



FORTRESS ENERGY INC.

Management's Discussion and Analysis

For the three and nine months ended September 30, 2011

HIGHLIGHTS

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Financial (\$000's except per share amounts)				
Natural gas sales	254	2,566	539	11,178
Funds from (used in) operations ⁽¹⁾	(1,290)	2,199	(2,616)	4,401
Per share – basic	(0.02)	0.04	(0.05)	0.08
Per share – diluted	(0.02)	0.04	(0.05)	0.08
Net loss	(2,549)	(1,148)	(4,980)	(25,656)
Per share – basic	(0.05)	(0.02)	(0.09)	(0.46)
Per share – diluted	(0.05)	(0.02)	(0.09)	(0.46)
Working capital ⁽²⁾	113	7,315	113	7,315
Operations				
Average production:				
Natural gas (Mcf/d)	553	7,084	353	9,055
Natural gas liquids (bbl/d)	11	17	8	21
Total (Mcfe/d)	619	7,185	402	9,182
Average sales price:				
Natural gas (\$/Mcf)	3.52	3.81	3.75	4.38
Natural gas liquids (\$/bbl)	74.33	54.12	80.64	60.56
Total (\$/Mcfe)	4.47	3.88	4.91	4.46
Operating netback ⁽¹⁾⁽³⁾ (\$/Mcfe)	1.61	6.24	2.03	3.75

⁽¹⁾ Non-IFRS term. See discussion in the following MD&A.

⁽²⁾ Non-IFRS term. Working capital (deficiency) is defined as current assets less current liabilities.

⁽³⁾ Operating netback includes realized gains (losses) on commodities contracts.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following Management Discussion and Analysis ("MD&A") was prepared at, and is dated November 28, 2011. This MD&A is provided by management of Fortress Energy Inc. ("Fortress" or the "Company") to review third quarter 2011 activities and results as compared to the same period in the previous year, and should be read in conjunction with the unaudited interim consolidated financial statements including selected notes for the three and nine months ended September 30, 2011, the MD&A and the audited consolidated financial statements including notes for the years ended December 31, 2010 and 2009. All tabular amounts 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.

Changeover to International Financial Reporting Standards

Prior to 2011, Fortress prepared its financial statements under Canadian Generally Accepted Accounting Principles ("previous GAAP"). Effective January 1, 2011, Canadian reporting issuers were required to adopt International Financial Reporting Standards ("IFRS"). The Company's interim consolidated financial statements for the three and nine months ended September 30, 2011, including comparative amounts, have been prepared on an IFRS basis. The 2009 information contained within this MD&A has been prepared following previous GAAP as allowed by the standard related to the first time adoption of IFRS ("IFRS 1") and has not been re-presented on an IFRS basis.

Information previously reported under previous GAAP has been restated under IFRS with reconciliations provided in note 18 to the interim consolidated financial statements for the three and nine months ended September 30, 2011. Also, for the Company's IFRS accounting policies refer to note 3 to the interim consolidated financial statements for the three months ended March 31, 2011.

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 ability to continue as a going concern, future sales of Terra Energy shares and the expectation of the provincial tax reassessment being vacated; and
- (ii) Under "Income Tax Refund" regarding a potential refund.

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.

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 provincial tax reassessment will not be vacated;
- (ii) Liquidity risk and working capital requirements (refer to “Liquidity and Capital Resources”);
- (iii) Uncertainty of estimates and projections of production, costs and expenses;
- (iv) 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);
- (v) Delays or changes in plans with respect to exploration or development projects or capital expenditures;
- (vi) Risks associated with the uncertainty of reserve estimates;
- (vii) Uncertainty of estimates and projections relating to recoverable reserves, costs and expenses;
- (viii) Health, safety and environmental risks; and
- (ix) Commodity price and exchange rate fluctuations.

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.

Forward-looking statements contained herein are made as of the date hereof and 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.

Non-IFRS Terms

This document contains the terms “funds from operations” and “operating netback” which are non-IFRS terms. 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 IFRS.

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 IFRS 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 loss and funds from (used in) operations. A summary of this reconciliation is as follows:

(\$000s)	Three months ended		Nine months ended	
	September 30,		September 30,	
	2011	2010	2011	2010
Cash provided by (used in) operating activities	(1,203)	3,625	(2,918)	5,228
Change in non-cash operating working capital	(87)	(1,426)	302	(827)
Funds from (used in) operations	(1,290)	2,199	(2,616)	4,401

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		Three months ended		Nine months ended		Nine months ended	
	September 30, 2011		September 30, 2010		September 30, 2011		September 30, 2010	
	(\$000s)	\$/Mcf	(\$000s)	\$/Mcf	(\$000s)	\$/Mcf	(\$000s)	\$/Mcf
Natural gas sales	254	4.47	2,566	3.88	539	4.91	11,178	4.46
Royalties	(33)	(0.58)	441	0.67	(47)	(0.43)	(264)	(0.11)
Realized gain on commodity contracts	-	-	2,846	4.31	-	-	5,268	2.10
Operating expenses	(69)	(1.21)	(1,487)	(2.25)	(148)	(1.35)	(5,846)	(2.33)
Transportation expenses	(61)	(1.07)	(243)	(0.37)	(121)	(1.10)	(936)	(0.37)
Operating netback	91	1.61	4,123	6.24	223	2.03	9,400	3.75

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.

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.

THIRD QUARTER 2011 FINANCIAL RESULTS

Production

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Natural gas (Mcf/d)	553	7,084	353	9,055
Natural gas liquids (bbl/d)	11	17	8	21
Total (Mcf/d)	619	7,185	402	9,182

Production for the three months ended September 30, 2011 was 619 Mcfe/d compared to 7,185 Mcfe/d for the three months ended September 30, 2010. This reduction is due to the sale of substantially all of the Company's oil and natural gas properties on August 31, 2010. Production for the three months ended September 30, 2011 relates entirely to the Buick Creek property which was shut-in for approximately 20 days for a turnaround at the Spectra operated McMahan gas processing facility in June and July 2011.

Production for the nine months ended September 30, 2011 was 402 Mcfe/d compared to 9,182 Mcfe/d for the nine months ended September 30, 2010. This reduction is consistent with the three months ended September 30, 2011, as previously noted.

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. The production volumes attributed to the sold properties for the three and nine months ended September 30, 2010 were 6,632 Mcfe/d and 8,669 Mcfe/d, respectively.

Revenue

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Natural gas sales (\$000s)	254	2,566	539	11,178
Average realized prices:				
Natural gas (\$/Mcf)	3.52	3.81	3.75	4.38
Natural gas liquids (\$/bbl)	74.33	54.12	80.64	60.56
Total (\$/Mcf)	4.47	8.19	4.91	6.56
Benchmark prices:				
AECO average natural gas price (\$/Mcf)	3.66	3.53	3.77	4.12
Edmonton Par crude oil (\$/bbl)	92.43	74.88	94.96	77.09

For the three months ended September 30, 2011, natural gas sales were \$254,000 compared to \$2,566,000 for the three months ended September 30, 2010. This decrease is due to the sale of oil and gas properties on August 31, 2010 and an 8 percent decrease in natural gas prices received.

The average realized natural gas price for the three months ended September 30, 2011 was \$3.52/Mcf compared to the average AECO natural gas price of \$3.66/Mcf. The average realized natural gas price for the three months ended September 30, 2010 was \$3.81/Mcf compared to average AECO natural gas price of \$3.53/Mcf.

For the nine months ended September 30, 2011, natural gas sales were \$539,000 compared to \$11,178,000 for the nine months ended September 30, 2010. This decrease is consistent with the three months ended September 30, 2011, as previously noted.

The average realized natural gas price for the nine months ended September 30, 2011 was \$3.75/Mcf compared to the average AECO natural gas price of \$3.77/Mcf. The average realized natural gas price for the three months ended September 30, 2010 was \$4.38/Mcf compared to average AECO natural gas price of \$4.12/Mcf.

Royalties

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Royalties (\$000s)	33	(441)	47	264
\$/Mcf	0.58	(0.67)	0.43	0.11
Percentage of natural gas sales	13.0%	(17.2%)	8.7%	2.3%

For the three months ended September 30, 2011, the Company recorded royalty expense of \$33,000 compared to a recovery of previously paid royalties of \$441,000 for the three months ended September 30, 2010. This change is due to the sale of oil and gas properties on August 31, 2010. In addition, royalties for the three months ended September 30, 2010 included Gas Cost Allowance and Custom Processing credits and price adjustments which reduced the royalty expense for that period. These credits and price adjustments related to properties that were sold on August 31, 2010.

Royalties for the nine months ended September 30, 2011 were \$47,000 compared to \$264,000 for the nine months ended September 30, 2010. This decrease is also attributed to the sale of oil and gas assets and royalty credits and adjustments, as previously noted. During the nine months ended September 30, 2010, the Company recognized Gas Cost Allowance and Custom Processing credits of \$1,106,000 and a price adjustment resulting in an additional royalty credit of \$425,000.

Commodity Contracts

The Company liquidated its commodity contract position effective August 31, 2010 and has not entered into any contracts since that time. For the comparative period in 2010, the Company recorded a realized gain on commodity contracts for the three and nine months ended September 30, 2010 of \$2,846,000 and \$5,268,000, respectively. For the three months and nine months ended September 30, 2010, the Company also recorded an unrealized loss on commodity contracts of \$2,407,000 and \$1,321,000, respectively.

Operating Expenses

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Operating expenses (\$000s)	69	1,487	148	5,846
\$/Mcf	1.21	2.25	1.35	2.33

For the three months ended September 30, 2011, operating expenses were \$69,000 compared to \$1,487,000 for the three months ended September 30, 2010. This decrease is due to the sale of oil and gas properties on August 31, 2010. On a per Mcfe basis, operating expenses decreased in the three months ended September 30, 2011 to \$1.21/Mcfe from \$2.25/Mcfe for the three months ended September 30, 2010. This decrease is due to the relatively low operating costs experienced at Buick Creek, the Company's only remaining producing property.

For the nine months ended September 30, 2011, operating expenses were \$148,000 compared to \$5,846,000 for the nine months ended September 30, 2010. This decrease is consistent with the three months ended September 30, 2011, as noted. The Company experienced higher than usual operating expenses in the first quarter of 2011 due to operation issues at Buick Creek that have since been resolved.

Transportation Expenses

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Transportation expenses (\$000s)	61	243	121	936
\$/Mcf	1.07	0.37	1.10	0.37

Transportation expenses include transportation and fuel costs associated with the usage of natural gas pipelines. For the three months ended September 30, 2011, transportation expenses were \$61,000 compared to \$243,000 for the three months ended September 30, 2010. This decrease is due to the sale of oil and gas properties on August 31, 2010 and lower production levels. On a per Mcfe basis, transportation expenses increased as the Buick Creek property, the Company's only remaining producing property, produces into a sour gas system which has significantly higher charges associated with it.

For the nine months ended September 30, 2011, transportation expenses were \$121,000 compared to \$936,000 for the nine months ended September 30, 2010. This decrease is due to the sale of oil and gas properties on August 31, 2010 and lower production levels, as previously noted.

Exploration and Evaluation Expenditures

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Exploration and evaluation expenditures (\$000s)	10	24	10	2,404
\$/Mcf	0.18	0.04	0.09	0.96

For the three and nine months ended September 30, 2011, the Company recorded an impairment loss on its Pine Creek property of \$10,000 due to declining natural gas prices. For the three months ended September 30, 2010, the Company recorded an impairment loss on its Pine Creek exploration and evaluation assets of \$24,000 due to declining natural gas prices.

For the nine months ended September 30, 2010, the Company recorded impairment losses on exploration and evaluation assets of \$2,404,000. The Company sold its Elsworth property on August 31, 2010 and recorded impairment losses for the nine months ended September 30, 2010 based on the sale price which established the fair value of that property. The Company also recorded an impairment loss on its Pine Creek property due to declining natural gas prices and the lack of a plan and budget to further develop the Pine Creek asset.

Depletion, Depreciation and Amortization Expense

	Three months ended		Nine months ended	
	September 30, 2011	2010	September 30, 2011	2010
Depletion, depreciation and amortization expense (\$000s)	106	894	198	4,235
Impairment losses (\$000s)	-	-	-	21,814
Total (\$000s)	106	894	198	26,049
Depletion, depreciation and amortization expense (\$/Mcfe)	1.86	1.35	1.81	1.69
Impairment losses (\$/Mcfe)	-	-	-	8.70
Total (\$/Mcfe)	1.86	1.35	1.81	10.39

Depletion, depreciation and amortization expense is calculated based on capital expenditures, production rates, and proved plus probable reserves. Depletion, depreciation and amortization expense was \$106,000 for the three months ended September 30, 2011 compared to \$894,000 for the three months ended September 30, 2010. This decrease is due to the sale of oil and gas properties on August 31, 2010.

Depletion, depreciation and amortization expense was \$198,000 for the nine months ended September 30, 2011 compared to \$4,235,000 for the nine months ended September 30, 2010. This decrease is also due to the sale of oil and gas properties on August 31, 2010, as previously noted. The Company recorded impairment losses of \$21,814,000 on all of its cash-generating units ("CGU's") for developed and producing properties due to declining natural gas prices in the nine months ended September 30, 2010.

General and Administrative Expenses

	Three months ended		Nine months ended	
	September 30, 2011	2010	September 30, 2011	2010
General and administrative expenses, net of recoveries (\$000)	482	1,617	1,936	3,887
Share-based compensation expense	-	438	-	586
Total	482	2,055	1,936	4,473
\$/Mcfe	8.49	3.11	17.65	1.78

General and administrative expenses, net of recoveries, for the three and nine months ended September 30, 2011 were \$482,000 and \$1,936,000, respectively. These compared to \$1,617,000 and \$3,887,000 for the three and nine months ended September 30, 2010. General and administrative expenses decreased substantially as a result of the reduction in staff levels following the sale of oil and gas properties on August 31, 2010. Included in general and administrative expenses for the three and nine months ended September 30, 2011 are fees for legal services, tax advisory services and other costs related to the CCAA order of \$176,000 and \$613,000, respectively. The Company did not capitalize any general and administrative expenses in the three and nine months ended September 30, 2011 (2010 - \$nil and \$292,000).

Share-based compensation expense for the three and nine months ended September 30, 2011 was \$nil compared to \$438,000 and \$586,000 for the three and nine months ended September 30, 2010, respectively. As a result of the sale of oil and gas assets on August 31, 2010, all outstanding stock options were vested and these vested options expired unexercised on November 29, 2010. Restricted stock units that were outstanding at the time of the sale were also vested and were settled in cash in September 2010. There are currently no stock options or restricted stock units outstanding.

Finance Expenses

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2011	2010	2011	2010
Unrealized loss on marketable securities	1,085	110	2,074	110
Realized loss on sale of marketable securities	48	-	48	-
Gain on sale of oil and gas properties	(166)	(567)	(166)	(567)
Interest on bank loans	-	306	-	960
Interest on unspent-flow through obligations	300	8	300	46
Interest – other	-	-	4	(1)
Accretion of decommissioning liabilities	10	41	34	155
	1,277	(102)	2,294	703
\$/Mcf	22.49	(0.15)	20.92	0.28

Finance expenses for the three and nine months ended September 30, 2011 were \$1,277,000 and \$2,294,000, respectively, compared to a net recovery of \$102,000 and an expense of \$703,000 for the three and nine months ended September 30, 2010. This increase is due to the following:

- Unrealized losses on marketable securities for the three and nine months ended September 30, 2011 of \$1,085,000 and \$2,074,000, respectively, pertaining to the shares of Terra Energy Corp. held by the Company as a result of the sale of oil and gas assets on August 31, 2010. The quoted market price of the Terra Energy shares has decreased from \$1.32 per share on August 31, 2010 to \$0.66 per share at September 30, 2011.
- Realized loss on sale of marketable securities of \$48,000 in the three and nine months ended September 30, 2011. The Company sold 76,500 shares of Terra Energy to fund its operations during the period.
- Interest of \$300,000 in the three and nine months ended September 30, 2011 on unspent flow-through funds related to an acquired business.

This increase was reduced by:

- A reduction in interest expense in 2011. The Company repaid its bank loans on the closing of the sale of oil and gas assets on August 31, 2010. And, a reduction in interest expense on unspent flow-through funds that were raised in 2009.
- A reduction in accretion of decommissioning liabilities in 2011 due to the sale of oil and gas properties on August 31, 2010 and the assumption by the purchaser of these liabilities.
- A gain of \$166,000 realized in the three months ended September 30, 2011 related to the Square Creek property that was sold in August 2010. This gain relates to royalty credits paid to Fortress that related to 2009 production.

Net Loss

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Net loss (\$000s)	(2,549)	(1,148)	(4,980)	(25,656)
Net loss per share - basic and diluted (\$)	(0.05)	(0.02)	(0.09)	(0.46)
Net loss (\$/Mcf)	(44.89)	(1.74)	(45.40)	(10.24)

The Company recorded a net loss of \$2,549,000 for the three months ended September 30, 2011 compared to \$1,148,000 for the three months ended September 30, 2010. This translates into a net loss per basic and diluted share of \$0.05 for the three months ended September 30, 2011 and \$0.02 for the three months ended September 30, 2010. The net loss for the three months ended September 30, 2011 is due to impairment losses on marketable securities, costs related to the CCAA order, costs related to the indemnification of flow-through shareholders, and a reduction in the operating netback resulting from the sale of oil and gas properties on August 31, 2010. The net loss for the three months ended September 30, 2010 is mainly attributed to low operating netbacks and severance costs paid as a result of the downsizing of the Company's operations after the sale of oil and gas assets on August 31, 2010.

The net loss for the nine months ended September 30, 2011 was \$4,980,000 compared to \$25,646,000 for the nine months ended September 30, 2010. The net loss for the nine months ended September 30, 2011 is consistent with the loss for the three months ended September 30, 2011. Contributing to the net loss for the nine months ended September 30, 2010 were impairment losses on oil and gas properties of \$24,218,000.

Funds from Operations

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Funds from (used in) operations (\$000s) ⁽¹⁾	(1,290)	2,199	(2,616)	4,401
Funds from (used in) operations (\$/Mcf)	(22.72)	3.32	(23.85)	1.76
Funds from (used in) operations per share – basic and diluted (\$)	(0.02)	0.04	(0.05)	0.08

⁽¹⁾ Non-IFRS term as defined on page 4.

Funds used in operations for the three months ended September 30, 2011 were \$1,290,000 compared to funds from operations of \$2,199,000 for the three months ended September 30, 2010. This decrease is due to the sale of oil and gas properties on August 31, 2010, lower operating netbacks realized, costs related to the indemnification of flow-through share subscribers, and costs incurred in 2011 related to the CCAA order. In addition, in the three months ended September 30, 2010, the Company realized gains on commodity contracts of \$2,846,000.

Funds used in operations for the nine months ended September 30, 2011 were \$2,616,000 compared to funds from operations of \$4,401,000 for the nine months ended September 30, 2010. This decrease is consistent with the three months ended September 30, 2011. Gains realized on commodity contracts in the nine months ended September 30, 2010 were \$5,268,000.

Capital Expenditures

(\$000s)	Three months ended		Nine months ended	
	September 30,		September 30,	
	2011	2010	2011	2010
Land and seismic	14	1	27	371
Drilling and completions	73	12	148	498
Equipment and facilities	194	-	305	653
Capitalized overhead costs	-	-	-	239
Other	-	-	-	3
	281	13	480	1,764

In the nine months ended September 30, 2011, the Company completed workovers on two wells at Buick Creek to restore lost production and work on its Buick Creek compressor and processing facility.

In the nine months ended September 30, 2010, the Company completed several operations related to oil and gas properties that were sold on August 31, 2010 including a fuel gas conversion at the Square Creek camp to reduce operating costs, workover operations on two wells at Buick Creek, replacement of coil tubing for two wells at Velma, and pipeline header repairs at Mearon North and Ladyfern North to restore lost production.

Outstanding Securities

Outstanding securities	
Common shares	55,294,617
Total outstanding securities at September 30, 2011	55,294,617
Total outstanding securities at November 28, 2011	55,294,617

21,779,000 warrants to acquire common shares expired on September 30, 2011.

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 September 30, 2011 (December 31, 2010 - \$107,000) which is secured by a cash deposit.

As at September 30, 2011, the Company has cash on hand of \$167,000 and 3,587,944 common shares of Terra with a carrying value of \$2,368,000. The Company sold 76,500 of Terra Energy in the third quarter of 2011 and anticipates that it will be required to sell additional Terra shares in the fourth quarter of 2011 to allow it to continue operations. The amount of capital available to the Company will depend upon the market price of the Terra Energy common shares and its ability to dispose of those shares. There can be no assurance as to the market price of the Terra Energy common shares at the time the Company may be required to dispose of such shares or the number of shares that can be sold at any particular time.

Cash used in operating activities for the three months ended September 30, 2011 was \$1,203,000 compared to cash provided by operating activities of \$3,625,000 for the three months ended September 30, 2010. This decrease is due to the sale of oil and gas properties on August 31, 2010 resulting in a significantly lower operating netback and costs related to the CCAA order. In addition, in the three months ended September 30, 2010, the Company realized gains on commodity contracts of \$2,846,000. Cash used in operating activities for the nine months ended September 30, 2011 was \$2,918,000

compared to cash generated by operating activities of \$5,228,000 for the nine months ended September 30, 2010. This decrease is consistent with the three months ended September 30, 2011.

Cash provided by investing activities for the three months ended September 30, 2011 was \$110,000 compared to cash provided by investing activities of \$23,235,000 for the three months ended September 30, 2010. Capital expenditures for the three months ended September 30, 2011 totaled \$281,000 compared to \$13,000 for the three months ended September 30, 2010. Also, in the three months ended September 30, 2010 the Company recorded cash proceeds on the sale of oil and gas properties of \$25,193,000. Cash used in investing activities for the nine months ended September 30, 2011 was \$113,000 compared to cash provided by investing activities of \$21,237,000 for the nine months ended September 30, 2010. Capital expenditures for the nine months ended September 30, 2011 were \$480,000 compared to \$1,764,000 for the nine months ended September 30, 2010.

Cash provided by financing activities for the three and nine months ended September 30, 2011 was \$765,000 compared to cash used in financing activities of \$23,375,000 and \$23,044,000 for the three and nine months ended September 30, 2010, respectively. Cash used in financing activities for the three and nine months ended September 30, 2010 reflects the repayment of the Company's operating loan facility on September 1, 2010.

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 October 30, 2011.

Fortress took this step to enable it to challenge a reassessment issued by the Canada Revenue Agency (the "CRA"), which reassessment was in the amount of approximately \$18,000,000. In addition, the Company received provincial reassessments of approximately \$6,200,000 as a result of the CRA reassessments. As a result of the reassessment, if the Company had taken no action, it would have been compelled to immediately remit \$9,000,000 to the CRA and the Company did not have the necessary funds to remit. Fortress maintained that the CRA's position was not sustainable and vigorously disputed the CRA's claim.

The reassessment denied 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.

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. Signal used its available tax pools to reduce its taxable income from the proceeds of the disposition. Signal was subsequently wound-up into Fortress.

Management maintained that no acquisition of control 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. Notwithstanding the explanations by Fortress, the CRA issued the reassessments.

On October 26, 2011, the Company received revised notices of reassessment from the CRA indicating that CRA was vacating its claim reversing the previous assessments and resulting in no federal income taxes or

penalties payable. The Company expects that the provincial claim will also be vacated in due course. As the claims by CRA have been vacated and no federal taxes or penalties are owing. Fortress no longer requires the protection of the Order under the CCAA. On October 28, 2011, the Company applied to the Court of Queen's Bench of Alberta to discharge the Company from the CCAA proceedings and is no longer subject to the CCAA.

Going concern uncertainty

The Company's interim 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 accumulated losses of \$157,392,000 as at September 30, 2011.

As at September 30, 2011, the Company has cash on hand of \$167,000 and 3,587,944 common shares of Terra with a carrying value of \$2,368,000. The Company has sold a portion of its Terra Energy shares and anticipates that it will be required to sell additional Terra Energy shares in future quarters to allow it to continue operations. The amount of capital available to the Company will depend upon the market price of the Terra Energy common shares and its ability to dispose of those shares. There can be no assurance as to the market price of the Terra Energy common shares at the time the Company may be required to dispose of such shares or the number of shares that can be sold at any particular time.

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 explore and develop its properties or acquire further properties or pursue other business opportunities 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 business opportunities or 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.

The financial statements for the three and nine months ended September 30, 2011 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

In the three and nine months ended September 30, 2011 the Company was charged \$61,000 and \$198,000, respectively (three and nine months ended September 30, 2010 - \$146,000 and 336,000, respectively) by a law firm of which a director of the Company is a partner.

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.

Subsequent Event

On October 26, 2011, the Company received revised notices of reassessment from the CRA indicating that CRA was vacating its claim reversing the previous assessments and resulting in no federal income taxes or penalties payable. The Company expects that the provincial claim will also be vacated in due course. Accordingly, Fortress no longer requires the protection of the Order under the CCAA. On October 28, 2011, the Company applied to the Court of Queen's Bench of Alberta to discharge the Company from the CCAA proceedings and is no longer subject to the CCAA.

Indemnification of Flow-Through Share Subscribers

- (a) The Canada Revenue Agency (CRA) conducted an audit in March 2009 of the 2004 flow-through expenditures of a business that was acquired by the Company in 2006. As a result of the audit, the Company was reassessed by the CRA for taxes of approximately \$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 on July 31, 2009 after consultation with its tax advisors and legal counsel to appeal this reassessment. The Company also indemnified the subscribers from income taxes related to the offering. The amount of the potential indemnification is approximately \$765,000.

As a result of recent discussions with the CRA and additional arguments put forward, the Company has determined that the continued appeal of this reassessment is unlikely to be successful. Accordingly, the Company has recorded the estimated taxes and indemnification as liabilities at September 30, 2011.

- (b) On September 30, 2009 the Company closed a public offering of 6,594,000 flow-through common shares. The expenditure commitment resulting from the issuance of flow-through common shares was \$3,000,270; however, the Company incurred expenditures of only \$104,000 by the December 31, 2010 deadline. Accordingly, the Company has recorded a liability of \$1,314,000 at September 30, 2011 (December 31, 2010 - \$1,314,000) which represents the anticipated payments to investors required under indemnification agreements.

Commitments and Contingencies

- (a) 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 biotechnology business of its predecessor company. These additional claims could result in a refund of approximately \$3,400,000 to the Company. A court date has been scheduled for January 2012 to advance these claims.

- (b) Letter of Guarantee

The Company has a letter of guarantee of \$107,000 outstanding as at September 30, 2011 (\$107,000 as at December 31, 2010) which is secured by a cash deposit.

(c) Office Premises

The Company is committed to minimum annual lease payments under an operating lease for office premises to January 2013, as follows:

	Total \$
Balance of 2011	6
2012	144
2013	12
	162

SELECTED QUARTERLY INFORMATION

This is our third reporting period using IFRS accounting policies. In accordance with IFRS 1, our transition date to IFRS was January 1, 2010 and therefore comparative information for 2010 has been prepared in accordance with our IFRS accounting policies. The 2009 financial information contained in this MD&A has been prepared following previous GAAP and, as allowed under IFRS1, has not been re-presented. Further information regarding our IFRS accounting policies can be found in the New Accounting Pronouncements section of this MD&A as well as in notes 3 and 18 to the interim consolidated financial statements for the three months ended March 31, 2011 and note 18 to the interim consolidated financial statements for the three and nine months ended September 30, 2011.

	2011				2010			2009
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
Production:								
Natural gas (Mcf/d)	553	365	137	433	7,084	9,903	10,212	8,288
Natural gas liquids (bbl/d)	11	9	5	9	17	20	27	19
Total (Mcf/d)	619	420	162	488	7,185	10,022	10,374	8,418
Average realized price:								
Natural gas (\$/Mcf)	3.52	4.05	3.90	3.77	8.12	5.28	6.49	6.15
Natural gas liquids (\$/bbl)	74.33	87.02	78.08	69.06	54.12	62.09	63.54	51.10
Combined average (\$/Mcf)	4.47	5.41	5.32	4.63	8.19	5.36	6.58	6.20
Benchmark prices:								
AECO average natural gas price (\$/Mcf)	3.66	3.88	3.77	3.61	3.53	3.89	4.94	4.55
Edmonton Par crude oil price (\$/bbl)	92.43	103.72	88.68	80.91	74.88	75.53	80.92	76.99
Financial (\$000s unless otherwise noted):								
Natural gas sales	254	207	78	210	2,566	3,625	4,986	4,798
Net loss	(2,549)	(1,246)	(1,185)	(2,041)	(1,148)	(15,577)	(8,931)	(7,357)
Net loss per share – basic (\$)	(0.05)	(0.02)	(0.02)	(0.04)	(0.02)	(0.28)	(0.16)	(0.13)
Net loss per share – diluted (\$)	(0.05)	(0.02)	(0.02)	(0.04)	(0.02)	(0.28)	(0.16)	(0.13)
Funds from (used in) operations	(1,290)	(655)	(671)	(2,194)	2,199	997	1,205	1,172
Weighted average shares outstanding – basic (000)	55,295	55,295	55,295	55,295	55,295	55,295	55,295	55,295
Weighted average shares outstanding – diluted (000)	55,295	55,295	55,295	55,295	55,295	55,295	55,295	55,295

⁽¹⁾ The 2010 and 2011 quarterly results have been adjusted to conform to IFRS. The quarterly results for 2009 have not been adjusted and reflect the results in accordance with the previous GAAP.

New Accounting Pronouncements

International Financial Reporting Standards

Effective January 1, 2011, Canadian public companies are required to adopt International Financial Reporting Standards (“IFRS”) which will include comparatives for 2010. The Company’s IFRS accounting policies are provided in note 3 to the interim consolidated financial statements for the three months ended March 31, 2011. In addition, note 18 to the interim consolidated financial statements for the three months ended March 31, 2011 and note 18 to the interim consolidated financial statements for the three and nine months ended September 30, 2011 provide reconciliations between the Company’s 2010 previous GAAP results and its 2010 results under IFRS.

The following provides summary reconciliations of Fortress’s January 1, 2010 previous GAAP to IFRS reconciliations along with a discussion of the significant IFRS accounting policy changes:

Summary Statement of Financial Position As at date of transition to IFRS – January 1, 2010

	Note	Previous GAAP	Effect of transition to IFRS	IFRS
Current assets		\$ 7,431	\$ -	\$ 7,431
Exploration and evaluation	(i)	-	3,900	3,900
Property, plant and equipment	(ii)	90,017	(28,698)	61,319
		\$ 97,448	\$(24,798)	\$ 72,650
Current liabilities	(iv)	\$ 30,928	\$ 462	\$31,390
Decommissioning liabilities	(vi)	4,324	1,362	5,686
Share capital		140,094	(647)	139,447
Warrants		5,406	-	5,406
Contributed surplus		15,435	-	15,435
Accumulated losses	(i) to (vii)	(98,739)	(25,975)	(124,714)
		\$ 97,448	\$(24,798)	\$72,650

On transition to IFRS, on January 1, 2010, Fortress used certain exemptions allowed under IFRS 1, “First Time Adoption of International Reporting Standards”. The exemptions used were as follows:

- (i) Oil and gas properties are classified as Property, Plant and Equipment (“PP&E”) or Exploration and Evaluation assets (“E&E”). Fortress reclassified all E&E expenditures included in the PP&E balance under previous GAAP, as a separate item under IFRS. These assets are measured at cost and are not depleted but will be assessed for impairment when indicators suggest the possibility of impairment. Once these E&E assets have reached technical feasibility and commercial viability, they are transferred to PP&E. At the time of transfer, they were subjected to an impairment test. Fortress’s E&E assets primarily consist of undeveloped exploration lands and at January 1, 2010 are valued at \$3,900,000.

The Company recorded an impairment loss of \$591,000 on E&E assets on transition to IFRS.

- (ii) Under IFRS, PP&E assets are grouped into areas designated as cash generating units (“CGU”) for the purposes of impairment testing and further broken down into components within the CGU for purposes of depletion and depreciation. IFRS 1 provides for the allocation of the previous GAAP net book value of PP&E assets, excluding E&E assets, to CGUs and components on a pro rata basis using the reserve volumes or values as at December 31, 2009.

Fortress elected to allocate the PP&E balance using reserve values and at January 1, 2010, the value allocated to the PP&E assets was \$61,319,000.

Under previous GAAP, impairment testing on oil and gas properties is performed at a cost centre level. Under IFRS, impairment testing is performed at the CGU level. This will result in a greater number of impairment tests. The Company recorded an impairment loss of \$24,207,000 on its PP&E assets on transition to IFRS.

- (iii) Depletion, depreciation and amortization of PP&E is calculated at a component level. Depletion of resource properties within PP&E is calculated using the unit-of-production method under IFRS using proved plus probable reserves. Depreciation of office equipment will continue to be calculated using the straight-line method.
- (iv) Flow-through shares are a Canadian income tax incentive which is the subject of specific guidance under previous GAAP; however there is no specific guidance under IFRS. Under previous GAAP, when flow-through shares were issued they were recorded at face value. The related deferred income tax liability was established for the tax effect of the difference between the tax basis and the book basis of the assets when renounced and was recorded as a reduction of share capital. The reduction to share capital under previous GAAP was based on the corporate tax rates in effect at that time. There was no income statement effect associated with the issuance of these shares, however upon renunciation to the flow-through subscriber, a deferred tax liability was recorded. In the Company’s case, since its tax basis was larger than its book basis, a deferred tax liability was reversed and taken into income as a deferred income tax reduction.

The Company has adopted a policy under IFRS where the proceeds from the offering are to be allocated between the sale of the shares and the sale of the income tax benefit. The allocation is made based on the difference between the quoted market price of the existing shares and the amount an investor pays for the flow-through shares. This flow-through premium is recorded as a liability that is reduced when qualifying flow-through expenditures are incurred. The reduction of the flow-through liability is offset by an increase in the deferred tax liability and due to the valuation allowance recognized in the Company’s case it is treated as a deferred income tax reduction. On transition to IFRS on January 1, 2010, the Company recorded a flow-through share liability of \$462,000 which has been included with trade and other payables, a decrease in share capital of \$647,000 and a decrease in accumulated losses of \$185,000.

- (v) IFRS 1 allows Fortress to use the IFRS rules for business combinations on a prospective basis rather than restating all prior business combinations. Fortress elected to use this exemption; therefore, Fortress did not record any adjustments to retrospectively restate any of its business combinations that have occurred prior to January 1, 2010.

- (vi) Under previous GAAP, Fortress's decommissioning liability was discounted over its life based on a credit adjusted risk free rate which was 9% at December 31, 2009. Under IFRS, Fortress is required to revalue its liability for decommissioning costs at each reporting date using a current liability-specific discount rate. As a result, the Company's decommissioning liability increased upon transition to IFRS as the liability was re-valued using a discount rate of 4.1% to reflect the Company's estimated risk-free rate of interest. The re-valued decommissioning liability at the transition date was \$5,686,000 with the offsetting \$1,362,000 increase in the liability being charged to accumulated losses.
- (vii) Under previous GAAP, Fortress expensed share-based compensation on a straight-line basis. Under IFRS, share-based payments are expensed based on a graded vesting schedule. Fortress also incorporated a forfeiture multiplier rather than account for forfeitures as they occur as was practiced under previous GAAP. There was no adjustment of the opening statement of financial position for share-based compensation.

The following provides summary reconciliations of Fortress' 2010 previous GAAP to IFRS results:

Summary Statement of Financial Position Reconciliations
As at December 31, 2010

	Note	Previous GAAP	Effect of transition to IFRS	IFRS
Current assets		\$ 9,065	\$ -	\$ 9,065
Exploration and evaluation	(i)	-	1,000	1,000
Property, plant and equipment	(ii)	2,178	1,240	3,418
		\$11,243	\$2,240	\$13,483
Current liabilities		\$ 3,734	\$ -	\$ 3,734
Decommissioning liabilities	(iii)	789	461	1,250
Share capital	(iv)	140,068	(621)	139,447
Warrants		5,406	-	5,406
Contributed surplus	(v)	16,239	(181)	16,058
Accumulated losses	(i) to (v)	(154,993)	2,581	(152,412)
		\$11,243	\$2,240	\$13,483

- (i) The E&E adjustment includes assets transferred from PP&E (increase of \$4,578,000 in E&E), an impairment loss (\$2,995,000 decrease in E&E), and a change in allocation of proceeds on the sale of oil and gas assets on August 31, 2010 (\$583,000 decrease in E&E).
- (ii) The PP&E adjustment includes the impact of the reclassification of E&E assets (\$4,578,000 decrease in PP&E), lower depletion as a result of using proved plus probable reserves to calculate depletion (\$3,089,000 increase in PP&E), a change in impairment losses (\$1,455,000 increase in PP&E), a change in the loss on sale of oil and gas assets (\$1,530,000 increase in PP&E), and a change in decommissioning liabilities (\$256,000 decrease in PP&E).
- (iii) The decommissioning liabilities adjustment includes the effects of a change in discount rate (increase of \$1,362,000 in decommissioning liabilities), a change in accretion expense (decrease of \$62,000 in decommissioning liabilities), and a change in net dispositions of oil and gas properties (decrease of \$839,000 in decommissioning liabilities).

- (iv) The adjustments related to accounting for flow-through shares resulted in a decrease to share capital of \$621,000 with a corresponding decrease in accumulated losses.
- (v) Includes recalculation of share-based compensation incorporating graded vesting and a forfeiture multiplier.

Summary Net Loss Reconciliation
2010

	2010				
	Q1	Q2	Q3	Q4	Annual
Net loss as reported under previous GAAP	\$(10,012)	\$(39,985)	\$(3,390)	\$(2,866)	\$(56,254)
Change in exploration and evaluation expenses	(443)	(1,937)	(24)	-	(2,404)
Change in depletion, depreciation and amortization	1,553	1,356	197	(17)	3,089
Change in impairment losses	705	24,957	-	-	25,662
Change in share-based compensation	(2)	(2)	185	-	181
Change in accretion expense	18	34	16	(6)	62
Change in loss on sale of oil and gas properties	-	-	1,868	(338)	1,530
Change in deferred income tax expense	(750)	-	-	1,186	436
	1,081	24,408	2,242	825	28,556
Net loss as reported under IFRS	\$(8,931)	\$(15,577)	\$(1,148)	\$(2,041)	\$(27,698)

Impact of Transition to IFRS on 2010 Results:

- Exploration and Evaluation (“E&E”) – In 2010, Fortress recorded impairment losses on E&E assets of \$2,404,000 on amounts reclassified from PP&E, under previous GAAP, to E&E under IFRS.
- Depletion, depreciation and amortization expense – Under IFRS, Fortress has chosen to calculate the depletion expense utilizing proved plus probable reserves as opposed to proved reserves under previous GAAP. This has resulted in a reduction of depletion, depreciation and amortization expense of \$3,089,000 in 2010.
- Divestitures – Under previous GAAP, proceeds from divestitures were deducted from the full cost pool without recognition of a gain or loss unless the divestiture resulted in a change in the depletion rate of 20% or greater in which case, a gain or loss was recorded. Also, under previous GAAP, the sale proceeds were allocated based on proved reserves. Under IFRS, gains and losses are recorded on divestitures and farmouts and are calculated as the difference between the proceeds and the net book value of the asset disposed of. For the year ended December 31, 2010, the Company recorded a \$530,000 gain on disposition of oil and gas properties for IFRS as compared to a loss of \$1,000,000 under previous GAAP.

- Impairment of PP&E – Under IFRS, impairment tests of PP&E are performed at a CGU level as opposed to the entire Company’s PP&E balance with a full cost ceiling test under previous GAAP. Impairment is recognized if the carrying value exceeds the recoverable amount for a CGU. The recoverable amount is determined using fair value less costs to sell based on discounted future cash flows of proved plus probable reserves using forecast prices and costs. As a result of decreased natural gas prices and the sale of oil and gas assets on August 31, 2010 which set the fair value less costs to sell for these properties, the Company recorded an impairment charge of \$25,662,000 on PP&E assets. PP&E impairments can be reversed in the future if the recoverable amount increases.
- Share-based compensation – the Company recorded a reduction in share-based compensation expense of \$181,000 reflecting the graded vesting schedule.
- Accretion expense – In 2010, the Company recorded a reduction in accretion expense of decommissioning liabilities of \$62,000 due to a change in the discount rate used.
- Deferred income tax expense – the Company recorded an additional reduction of deferred income taxes in 2010 related to flow-through shares.

New Standards and Interpretations Not Yet Adopted

We are currently evaluating the impact these standards will have on our results of operations and financial position:

IFRS 9 *Financial Instruments* – in November 2009, the International Accounting Standards Board (IASB) issued IFRS 9 to address classification and measurement of financial assets. In October 2010, the IASB revised the standard to include financial liabilities. The standard is required to be adopted for periods beginning January 1, 2013. Portions of the standard remain in development and the full impact of the standard will not be known until the project is complete.

IFRS 10 *Consolidated Financial Statements* – in May 2011, the IASB issued IFRS 10 which provides additional guidance to determine whether an investee should be consolidated. The guidance applies to all investees, including special purpose entities. The standard is required to be adopted for periods beginning January 1, 2013. We are evaluating the impact that this standard may have on our results of operations and financial position.

IFRS 11 *Joint Arrangements* – in May 2011, the IASB issued IFRS 11 which presents a new model for determining whether an entity should account for joint arrangements using proportionate consolidation or the equity method. An entity will have to follow the substance rather than legal form of a joint arrangement and will no longer have a choice of accounting method. The standard is required to be adopted for periods beginning January 1, 2013. We are evaluating the impact that this standard may have on our results of operations and financial position.

IFRS 12 *Disclosure of Interests in Other Entities* – in May 2011, the IASB issued IFRS 12 which aggregates and amends disclosure requirements included within other standards. The standard requires a company to provide disclosures about subsidiaries, joint arrangements, associates and unconsolidated structured entities. The standard is required to be adopted for periods beginning January 1, 2013. We are evaluating the impact that this standard may have on our results of operations and financial position.

IFRS 13 *Fair Value Measurement* – in May 2011, the IASB issued IFRS 13 to provide comprehensive guidance for instances where IFRS requires fair value to be used. The standard provides guidance on determining fair value and requires disclosures about those measurements. The standard is required to be adopted for periods beginning January 1, 2013. We are evaluating the impact that this standard may have on our results of operations and financial position.

IAS 1 *Presentation of Items of Other Comprehensive Income* – in June 2011, the IASB issued amendments to IAS 1 *Presentation of Financial Statements* to split items of other comprehensive income (OCI) between those that are reclassified to income and those that do not. The standard is required to be adopted for periods beginning on or after July 1, 2012. We are evaluating the impact that this standard may have on our results of operations and financial position.

RISK FACTORS

Going Concern Issues

The Company is experiencing negative cash flow. There is no certainty as to when it will have operating revenue or positive cash flow. As the Company has negative cash flow, it will be solely dependent upon outside sources and third party financings to obtain the necessary capital to explore and develop its properties or acquire further properties or pursue other business opportunities or restructure the Company and continue as a going concern. While the Company has repaid its outstanding bank debt, it does not have access to short term bank financing. If the Company is unable to raise the required funds then it will not be able to take any such steps. Therefore, failure to obtain such financing would, in all likelihood, lead to the liquidation of the Company's assets. The amount of capital that is currently available to the Company is dependent upon the market price of the Terra Energy common shares and its ability to dispose of those shares. There can be no assurance as to the market price of the Terra Energy common shares at the time the Company may be required to dispose of such shares or the number of shares that can be sold at any particular time.

The Company's exploration and development activities will also require additional financing. If the Company is unable to secure sufficient financing, delays or postponement of future business opportunities or 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.

Delisting

As a result of the sale of substantially all its oil and gas properties in September, 2010, the Company was delisted from the TSX on March 30, 2011. Failure or delay in obtaining a listing on another stock exchange will drastically reduce the liquidity of the Common Shares. There can be no assurance that a listing on another exchange will be obtained.

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 require 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 Fortress' business, financial condition, results of operations and prospects including its ability to continue in business.

Volatility of Oil and Natural Gas Prices

The results of operations and financial condition are dependent on the prices received for the Company's natural gas production. Natural gas prices have fluctuated widely during recent years and are subject to fluctuations in response to relatively minor changes in supply, demand, market uncertainty and other factors that are beyond the Company's control. These factors include, but are not limited to, worldwide political instability, foreign supply of natural gas, the level of consumer product demand, government regulations and taxes, the price and availability of alternative fuels and the overall economic environment. Any decline in natural gas prices could have a material adverse effect on the Company's operations, financial condition, proved reserves, borrowing capacity, profitability, cash flow from operating activities. No assurance can be given that natural gas prices will be at levels which will generate profits for the Company.

Capital Markets

As a result of the weakened global economic situation and the Company's current financial status, the Company will have restricted access to capital. As future capital expenditures will be financed out of cash generated from operations, borrowings and possible future equity sales, the Company's ability to do so is dependent on, among other factors, the overall state of capital markets and investor demand for investments in the energy industry and the Company's securities in particular.

To the extent that external sources of capital become limited or unavailable or available on onerous terms, the Company's ability to make capital investments, maintain existing assets or acquire additional assets may be impaired, and its assets, liabilities, business, financial condition and results of operations may be materially and adversely affected as a result.

Need to Replace Reserves

Given the Company's sale of substantially all its assets, the Company's future oil and natural gas reserves and production, and therefore its cash flows, will be highly dependent upon the Company's success in acquiring or discovering additional reserves. Without reserve additions through exploration, acquisition or development activities, the Company's reserves and production will decline over time as reserves are exploited. The business of exploring for, developing or acquiring reserves is capital intensive. As the Company is currently cash flow negative, to the extent external sources of capital become limited or unavailable, the Company's ability to make the necessary capital investments to maintain and expand its oil and natural gas reserves will be impaired. In addition, there can be no assurance that the Company will be able to find and develop or acquire additional reserves at acceptable costs.

Operating Hazards and Other Uncertainties

Acquiring, developing and exploring for oil and natural gas involves many risks, which even a combination of experience, knowledge and careful evaluation may not be able to overcome. These risks include, but are not limited to, encountering unexpected formations or pressures, premature declines of reservoirs, blow-outs, equipment failures and other accidents, cratering, sour gas releases, uncontrollable flows of oil, natural gas or well fluids, adverse weather conditions, pollution, other environmental risks, fires and spills. Although the Company maintains insurance in accordance with customary industry practice, the Company is not fully insured against all of these risks. Losses resulting from the occurrence of these risks could have a material adverse impact on us. Like other oil and natural gas companies, the Company attempts to conduct its business and financial affairs so as to protect against political and economic risks applicable to operations in the jurisdictions where the Company operates but there can be no assurance that the Company will be successful in so protecting itself. Losses resulting from the occurrence of any of these risks could have a material effect on the Company's financial condition and therefore on the amounts to be distributed to shareholders.

The Company is also subject to deliverability uncertainties related to the proximity of its reserves to pipeline and processing facilities and the possible inability to secure space on pipelines, which deliver oil and natural gas to commercial markets.

CORPORATE INFORMATION

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Auditors

KPMG LLP

Bankers

ATB Financial

Legal Counsel

Fraser Milner Casgrain LLP

Reserve Engineers

Sproule Associates Limited

Transfer Agent

Olympia Trust

Abbreviations

bbl(s) barrel(s)
bbl/d barrels per day
Mcf thousand cubic feet
Mcf/d thousand of cubic feet per day
Mcfe thousand of cubic feet equivalent

Board of Directors

George Watson, Chairman
Independent Director

Ron McIntosh
Independent Director

Donald Leitch, QC
Partner, Fraser Milner Casgrain LLP

J. Cameron Bailey, CFA
President and CEO, Fortress Energy Inc.

Officers

J. Cameron Bailey, CFA
President and Chief Executive Officer

Jamie Jeffs, CA
VP Finance and Chief Financial Officer

Donald Leitch, QC
Secretary

Corporate Analyst

Jocelyn Tochor



FORTRESS ENERGY INC.

Interim Consolidated Financial Statements (unaudited)

For the three and nine months ended September 30, 2011

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 STATEMENTS OF FINANCIAL POSITION**

(Under Creditor Protection Proceedings as of March 2, 2011 – notes 2 and 17)

(in thousands of Canadian dollars)

(unaudited)

	Note	September 30, 2011	December 31, 2010
ASSETS			
Current assets			
Cash and cash equivalents		\$ 167	\$ 2,433
Trade and other receivables		510	1,750
Prepaid expenses and deposits		528	338
Marketable securities	7	2,368	4,544
Total current assets		3,573	9,065
Non-current assets			
Exploration and evaluation	8	1,000	1,000
Property, plant and equipment	9	4,045	3,418
Total non-current assets		5,045	4,418
TOTAL ASSETS		\$ 8,618	\$ 13,483
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities			
Trade and other payables		\$ 917	\$ 2,256
Indemnification of flow-through share subscribers payable	11	2,079	1,314
Income and other taxes payable	11	464	164
Total current liabilities		3,460	3,734
Non-current liabilities			
Decommissioning liabilities	12	1,639	1,250
Total non-current liabilities		1,639	1,250
TOTAL LIABILITIES		5,099	4,984
SHAREHOLDERS' EQUITY			
Share capital	13	139,447	139,447
Warrants	13	-	5,406
Contributed surplus	13	21,464	16,058
Accumulated losses		(157,392)	(152,412)
TOTAL EQUITY		3,519	8,499
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		\$ 8,618	\$ 13,483

The notes are an integral part of these consolidated financial statements.

FORTRESS ENERGY INC.**CONSOLIDATED STATEMENTS OF LOSS AND COMPREHENSIVE LOSS**

(Under Creditor Protection Proceedings as of March 2, 2011 – notes 2 and 17)

(in thousands of Canadian dollars, except per share amounts)

(unaudited)

	Note	Three months ended September 30,		Nine months ended September 30,	
		2011	2010	2011	2010
REVENUE					
Natural gas sales		\$ 254	\$ 2,566	\$ 539	\$ 11,178
Royalties		(33)	441	(47)	(264)
Gain on commodity contracts		-	439	-	3,947
		221	3,446	492	14,861
EXPENSES					
Operating		69	1,487	148	5,846
Transportation		61	243	121	936
Exploration and evaluation		10	24	10	2,404
Depletion, depreciation and amortization		106	894	198	26,049
General and administrative		482	2,055	1,936	4,473
Indemnification of flow-through share subscribers		765	-	765	-
		1,493	4,703	3,178	39,708
Results from operating activities		(1,272)	(1,257)	(2,686)	(24,847)
Finance expenses	6	1,277	(102)	2,294	703
Loss before income tax		(2,549)	(1,155)	(4,980)	(25,550)
Income tax expense		-	(7)	-	106
Net loss and comprehensive loss for the period		\$ (2,549)	\$ (1,148)	\$ (4,980)	\$ (25,656)
Net loss per share					
Basic		\$ (0.05)	\$ (0.02)	\$ (0.09)	\$ (0.46)
Diluted		\$ (0.05)	\$ (0.02)	\$ (0.09)	\$ (0.46)

The notes are an integral part of these consolidated financial statements.

FORTRESS ENERGY INC.**CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**

(Under Creditor Protection Proceedings as of March 2, 2011 – notes 2 and 17)

(in thousands of Canadian dollars)

(unaudited)

	Note	Share capital	Warrants	Contributed surplus	Accumulated losses	Total equity
Balance at January 1, 2010	13	\$139,447	\$5,406	\$15,435	\$(124,714)	\$ 35,574
Share-based compensation		-	-	623	-	623
Net loss for the period		-	-	-	(25,656)	(25,656)
Balance at September 30, 2010		\$139,447	\$5,406	\$16,058	\$(150,370)	\$ 10,541
Balance at January 1, 2011		\$139,447	\$5,406	\$16,058	\$(152,412)	\$ 8,499
Net loss for the period		-	-	-	(4,980)	(4,980)
Expiry of warrants		-	(5,406)	5,406	-	-
Balance at September 30, 2011		\$139,447	\$ -	\$21,464	\$(157,392)	\$ 3,519

The notes are an integral part of these consolidated financial statements.

FORTRESS ENERGY INC.**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Under Creditor Protection Proceedings as of March 2, 2011 – notes 2 and 17)

(in thousands of Canadian dollars)

(unaudited)

	Note	Three months ended September 30,		Nine months ended September 30,	
		2011	2010	2011	2010
OPERATING ACTIVITIES					
Net loss for the period		\$ (2,549)	\$ (1,148)	\$ (4,980)	\$ (25,656)
Unrealized loss on commodity contracts		-	2,407	-	1,321
Exploration and evaluation		10	24	10	2,404
Depletion, depreciation and amortization		106	894	198	26,049
Share-based compensation		-	438	-	586
Finance expenses		1,143	(102)	2,160	703
Interest paid		-	(314)	(4)	(1,006)
Change in non-cash working capital	15	87	1,426	(302)	827
Net cash from (used in) operating activities		(1,203)	3,625	(2,918)	5,228
INVESTING ACTIVITIES					
Capital expenditures - exploration and evaluation		(1)	(5)	(1)	(63)
Capital expenditures - property, plant and equipment		(280)	(8)	(479)	(1,701)
Proceeds from divestitures		-	25,193	-	25,193
Proceeds on sale of marketable securities		54	-	54	-
Change in non-cash working capital	15	337	(1,945)	313	(2,192)
Net cash from (used in) investing activities		110	23,235	(113)	21,237
FINANCING ACTIVITIES					
Repayment of bank loans		-	(23,375)	-	(23,044)
Change in non-cash working capital	15	765	-	765	-
Net cash from (used in) financing activities		765	(23,375)	765	(23,044)
Change in cash and cash equivalents		(328)	3,485	(2,266)	3,421
Cash and cash equivalents at beginning of period		495	-	2,433	64
Cash and cash equivalents at end of period		\$ 167	\$ 3,485	\$ 167	\$ 3,485

The notes are an integral part of these consolidated financial statements.

FORTRESS ENERGY INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

For the three and nine months ended September 30, 2011

(unaudited)

1. REPORTING ENTITY

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 operating in the Western Canadian Sedimentary Basin ("WCSB"), which comprises a single operating segment.

The interim consolidated financial statements of the Company as at and for the three and nine months ended September 30, 2011 comprises the Company and its wholly-owned subsidiary. The Company conducts many of its activities jointly with others; these financial statements reflect only the Company's proportionate interest in such activities.

2. BASIS OF PRESENTATION**(a) 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 October 30, 2011.

Fortress took this step to enable it to challenge a reassessment issued by the Canada Revenue Agency (the "CRA"), which reassessment was in the amount of approximately \$18,000,000. In addition, the Company received provincial reassessments of approximately \$6,200,000 as a result of the CRA reassessments. As a result of the reassessment, if the Company had taken no action, it would have been compelled to immediately remit \$9,000,000 to the CRA and the Company did not have the necessary funds to remit. Fortress maintained that the CRA's position was not sustainable and vigorously disputed the CRA's claim.

The reassessment denied 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.

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. Signal used its available tax pools to reduce its taxable income from the proceeds of the disposition. Signal was subsequently wound-up into Fortress.

Management maintained that no acquisition of control 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. Notwithstanding the explanations by Fortress, the CRA issued the reassessments.

On October 26, 2011, the Company received revised notices of reassessment from the CRA indicating that CRA was vacating its claim reversing the previous assessments and resulting in no federal income taxes or penalties payable. The Company expects that the provincial claim will also be vacated in due course. As the claims by CRA have been vacated and no federal taxes or penalties are owing. Fortress no longer requires the protection of the Order under the CCAA. On October 28, 2011, the Company applied to the Court of Queen's Bench of Alberta to discharge the Company from the CCAA proceedings and is no longer subject to the CCAA.

FORTRESS ENERGY INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

For the three and nine months ended September 30, 2011

(unaudited)

2. BASIS OF PRESENTATION (CONTINUED)

(b) Going concern uncertainty

The Company's interim 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 accumulated losses of \$157,392,000 as at September 30, 2011.

As at September 30, 2011, the Company has cash on hand of \$167,000 and 3,587,944 common shares of Terra with a carrying value of \$2,368,000. The Company has sold a portion of its Terra Energy shares and anticipates that it will be required to sell additional Terra Energy shares in future quarters to allow it to continue operations. The amount of capital available to the Company will depend upon the market price of the Terra Energy common shares and its ability to dispose of those shares. There can be no assurance as to the market price of the Terra Energy common shares at the time the Company may be required to dispose of such shares or the number of shares that can be sold at any particular time.

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 explore and develop its properties or acquire further properties or pursue other business opportunities 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 business opportunities or 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.

The financial statements for the three and nine months ended September 30, 2011 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.

(c) Statement of compliance:

These interim consolidated financial statements have been prepared in accordance with International Accounting Standard ("IAS") 34, "Interim Financial Reporting". These are the Company's third IFRS interim consolidated financial statements for part of the period covered by the first IFRS annual financial statements and IFRS 1, "First-time Adoption of International Financial Reporting Standards" has been applied. The interim consolidated financial statements do not include all the information required for full annual financial statements.

An explanation of how the transition to IFRS has affected the reported financial position, financial performance and cash flows of the Company is provided in note 18. This note includes reconciliations of equity and total comprehensive income for comparative periods and of equity at the date of transition reported under Canadian GAAP ("Previous GAAP") to those reported for those periods and at the date of transition to IFRS. These financial statements should also be read in conjunction with the IFRS accounting policies described in note 3 to the interim consolidated financial statements for the three months ended March 31, 2011.

These interim consolidated financial statements were authorized for issue by the Board of Directors on November 28, 2011.

2. BASIS OF PRESENTATION (CONTINUED)

(d) Basis of measurement:

The interim consolidated financial statements have been prepared on the historical cost basis except for the following:

- (i) derivative financial instruments are measured at fair value; and
- (ii) liabilities for cash-settled share-based compensation are measured at fair market value.

The methods used to measure fair values are discussed in note 4.

(e) Functional and presentation currency:

These interim consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency.

(f) Use of estimates and judgments:

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the year in which the estimates are revised and in any future years affected.

Reserve estimates including production profiles, future development costs, and discount rates are a critical part of many of the estimated amounts and calculations contained in the financial statements. These estimates are verified by third party professional engineers, who work with information provided by the Company to establish reserve determinations. These determinations are updated at least on an annual basis. Significant areas of estimation, uncertainty and critical judgments in applying accounting policies that impact the amounts recognized in the interim consolidated financial statements include:

- Impairment testing – estimates of reserves, future commodity prices, future costs, production profiles, discount rates, market value of land.
- Depletion and depreciation - oil and natural gas reserves, including future prices, costs and reserve base used in the calculation of depletion.
- Decommissioning obligations – estimates relating to amounts, likelihood, timing, inflation and discount rates.
- Stock-based compensation – forfeiture rates and volatility.
- Derivatives – expected future oil and natural gas prices and expected volatility in these prices; expected interest rates; expected future foreign exchange rates.
- Deferred tax – estimates of reversal of temporary differences, tax rates substantively enacted, and likelihood of assets being realized.
- Provisions and contingencies – estimates relating to onerous contracts, including discount rates associated with long term contracts.

3. SIGNIFICANT ACCOUNTING POLICIES

The interim consolidated financial statements have been prepared following the same accounting policies and methods of computation as the interim consolidation financial statements for the three months ended March 31, 2011, as described in note 3 to those financial statements.

We are currently evaluating the impact these standards will have on our results of operations and financial position:

IFRS 9 Financial Instruments – in November 2009, the International Accounting Standards Board (IASB) issued IFRS 9 to address classification and measurement of financial assets. In October 2010, the IASB revised the standard to include financial liabilities. The standard is required to be adopted for periods beginning January 1, 2013. Portions of the standard remain in development and the full impact of the standard will not be known until the project is complete.

IFRS 10 Consolidated Financial Statements – in May 2011, the IASB issued IFRS 10 which provides additional guidance to determine whether an investee should be consolidated. The guidance applies to all investees, including special purpose entities. The standard is required to be adopted for periods beginning January 1, 2013. We are evaluating the impact that this standard may have on our results of operations and financial position.

IFRS 11 Joint Arrangements – in May 2011, the IASB issued IFRS 11 which presents a new model for determining whether an entity should account for joint arrangements using proportionate consolidation or the equity method. An entity will have to follow the substance rather than legal form of a joint arrangement and will no longer have a choice of accounting method. The standard is required to be adopted for periods beginning January 1, 2013. We are evaluating the impact that this standard may have on our results of operations and financial position.

IFRS 12 Disclosure of Interests in Other Entities – in May 2011, the IASB issued IFRS 12 which aggregates and amends disclosure requirements included within other standards. The standard requires a company to provide disclosures about subsidiaries, joint arrangements, associates and unconsolidated structured entities. The standard is required to be adopted for periods beginning January 1, 2013. We are evaluating the impact that this standard may have on our results of operations and financial position.

IFRS 13 Fair Value Measurement – in May 2011, the IASB issued IFRS 13 to provide comprehensive guidance for instances where IFRS requires fair value to be used. The standard provides guidance on determining fair value and requires disclosures about those measurements. The standard is required to be adopted for periods beginning January 1, 2013. We are evaluating the impact that this standard may have on our results of operations and financial position.

IAS 1 Presentation of Items of Other Comprehensive Income – in June 2011, the IASB issued amendments to IAS 1 *Presentation of Financial Statements* to split items of other comprehensive income (OCI) between those that are reclassified to income and those that do not. The standard is required to be adopted for periods beginning on or after July 1, 2012. We are evaluating the impact that this standard may have on our results of operations and financial position.

FORTRESS ENERGY INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

For the three and nine months ended September 30, 2011

(unaudited)

4. DETERMINATION OF FAIR VALUES

A number of the Company's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

(i) Property, plant and equipment and exploration and evaluation assets:

The fair value of property, plant and equipment recognized in a business combination, is based on market values. The market value of property, plant and equipment is the estimated amount for which property, plant and equipment could be exchanged on the acquisition date between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. The market value of oil and natural gas interests (included in property, plant and equipment) and exploration and evaluation assets is estimated with reference to the discounted cash flows expected to be derived from oil and natural gas production based on externally prepared reserve reports. The risk-adjusted discount rate is specific to the asset with reference to general market conditions.

The market value of other items of property, plant and equipment is based on the quoted market prices for similar items.

(ii) Cash and cash equivalents, trade and other receivables, and trade and other payables:

The fair value of cash and cash equivalents, trade and other receivables, and trade and other payables is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. At September 30, 2011, the fair value of these balances approximated their carrying value due to their short term to maturity.

(iii) Share options:

The fair value of employee share options is measured using a Black-Scholes option pricing model. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility (based on weighted average historic volatility adjusted for changes expected due to publicly available information), weighted average expected life of the instruments (based on historical experience and general option holder behaviour), expected dividends, and the risk-free interest rate (based on government bonds).

5. FINANCIAL RISK MANAGEMENT

(a) Overview:

The Company's activities expose it to a variety of financial risks that arise as a result of its exploration, development, production, and financing activities such as:

- credit risk;
- liquidity risk; and
- market risk.

This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk, and the Company's management of capital. Further quantitative disclosures are included throughout these consolidated financial statements.

The Board of Directors oversees managements' establishment and execution of the Company's risk management framework. Management has implemented and monitors compliance with risk management policies. The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's activities.

(b) Credit risk:

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's receivables from joint venture partners and oil and natural gas marketers.

Trade and other receivables

All of the Company's operations are conducted in Canada. The Company's exposure to credit risk is influenced mainly by the individual characteristics of each customer.

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 a single petroleum and natural gas marketer 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.

FORTRESS ENERGY INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

For the three and nine months ended September 30, 2011

(unaudited)

5. FINANCIAL RISK MANAGEMENT (CONTINUED)

(c) Liquidity risk:

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due (see note 2). The Company's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Company's reputation.

The Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. Further, the Company utilizes authorizations for expenditures on both operated and non operated projects to further manage capital expenditure. The Company also attempts to match its payment cycle with collection of oil and natural gas revenue on the 25th of each month. To facilitate the capital expenditure program, the Company relies on working capital and cash flows from operations (see note 2).

(d) Market risk:

Market risk is the risk that changes in market prices, such as commodity prices, foreign exchange rates and interest rates will affect the Company's income or the value of the financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return.

Currency risk

Prices for oil are determined in global markets and generally denominated in United States dollars. Natural gas prices obtained by the Company are influenced by both US and Canadian demand and the corresponding North American supply, and recently, by imports of liquefied natural gas. The exchange rate effect cannot be quantified but generally an increase in the value of the \$CDN as compared to the \$US will reduce the prices received by the Company for its petroleum and natural gas sales.

Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company has no outstanding loans or borrowings at September 30, 2011 and, accordingly, is not subject to interest rate risk.

Commodity price risk

Commodity price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for oil and natural gas are impacted by not only the relationship between the Canadian and United States dollar but also world economic events that dictate the levels of supply and demand.

The Company does not enter into commodity contracts other than to meet the Company's expected sale requirements.

FORTRESS ENERGY INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

For the three and nine months ended September 30, 2011
(unaudited)

5. FINANCIAL RISK MANAGEMENT (CONTINUED)**(e) Capital management:**

The Company manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying oil 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 issue shares and adjust its capital spending to manage current and projected debt levels.

The Company prepares annual capital expenditure budgets, which are updated as necessary depending on varying factors including current and forecast prices, successful capital deployment and general industry conditions. The annual and updated budgets are approved by the Board of Directors.

To assess capital and operating efficiency and financial strength, the Company continually monitors its working capital deficiency which is a non-IFRS measure and is calculated as follows:

	September 30, 2011	December 31, 2010
	\$	\$
Current assets	3,573	9,065
Current liabilities	(3,460)	(3,734)
Working capital	113	5,331

The Company has not paid or declared any dividends since the date of incorporation.

6. FINANCE EXPENSES

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
	\$	\$	\$	\$
Unrealized loss on marketable securities	1,085	110	2,074	110
Realized loss on marketable securities	48	-	48	-
Gain on sale of oil and gas assets	(166)	(567)	(166)	(567)
Interest on bank loans	-	307	-	960
Interest on unspent flow-through funds	300	7	300	45
Interest – other	-	-	4	-
Accretion of decommissioning liabilities	10	41	34	155
Finance expenses (income)	1,277	(102)	2,294	703

The Company recorded an additional gain on sale of oil and gas assets in the three and nine months ended September 30, 2011 of \$166,000 related to assets sold in August 2010. The additional gain relates to royalty credits paid to a former joint venture partner that belonged to the Company, and has since been paid to the Company, due the acquisition of that partners working interest in September 2009.

FORTRESS ENERGY INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**For the three and nine months ended September 30, 2011
(unaudited)

7. MARKETABLE SECURITIES

Marketable securities reflect the Company's investment in 3,587,944 common shares of Terra Energy Corp. ("Terra") which had a quoted market value on September 30, 2011 of \$2,368,000 or \$0.66 per share. The Terra shares trade on the Toronto Stock Exchange ("TSX") under the symbol "TT". The Company sold 76,500 Terra shares in September 2011 for cash proceeds of \$54,000, resulting in a loss on the sale of \$48,000.

8. EXPLORATION AND EVALUATION ASSETS

	Exploration and evaluation assets \$
Cost:	
At January 1, 2010	3,900
Additions	62
Impairments	(2,404)
Divestitures	(583)
Change in decommissioning liabilities	25
Balance, December 31, 2010	1,000
Additions	1
Impairments	(10)
Change in decommissioning liabilities	9
Balance, September 30, 2011	1,000

Exploration and evaluation (E&E) assets consist of the Company's exploration projects which are pending the determination of proven or probable reserves. Additions represent the Company's share of costs incurred on E&E assets during the period. As at September 30, 2011 an amount of \$1,000,000 (December 31, 2010 - \$1,000,000) remains in exploration and evaluation assets in respect of the Pine Creek project.

(a) Amortization and impairment charge:

The impairment of exploration and evaluation assets, and any eventual reversal thereof, is recognized as additional depletion and depreciation expense in the statement of loss and comprehensive loss. The impairment of other intangible assets and goodwill, and any eventual reversal thereof (excluding goodwill), is recognized as amortization expense in the statement of loss and comprehensive loss.

(b) Recoverability of exploration and evaluation assets:

The Company assesses the recoverability of exploration and evaluation assets, before and at the moment of reclassification to property, plant and equipment, using CGU's.

FORTRESS ENERGY INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**For the three and nine months ended September 30, 2011
(unaudited)**9. PROPERTY, PLANT AND EQUIPMENT**

	Property, plant and equipment \$
Cost:	
At January 1, 2010	61,319
Additions	1,667
Divestitures	(33,366)
Change in decommissioning liabilities	(79)
At December 31, 2010	29,541
Additions	479
Change in decommissioning liabilities	346
At September 30, 2011	30,366
Accumulated depletion, depreciation and impairment losses:	
At January 1, 2010	-
Depletion, depreciation and amortization expense	(4,309)
Impairment losses	(21,814)
At December 31, 2010	(26,123)
Depletion, depreciation and amortization expense	(198)
At September 30, 2011	(26,321)
Carrying amount:	
At January 1, 2010	\$ 61,319
At December 31, 2010	\$ 3,418
At September 30, 2011	\$ 4,045

Amortization and impairment charge:

The depletion, depreciation and impairment of property, plant and equipment, and any eventual reversal thereof, are recognized in depletion, depreciation and amortization in the statement of loss and comprehensive loss.

The calculation of depletion expense for the three and nine months ended September 30, 2011 included estimated future development costs of \$875,000 (December 31, 2010 - \$875,000) associated with the development of the Company's proved plus probable reserves. The depletion, depreciation and amortization expense for the three and nine months ended September 30, 2011 was \$106,000 and \$198,000, respectively.

In the three and nine months ended September 30, 2011, the Company did not capitalize any general and administrative expenses or share-based compensation expenses (December 31, 2010 - \$292,000).

FORTRESS ENERGY INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**For the three and nine months ended September 30, 2011
(unaudited)

10. IMPAIRMENTS LOSSES

During the year ended December 31, 2010, the Company recorded an impairment loss of \$21,814,000 on its development and production oil and gas properties due to declining natural gas prices and the eventual sale of oil and gas properties on August 31, 2010 which established the fair value less cost to sell for those sold properties.

The Company also evaluated its Pine Creek CGU for impairment at December 31, 2010. As a result, the Company recorded an impairment loss of \$2,404,000 on its E&E assets for the year ended December 31, 2010 as the Company currently has no plans or resources to further develop this property. The Company recorded an additional impairment loss of \$10,000 in the three and nine months ended September 30, 2011 on its Pine Creek property.

11. INDEMNIFICATION OF FLOW-THROUGH SHARE SUBSCRIBERS

(a) The CRA conducted an audit in March 2009 of the 2004 flow-through expenditures of a business that was acquired by the Company in 2006. As a result of the audit, the Company was reassessed by the CRA for taxes of approximately \$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 on July 31, 2009 after consultation with its tax advisors and legal counsel to appeal this reassessment. The Company also indemnified the subscribers from income taxes related to the offering. The amount of the potential indemnification is approximately \$765,000.

As a result of recent discussions with the CRA and additional arguments put forward, the Company has determined that the continued appeal of this reassessment is unlikely to be successful. Accordingly, the Company has recorded the estimated taxes and indemnification as liabilities at September 30, 2011.

(b) On September 30, 2009 the Company closed a public offering of 6,594,000 flow-through common shares. The expenditure commitment resulting from the issuance of flow-through common shares was \$3,000,270; however, the Company incurred expenditures of only \$104,000 by the December 31, 2010 deadline. Accordingly, the Company has recorded a liability of \$1,314,000 at September 30, 2011 (December 31, 2010 - \$1,314,000) which represents the anticipated payments to investors required under indemnification agreements.

12. DECOMMISSIONING LIABILITIES

The Company's decommissioning liabilities result from its ownership interest in oil and natural gas assets including well sites and gathering systems. The total decommissioning liabilities are estimated based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon these wells and facilities and the estimated timing of the cash flows to be incurred in future years. The Company has estimated the net present value of the decommissioning liabilities to be \$1,639,000 as at September 30, 2011 (December 31, 2010: \$1,250,000) based on an undiscounted total future liability of \$2,966,000 (December 31, 2010 - \$2,966,000). These payments are expected to be made over the next 25 years. A risk-free rate of 2.77 percent (December 31, 2010: 4.1 %) and an inflation rate of 2.0 percent were used to calculate the net present value of decommissioning liabilities.

Decommissioning liabilities	\$
Balance, January 1, 2010	5,686
Adjustments to assumptions	51
Liabilities incurred and acquired	25
Accretion expense	170
Disposition of abandonment liability	(4,682)
Balance, December 31, 2010	1,250
Adjustments to assumptions	355
Accretion expense	34
Balance, September 30, 2011	1,639

FORTRESS ENERGY INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**For the three and nine months ended September 30, 2011
(unaudited)**13. SHARE CAPITAL**

(a) Authorized:

Fortress is authorized to issue an unlimited number of voting common shares and an unlimited number of preferred shares.

(b) Common shares issued and outstanding:

	Number of Common Shares	\$
Balance, January 1, 2010	55,294,617	139,447
Balance, December 31, 2010	55,294,617	139,447
Balance, September 30, 2011	55,294,617	139,447

(c) Warrants issued and outstanding:

	Number of warrants	\$
Balance, January 1, 2010	27,295,700	5,406
Balance, December 31, 2010	27,295,700	5,406
Expired	(27,295,700)	(5,406)
Balance, September 30, 2011	-	-

(d) Contributed surplus:

	\$
Balance, January 1, 2010	15,435
Share-based compensation expense	623
Balance, December 31, 2010	16,058
Expiry of warrants	5,406
Balance, September 30, 2011	21,464

FORTRESS ENERGY INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

For the three and nine months ended September 30, 2011
(unaudited)

13. SHARE CAPITAL (CONTINUED)

(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.

The following table summarizes stock option transactions:

	Number of options	Weighted average exercise price \$
Balance, January 1, 2010	4,774,579	0.50
Cancelled or expired	(4,773,779)	0.50
Balance, December 31, 2010	800	50.00
Expired	(800)	50.00
Balance, September 30, 2011	-	-

(g) Share-based compensation expense:

The following table summarizes the share-based compensation expense (recovery) recorded for all plans within general and administrative expenses in the consolidated statements of loss and comprehensive loss:

	Three months ended September 30, 2011		Nine months ended September 30,	
	2011	2010	2011	2010
Stock options	-	86	-	170
Restricted stock units	-	(35)	-	(23)
Total share-based compensation expense	-	51	-	147

(h) Loss per share:

	Three months ended September 30, 2011		Nine months ended September 30,	
	2011	2010	2011	2010
Loss for the period	\$ 2,549	\$ 15,577	\$ 4,980	\$ 24,508
Weighted average shares outstanding -				
basic and diluted	55,294,617	55,294,617	55,294,617	55,294,617
Loss per share – basic and diluted	\$ 0.05	\$ 0.28	\$ 0.09	\$ 0.44

FORTRESS ENERGY INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

For the three and nine months ended September 30, 2011
(unaudited)

14. COMMITMENTS AND CONTINGENCIES

(a) 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. A court date has been scheduled for January 2012 to advance these claims.

(b) Letter of Guarantee

The Company has a letter of guarantee of \$107,000 outstanding as at September 30, 2011 (\$107,000 as at December 31, 2010) which is secured by a cash deposit.

(c) Office Premises

The Company is committed to minimum annual lease payments under an operating lease for office premises to January 2013, as follows:

	Total
	\$
Balance of 2011	6
2012	144
2013	12
	162

15. SUPPLEMENTAL CASH FLOW INFORMATION

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

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2011	2010	2011	2010
	\$	\$	\$	\$
Trade and other receivables	1,022	(360)	1,240	2,808
Prepaid expenses and deposits	183	176	(190)	128
Trade and other payables	(1,081)	(214)	(1,339)	(4,328)
Indemnification of flow-through share subscribers	765	-	765	-
Income and other taxes	300	(121)	300	(8)
	1,189	(519)	776	(1,400)
Non-cash share-based compensation included in trade and other payables	-	-	-	35
	1,189	(519)	776	(1,365)
Attributable to operating activities	87	1,426	(302)	827
Attributable to investing activities	337	(1,945)	313	(2,192)
Attributable to financing activities	765	-	765	-

FORTRESS ENERGY INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

For the three and nine months ended September 30, 2011

(unaudited)

16. RELATED PARTY TRANSACTIONS

In the three and nine months ended September 30, 2011 the Company was charged \$61,000 and \$198,000, respectively (three and nine months ended September 30, 2010 - \$146,000 and \$336,000, respectively, by a law firm of which a director of the Company is a partner.

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.

17. SUBSEQUENT EVENT

On October 26, 2011, the Company received revised notices of reassessment from the CRA indicating that CRA was vacating its claim reversing the previous assessments and resulting in no federal income taxes or penalties payable. The Company expects that the provincial claim will also be vacated in due course. Accordingly, Fortress no longer requires the protection of the Order under the CCAA. On October 28, 2011, the Company applied to the Court of Queen's Bench of Alberta to discharge the Company from the CCAA proceedings and is no longer subject to the CCAA.

18. TRANSITION TO IFRS

The adoption of IFRS requires the application of IFRS 1. IFRS 1 generally requires that an entity retrospectively apply all IFRS effective at the end of its first IFRS reporting period; however IFRS 1 provides certain mandatory exceptions and permits limited optional exemptions. Certain IFRS 1 optional exemptions have been applied including:

- Deemed cost exemption for full cost oil and gas entities whereby exploration and evaluation assets were classified from the full cost pool to intangible exploration assets at the amount that was recorded under previous GAAP and the remaining full cost pool was allocated to the development assets and components pro rata using reserve values.
- Decommissioning liabilities exemption that allows any changes in decommissioning liabilities on transition to IFRS to be adjusted through opening accumulated losses.
- Share-based compensation exemption that allows a company to only have to evaluate share-based compensation awards that were unvested as of the date of transition and that were issued subsequent to November 7, 2002.
- Business combinations exemption that allows a company to not have to restate any business combinations that occurred prior to the date of transition.

IFRS accounting policies (refer to note 3 to the interim consolidated financial statements as at and for the three months ended March 31, 2011 for details) have been applied in preparing the interim consolidated financial statements for the three and nine months ended September 30, 2011, the comparative information for the three and nine months ended September 30, 2010, the financial statements for the year ended December 31, 2010 and the preparation of the opening IFRS statement of financial position at January 1, 2010, the Company's date of transition to IFRS. In preparing its opening IFRS statement of financial position, comparative information for the three and nine months ended September 30, 2010 and financial statements for the year ended December 31, 2010, the Company adjusted amounts previously reported in financial statements prepared in accordance with previous GAAP. An explanation of how the transition from previous GAAP to IFRS has affected the Company's financial position, financial performance and cash flows is set out in the following tables and the notes accompanying the tables.

FORTRESS ENERGY INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

For the three and nine months ended September 30, 2011
(unaudited)

18. TRANSITION TO IFRS (CONTINUED)

- (a) Reconciliation of consolidated statement of financial position from previous GAAP to IFRS:

At September 30, 2010:

	Note 18 (d)	Previous GAAP	Effect of transition to IFRS	IFRS
ASSETS				
Current assets				
Cash and cash equivalents		\$ 3,485	-	\$ 3,485
Trade and other receivables		2,769	-	2,769
Prepaid expenses and deposits		342	-	342
Marketable securities		4,727	-	4,727
Total current assets		11,323	-	11,323
Non-current assets				
Exploration and evaluation	(i)	-	1,000	1,000
Property, plant and equipment	(ii)	2,023	1,439	3,462
Total non-current assets		2,023	2,439	4,462
TOTAL ASSETS		\$ 13,346	\$ 2,439	\$ 15,785
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current liabilities				
Trade and other payables	(vii)	\$ 3,548	460	\$ 4,008
Total current liabilities		3,548	460	4,008
Non-current liabilities				
Decommissioning liabilities	(iii)	937	299	1,236
Total non-current liabilities		937	299	1,236
TOTAL LIABILITIES		4,485	759	5,244
SHAREHOLDERS' EQUITY				
Share capital	(vii), (viii)	139,344	103	139,447
Warrants		5,406	-	5,406
Contributed surplus	(v),(viii)	16,239	(181)	16,058
Accumulated losses	(viii)	(152,128)	1,758	(150,370)
TOTAL EQUITY		8,861	1,680	10,541
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		\$ 13,346	\$ 2,439	\$ 15,785

FORTRESS ENERGY INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**For the three and nine months ended September 30, 2011
(unaudited)**18. TRANSITION TO IFRS (CONTINUED)**

(b) Reconciliation of consolidated statement of loss and comprehensive loss from previous GAAP to IFRS:

For the three months ended September 30, 2010:

	Note 18 (d)	Previous GAAP	Effect of transition to IFRS	IFRS
REVENUE				
Natural gas sales		\$ 2,566	\$ -	\$ 2,566
Royalties		441		441
Gain on commodity contracts		439	-	439
		3,446	-	3,446
EXPENSES				
Operating		1,487	-	1,487
Transportation		243	-	243
Impairment of exploration and evaluation	(i)	-	24	24
Depletion, depreciation and amortization	(iv)	1,091	(197)	894
General and administrative	(v)	2,240	(185)	2,055
		5,061	(358)	4,703
Results from operating activities		(1,615)	358	(1,257)
Finance expenses	(iii), (vi)	1,782	(1,884)	(102)
Loss before income tax		(3,397)	2,242	(1,155)
Income tax expense		(7)	-	(7)
Net loss and comprehensive loss for the period		\$ (3,390)	\$ 2,242	\$ (1,148)
Net loss per share				
Basic		\$ (0.06)	\$ 0.04	\$ (0.02)
Diluted		\$ (0.06)	\$ 0.04	\$ (0.02)

FORTRESS ENERGY INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**For the three and nine months ended September 30, 2011
(unaudited)**18. TRANSITION TO IFRS (CONTINUED)**

(b) Reconciliation of consolidated statement of loss and comprehensive loss from previous GAAP to IFRS (continued):

For the nine months ended September 30, 2010:

	Note 18 (d)	Previous GAAP	Effect of transition to IFRS	IFRS
REVENUE				
Natural gas sales		\$ 11,177	\$ -	\$ 11,178
Royalties		(264)		(264)
Gain on commodity contracts		3,948	-	3,947
		14,861	-	14,861
EXPENSES				
Operating		5,846	-	5,846
Transportation		936	-	936
Exploration and evaluation	(i)	-	2,404	2,404
Depletion, depreciation and amortization	(iv)	54,817	(28,768)	26,049
General and administrative	(v)	4,654	(181)	4,473
		66,253	(26,545)	39,708
Results from operating activities		(51,392)	26,545	(24,847)
Finance expenses	(iii), (vi)	2,640	(1,937)	703
Loss before income tax		(54,032)	28,482	(25,550)
Income tax expense (reduction):				
Current		106	-	106
Deferred	(vii)	(750)	750	-
		(644)	750	106
Net loss and comprehensive loss for the period		\$ (53,388)	\$ 27,732	\$ (25,656)
Net loss per share				
Basic		\$ (0.95)	\$ 0.49	\$ (0.46)
Diluted		\$ (0.95)	\$ 0.49	\$ (0.46)

FORTRESS ENERGY INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**For the three and nine months ended September 30, 2011
(unaudited)**18. TRANSITION TO IFRS (CONTINUED)**

(c) Reconciliation of consolidated cash flow statement from previous GAAP to IFRS:

For the three months ended September 30, 2010:

	Note 18 (d)	Previous GAAP	Effect of transition to IFRS	IFRS
OPERATING ACTIVITIES				
Loss of the period		\$(3,390)	\$ 2,242	\$ (1,148)
Unrealized loss on commodity contracts		2,407	-	2,407
Exploration and evaluation	(i)	-	24	24
Depletion, depreciation and amortization	(iv)	1,091	(197)	894
Share-based compensation	(v)	623	(185)	438
Finance expenses	(iii)	1,782	(1,884)	(102)
Interest paid		(314)	-	(314)
Change in non-cash working capital		1,426	-	1,426
Net cash from operating activities		3,625	-	3,625
INVESTING ACTIVITIES				
Capital expenditures - exploration and evaluation	(i)	-	(5)	(5)
Capital expenditures - property, plant and equipment	(i), (ii)	(13)	5	(8)
Proceeds from divestitures		25,193	-	25,193
Change in non-cash working capital		(1,945)	-	(1,945)
Net cash used in investing activities		23,235	-	23,235
FINANCING ACTIVITIES				
Repayment of bank loans		(23,375)	-	(23,375)
Net cash from financing activities		(23,375)	-	(23,375)
Change in cash and cash equivalents		3,485	-	3,485
Cash and cash equivalents at beginning of period		-	-	-
Cash and cash equivalents at end of period		\$ 3,485	\$ -	\$ 3,485

FORTRESS ENERGY INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**For the three and nine months ended September 30, 2011
(unaudited)**18. TRANSITION TO IFRS (CONTINUED)**

(c) Reconciliation of consolidated cash flow statement from previous GAAP to IFRS:

For the nine months ended September 30, 2010:

	Note 18 (d)	Previous GAAP	Effect of transition to IFRS	IFRS
OPERATING ACTIVITIES				
Loss of the period		\$(53,388)	\$ 27,732	\$ (25,656)
Unrealized gain on commodity contracts		1,321	-	1,321
Exploration and evaluation	(i)	-	2,404	2,404
Depletion, depreciation and amortization	(iv)	54,817	(28,768)	26,049
Share-based compensation	(v)	767	(181)	586
Finance expenses	(iii)	2,640	(1,937)	703
Deferred income tax	(vii)	(750)	750	-
Interest paid		(1,006)	-	(1,006)
Change in non-cash working capital		827	-	827
Net cash from operating activities		5,228	-	5,228
INVESTING ACTIVITIES				
Capital expenditures - exploration and evaluation	(i)	-	(63)	(63)
Capital expenditures - property, plant and equipment	(i), (ii)	(1,764)	63	(1,701)
Proceeds from divestitures		25,193	-	25,193
Change in non-cash working capital		(2,192)	-	(2,192)
Net cash used in investing activities		21,237	-	21,237
FINANCING ACTIVITIES				
Repayment of bank loans		(23,044)	-	(23,044)
Net cash from financing activities		(23,044)	-	(23,044)
Change in cash and cash equivalents		3,421	-	3,421
Cash and cash equivalents at beginning of period		64	-	64
Cash and cash equivalents at end of period		\$ 3,485	\$ -	\$ 3,485

FORTRESS ENERGY INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

For the three and nine months ended September 30, 2011

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18. TRANSITION TO IFRS (CONTINUED)

(d) Impact of transition to IFRS on 2010 results:

- (i) Exploration and Evaluation assets ("E&E") – As required under IFRS 6, upon transition to IFRS, Fortress reclassified \$4,491,000 from Property, Plant and Equipment ("PP&E") to E&E, which primarily consisted of undeveloped exploration lands. The Company reclassified \$4,578,000 at September 30, 2010 and \$4,578,000 at December 31, 2010.

On transition to IFRS, the Company recorded an impairment loss on E&E assets of \$591,000 which resulted in a reduction in E&E assets with the offset to accumulated losses. For the three and nine months ended September 30, 2010, the Company recorded additional impairment losses on E&E assets of \$24,000 and \$2,404,000, respectively (year ended December 31, 2010 - \$2,404,000) due to a decrease in natural gas prices.

The following table summarizes the changes to E&E assets resulting from the transition to IFRS:

E&E assets	January 1, 2010 \$	September 30, 2010 \$	December 31, 2010 \$
Transferred from PP&E assets	4,491	4,578	4,578
Impairment losses	(591)	(2,995)	(2,995)
Change in allocation of sales proceeds	-	(583)	(583)
E&E assets as reported under IFRS	3,900	1,000	1,000

- (ii) Property, Plant and Equipment ("PP&E") – The Company's PP&E assets were allocated to CGU's unlike under previous GAAP where all oil and natural gas assets are accumulated into one cost centre. Under IFRS 1, the deemed cost of the Company's oil and natural gas assets were allocated to CGU's based on total proved plus probable reserve values as at January 1, 2010.

Under IFRS, impairment tests for PP&E are performed at a CGU level as opposed to the entire Company's PP&E balance being subjected to a full cost ceiling test under previous GAAP. Impairment is recognized if the carrying value exceeds the recoverable amount for a CGU. The recoverable amount is determined using the greater of the fair value less costs to sell based on discounted future cash flows of proved plus probable reserves using forecast prices and costs, and the value in use. As a result of decreased natural gas prices and the sale of oil and gas assets on August 31, 2010 which impacted the fair value less costs to sell, the Company recognized impairment losses for the three and nine months ended September 30, 2010 of \$11,804,000 and \$21,814,000, respectively (year ended December 31, 2010 – \$21,814,000). This resulted in a reduction of PP&E with the offset charged to depletion, depreciation and amortization expense. The Company also recorded an impairment loss of \$24,207,000 on January 1, 2010, on transition to IFRS.

FORTRESS ENERGY INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

For the three and nine months ended September 30, 2011

(unaudited)

18. TRANSITION TO IFRS (CONTINUED)

(d) Impact of transition to IFRS on 2010 results (continued):

(ii) Property, Plant and Equipment ("PP&E") (continued):

The following table summarizes the changes to PP&E assets resulting from the transition to IFRS:

PP&E assets	January 1, 2010 \$	September 30, 2010 \$	December 31, 2010 \$
PP&E assets as reported under previous GAAP	90,017	2,023	2,178
Transferred to E&E assets	(4,491)	(4,578)	(4,578)
Change in depletion, depreciation and amortization	-	3,106	3,089
Change in impairment losses	(24,207)	1,455	1,455
Change in decommissioning liabilities	-	(412)	(256)
Change in loss on sale of oil and gas properties	-	1,868	1,530
PP&E assets as reported under IFRS	61,319	3,462	3,418

(iii) Decommissioning liabilities – Under previous GAAP, Fortress's decommissioning liabilities were discounted based on a credit adjusted risk-free rate which was 9 percent at December 31, 2009. Under IFRS, the Company is required to revalue its obligation at each balance sheet date using a current liability-specific discount rate. At transition, Fortress revalued the obligation based on a risk-free rate of 4.1% resulting in a \$1,362,000 increase to the liability with the offset charged to accumulated losses. As a result of the change in the discount rate applied, accretion of decommissioning liabilities expense decreased by \$16,000 and \$68,000 for the three and nine months ended September 30, 2010, respectively (year ended December 31, 2010 - \$62,000). The accretion of decommissioning liabilities expense has been included in finance expenses.

The following table summarizes the changes to decommissioning liabilities resulting from the transition to IFRS:

Decommissioning liabilities	January 1, 2010 \$	September 30, 2010 \$	December 31, 2010 \$
Decommissioning liabilities as reported under previous GAAP	4,324	937	789
Increase resulting from change in discount rate	1,362	1,362	1,362
Change in accretion expense	-	(69)	(62)
Change in net additions/(disposals)	-	(994)	(839)
Decommissioning liabilities as reported under IFRS	5,686	1,236	1,250

(iv) Depletion, depreciation and amortization expense – Under IFRS, Fortress has chosen to calculate depletion expense based on proved plus probable reserves as opposed to proved reserves under previous GAAP. This has resulted in a reduction of depletion, depreciation and amortization expense for the three and nine months ended September 30, 2010 of \$197,000 and \$3,106,000, respectively (year ended December 31, 2010 - \$3,089,000).

FORTRESS ENERGY INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

For the three and nine months ended September 30, 2011

(unaudited)

18. TRANSITION TO IFRS (CONTINUED)

- (d) Impact of transition to IFRS on 2010 results (continued):

The following table summarizes the changes to depletion, depreciation and amortization expense resulting from the transition to IFRS:

	Three months ended September 30, 2010 \$	Nine months ended September 30, 2010 \$	Year ended December 31, 2010 \$
Depletion, depreciation and amortization expense as reported under previous GAAP	39,668	54,817	54,874
Decrease in depletion, depreciation and amortization expense	(1,356)	(3,106)	(3,089)
Decrease in impairment losses on PP&E	(24,957)	(25,662)	(25,662)
Depletion, depreciation and amortization expense as reported under IFRS	13,355	26,049	26,123

- (v) Under previous GAAP, Fortress expensed share-based compensation on a straight-line basis. Under IFRS, share-based payments are expensed based on a graded vesting schedule. Fortress also incorporated a forfeiture multiplier rather than accounting for forfeitures as they occur as currently practiced under previous GAAP. This resulted in a decrease in share-based compensation expense for the three and nine months ended September 30, 2010 of \$185,000 and \$181,000, respectively (year ended December 31, 2010 – reduction of \$181,000). This decrease in share-based compensation expense resulted in no change in amounts previously capitalized to PP&E for the three and nine months ended September 30, 2010 (year ended December 31, 2010 also no change). Share-based compensation expense has been included in general and administrative expenses on the statement of loss and comprehensive loss.

- (vi) Divestitures – Under previous GAAP, proceeds from divestitures were deducted from the full cost pool without recognition of a gain or loss unless the divestiture resulted in a change in the depletion rate of 20% or greater in which case, a gain or loss was recorded. Under IFRS, gains and losses are recorded on divestitures and are calculated as the difference between the proceeds and the net book value of the asset disposed of.

The Company sold substantially all of its oil and gas properties on August 31, 2010. Under previous GAAP the Company recorded a loss on sale of oil and gas assets of \$1,000,000 for the year ended December 31, 2010. Under IFRS, the Company has recorded a gain on the sale of oil and gas assets of \$530,000 as a result of an increase in decommissioning liabilities and a change in the allocation of the sale proceeds to specific CGU's.

- (vii) Flow-through shares are a Canadian income tax incentive which is the subject of specific guidance under previous GAAP, however there is no specific guidance under IFRS. Under previous GAAP, when flow-through shares were issued they were recorded at face value. The related deferred income tax liability was established for the tax effect of the difference between the tax basis and the book basis of the assets when renounced and was recorded as a reduction of share capital. The reduction to share capital under previous GAAP was based on the corporate tax rates in effect at that time. There was no income statement effect associated with the issuance of these shares, however upon renunciation to the flow-through subscriber, a deferred tax liability was recorded. In the Company's case, since its tax basis was larger than its book basis, a deferred tax liability was reversed and taken into income as a deferred income tax reduction.

FORTRESS ENERGY INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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18. TRANSITION TO IFRS (CONTINUED)

(d) Impact of transition to IFRS on 2010 results (continued):

The Company has adopted a policy under IFRS where the proceeds from the offering are to be allocated between the sale of the shares and the sale of the income tax benefit. The allocation is made based on the difference between the quoted market price of the existing shares and the amount an investor pays for the flow-through shares. This flow-through premium is recorded as a liability that is reduced when qualifying flow-through expenditures are incurred. The reduction of the flow-through liability is offset by an increase in the deferred tax liability and due to the valuation allowance recognized in the Company's case it is treated as a deferred income tax reduction. On transition to IFRS on January 1, 2010, the Company recorded a flow-through share liability of \$462,000 which has been included with trade and other payables, a decrease in share capital of \$647,000 and a decrease in accumulated losses of \$185,000.

For the nine months ended September 30, 2010, the effects of these changes resulted in an increase to share capital of \$103,000 (December 31, 2010 – a decrease of \$621,000), an increase in trade and other payables of \$461,000 (December 31, 2010 - \$nil) and an increase in accumulated losses of \$564,000 (December 31, 2010 – a decrease of \$621,000).

(viii) The following table summarizes the changes to share capital resulting from the transition to IFRS:

	January 1, 2010 \$	September 30, 2010 \$	December 31, 2010 \$
Share capital as reported under previous GAAP	140,094	139,344	140,068
Flow-through shares	(647)	103	(621)
Share capital as reported under IFRS	139,447	139,447	139,447

(ix) The following table summarizes the changes to contributed surplus resulting from the transition to IFRS:

	January 1, 2010 \$	September 30, 2010 \$	December 31, 2010 \$
Contributed surplus as reported under previous GAAP	15,435	16,239	16,239
Change in share-based compensation	-	(181)	(181)
Contributed surplus as reported under IFRS	15,435	16,058	16,058

(x) The following table summarizes the changes to accumulated losses resulting from the transition to IFRS:

	January 1, 2010 \$	September 30, 2010 \$	December 31, 2010 \$
Accumulated losses as reported under previous GAAP	(98,739)	(152,128)	(154,993)
Change in decommissioning liabilities	(1,362)	(1,293)	(1,300)
Change in depletion, depreciation and amortization	(24,207)	4,561	4,544
Change in loss on sale of oil and gas properties	-	1,868	1,530
Change in impairment of E&E assets	(591)	(2,995)	(2,995)
Change in share-based compensation	-	181	181
Flow-through shares	185	(564)	621
Accumulated losses as reported under IFRS	(124,714)	(150,370)	(152,412)

FORTRESS ENERGY INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

For the three and nine months ended September 30, 2011

(unaudited)

18. TRANSITION TO IFRS (CONTINUED)

(d) Impact of transition to IFRS on 2010 results (continued):

(xi) The following table summarizes the changes to net loss and comprehensive loss resulting from the transition to IFRS:

	Three months ended September 30, 2010 \$	Nine months ended September 30, 2010 \$	Year ended December 31, 2010 \$
Net loss and comprehensive loss as reported under previous GAAP	(3,391)	(53,388)	(56,254)
Change in exploration and evaluation expenses	(24)	(2,404)	(2,404)
Change in depletion, depreciation and amortization expense	197	3,106	3,089
Change in impairment losses included in depletion, depreciation and amortization expense	-	25,662	25,662
Change in share-based compensation	185	181	181
Change in accretion expense included in finance expenses	17	69	62
Change in loss on sale of oil and gas properties	1,868	1,868	1,530
Change in deferred income tax expense	-	(750)	436
Net loss and comprehensive loss as reported under IFRS	(1,148)	(25,656)	(27,698)