf and the average AECO natural gas price was $3.00/Mcf. The average realized natural gas price for the nine months ended September 30, 2010 was $4.38/Mcf compared to the average AECO natural gas price of $4.12/Mcf. The average realized natural gas price in the nine months ended September 30, 2009 was $4.18/Mcf and the average AECO natural gas price was $3.78/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.

Royalties

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Royalties ($000s)	(441)	(135)	264	785
$/Mcfe	(0.67)	(0.22)	0.11	0.39
Percentage of petroleum and natural gas sales [(1)]	(17.2%)	(6.1%)	2.3%	9.1%

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

For the three months ended September 30, 2010, the Company recorded a recovery of royalties of $441,000 compared to $135,000 for the three months ended September 30, 2009. This increase is due to the recognition of 2009 Gas Cost Allowance and Custom Processing credits received and recorded in the three months ended September 30, 2009 of approximately $345,000. These credits were mainly attributable to the Company's Square Creek property which commenced production in March 2008. In addition, the Company recorded an adjustment to Alberta Royalty Tax Credits ("ARTC") of $170,000 related to its 2005 and 2006 tax years that have been recently assessed. The effective royalty rate for the three months ended September 30, 2010 was a recovery of 17.2 percent (as a percentage of petroleum and natural gas sales) compared to a recovery of 6.1 percent for the three months ended September 30, 2009. Royalties are not calculated or payable on realized gains and losses on commodity contracts.

For the nine months ended September 30, 2010, the Company recorded royalties of $264,000 compared to $785,000 for the nine months ended September 30, 2009. This decrease is consistent with the three months ended September 30, 2010, as previously noted. The Company recognized Gas Cost Allowance and Custom Processing credits of approximately $1,106,000 in the nine months ended September 30, 2010 reducing its overall royalty expense (three months ended September 30, 2009 - $480,000). In addition, a price adjustment on the crown royalty expense charged on the Mearon property resulted in a reduction of crown royalty expense in the nine months ended September 30, 2010 of $425,000 related to prior periods. The effective royalty rate for the nine months ended September 30, 2010 was 2.3 percent (as a percentage of petroleum and natural gas sales) compared to 9.1 percent for the nine months ended September 30, 2009.

Operating Expenses

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Operating costs ($000s)	1,487	1,757	5,846	5,427
$/Mcfe	2.25	2.80	2.33	2.68

For the three months ended September 30, 2010, operating expenses were $1,487,000, or $2.25/Mcfe, compared to $1,757,000, or $2.80/Mcfe, for the three months ended September 30, 2009. Operating expenses decreased in the three months ended September 30, 2010 due to the sale of oil and gas properties effective August 31, 2010. On a per Mcfe basis, operating expenses decreased in the three months ended September 30, 2010 due to higher production levels as a significant component of operating expenses are fixed as opposed to varying with production.

For the nine months ended September 30, 2010, operating expenses were $5,846,000 compared to $5,427,000 for the nine months ended September 30, 2009. Despite the sale of oil and gas properties on August 31, 2010, operating costs for the nine months ended September 30, 2010 were higher than the nine months ended September 30, 2009 because they reflect the Company's acquisition of its partner's 50 percent working interest in Square Creek on October 23, 2009.

Transportation Expenses

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Transportation costs ($000s)	243	197	936	692
$/Mcfe	0.37	0.31	0.37	0.34

Transportation expenses include transportation and fuel costs associated with the usage of natural gas pipelines. For the three months ended September 30, 2010, transportation expenses were $243,000 compared to $197,000 for the three months ended September 30, 2009. This increase is due to the additional Square Creek volumes. In addition, the rate that the Company was charged for interruptible transportation services increased in the fourth quarter of 2009.

For the nine months ended September 30, 2010, transportation expenses were $936,000 compared to $692,000 for the nine months ended September 30, 2009. This increase is consistent with the three months ended September 30, 2010, as previously noted.

General and Administrative Expenses

	Three months ended September 30,				Nine months ended September 30,			
	2010		2009		2010		2009	
	($000s)	($/Mcfe)	($000s)	($/Mcfe)	($000s)	($/Mcfe)	($000s)	($/Mcfe)
General and administrative expenses, net of recoveries	1,595	2.41	726	1.16	3,008	1.20	2,087	1.03
Professional fees	89	0.13	114	0.18	386	0.15	602	0.30
Bad debts	(78)	(0.12)	(17)	(0.03)	(71)	(0.03)	162	0.08
Transaction costs	11	0.02	-	-	564	0.23	-	-
Total	1,617	2.44	823	1.31	3,565	1.55	2,851	1.41

General and administrative expenses, net of recoveries, for the three months ended September 30, 2010 were $1,595,000 compared to $726,000 for the three months ended September 30, 2009. This increase is due to severances paid in the three months ended September 30, 2010 as a result of the downsizing of the Company's operations after the sale of oil and gas properties on August 31, 2010. General and administrative expenses, net of recoveries, for the nine months ended September 30, 2010 were $3,008,000 compared to $2,087,000 for the nine months ended September 30, 2009. This increase is consistent with that of the three months ended September 30, 2010.

Professional fees include fees for lawyers, auditors, income tax professionals, and independent reserves evaluators. Professional fees decreased in the three months ended September 30, 2010 to $89,000 from $114,000 for the three months ended September 30, 2009. This decrease is due to a reduction in the Company's accounting and tax compliance fees. Professional fees for the nine months ended September 30, 2010 were $386,000 compared to $602,000 for the nine months ended September 30, 2009. This decrease is consistent with that of the three months ended September 30, 2010. The Company incurred significant tax compliance costs in the first nine months of 2009.

For the three months ended September 30, 2010 the Company recorded a recovery of bad debts of $78,000 compared to $17,000 for the three months ended September 30, 2009. For the nine months ended September 30, 2010, the Company recorded a recovery of bad debts of $71,000 compared to bad debts expense of $162,000 for the nine months ended September 30, 2009. Bad debts 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. In the three and nine months ended September 30, 2010, the Company was able to recover funds from partners as a result of collection efforts.

The Company incurred transaction costs of $564,000 related to the Boyer assets that were expensed in the nine months ended September 30, 2010. The Company was not able to consummate this transaction.

Stock-based Compensation Expense

($000s except $/Mcfe)	Three months ended September 30, 2010	2009	Nine months ended September 30, 2010	2009
Stock-based compensation expense:				
Stock options	420	54	586	150
Restricted stock units	45	54	22	85
Total	623	108	767	235
$/Mcfe	0.94	0.17	0.31	0.12

Stock-based compensation expense for the three months ended September 30, 2010 was $623,000 compared to $108,000 for the three months ended September 30, 2009. Stock-based compensation expense for the nine months ended September 30, 2010 was $767,000 compared to $235,000 for the nine months ended September 30, 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 three and nine months ended September 30, 2010 reflects this accelerated vesting. All stock options outstanding at September 30, 2010 will expire unless exercised prior to November 29, 2010.

Interest Expense

	Three months ended September 30, 2010	2009	Nine months ended September 30, 2010	2009
Interest expense ($000s)	314	187	1,006	640
$/Mcfe	0.47	0.30	0.40	0.32

The Company recorded interest expense of $314,000 for the three months ended September 30, 2010 compared to $187,000 for the three months ended September 30, 2009. Interest expense for the three months ended September 30, 2010 reflects interest and facility extension fees on the Company's bank indebtedness and accrued interest on flow-through commitments. Interest expense for the nine months ended September 30, 2010 was $1,006,000 compared to $640,000 for the nine months ended September 30, 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 September 30, 2010	2009	Nine months ended September 30, 2010	2009
Depletion and depreciation expense ($000s)	1,091	2,885	7,341	10,278
Accretion of asset retirement obligations ($000s)	57	57	223	172
Depletion, depreciation and accretion expense ($000s)	1,148	2,942	7,564	10,450
Ceiling test impairment ($000s)	-	-	47,476	14,276
Depletion and depreciation expense ($/Mcfe)	1.65	4.61	2.93	5.07
Accretion of asset retirement obligations ($/Mcfe)	0.09	0.09	0.09	0.09
Depletion, depreciation and accretion expense ($/Mcfe)	1.74	4.70	3.02	5.16
Ceiling test impairment ($/Mcfe)	-	-	18.93	7.06

Depletion and depreciation expense is calculated based on capital expenditures, production rates, and proved reserves. Depletion and depreciation expense was $1,091,000 for the three months ended September 30, 2010 compared to $2,885,000 for the three months ended September 30, 2009. Depletion and depreciation expense for the three months ended September 30, 2010 amounted to $1.65/Mcfe compared to $4.61/Mcfe for the three months ended September 30, 2009. This decrease is due to a significant decrease in the Company's asset base as a result of sale of oil and gas assets on August 31, 2010

Depletion and depreciation expense for the nine months ended September 30, 2010 was $7,341,000 compared to $10,278,000 for the nine months ended September 30, 2009. On a per Mcfe basis, depletion and depreciation expense decreased to $2.93/Mcfe for the nine months ended September 30, 2010 from $5.07/Mcfe for the nine months ended September 30, 2009. This decrease is attributed to the sale of oil and gas assets on August 31, 2010 and a ceiling test impairment charge booked in the first six months of 2010 of $47,476,000, resulting in a substantial reduction in the Company's asset base.

Accretion expense for the three months ended September 30, 2010 was $57,000 – unchanged from the three months ended September 30, 2009. For the nine months ended September 30, 2010, accretion costs amounted to $223,000 compared to $172,000 for the nine months ended September 30, 2009. This increase reflects the acquisition of a partner's 50% working interest in Square Creek on October 23, 2010 and changes to the assumptions used to calculate the Company's asset retirement obligations.

For the nine months ended September 30, 2010, the Company recorded a ceiling test impairment charge of $47,476,000, consisting of a charge of $10,715,000 recorded in the first quarter and an additional charge of $36,761,000 recorded in the second quarter of 2010.

Income Tax

	Three months ended September 30,		Nine months ended September 30,	
($000s except $/Mcfe)	2010	2009	2010	2009
Current income tax expense (reduction)	(7)	18	106	54
Future income tax expense (reduction)	-	275	(750)	(3,592)
Total	(7)	293	(644)	(3,538)
$/Mcfe	(0.01)	0.47	(0.26)	(1.75)

The Company recorded a reduction of income tax expense for the three months ended September 30, 2010 of $7,000 compared to an income tax expense of $293,000 for the three months ended September 30, 2009. This change is attributed to a reduction of current income taxes payable as a result of differences arising on assessment by taxation authorities.

For the nine months ended September 30, 2010, the Company recorded an income tax reduction of $644,000 which is mainly attributed to the recognition of the tax effect of the renunciation of flow-through expenditures in the first quarter of 2010. The Company recorded an income tax reduction of $3,538,000 in the comparable 2009 period which was the result of the ceiling test impairment charge recorded in that period. As a result of the sale of oil and gas assets and ceiling test impairment charges recorded, the Company has tax pools in excess of its underlying net assets for which the Company has taken a valuation allowance.

The estimated tax pools of the Company at September 30, 2010 are as follows:

	($000s)
Canadian Oil and Gas Property Expenses	344
Canadian Development Expenses	21,577
Canadian Exploration Expenses	10,092
Undepreciated Capital Cost	23,660
	55,673

Net Loss

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Net loss ($000s)	(3,390)	(3,787)	(53,388)	(18,385)
Net loss per share - basic and diluted ($)	(0.06)	(0.14)	(0.97)	(0.68)
Net loss ($/Mcfe)	(5.14)	(6.03)	(21.29)	(9.09)

The Company recorded a net loss of $3,390,000 for the three months ended September 30, 2010 compared to $3,787,000 for the three months ended September 30, 2009. This translates into a net loss per basic and diluted share of $0.06 for the three months ended September 30, 2010 and $0.14 for the three months ended September 30, 2009. The net loss for the three months ended September 30, 2010 is mainly due to unrealized losses on commodity contracts, an increase in general and administrative and stock-based compensation expenses, and a loss on the sale of oil and gas properties. The net loss for the three months ended September 30, 2009 is due to reduced natural gas prices and depletion, depreciation and accretion expense.

The net loss for the nine months ended September 30, 2010 was $53,388,000 compared to $18,385,000 for the nine months ended September 30, 2009. Both periods 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 September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Funds from operations ($000s) [(1)]	2,199	1,393	4,401	3,342
Funds from operations ($/Mcfe)	3.32	2.23	1.76	1.65
Funds from operations per share – basic and diluted ($)	0.04	0.05	0.08	0.12

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

Funds from operations for the three months ended September 30, 2010 were $2,199,000 compared to $1,393,000 for the three months ended September 30, 2009. This increase is attributed to a realized gains recorded on commodity contracts and royalty credits recorded in the three months ended September 30, 2010.

The Company recorded funds from operations of $4,401,000 for the nine months ended September 30, 2010 compared to $3,342,000 for the nine months ended September 30, 2009. This increase is consistent with that of the three months ended September 30, 2009.

Capital Expenditures

	Three months ended September 30,		Nine months ended September 30,	
($000s)	2010	2009	2010	2009
Land and seismic	(83)	147	371	411
Drilling and completions	12	-	498	4,231
Equipment and facilities	84	822	653	2,823
Capitalized overhead costs	-	215	239	701
Abandonments	-	-	-	172
Disposition	(25,193)	-	(25,193)	-
Other	-	7	3	27
	(25,180)	1,737	(23,429)	8,365

In the nine months ended September 30, 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 $407,000. The Company recorded a loss on the sale of oil and gas assets of $1,301,000 in the three and nine months ended September 30, 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	4,774,579
Total outstanding securities at September 30, 2010 and November 12, 2010	87,364,896

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 is $3,000,270 and was renounced to subscribers effective December 31, 2009 with all expenditures to be incurred by December 31, 2010. The Company is reviewing alternatives with respect to the flow-through expenditures.

Options to purchase 4,774,579 common shares and warrants to purchase 27,295,700 common shares at September 30, 2010 were not included in the calculation of diluted common shares outstanding because they were anti-dilutive. All stock options vested as a result of the sale oil and gas assets on August 31, 2010 and expire on November 29, 2010 if not exercised prior to that date.

Liquidity and Capital Resources

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. As a result of continued low natural gas prices, the Company has experienced consecutive losses and has an accumulated deficit of $152,128,000 as at September 30, 2010.

There is substantial doubt 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 investors.

Cash provided by operating activities for the three months ended September 30, 2010 was $3,625,000 compared to cash used in operating activities of $396,000 for the three months ended September 30, 2009. This increase is due to an increase in non-cash working capital balances and an increase in realized gains on commodity contracts for the three months ended September 30, 2010 compared to the three months ended September 30, 2009. Cash provided by operating activities for the nine months ended September 30, 2010 was $5,228,000 compared to $2,079,000 for the nine months ended September 30, 2009. This increase is consistent with the three months ended September 30, 2010.

Cash used in financing activities for the three months ended September 30, 2010 was $23,375,000 compared to cash provided by financing activities of $7,851,000 for the three months ended September 30, 2009. Cash used in financing activities for the three months ended September 30, 2010 reflects the repayment of the Company's bank indebtedness as a result of the sale of oil and gas assets on August 31, 2010. Cash provided by financing activities for the three months ended September 30, 2009 reflects the equity financing completed in that period net of changes in bank indebtedness. Cash used in financing activities for the nine months ended September 30, 2010 was $23,044,000 compared to cash provided by financing activities of $10,696,000 for the nine months ended September 30, 2009. Cash used in financing activities for the nine months ended September 30, 2010 reflects the repayment of the Company's bank indebtedness. Cash provided by financing activities for the three months ended September 30, 2009 represents an increase in the amounts drawn on loan facilities and proceeds from the equity financing that closed in July 2009.

Cash provided by investing activities for the three months ended September 30, 2010 was $23,235,000 compared to cash used in investing activities of $462,000 for the three months ended September 30, 2009. The Company's capital expenditures in the three months ended September 30, 2010 were $13,000 compared to $1,191,000 in the three months ended September 30, 2009. The cash proceeds from the sale of oil and gas assets on August 31, 2010 were $25,193,000, net of transaction costs of $407,000. Cash provided by investing activities for the nine months ended September 30, 2010 was $21,237,000 compared to cash used in investing activities of $5,892,000 for the nine months ended September 30, 2009. The Company's capital expenditures in the nine months ended September 30, 2010 were $1,764,000 compared to $8,193,000 in the nine months ended September 30, 2009. Cash provided by investing activities for the nine months ended September 30, 2010 includes the net cash proceeds on the sale of oil and gas assets in August.

Related-Party Transactions

In the three and nine months ended September 30, 2010 the Company was charged $188,000 and $243,000, respectively (three and nine months ended September 30, 2009 - $160,000 and $244,000, respectively) by a law firm of which a director of the Company is a partner, of which $48,000 is included in accounts payable and accrued liabilities at September 30, 2010.

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 space and equipment

The Company's commitment under equipment and office leases were included as part of the sale of oil and gas assets on August 31, 2010 and have been assigned to the acquirer.

Transportation and Processing

The Company's commitment under a transportation and processing agreement was included as part of the sale of oil and gas assets on August 31, 2010 and was assigned to the acquirer.

Flow-Through Share Expenditures

In September 2009, the Company issued 6,594,000 flow-through common shares at $0.455 per share for gross proceeds of $3,000,270 and renounced the related resource expenditures to the subscribers effective December 31, 2009 with all expenditures to be incurred by December 31, 2010. As of September 30, 2010, the Company had not incurred any eligible flow-through expenditures. The Company is reviewing alternatives with respect to the flow-through expenditures.

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.

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.

Income Tax Audit

In January 2010, the Company received an audit letter from the 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. The CRA proposes to deny the use of tax pools existing at the time of the conversion. The Company responded to the CRA audit letter on March 26, 2010 and believes that this matter will be resolved in the Company's favour. If the CRA are successful in their challenge to the Company's interpretation of the tax legislation, it will result in additional taxes, interest and penalties of a material amount.

SELECTED QUARTERLY INFORMATION

	2010			2009				2008
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
Production:								
Natural gas (Mcf/d)	7,084	9,903	10,212	8,288	6,741	7,603	7,665	8,118
Oil and NGL (bbl/d)	17	20	27	19	13	12	14	14
Total (Mcfe/d)	7,185	10,022	10,374	8,418	6,822	7,675	7,752	8,202
Average realized price:								
Natural gas ($/Mcf)	8.12	5.28	6.49	6.15	6.65	6.22	7.47	6.69
Oil and NGL ($/bbl)	54.12	62.09	63.54	51.10	82.45	45.11	37.72	60.42
Combined average ($/Mcfe)	8.19	5.36	6.58	6.20	6.76	6.23	7.47	7.92
Benchmark prices:								
AECO average natural gas price ($/Mcf)	3.53	3.89	4.94	4.55	3.00	3.45	4.92	6.69
Edmonton Par crude oil price ($/bbl)	74.88	75.53	80.92	76.99	71.65	66.70	51.13	64.18
Financial ($000s unless otherwise noted):								
Petroleum and natural gas sales	5,412	4,886	6,148	4,798	4,240	4,346	5,206	5,962
Net income (loss)	(3,390)	(39,985)	(10,012)	(7,357)	(3,787)	(14,605)	7	(624)
Net income (loss) per share – basic ($)	(0.06)	(0.72)	(0.18)	(0.13)	(0.14)	(0.54)	0.00	(0.02)
Net income (loss) per share – diluted ($)	(0.06)	(0.72)	(0.18)	(0.13)	(0.14)	(0.54)	0.00	(0.02)
Funds from operations	2,199	997	1,205	1,172	1,393	557	1,393	1,113
Operating expenses ($/Mcfe)	2.25	2.34	2.38	2.58	2.80	2.66	2.60	2.42
Weighted average shares outstanding – basic (000)	55,295	55,295	55,295	55,295	27,230	26,922	26,922	26,965
Weighted average shares outstanding – diluted (000)	55,295	55,295	55,295	55,295	27,230	26,922	26,922	26,965

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

The Company's Chief Executive Officer and Chief Financial Officer have designed or caused to be designed under their supervision, internal controls over financial reporting to provide reasonable assurance regarding the reliability of the Company's financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP.

No material changes in the Company's internal controls over financial reporting were identified during the nine months ended September 30, 2010, that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

It should be noted that a control system, including the Company's disclosure and internal controls and procedures, no matter how well conceived can provide only reasonable, but not absolute, assurance that the objectives of the control system will be met and it should not be expected that the disclosure and internal controls and procedures will prevent all errors or fraud.

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 nine months ended September 30, 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 Chief Financial Officer has been appointed to lead the conversion project. Resource requirements have been identified and all IFRS requirements will be met with internal employees supplemented with consultants as needed. Regular progress reporting to the Board of Directors on the status of the IFRS conversion has been implemented. The Company has begun the process of training key personnel within the accounting function. Training occurred through external IFRS oil and gas workshops that were attended by key members of the accounting team in 2008 through to the first quarter of 2010.

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 are 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 involves 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 in 2009, the sale of oil and gas properties in August 2010 and the resulting reallocation of staff resources, the Company is behind on its schedule. The Company is in discussions with consultants and other external resources to assist with the project.

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 has not yet concluded which method for calculating depletion will be used.

- 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 through 2010 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. The Company anticipates delivering investor presentations during the fourth quarter of 2010 to explain the differences between the historical Canadian GAAP statements and the IFRS statements.

- 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.

BUSINESS RISKS and UNCERTAINTIES

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.

The Company is reviewing strategic alternatives and there is no certainty that it will be able to achieve a satisfactory outcome.

Substantial Capital Requirements

The Company anticipates making substantial capital expenditures for the acquisition, exploration, development and production of oil and natural gas reserves in the future. As the Company's revenues may decline as a result of decreased commodity pricing, it may be required to reduce capital expenditures. In addition, uncertain levels of near-term industry activity coupled with the current global credit crisis expose the Company to access-to-capital risk. 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.

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. As a result of continued low natural gas prices, the Company has experienced consecutive losses and has an accumulated deficit of $152,128,000 as at September 30, 2010.

There is substantial doubt 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 investors.

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.

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 2009 Annual Information Form which can be found on the Company's website www.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.

NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS

Under National Instrument 51-102, part 4, subsection 4.3(3), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying unaudited financial statements of Fortress Energy Inc. (the “Company”) have been prepared by and are the responsibility of the Company’s management. The Company’s independent auditor has not performed a review of these financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements.

FORTRESS ENERGY INC.
CONSOLIDATED BALANCE SHEETS
(See Nature of Operations and Going Concern Uncertainty – note 1)
As at
(in thousands)
(unaudited)

	September 30, 2010	December 31, 2009
ASSETS		
Current Assets		
Cash and cash equivalents	$ 3,485	$ 64
Accounts receivable	2,769	5,576
Prepaid expenses and deposits	342	470
Commodity contracts (note 9)	-	1,321
Temporary investment (note 3)	4,727	-
	11,323	7,431
Property, plant and equipment (note 4)	2,023	90,017
	$ 13,346	$ 97,448
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Bank indebtedness (note 5)	$ -	$ 23,044
Accounts payable and accrued liabilities	3,384	7,712
Income taxes	164	172
	3,548	30,928
Asset retirement obligations (note 7)	937	4,324
	4,485	35,252
Shareholders' Equity		
Share capital (note 8)	139,344	140,094
Warrants (note 8)	5,406	5,406
Contributed surplus (note 8)	16,239	15,435
Deficit	(152,128)	(98,739)
	8,861	62,196
Commitments and contingencies (note 10)		
	$ 13,346	$ 97,448

See accompanying notes to consolidated financial statements.

FORTRESS ENERGY INC.

CONSOLIDATED STATEMENTS OF OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT
(See Nature of Operations and Going Concern Uncertainty – note 1)
For the three and nine months ended September 30
(in thousands, except per share amounts and number of shares)
(unaudited)

	Three months ended September 30, 2010	Three months ended September 30, 2009	Nine months ended September 30, 2010	Nine months ended September 30, 2009
REVENUES				
Petroleum and natural gas sales	$ 5,412	$ 4,240	$ 16,446	$ 13,791
Royalties	441	135	(264)	(785)
Unrealized loss on commodity contracts (note 9)	(2,407)	(1,855)	(1,321)	(358)
	3,446	2,520	14,861	12,648
EXPENSES				
Operating	1,487	1,757	5,846	5,427
Transportation	243	197	936	692
General and administrative	1,595	726	3,008	2,087
Professional fees (note 12)	89	114	386	602
Bad debts	(78)	(17)	(71)	162
Transaction costs	11	-	564	-
Stock-based compensation (note 8)	623	108	767	235
Interest	314	187	1,006	640
Depletion, depreciation and accretion	1,148	2,942	7,564	10,450
Ceiling test impairment (note 4)	-	-	47,476	14,276
Loss on sale of oil and gas properties (note 4)	1,301	-	1,301	-
Write down of temporary investment	110	-	110	-
	6,843	6,014	68,893	34,571
Loss before income taxes	(3,397)	(3,494)	(54,032)	(21,923)
Income tax expense (reduction) (note 6)				
Current	(7)	18	106	54
Future	-	275	(750)	(3,592)
	(7)	293	(644)	(3,538)
Net loss and comprehensive loss for the period	(3,390)	(3,787)	(53,388)	(18,385)
Deficit, beginning of period	(148,738)	(87,595)	(98,740)	(72,997)
Deficit, end of period	$(152,128)	$(91,382)	$(152,128)	$(91,382)
Weighted average shares outstanding (note 8)	55,294,617	27,230,190	55,294,617	27,025,718
Net loss per share – basic and diluted	$(0.06)	$(0.14)	$(0.97)	$(0.68)

See accompanying notes to consolidated financial statements.

FORTRESS ENERGY INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(See Nature of Operations and Going Concern Uncertainty – note 1)
For the three and nine months ended September 30
(in thousands)
(unaudited)

	Three months ended September 30, 2010	Three months ended September 30, 2009	Six months ended September 30, 2010	Six months ended September 30, 2009
CASH PROVIDED BY (USED IN):				
OPERATING ACTIVITIES				
Net loss for the period	$ (3,390)	$ (3,787)	$ (53,388)	$ (18,385)
Items not affecting cash flows:				
Unrealized loss on commodity contracts	2,407	1,855	1,321	358
Stock-based compensation	623	108	767	235
Depletion, depreciation and accretion	1,148	2,942	7,564	10,450
Ceiling test impairment	-	-	47,476	14,276
Loss on sale of oil and gas properties	1,301	-	1,301	-
Write down of temporary investment	110	-	110	-
Future income tax expense (recovery)	-	275	(750)	(3,592)
Abandonment expenditures	-	-	-	(172)
	2,199	1,393	4,401	3,170
Change in non-cash operating working capital (note 11)	1,426	(1,789)	827	(1,091)
Cash provided by (used in) operating activities	3,625	(396)	5,228	2,079
FINANCING ACTIVITIES				
Change in bank indebtedness	(23,375)	(2,436)	(23,044)	409
Issue of common shares and warrants	-	11,385	-	11,385
Share issuance costs	-	(1,098)	-	(1,098)
Cash provided by (used in) financing activities	(23,375)	7,851	(23,044)	10,696
INVESTING ACTIVITIES				
Property, plant and equipment additions	(13)	(1,191)	(1,764)	(8,193)
Proceeds on sale of property, plant and equipment	25,193	-	25,193	-
Change in non-cash investing working capital (note 11)	(1,945)	729	(2,192)	2,301
Cash provided by (used in) investing activities	23,235	(462)	21,237	(5,892)
Net change in cash	3,485	6,993	3,421	6,883
Cash and cash equivalents - beginning of period	-	70	64	180
Cash and cash equivalents - end of period	$ 3,485	$ 7,063	$ 3,485	$ 7,063
Supplemental cash flow information:				
Interest paid	306	187	961	640

See accompanying notes to consolidated financial statements.

1. NATURE OF OPERATIONS AND GOING CONCERN UNCERTAINTY

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. Fortress is listed on the TSX under the symbol “FEI”.

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 $152,128,000 as at September 30, 2010.

There is substantial doubt 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 investors.

These 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.

2. SIGNIFICANT ACCOUNTING POLICIES

a) Basis of presentation

Except as noted below, the unaudited interim financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles (GAAP) using the same accounting policies as set out in note 2 to the audited consolidated financial statements for the year ended December 31, 2009. Certain information or disclosures normally required to be included in notes to annual audited financial statements have been condensed or omitted. The unaudited interim financial statements should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2009.

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

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

(Tabular figures are in thousands of Canadian dollars unless otherwise indicated)

b) Change in accounting policy

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 and nine months ended September 30, 2010. This standard has been applied on a prospective basis with no restatement of prior periods.

3. TEMPORARY INVESTMENT

Temporary investment reflects the Company's investment in 3,664,444 common shares of Terra Energy Corp. ("Terra") which had a quoted market value on September 30, 2010 of $1.29 per share. The Terra shares trade on the Toronto Stock Exchange ("TSX") under the symbol "TT" and are subject to a four month hold period that expires on December 29, 2010.

4. PROPERTY, PLANT AND EQUIPMENT

On 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. 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 Terra shares are subject to a four month hold period. The transaction costs associated with this transaction were $407,000. The cash proceeds were used to repay bank indebtedness of $21,457,000. The Company realized a loss on the sale of oil and gas properties of $1,301,000.

September 30, 2010	Cost $	Accumulated Depletion and Depreciation $	Net Book Value $
Oil and natural gas properties	7,535	5,653	1,882
Other	423	282	141
	7,958	5,935	2,023

December 31, 2009	Cost $	Accumulated Depletion and Depreciation $	Net Book Value $
Oil and natural gas properties	153,662	63,809	89,853
Other	420	256	164
	154,082	64,065	90,017

For the three and nine months ended September 30, 2010, the Company capitalized general and administrative and stock-based compensation expenses of $nil and $292,000 respectively (three and nine months ended September 30, 2009 - $189,000 and $654,000, respectively) directly attributable to exploration and development activities.

(Tabular figures are in thousands of Canadian dollars unless otherwise indicated)

Estimated future development costs of $100,000 (December 31, 2009 - $7,456,000) were included in the calculation of depletion expense for the nine months ended September 30, 2010. As at September 30, 2010, undeveloped land costs of $170,000 (December 31, 2009 - $7,519,000) were excluded from assets subject to depletion.

For the nine months ended September 30, 2010, the Company recorded a ceiling test impairment charge of $47,476,000 (nine months ended September 30, 2009 - $14,276,000), consisting of a charge of $10,715,000 recorded in the first quarter and an additional charge of $36,761,000 recorded in the second quarter of 2010 related to the Terra transaction.

5. CREDIT FACILITIES

The Company repaid it bank indebtedness on the closing of the sale of oil and gas properties on August 31, 2010. The Company has letters of guarantee outstanding of $107,000 (December 31, 2009 - $810,000).

6. INCOME TAXES

The provision for income tax expense (reduction) is summarized as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
	$	$	$	$
Current income tax expense (reduction)	(7)	18	106	54
Future income tax expense (reduction)	-	275	(750)	(3,592)
Income tax expense (reduction)	(7)	293	(644)	(3,538)

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

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
	$	$	$	$
Loss before tax	(3,397)	(3,494)	(54,032)	(21,923)
Expected tax recovery at 28.25% (2009 – 29.50%)	(960)	(1,031)	(15,264)	(6,468)
Add (deduct) income tax effect of:				
Stock-based compensation	176	32	217	69
Non-deductible interest expenses	(7)	19	106	79
Rate adjustments and other	40	100	1,649	(45)
Change in valuation allowance	744	1,173	12,648	2,827
Income tax expense (reduction)	(7)	293	(644)	(3,538)

(Tabular figures are in thousands of Canadian dollars unless otherwise indicated)

7. ASSET RETIREMENT OBLIGATIONS

The Company's asset retirement obligations result from net ownership interests in oil and natural gas assets including well sites, gathering systems and processing facilities. The Company estimates the net present value of its total asset retirement obligations at September 30, 2010 to be $937,000 (December 31, 2009 - $4,324,000) based on a total undiscounted future liability at September 30, 2010 of $3,058,000 (December 31, 2009 – $8,655,000) which will be primarily incurred between 2012 and 2029. An inflation rate of 2.0 percent (2009 – 2.0 percent) and a credit-adjusted risk-free interest rate of 9.0 percent (December 31, 2009 – 9.0 percent) were used to calculate the fair value of the asset retirement obligations.

Asset retirement obligations	$
Balance, December 31, 2009	4,324
Adjustments to assumptions	117
Disposition	(3,713)
Accretion expense	209
Balance, September 30, 2010	937

8. SHARE CAPITAL

(a) Authorized:

Unlimited number of voting common shares.
Unlimited number of preferred shares.

(b) Common shares issued and outstanding:

	Number of Common Shares	$
Balance, December 31, 2009	55,294,617	140,094
Tax effect of flow-through share renouncement	-	(750)
Balance, September 30, 2010	55,294,617	139,344

(c) Warrants issued and outstanding:

	Number of Warrants	$
Balance, September 30, 2010 and December 31, 2009	27,295,700	5,406

(d) Contributed surplus:

	$
Balance, December 31, 2009	15,435
Stock-based compensation expense	804
Balance, September 30, 2010	16,239

(e) Stock option plan:

The Company grants stock options to employees, officers, directors and consultants of the Company pursuant to an incentive plan. Under this 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 vest over a three-year period and expire five years from the date of grant.

(Tabular figures are in thousands of Canadian dollars unless otherwise indicated)

The Company has the following stock options outstanding:

Outstanding at September 30, 2010				Exercisable at September 30, 2010	
Exercise Price	Number	Weighted average years to expiry	Weighted Average Exercise Price	Number exercisable	Weighted Average Exercise Price
$			$		$
0.245	3,680,000	4.0	0.245	3,680,000	0.245
1.18 – 1.35	1,092,979	2.7	1.32	1,092,979	1.32
19.50 – 50.00	1,600	0.3	36.00	1,600	36.00
	4,774,579	3.7	0.50	4,774,579	0.50

The Company records compensation costs over the vesting period, commencing on the granting of stock options using the fair value method. Compensation expense is calculated using the Black-Scholes option pricing model. The Company has not incorporated an estimated forfeiture rate for stock options that will not vest but accounts for the actual forfeitures as they occur.

The estimated fair value of stock options of $0.27 per share at September 30, 2010 (September 30, 2009 - $0.56) is amortized to expense over the vesting period on a straight-line basis. Stock-based compensation expense related to stock options for the three and nine months ended September 30, 2010 was $575,000 and $741,000 respectively (three and nine months ending September 30, 2009 – $54,000 and $150,000, respectively). The Company did not record any capitalized stock-based compensation expense related to stock options in the three months ended September 30, 2010 (three months ended September 30, 2009 $27,000). The Company capitalized stock-based compensation expense related to stock options for the nine months ended September 30, 2010 of $63,000 (nine months ending September 30, 2009 $32,000).

As a result of the sale of oil and gas properties on August 31, 2010 and the substantial reduction in the Company's asset base, all stock options that were outstanding on August 31, 2010 were vested. The increase in stock-based compensation expense for the three and nine months ended September 30, 2010 reflects this accelerated vesting. All stock options outstanding at September 30, 2010 will expire unless exercised prior to November 29, 2010.

(f) Per share amounts:

The weighted average number of common shares outstanding for the three and nine months ended September 30, 2009 and 2008 are as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Weighted average – basic and diluted	55,294,617	27,230,190	55,294,617	27,025,718

Options to purchase 4,774,579 (September 30, 2009 – 1,265,379) common shares and warrants to purchase 27,295,700 (September 30, 2009 – 27,295,700) common shares at September 30, 2010 were not included in the calculation of diluted common shares outstanding because they were anti-dilutive.

(g) Restricted stock unit plan:
In June 2008, the Company approved a restricted stock unit plan. The Board of Directors, in its sole discretion may determine the period in which units credited under this plan shall vest; however, such period shall not exceed three years. Holders are credited with additional units as dividends are declared on the common shares. The value of vested units is determined by the weighted average of the board lot trading prices of the Company's common shares traded on the TSX for the last 20 trading days immediately prior to the day such units mature. Such amount is paid in cash within 30 days.

For the three and nine months ended September 30, 2010, the Company recorded compensation expense related to the restricted stock unit plan of $48,000 and $26,000, respectively (three and nine months ended September 30, 2009 – $54,000 and $86,000, respectively). The Company did not record any capitalized stock-based compensation expense related to the restricted stock units in the three months ended September 30, 2010 (three months ended September 30, 2009 $27,000). A recovery of previously capitalized stock based compensation related to the restricted stock units of $11,000 was recorded in the nine months ending September 30, 2010 (nine months ended September 30, an expense of $32,000). As a result of the sale of oil and gas properties on August 31, 2010 and the substantial reduction in the Company's asset base, all restricted stock units outstanding on August 31, 2010 were immediately vested.

9. FINANCIAL INSTRUMENTS

Overview

The Company has exposure to the following risks from its financial instruments:

- Credit risk;
- Liquidity risk;
- Market risk;
- Foreign currency exchange risk;
- Commodity price risk; and

The Company's Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework and establishes and monitors risk management policies to: identify and analyze the risks faced by the Company, set appropriate limits and controls, and monitor risks and adherence to market conditions and the Company's activities.

Credit Risk

Credit risk is primarily related to the Company's receivables from joint venture partners and petroleum and natural gas marketers and the risk of financial loss if a customer, partner or counterparty to a financial instrument fails to meet its contractual obligations. A substantial portion of the Company's accounts receivable is with partners in the energy industry and is subject to normal industry credit risk. The Company generally grants unsecured credit but routinely assesses the financial strength of its partners.

Receivables from petroleum and natural gas marketers are normally collected on the 25th day of the month following production. The Company sells the majority of its production to two petroleum and natural gas marketers and, therefore, is subject to concentration risk which is mitigated by management's policies and practices related to credit risk, as discussed above. The Company historically has not experienced any collection issues with its petroleum and natural gas marketers. However, the receivables are from participants in the petroleum and natural gas sector, and collection of the outstanding balances is dependent on industry factors such as commodity price fluctuations, escalating costs, the risk of unsuccessful drilling and occasional disagreements between parties. The Company attempts to mitigate the risk from joint venture receivables by obtaining partner approval of significant capital expenditures prior to expenditure. The Company does not typically obtain collateral from petroleum and natural gas marketers or joint venture partners; however in certain circumstances, it may cash call a partner in advance of the work. As well, the Company does have the ability to withhold production from joint venture partners in the event of non-payment.

The Company establishes an allowance for doubtful accounts as determined by management based on their assessment of collection and, therefore the carrying amount of accounts receivable generally represents the maximum credit exposure.

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they are due (see note 1). The Company's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due without incurring unacceptable losses or risking harm to the Company's reputation.

The Company prepares capital expenditures budgets which are regularly monitored and updated as considered necessary. As well, the Company utilizes authorizations for expenditures on operated and non-operated projects to further manage capital expenditures.

Market Risk

Market risk is the risk that changes in market prices such as foreign exchange rates, commodity prices, and interest rates will affect the Company's net earnings or the value of financial instruments. The objective of market risk management is to mitigate exposures within acceptable limits, while maximizing returns.

The Company utilizes commodity price contracts to manage market risks relevant to commodity prices. All such transactions are conducted in accordance with the risk management policy that has been approved by the Board of Directors.

Foreign Currency Exchange Risk

Foreign currency exchange rate risk is the risk that the fair value of financial instruments or future cash flows will fluctuate as a result of changes in foreign exchange rates. Although all of the Company's petroleum and natural gas sales are denominated in Canadian dollars, the underlying market prices in Canada for petroleum and natural gas are impacted by changes in the exchange rate between the Canadian and United States dollar. The Company had no forward exchange rate contracts in place as at September 30, 2010.

(Tabular figures are in thousands of Canadian dollars unless otherwise indicated)

Commodity Price Risk

Commodity price risk is the risk that the fair value of financial instruments or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are impacted by world economic events that dictate the levels of supply and demand. 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 three and nine months ended September 30, 2010, the Company realized a gain related to commodity contracts of $2,846,000 and $5,268,000, respectively (three and nine months ended September 30, 2009 – $2,032,000 and $5,224,000, respectively) which has been included in petroleum and natural gas sales. In the three months ended September 30, 2010, the Company recorded an unrealized loss on commodity contracts of $2,407,000 (three months ended September 30, 2009 – unrealized loss of $1,855,000). For the nine months ended September 30, 2010 the Company recorded an unrealized loss on commodity contracts of $1,321,000 (nine months ended September 30, 2009 – unrealized loss of $358,000).

Capital Management

The Company manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying petroleum and natural gas assets. The Company considers its capital structure to include shareholders' equity and working capital. In order to maintain or adjust the capital structure, the Company may from time to time issue shares and adjust its capital spending to manage projected debt levels. To assess capital and operating efficiency and financial strength, the Company continually monitors its working capital (deficiency) which is a non-GAAP measure and is calculated as follows:

	September 30, 2010 $	December 31, 2009 $
Current assets	11,323	7,431
Current liabilities	(3,548)	(30,928)
Working capital (deficiency)	7,775	(23,497)

Fair Value of Financial Instruments

The Company's financial instruments as at September 30, 2010 include cash, accounts receivable, temporary investment, and accounts payable. The fair values of accounts receivable and accounts payable approximate their carrying amounts due to their short terms to maturity.

The carrying and fair values of the Company's financial instruments as at September 30, 2010 are as follows:

Classification	Carrying Value $	Fair Value $
Held-for-trading (cash, temporary investment)	8,212	8,212
Loans and receivables (accounts receivable)	2,769	2,769
Other liabilities (accounts payable)	(3,384)	(3,384)
Total	7,597	7,597

10. COMMITMENTS AND CONTINGENCIES

Office space and equipment

The Company's commitment under equipment and office leases were included as part of the sale of oil and gas assets on August 31, 2010 and were assigned to the acquirer.

Transportation and Processing

The Company's commitment under a transportation and processing agreement was included as part of the sale of oil and gas assets on August 31, 2010 and was assigned to the acquirer.

Flow-Through Share Expenditures

In September 2009, the Company issued 6,594,000 flow-through common shares at $0.455 per share for gross proceeds of $3,000,270 and renounced the related resource expenditures to the subscribers effective December 31, 2009 with all expenditures to be incurred by December 31, 2010. As of September 30, 2010, the Company had not incurred any eligible flow-through expenditures.

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 outcome is unfavourable, it could have a materially adverse impact on the Company's financial position or results of operations.

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 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.

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 the 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 the 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.

(Tabular figures are in thousands of Canadian dollars unless otherwise indicated)

Income Tax Audit

In January 2010, the Company received an audit letter from the 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. The CRA proposes to deny the use of tax pools existing at the time of the conversion. The Company responded to the CRA audit letter on March 26, 2010 and believes that this matter will be resolved in the Company's favour. If the CRA are successful in their challenge to the Company's interpretation of the tax legislation, it will result in additional taxes, interest and penalties of a material amount.

11. CHANGE IN NON-CASH WORKING CAPITAL

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

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
	$	$	$	$
Accounts receivable	(360)	(161)	2,808	436
Prepaid expenses and deposits	176	261	128	334
Accounts payable and accrued liabilities	(214)	(1,178)	(4,328)	386
Income taxes	(121)	18	(8)	54
Non-cash items included in accounts payable	-	-	35	-
	(519)	(1,060)	(1,365)	1,210
Attributable to investing activities	(1,945)	729	(2,192)	2,301
Attributable to operating activities	1,426	(1,789)	827	(1,091)

12. RELATED PARTY TRANSACTIONS

In the three and nine months ended September 30, 2010 the Company was charged $188,000 and $243,000, respectively (three and nine months ended September 30, 2009 - $160,000 and $244,000, respectively) by a law firm of which a director of the Company is a partner, of which $48,000 is included in accounts payable and accrued liabilities at September 30, 2010.

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.