

Fortress International Group, Inc.  
Form 10-Q  
November 14, 2011

---

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2011

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number: 000-51426

---

FORTRESS INTERNATIONAL GROUP, INC.  
(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

20-2027651  
(I.R.S. Employer Identification No.)

7226 Lee DeForest Drive, Suite 209  
Columbia, Maryland  
(Address of principal executive offices)

21046  
(Zip Code)

(410) 423-7300  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether each registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer,

Edgar Filing: Fortress International Group, Inc. - Form 10-Q

or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

Indicated by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
Yes  No

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date.

Common Stock, par value \$0.0001 per share, as of November 1, 2011 14,626,162

---

FORTRESS INTERNATIONAL GROUP, INC.  
Table of Contents

	Page
<b>PART I - FINANCIAL INFORMATION</b>	
<b>Item 1. Financial Statements</b>	
Condensed Consolidated Balance Sheets as of September 30, 2011 and as of December 31, 2010	1
Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2011 and September 30, 2010	2
Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2011 and September 30, 2010	3
Notes to Condensed Consolidated Financial Statements	4
<b>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</b>	11
<b>Item 3. Quantitative and Qualitative Disclosures about Market Risk</b>	20
<b>Item 4T. Controls and Procedures</b>	20
<b>PART II - OTHER INFORMATION</b>	
<b>Item 1. Legal Proceedings</b>	21
<b>Item 1A. Risk Factors</b>	21
<b>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</b>	21
<b>Item 3. Defaults upon Senior Securities</b>	21
<b>Item 4. Removed and reserved.</b>	21
<b>Item 5. Other Information</b>	21
<b>Item 6. Exhibits</b>	22
<b>SIGNATURES</b>	23

## PART I - FINANCIAL INFORMATION

## Item 1. Financial Statements

FORTRESS INTERNATIONAL GROUP, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS

	(Unaudited) September 30, 2011	December 31, 2010
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$7,490,034	\$10,980,420
Contract and other receivables, net	6,167,974	10,134,475
Costs and estimated earnings in excess of billings on uncompleted contracts	1,055,756	1,079,813
Prepaid expenses and other current assets	689,637	555,375
<b>Total current assets</b>	<b>15,403,401</b>	<b>22,750,083</b>
Property and equipment, net	333,731	375,926
Goodwill	3,839,682	3,811,127
Other intangible assets, net	60,000	60,000
Other assets	23,857	40,210
<b>Total assets</b>	<b>\$19,660,671</b>	<b>\$27,037,346</b>
<b>Liabilities and Stockholders' Equity</b>		
<b>Current Liabilities</b>		
Notes payable, current portion	\$250,000	\$200,572
Accounts payable and accrued expenses	3,894,395	9,370,446
Billings in excess of costs and estimated earnings on uncompleted contracts	2,873,858	7,892,460
<b>Total current liabilities</b>	<b>7,018,253</b>	<b>17,463,478</b>
Convertible notes, less current portion	2,582,301	2,750,000
Other liabilities	92,944	137,218
<b>Total liabilities</b>	<b>9,693,498</b>	<b>20,350,696</b>
<b>Commitments and Contingencies</b>		
	-	-
<b>Stockholders' Equity</b>		
Preferred stock- \$.0001 par value; 1,000,000 shares authorized; no shares issued or outstanding	-	-
Common stock- \$.0001 par value, 49,000,000 and 100,000,000 shares authorized; 14,491,307 and 13,857,127 issued; 13,857,420 and 13,384,860 outstanding at September 30, 2011 and December 31, 2010, respectively	1,449	1,386
Additional paid-in capital	65,719,197	65,247,545
Treasury stock 633,887 and 472,267 shares at cost at September 30, 2011 and December 31, 2010, respectively	(1,373,242 )	(1,084,809 )
Accumulated deficit	(54,380,231)	(57,477,472)
<b>Total stockholders' equity</b>	<b>9,967,173</b>	<b>6,686,650</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$19,660,671</b>	<b>\$27,037,346</b>

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



FORTRESS INTERNATIONAL GROUP, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	(Unaudited)		(Unaudited)	
	For the Three Months Ended September 30, 2011	September 30, 2010	For the Nine Months Ended September 30, 2011	September 30, 2010
<b>Results of Operations:</b>				
Revenue	\$ 7,681,732	\$ 21,000,377	\$ 27,812,160	\$ 60,770,283
Cost of revenue, excluding depreciation and amortization	4,718,065	17,753,803	16,811,234	51,859,226
Gross profit, excluding depreciation and amortization	2,963,667	3,246,574	11,000,926	8,911,057
<b>Operating expenses:</b>				
Selling, general and administrative	2,764,176	2,666,823	8,581,016	7,936,667
Depreciation and amortization	59,233	84,017	179,730	271,817
Total operating costs	2,823,409	2,750,840	8,760,746	8,208,484
Operating income	140,258	495,734	2,240,180	702,573
Interest income (expense), net	(27,440 )	(30,052 )	(62,023 )	(92,657 )
Other income (expense), net	-	-	919,084	-
Income before income taxes	112,818	465,682	3,097,241	609,916
Income tax expense	-	-	-	-
Net income	\$ 112,818	\$ 465,682	\$ 3,097,241	\$ 609,916
<b>Basic Earnings per Share:</b>				
Earnings per common share	\$ 0.01	\$ 0.03	\$ 0.23	\$ 0.05
Weighted average common shares outstanding	13,686,977	13,415,580	13,514,323	13,252,624
<b>Diluted Earnings per Share:</b>				
Earnings per common share	\$ 0.01	\$ 0.03	\$ 0.21	\$ 0.04
Weighted average common shares outstanding	14,915,336	14,229,238	14,857,206	14,083,280

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

FORTRESS INTERNATIONAL GROUP, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)  
For the Nine Months Ended

	September 30, 2011	September 30, 2010
<b>Cash Flows from Operating Activities:</b>		
Net income	\$ 3,097,241	\$ 609,916
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	179,730	271,817
Provision for doubtful accounts	90,000	-
Stock-based compensation	429,732	453,396
Extinguishment of contract liabilities	(310,168 )	-
Other non-cash items	(33,062 )	(36,484 )
Changes in operating assets and liabilities:		
Contracts and other receivables	3,876,501	(3,823,350 )
Costs and estimated earnings in excess of billings on uncompleted contracts	24,057	286,764
Prepaid expenses and other current assets	(269,774 )	(91,451 )
Other assets	16,353	199,470
Accounts payable and accrued expenses	(5,029,109 )	8,074,342
Billings in excess of costs and estimated earnings on uncompleted contracts	(5,018,602 )	2,994,052
Other liabilities	(44,274 )	(34,597 )
Net cash (used in) provided by operating activities	(2,991,375 )	8,903,875
<b>Cash Flows from Investing Activities:</b>		
Purchase of property and equipment	(137,535 )	(78,045 )
Proceeds from repayment of note in connection with the sale of substantially all assets and liabilities of Rubicon	135,512	279,756
Acquisition of Alletag, Inc.	(28,555 )	-
Net cash (used in) provided by investing activities	(30,578 )	201,711
<b>Cash Flows from Financing Activities:</b>		
Payments on notes payable	-	(4,915 )
Payment on seller notes	(180,000 )	(54,692 )
Purchase of treasury stock	(288,433 )	(120,021 )
Net cash used in financing activities	(468,433 )	(179,628 )
Net (decrease) increase in cash	(3,490,386 )	8,925,958
Cash, beginning of period	10,980,420	2,263,146
Cash, end of period	\$ 7,490,034	\$ 11,189,104
<b>Supplemental disclosure of cash flow information:</b>		
Cash paid for interest	\$ 107,910	\$ 277,570
<b>Supplemental disclosure of non-cash operating activities:</b>		
Interest forgiveness in settlement of SMLB seller notes	\$ 25,310	\$ -
<b>Supplemental disclosure of non-cash financing activities:</b>		

Edgar Filing: Fortress International Group, Inc. - Form 10-Q

Promissory notes, issued to an officer, converted to common stock	\$	-	\$	1,250,000
Principal forgiveness in settlement of SMLB seller notes		20,572		-

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



FORTRESS INTERNATIONAL GROUP, INC.  
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) Basis of Presentation

The unaudited condensed consolidated financial statements are as of September 30, 2011 and December 31, 2010 and for the three and nine months ended September 30, 2011 and 2010 for Fortress International Group, Inc. (“Fortress” or the “Company” or “We”).

The accompanying unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Certain information and note disclosures normally included in the annual financial statements, prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”), have been condensed or omitted pursuant to those rules and regulations. We recommend that you read these unaudited condensed consolidated financial statements in conjunction with the audited consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2010, previously filed with the SEC. We believe that the unaudited condensed consolidated financial statements in this Quarterly Report on Form 10-Q reflect all adjustments that are necessary to fairly present the financial position, results of operations and cash flows for the interim periods presented. The results of operations for such interim periods are not necessarily indicative of the results that can be expected for the full year.

Nature of Business and Organization

The Company provides a single source solution for highly technical mission-critical facilities such as data centers, operations centers, network facilities, server rooms, security operations centers, communications facilities and the infrastructure systems that are critical to their function. The Company’s services consist of technology consulting, design and engineering, construction management, systems installations and facilities management.

The Company’s focus is centered on growing long term cash reserves and net income, while attempting to organically grow profitability and corresponding cash flow. In response to the downturn in the economy during the past several years and continuing in 2011, the Company worked to increase project utilization and realign selling, general and administrative expenses through cost cutting measures. In our efforts to maintain and grow profitability, we will closely monitor our costs relative to actual and anticipated revenues and may make further reductions to operating costs.

In an effort to improve our capitalization and liquidity in 2010, the Company restructured scheduled debt repayments with its creditors. In addition to the added liquidity from the proceeds of the sale of Rubicon, the Company eliminated scheduled debt repayments through debt forgiveness of approximately \$0.5 million owed to the Chief Operating Officer (“COO”). On February 28, 2010, the Company improved its net worth through the principal conversion of \$1.3 million of principal due on a seller note to its COO. Furthermore, the principal repayment of the remaining \$2.8 million was amended to begin in the second quarter of 2012.

As a result of the cost reduction efforts to realign operations with decreased anticipated revenues undertaken during 2010, the resulting operating profitability and the financial restructuring of the \$4.0 million owed to our COO, management believes the Company’s current cash and cash equivalents and expected future cash generated from operations will satisfy its expected working capital, capital expenditure and investment requirements and financing obligations of \$0.3 million on convertible notes through the next twelve months.

Recently Issued Accounting Pronouncements

In December 2010, the FASB issued ASU No. 2010-29, “Business combinations – disclosure of supplementary pro forma information,” (“ASU 2010-29”) to amend topic ASC 805 “Business Combinations,” by improving disclosure requirements related to the business combinations performed during the year being reported on. Under the amended guidance, a public entity that presents comparative financial statements must disclose the pro forma revenue and earnings of the combined entity as though the business combination had occurred as of the beginning of the prior annual reporting period. The provision of ASU 2010-29 will be adopted in the event of future acquisitions.

In September 2011, the FASB issued guidance that simplified how entities test for goodwill impairment. This guidance permits entities to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform a two-step goodwill impairment test. This guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, and early adoption is permitted. The Company neither expects early adoption of the guidance nor the adoption to have a material effect on its financial statements.

FORTRESS INTERNATIONAL GROUP, INC.  
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## (2) Accounts Receivable, net

The Company had an accounts receivable allowance for doubtful accounts of \$0.1 and \$0.5 million at September 30, 2011 and December 31, 2010. The reduction in allowance of \$0.4 million was attributable to accounts receivable written off during the nine months ended September 30, 2011, as the Company ceased its collection efforts of certain previously reserved accounts. Bad debt expense for the three months ended September 30, 2011 and 2010 was zero. Bad debt expense for the nine months ended September 30, 2011 and 2010 was \$0.1 million and zero, respectively.

Included in accounts receivable was retainage associated with construction projects of zero and \$1.1 million at September 30, 2011 and December 31, 2010, respectively.

The Company earned approximately 27 % and 74% of its revenue from two customers for the three months ended September 30, 2011 and 2010, respectively. The Company earned approximately 39% and 72% of its revenue from two customers for the nine months ended September 30, 2011 and 2010, respectively. Accounts receivable from these customers at September 30, 2011 and December 31, 2010 was \$1.0 million and \$1.2 million, respectively.

## (3) Goodwill

On July 1, 2011, the Company acquired 100% of the issued and outstanding stock of Alletag Builders, Inc. (Alletag) for a cash purchase price of \$28,535, including acquisition costs. The Company acquired Alletag, as it sought to expand its operations in support of a particular customer opportunity.

## (4) Basic and Diluted Earnings per Share

Basic and diluted net earnings per common share are computed as follows:

	Three Months Ended September 30, 2011			2010		
	Income	Shares	\$ per Share	Income	Shares	\$ per Share
<b>BASIC EARNINGS PER SHARE</b>						
Net income	\$ 112,818	13,686,977	\$ 0.01	\$ 465,682	13,415,580	\$ 0.03
<b>EFFECT OF DILUTIVE SECURITIES</b>						
Unvested restricted stock	-	850,719	-	-	813,658	-
Unsecured convertible note	28,323	377,640	-	-	-	-
<b>DILUTED EARNINGS PER SHARE</b>						
	\$ 141,141	14,915,336	\$ 0.01	\$ 465,682	14,229,238	\$ 0.03

Nine Months Ended September 30,  
2011

2010

Edgar Filing: Fortress International Group, Inc. - Form 10-Q

	Income	Shares	\$ per Share	Income	Shares	\$ per Share
<b>BASIC EARNINGS PER SHARE</b>						
Net income	\$ 3,097,241	13,514,323	\$ 0.23	\$ 609,916	13,252,624	\$ 0.05
<b>EFFECT OF DILUTIVE SECURITIES</b>						
Unvested restricted stock	-	965,243	(0.02 )	-	830,656	(0.01 )
Unsecured convertible note	84,695	377,640	-	-	-	-
<b>DILUTED EARNINGS PER SHARE</b>	<b>\$ 3,181,936</b>	<b>14,857,206</b>	<b>\$ 0.21</b>	<b>\$ 609,916</b>	<b>14,083,280</b>	<b>\$ 0.04</b>

624,672 unvested shares of restricted stock and 377,640 shares associated with convertible notes that were outstanding at September 30, 2011 were included in the weighted average dilutive earnings per share calculation for the three and nine months ended September 30, 2011. While the convertible note was included in dilutive earnings per share, it did not impact the per share calculation.

87,167 unvested restricted stock units and options to purchase 700,000 shares of common stock that were outstanding at September 30, 2010 were not included in the computation of diluted net income per common share for the three and nine months ended September 30, 2010 because the restricted stock units vested only if the closing price per share of the Company's common stock was at least \$3.00 or expired out of the money. Additionally, for the three and nine months ended September 30, 2010, all convertible notes were omitted from the earnings per share calculation because the effect of conversion would be anti-dilutive.

FORTRESS INTERNATIONAL GROUP, INC.  
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(5) Employee Benefit Plans

Restricted Stock

For the three months ended September 30, 2011 and September 30, 2010, the Company granted 50,000 and 90,000 shares of restricted stock, respectively, under the 2006 Omnibus Incentive Compensation Plan (Stock Plan). For the three months ended September 30, 2011 and 2010, the Company recorded non-cash compensation expense included in selling, general and administrative expenses associated with vesting awards of \$0.1 million in both periods.

For the nine months ended September 30, 2011 and September 30, 2010, the Company granted 281,250 and 90,000 shares of restricted stock, respectively, under the Stock Plan. For the nine months ended September 30, 2011 and 2010, the Company recorded non-cash compensation expense included in selling, general and administrative expenses associated with vesting awards of \$0.4 million in both periods and in cost of revenue included \$0.1 million for both periods.

At September 30, 2011, there was approximately \$0.5 million of unrecognized stock compensation with a weighted average remaining life of approximately one year.

(6) Income Taxes

The Company accounts for income taxes under the asset and liability method. Deferred income taxes are provided for the temporary differences between the financial reporting and tax basis of the Company's assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse.

The Company is in a net operating loss carryover position. The net operating losses not utilized can be carried forward for 20 years to offset future taxable income. As of September 30, 2011 and December 31, 2010, a full valuation allowance has been recorded against the Company's deferred tax assets, as the Company has concluded that, under relevant accounting standards, it is more likely than not that the deferred tax assets will not be realizable.

The Company's effective tax rate is based upon the rate expected to be applicable to the full fiscal year.

The Company files a consolidated federal tax return in states that allow it, and in other states the Company files separate tax returns.

The Company's prior federal and state income tax filings since 2007 remain open under statutes of limitation. Innovative Power System Inc.'s statutes of limitation are open from the 2007 tax year forward for both federal and Commonwealth of Virginia purposes. Quality Power Systems Inc.'s statutes of limitation are open from the 2007 tax year forward for both federal and Commonwealth of Virginia purposes. SMLB, Ltd. statutes of limitation are open from the 2007 tax year forward for both federal and State of Illinois purposes.

FORTRESS INTERNATIONAL GROUP, INC.  
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## (7) Notes Payable

	September 30, 2011	December 31, 2010
Convertible, unsecured promissory note, due 2012 (4.0%)	\$ 2,832,301	\$ 2,750,000
Unsecured promissory note, due 2011 (6.0%)	-	120,572
Unsecured promissory note, due 2011 (6.0%)	-	80,000
Total debt	2,832,301	2,950,572
Less current portion	250,000	200,572
Total debt, less current portion	\$ 2,582,301	\$ 2,750,000

During the nine months ended September 30, 2011, the Company made its final payment of \$0.1 million and \$0.1 million on seller notes associated with the acquisition of Innovative Power Systems, Inc. (“Innovative”) and SMLB, Ltd. (“SMLB”), respectively. The Company paid \$0.1 million in settlement of the unsecured promissory notes held by the sellers of SMLB that previously were not paid on schedule at December 31, 2010. As part of the settlement, the Company received a full release that no other amounts were due under any of the provisions of the purchase agreement. The settlement resulted in extinguishment of principal and accrued interest totaling \$0.05 million, which was recorded in other income.

On February 28, 2010, the COO entered into an agreement with the Company to convert \$1.3 million of the outstanding note balance into equity at a conversion price of \$2.00 per share, resulting in the aggregate issuance of 625,000 shares of the Company’s common stock. The amount of the excess of the conversion price of \$2.00 over the market price at \$0.56 on the date of conversion totaling \$0.9 million has been recorded as additional paid-in capital. The shares will be subject to a Registration Rights Agreement between the Company and the COO. The terms on the remaining principal balance of \$2.8 million were amended reducing the interest rate under the note from 6% to 4%, providing for the payment of certain amounts of accrued interest over time, providing for interest-only payments under the note until April 1, 2012, providing for eight principal payments in the amount of \$125,000 each beginning on April 1, 2012, and providing for a final payment of all remaining amounts of principal and interest due under the note on April 1, 2014. The note amendment also provides for the acceleration of all amounts due under the note upon a change of control of the Company or the death of the COO.

FORTRESS INTERNATIONAL GROUP, INC.  
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(8) Related Party Transactions

The Company participates in transactions with the following entities affiliated through common ownership and management. The Audit Committee in accordance with its written charter reviews and approves in advance all related party transactions greater than \$25,000 and follows a pre-approved process for contracts with a related party for less than \$25,000.

S3 Integration, LLC (S3 Integration) is 15% owned by each of the Company's Chief Executive Officer and Chief Operating Officer. S3 Integration provides commercial security systems design and installation services as a subcontractor to the Company.

Chesapeake Systems, LLC (Chesapeake Systems) was 9% owned and significantly indebted to the Company's Chief Executive Officer until the sale of his equity interest and satisfaction of his note on December 31, 2010. Chesapeake Systems is a manufacturers' representative and distributor of mechanical and electrical equipment.

Chesapeake Mission Critical, LLC (Chesapeake MC) is 9% owned by each of the Company's Chief Executive Officer and its Chief Operating Officer. Additionally, it is significantly indebted to the Company's Chief Executive Officer. Chesapeake MC is a manufacturers' representative and distributor of electrical equipment.

CTS Services, LLC (CTS) is 9% owned by the Company's Chief Executive Officer. CTS is a mechanical contractor that acts as a subcontractor to the Company for certain projects. In addition, CTS utilizes the Company as a subcontractor on projects as needed.

Telco P&C, LLC (Telco P&C) is 12% owned by the Company's Chief Executive Officer. Telco P&C is a specialty electrical installation company that acts as a subcontractor to the Company. The Company has also acted as a subcontractor to Telco P&C as needed.

TPR Group Re Three, LLC (TPR Group Re Three) is 50% owned by each of the Company's Chief Executive Officer and its Chief Operating Officer. TPR Group Re Three leases office space to the Company under the terms of a real property lease. Upon entering the lease, the Company obtained an independent appraisal of the lease, which determined the lease to be at fair value.

Chesapeake Tower Systems, LLC (Chesapeake) is owned 100% by the Company's Chief Executive Officer. The Company leases approximately 25,000 square feet of combined office and warehouse space from Chesapeake. Upon entering the lease, the Company obtained an independent appraisal of the lease, which determined the lease to be at fair value.

E-Site Systems, LLC is a partnership formed during 2011 that was financed with initial debt capital of \$0.1 million by the Company's Chief Executive Officer. The Company is a manufacturers' representative and distributor of mechanical and electrical equipment. The Company has not entered into any contracts with the related entity greater than \$25,000 to date.

FORTRESS INTERNATIONAL GROUP, INC.  
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The following table sets forth transactions the Company has entered into with the above related parties for the three and nine months ended September 30, 2011 and 2010. It should be noted that revenue represents amounts earned on contracts with related parties under which we provide services; and cost of revenue represents costs incurred in connection with related parties which provide services to us on contracts for our customers. As such a direct relationship to the revenue and cost of revenue information below by company should not be expected.

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
<b>Revenue</b>				
CTS Services, LLC	\$ -	\$ 23,902	\$ -	\$ 23,902
Telco P&C, LLC	32,785	93,764	317,857	559,099
Chesapeake Systems	4,903	-	4,903	-
Chesapeake Mission Critical, LLC	21,392	9,031	303,358	20,531
<b>Total</b>	<b>\$ 59,081</b>	<b>\$ 126,697</b>	<b>\$ 626,118</b>	<b>\$ 603,532</b>
<b>Cost of Revenue</b>				
CTS Services, LLC	\$ -	\$ -	\$ 17,413	\$ 134,109
Chesapeake Systems, LLC	-	-	6,000	-
Chesapeake Mission Critical, LLC	2,200	47,490	73,391	135,257
S3 Integration, LLC	3,447	240,649	54,144	540,936
Telco P&C, LLC	-	-	-	37,278
<b>Total</b>	<b>\$ 5,647</b>	<b>\$ 288,139</b>	<b>\$ 150,947</b>	<b>\$ 847,579</b>
<b>Selling, general and administrative</b>				
<b>Office rent paid on Chesapeake</b>				
Tower Systsems	25,332	50,664	121,253	125,682
<b>Office rent paid to TPR Group Re</b>				
Three, LLC	107,049	122,047	321,148	323,901
<b>Total</b>	<b>\$ 132,381</b>	<b>\$ 172,711</b>	<b>\$ 442,401</b>	<b>\$ 449,583</b>

	September 30, 2011	December 31, 2010
<b>Accounts receivable/(payable):</b>		
CTS Services, LLC	\$ 8,555	\$ 17,555
CTS Services, LLC	1,400	-
Chesapeake Systems, LLC	6,621	-
Chesapeake Mission Critical, LLC	14,301	-
Chesapeake Tower Systems, Inc.	(12,666 )	-
Telco P&C, LLC	112,512	364,348
Telco P&C, LLC	-	(600 )
S3 Integration, LLC	(2,888 )	(25,924 )
TPR Group RE Three, LLC	(35,683 )	-
<b>Total Accounts receivable</b>	<b>\$ 143,389</b>	<b>\$ 381,903</b>
<b>Total Accounts (payable)</b>	<b>\$ (51,237 )</b>	<b>\$ (26,524 )</b>





FORTRESS INTERNATIONAL GROUP, INC.  
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(9) Subsequent Events

On November 8, 2011, the Company and its subsidiaries Innovative Power Systems, Inc., VTC, L.L.C., Total Site Solutions Arizona, LLC, and Alletag Builders, Inc. (together with the Company, collectively, "Borrowers") obtained a credit facility (the "Credit Facility") from Wells Fargo Bank, National Association ("Lender") pursuant to a Credit Agreement by and among Borrowers and Lender (the "Credit Agreement"). Borrowers' obligations under the Credit Facility are joint and several.

The maximum amount of the Credit Facility is \$2,000,000. The Credit Facility is subject to a borrowing base of 80% of eligible accounts receivable. Borrowings under the Credit Facility will bear interest at the London interbank offered rate plus 2.25% per annum. The Credit Facility matures on November 1, 2012.

The obligations under the Credit Facility are secured by substantially all of Borrowers' assets.

In addition to interest payable on the principal amount of indebtedness outstanding from time to time under the Credit Facility, Borrowers (a) paid a commitment fee equal to \$5,000 to Lender and (b) are required to pay to Lender a quarterly fee equal to 0.25% per annum on the average daily unused amount of the Credit Facility.

The Credit Agreement and ancillary documents include customary affirmative covenants for secured transactions of this type, including maintaining adequate books and records, periodic financial reporting, compliance with laws, maintenance of insurance, maintenance of assets, timely payment of taxes, and notice of adverse events. The Credit Agreement and ancillary documents include customary negative covenants, including limitations on use of funds, incurrence of other indebtedness, mergers, consolidations and transfers of assets, liens on assets of Borrowers, guaranties, loans, advances, investments, and dividends and distributions.

The Credit Facility requires that Borrowers' maintain the following financial covenants: (a) a maximum ratio of total liabilities to tangible net worth as set forth in the Credit Agreement; (b) a minimum debt service coverage ratio as set forth in the Credit Agreement; and (c) an amount of unencumbered liquid assets as set forth in the Credit Agreement.

The Credit Agreement and ancillary documents include customary events of default, including payment defaults, failure to perform or observe terms, covenants or agreements included in the Credit Agreement and ancillary documents, insolvency and bankruptcy defaults, judgment defaults, material adverse change defaults, dissolution and liquidation defaults, and change of control defaults.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion should be read in conjunction with our Financial Statements and related Notes thereto included elsewhere in this report.

The terms "we" and "our" and the "Company" as used throughout this Quarterly Report on Form 10-Q refer to Fortress International Group, Inc. and its consolidated subsidiaries, unless otherwise indicated.

Business Formation and Overview

We were incorporated in Delaware on December 20, 2004 as a special purpose acquisition company formed under the name "Fortress America Acquisition Corporation" for the purpose of acquiring an operating business that performs services in the homeland security industry. On July 20, 2005, we closed our initial public offering of 7,800,000 units (including underwriters' exercise of an over-allotment option), resulting in proceeds net of fees to us of approximately \$43.2 million.

On January 19, 2007, we acquired all of the outstanding membership interests of each of VTC, L.L.C., doing business as "Total Site Solutions" ("TSS"), and Vortech, L.L.C. ("Vortech" and, together with TSS, "TSS/Vortech") and simultaneously changed our name to "Fortress International Group, Inc." The acquisition fundamentally transformed the Company from a special purpose acquisition company to an operating business.

Building on the TSS/Vortech business, management continued an acquisition strategy to expand our geographical footprint, add complementary services, and diversify and expand our customer base. After acquiring TSS/Vortech, the Company continued its expansion through the acquisitions of Comm Site of South Florida, Inc. on May 7, 2007 ("Comm Site"), Innovative Power Systems, Inc. and Quality Power Systems, Inc. (collectively, "Innovative") on September 24, 2007, Rubicon Integration, LLC ("Rubicon") on November 30, 2007 and SMLB Ltd. ("SMLB") on January 2, 2008.

The Company's strategic growth through acquisitions was suspended due to the downturn in the economy, the impact this had on its existing customer base, and the impact it had on the Company's own financial security and common stock value. The corporate focus became centered on preserving cash, achieving positive cash flow and discontinuing or selling operations that threatened that focus. The Company engaged an investment bank to assist it in evaluating various disposition and financial alternatives, which culminated in the sale of the Rubicon division to its management and former owners on December 29, 2009.

Based on an unexpected lack of closed contracts and continued customer delays experienced during 2009, management revised our financial forecast and implemented selling, general and administrative cost cutting measures with an approximate annual savings of \$2.2 million. In an effort to attempt to achieve positive cash flows from operations and align costs with forecasted revenues in the future, the Company delisted from the NASDAQ Capital Market in March 2010 to reduce professional fees and other costs necessary to maintain a listing on the NASDAQ Capital Market.

We provide comprehensive services for the planning, design, and development of mission-critical facilities and information infrastructure. We also provide a single source solution for highly technical mission-critical facilities such as data centers, operation centers, network facilities, server rooms, security operations centers, communications facilities and the infrastructure systems that are critical to their function. Our services include technology consulting, engineering and design management, construction management, system installations, operations management, and facilities management and maintenance.

Competition in Current Economic Environment

Our industry has been and may be further adversely impacted by the current economic environment and tight credit conditions. We have seen larger competitors seek to expand their services offerings including a focus in the mission-critical market. These larger competitors have an infrastructure and support greater than ours, and accordingly, we have experienced some price pressure as some companies are willing to take on projects at lower margins. With certain customers, we have experienced a delay in spending, or deferral of projects to an indefinite commencement date due to the economic uncertainty or lack of access to capital.

We compete for business based upon our reputation, past experience, and our technical engineering knowledge of mission-critical facilities and their infrastructure. We are developing and creating long term relationships with our customers because of our excellent reputation in the industry and will continue to create facility management relationships with our customers that we expect will provide us with steadier revenue streams to improve the value of our business. Finally, we seek to further expand our energy services that focus on operational cost savings that may be used to either fund the project or increase returns to the facility operator. We believe our technical capabilities and experience will differentiate us to compete with new entrants into the market or pricing pressures.

Although we will closely monitor our proposal pricing and the volume of the work, we have seen our margins decrease in the current quarter and cannot be certain that our current margins will be sustained. Furthermore, given the economic environment, to the extent the volume of our contracts further decreases, we may have to take additional measures to reduce our operating costs.

### Contract Backlog

We believe an indicator of our future performance is our backlog of uncompleted projects in process or recently awarded. Our backlog represents our estimate of anticipated revenue from executed and awarded contracts that have not been completed and that we expect will be recognized as revenues over the life of the contracts. We have broken our backlog into the following three categories: (i) technology consulting, consisting of services related to consulting and/or engineering design contracts, (ii) construction management, and (iii) facility management.

Backlog is not a measure defined in generally accepted accounting principles, and our methodology for determining backlog may not be comparable to the methodology of other companies in determining their backlog. Our backlog is generally recognized under two categories: (1) contracts for which work authorizations have been or are expected to be received on a fixed-price basis, guaranteed maximum price basis or time and materials basis, and (2) contracts awarded to us where some, but not all, of the work has not yet been authorized. At September 30, 2011, we had authorizations to proceed with work for approximately \$27.2 million, or 76% of our total backlog of \$35.9 million. At December 31, 2010, we had authorizations to proceed with work for approximately \$13.9 million, or 45% of our total backlog of \$30.6 million.

Approximately \$27.8 million, or 69% of our backlog, relates to two customers at September 30, 2011 and \$25.9 million, or 85%, to four customers at December 31, 2010. Additionally, two customers who comprised 42% of our total backlog December 31, 2010 were purchased in 2010 and currently there is no related backlog from these customers. As a result of one of these acquisitions, a customer cancelled a contract during the second quarter 2011 resulted in a \$7.2 million reduction in backlog during that period.

As of September 30, 2011, our backlog was approximately \$35.9 million, compared to approximately \$30.6 million at December 31, 2010. We believe that approximately 80% of the backlog at September 30, 2011 will be recognized during the next twelve months. The following table reflects the value of our backlog in the above three categories as of September 30, 2011 and December 31, 2010, respectively.

(In millions)

	September 30, 2011	December 31, 2010
Technology consulting	\$ 9.2	\$ 9.9
Construction management	18.6	7.5
Facilities management	8.1	13.2
Total	\$ 35.9	\$ 30.6



## Critical Accounting Policies and Estimates

Our financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America, or GAAP. The preparation of the financial statements included elsewhere in this Quarterly Report on Form 10-Q requires that management make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ significantly from those estimates.

We believe the following critical accounting policies affect the more significant estimates and judgments used in the preparation of our financial statements.

### Revenue Recognition

We recognize revenue when pervasive evidence of an arrangement exists, the contract price is fixed or determinable, services have been rendered or goods delivered, and collectability is reasonably assured. Our revenue is derived from the following types of contractual arrangements: fixed-price contracts, time-and-materials contracts and cost-plus-fee contracts (including guaranteed maximum price contracts). Revenue from fixed-price contracts is accounted for under the application of ASC 605-35 Construction-Type and Certain Production-Type Contracts, recognizing revenue on the percentage-of-completion method using costs incurred in relation to total estimated project costs. The cost to total cost method is used because management considers costs incurred and costs to complete to be the best available measure of progress in the contracts. Contract costs include all direct materials, subcontract and labor costs and those indirect costs related to contract performance, such as indirect labor, payroll taxes, employee benefits and supplies.

Revenue on time-and-material contracts is recognized based on the actual labor hours performed at the contracted billable rates, and costs incurred on behalf of the customer. Revenue on cost-plus-fee contracts is recognized to the extent of costs incurred, plus an estimate of the applicable fees earned. Fixed fees under cost-plus-fee contracts are recorded as earned in proportion to the allowable costs incurred in performance of the contract.

Contract revenue recognition inherently involves estimation. Examples of estimates include the contemplated level of effort to accomplish the tasks under the contract, the costs of the effort and an ongoing assessment of the Company's progress toward completing the contract. From time to time, as part of our standard management process, facts develop that require us to revise our estimated total costs on revenue. To the extent that a revised estimate affects contract profit or revenue previously recognized, we record the cumulative effect of the revision in the period in which the revisions become known. The full amount of an anticipated loss on any type of contract is recognized in the period in which it becomes probable and can reasonably be estimated.

Under certain circumstances, we may elect to work at risk prior to receiving an executed contract document. We have a formal procedure for authorizing any such at risk work to be incurred. Revenue, however, is deferred until a contract modification or vehicle is provided by the customer.

### Allowance for Doubtful Accounts

The allowance for doubtful accounts is our best estimate of the amount of probable credit losses in our existing accounts receivable. We determine the allowance based on an analysis of our historical experience with bad debt write-offs and an aging of the accounts receivable balance. Unanticipated changes in the financial condition of clients, or significant changes in the economy could impact the reserves required. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote.

### Non-cash Compensation

The Company applies the fair value method that requires all share-based payments to employees be expensed over their requisite service period based on their fair value at the grant date. The recognition of the value of the instruments results in compensation or professional expenses in our financial statements. The expense differs from other compensation and professional expenses in that these charges are typically settled through the issuance of common stock, which would have a dilutive effect upon earnings per share, if and when such restricted stock vests. The determination of the estimated fair value used to record the compensation or professional expenses associated with the equity or liability instruments issued requires management to make a number of assumptions and estimates that can change or fluctuate over time.

#### Goodwill and Other Purchased Intangible Assets

Goodwill represents the excess of costs over fair value of net assets of businesses acquired. Other purchased intangible assets include the fair value of items such as customer contracts, backlog and customer relationships. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but rather tested for impairment on an annual basis or triggering event. Purchased intangible assets with a definite useful life are amortized on a straight-line basis over their estimated useful lives.



The estimated fair market value of identified intangible assets with definitive lives are amortized over the estimated useful life of the related intangible asset. We have a process pursuant to which we typically retain third-party valuation experts to assist us in determining the fair market values and useful lives of identified intangible assets. We evaluate these assets for impairment when events occur that suggest a possible impairment. Such events could include, but are not limited to, the loss of a significant client or contract, decreases in federal government appropriations or funding for specific programs or contracts, or other similar events. We determine impairment by comparing the net book value of the asset to its future undiscounted net cash flows. If impairment occurs, we will record an impairment expense equal to the difference between the net book value of the asset and its estimated discounted cash flows using a discount rate based on our cost of capital and the related risks of recoverability.

#### Long-Lived Assets (Excluding Goodwill)

In accordance with the accounting guidance related to accounting for long-lived assets such as property, equipment and intangible assets subject to amortization, we review the assets for impairment. If circumstances indicate the carrying value of the asset may not be fully recoverable, a loss is recognized at the time impairment exists and a permanent reduction in the carrying value of the asset is recorded. We believe that the carrying values of our long-lived assets as of September 30, 2011 are fully realizable.

#### Income Taxes

Deferred income taxes are provided for the differences between the basis of assets and liabilities for financial reporting and income tax purposes. Deferred tax assets and liabilities are measured using tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. A valuation allowance is established when necessary to reduce deferred tax assets to the amount expected to be realized.

We make certain estimates and judgments in determining income tax expense for financial statement purposes. These estimates and judgments occur in the calculation of certain tax assets and liabilities, which principally arise from differences in the timing of recognition of revenue and expense for tax and financial statement purposes. We also must analyze income tax reserves, as well as determine the likelihood of recoverability of deferred tax assets, and adjust any valuation allowances accordingly. Considerations with respect to the recoverability of deferred tax assets include the period of expiration of the tax asset, planned use of the tax asset, and historical and projected taxable income, as well as tax liabilities for the tax jurisdiction to which the tax asset relates. Valuation allowances are evaluated periodically and will be subject to change in each future reporting period as a result of changes in one or more of these factors.

We adopted ASC 740 Income Taxes, which prescribes a more-likely-than-not threshold of financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on de-recognition of income tax assets and liabilities, classification of current and deferred tax assets and liabilities, accounting for interest and penalties associated with tax positions, accounting for income taxes in interim periods and income tax disclosures. As of September 30, 2011, we do not have any material gross unrecognized tax benefit liabilities.

#### Recently Issued Accounting Pronouncements

In December 2010, the FASB issued ASU No. 2010-29, "Business combinations – disclosure of supplementary pro forma information," ("ASU 2010-29") to amend topic ASC 805 "Business Combinations," by improving disclosure requirements related to the business combinations performed during the year being reported on. Under the amended guidance, a public entity that presents comparative financial statements must disclose the pro forma revenue and earnings of the combined entity as though the business combination had occurred as of the beginning of the prior annual reporting period. The adoption of ASU 2010-29 did not have a material impact on the Company's condensed

consolidated financial statements.

In September 2011, the FASB issued guidance that simplified how entities test for goodwill impairment. This guidance permits entities to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform a two-step goodwill impairment test. This guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, and early adoption is permitted. The Company neither expects early adoption of the guidance nor the adoption to have a material effect on its financial statements.

Results of operations for the three months ended September 30, 2011 compared with the three months ended September 30, 2010.

Revenue. Revenue decreased \$13.3 million to \$7.7 million for the three months ended September 30, 2011 from \$21.0 million for the three months ended September 30, 2010. The decrease primarily relates to a \$14.8 million decrease in construction management services driven by a large project that was substantially complete in the second quarter of 2011 as compared to its full production in the third quarter of 2010. The decrease was offset in part by an increase of \$1.3 million in our facilities management services over the comparable periods.

Cost of Revenue. Cost of revenue decreased \$13.1 million to \$4.7 million for the three months ended September 30, 2011 from \$17.8 million for the three months ended September 30, 2010. The decrease in revenue described above from construction management services was the primary driver for the decrease in cost of revenue.

Gross Margin Percentage. Gross margin percentage increased to 38.6% for the three months ended September 30, 2011 compared to 15.5% for the three months ended September 30, 2010. The increase in gross margin percentage is attributable to a mix of our services as construction management services that typically have lower margins comprised 29% of total sales as compared to 81% in the prior year and the effect of a large construction management project entering its final stages of completion, whereby claims associated with delivered product were concluded favorably.

A single customer comprised 26% and 60% of gross margin dollars for the three months ended September 30, 2011 and 2010, respectively. We anticipate gross margin percentage to decrease in the future as anticipated construction management projects commence.

Selling, general and administrative expenses. Selling, general and administrative expenses increased \$0.1 million to \$2.8 million for the three months ended September 30, 2011 from \$2.7 million for the three months ended September 30, 2010. The increase is primarily driven by \$0.4 million increase due almost equally to an increase in salaries and related costs and increased variable compensation from improved profitability, offset by \$0.2 million in collected accounts receivable previously written off, and \$0.1 million in aggregate reductions in professional fees and office related costs. We will continue to closely monitor our bookings and anticipated revenues, and we may take future actions to reduce operating costs associated with personnel and related costs in an effort to remain profitable.

Depreciation. Depreciation remained consistent at \$0.1 million for the three months ended September 30, 2011 compared to \$0.1 million for the three months ended September 30, 2010.

Interest income (expense), net. Interest income (expense), net remained consistent at (\$0.03) million for the three months ended compared to (\$0.03) million for the three months ended September 30, 2011.

Results of operations for the nine months ended September 30, 2011 compared with the nine months ended September 30, 2010.

**Revenue.** Revenue decreased \$33.0 million to \$27.8 million for the nine months ended September 30, 2011 from \$60.8 million for the nine months ended September 30, 2010. The decrease primarily relates to a \$35.4 million decrease in construction management services driven by a large construction management project that was entering final stages and was substantially complete in the second quarter of 2011 as compared to it being in full production during the nine months ended September 30, 2010. The decrease was offset in part by an increase of \$3.5 million in our facilities management services over the comparable periods.

**Cost of Revenue.** Cost of revenue decreased \$35.1 million to \$16.8 million for the nine months ended September 30, 2011 from \$51.9 million for the nine months ended September 30, 2010. The decrease in revenue described above was the primary driver for the decrease in cost of revenue.

**Gross Margin Percentage.** Gross margin percentage increased to 39.6% for the nine months ended September 30, 2011 compared to 14.7% for the nine months ended September 30, 2010. The increase in gross margin percentage is attributable to a mix of our services as construction management services that typically have lower margins comprised 41% of total sales as compared to 77% in the prior year, and the effect of a large construction management project entered its final stages of completion, whereby claims and estimates related to disputed change orders were concluded favorably.

A single customer comprised 48% and 46% of gross margin dollars for the nine months ended September 30, 2011 and 2010, respectively. We anticipate gross margin percentage to decrease in the future as anticipated construction management projects commence.

**Selling, general and administrative expenses.** Selling, general and administrative expenses increased \$0.7 million to \$8.6 million for the nine months ended September 30, 2011 from \$7.9 million for the nine months ended September 30, 2010. The increase is primarily driven by \$1.2 million increase due almost equally to increased salaries and related costs due to a reinstatement of previously reduced salaries in the second half of 2010 and variable compensation from improved profitability. The increase was partially offset by \$0.3 million in collected accounts receivable previously written off, and \$0.2 million in aggregate reductions in professional fees and office related costs. We will continue to closely monitor our bookings and anticipated revenues, and we may take future actions to reduce operating costs associated with personnel and related costs in an effort to remain profitable.

**Depreciation.** Depreciation decreased \$0.1 million to \$0.2 million for the nine months ended September 30, 2011 compared to \$0.3 million for the nine months ended September 30, 2010. The decrease in depreciation expense is a result of a slight decrease in the average depreciable asset balance as certain assets reached their fully depreciable lives.

**Interest income (expense), net.** Our interest income (expense), net decreased \$0.03 million to (\$0.06) million for the nine months ended September 30, 2011 compared to (\$0.09) million for the nine months ended September 30, 2010. The decrease is due to lower average balances from principal repayments and settlement of notes.

**Other income (expense), net.** Other income (expense), net increased \$0.9 million to \$0.9 million for the nine months ended September 30, 2011 compared to zero for the nine months ended September 30, 2010. The increase was primarily a result of the Company settling a dispute relating to a potential project. The parties reached a mutual settlement that included a general release through the date of the agreement. As the settlement was unrelated to an existing customer contract or ongoing customer relationship, it has been included as other income.



## Financial Condition, Liquidity and Capital Resources

	For the Nine Months Ended September 30,		
	2011	2010	Change
Net income	\$ 3,097,241	\$ 609,916	\$ 2,487,325
Adjustments to reconcile net income to net cash (used in) provided by operations:			
Depreciation and amortization	179,730	271,817	(92,087 )
Stock and warrant-based compensation	429,732	453,396	(23,664 )
Provision for doubtful accounts	90,000	-	90,000
Extinguishment of contract liabilities	(310,168 )	-	(310,168 )
Other non-cash items	(33,062 )	(36,484 )	3,422
Net adjustments to reconcile net income for non-cash items	356,232	688,729	(332,497 )
Net change in working capital	(6,444,848 )	7,605,230	(14,050,078 )
Cash (used in) provided by operations	(2,991,375 )	8,903,875	(11,895,250 )
Cash (used in) provided by investing	(30,578 )	201,711	(232,289 )
Cash used in financing	(468,433 )	(179,628 )	(288,805 )
Net (decrease) increase in cash	\$ (3,490,386 )	\$ 8,925,958	\$ (12,416,344 )

Cash and cash equivalents decreased \$3.5 million to \$7.5 million at September 30, 2011 from \$11.0 million at December 31, 2010. The decrease was primarily attributable to \$3.0 million used in operating activities driven by a \$6.4 million decrease in working capital.

## Operating Activity

Net cash used by operating activities totaled \$3.0 million for the nine months ended September 30, 2011 compared to \$8.9 million provided by operating activities for the nine months ended September 30, 2010. The \$11.9 million decrease in operating cash flow was attributable to a \$14.1 million decrease in working capital, offset in part by an increase in net income of \$2.5 million. The decrease in working capital was attributable primarily to a significant project being completed during the nine months ended September 30, 2011 as compared to the same project under full production and being billed ahead during the nine months ended September 30, 2010. The result of the project concluding attributed primarily to the decrease in billings in excess of costs and accounts payable of \$5.0 million and \$5.0 million, respectively, for the nine months ended September 30, 2011.

## Investing Activity

Net cash used in investing activities increased \$0.2 million to \$0.03 million used in for the nine months ended September 30, 2011 from \$0.2 million provided by for the nine months ended September 30, 2010. The \$0.2 million increase in use of cash related primarily to a decrease in scheduled proceeds from repayment of a seller note issued in conjunction with the disposition of Rubicon. At September 30, 2011, the note receivable balance was \$0.03 million which is scheduled to be repaid in full in the fourth quarter 2011.

## Financing Activity

Net cash used in financing increased \$0.3 million to \$0.5 million for the nine months ended September 30, 2011 from \$0.2 million for the nine months ended September 30, 2010. The increase was due to a \$0.2 million increase in treasury stock repurchases associated with payment of taxes on the vesting of restricted stock held by employees, and the remaining \$0.1 million increase is from scheduled and final balloon principal repayments on seller notes due to the

Innovative and SMLB sellers.

17

---

## Non-Cash Financing Activity

During the nine months ended September 30, 2011, we paid \$0.1 million in settlement of the unsecured promissory notes held by the sellers of SMLB that previously were not paid on schedule at December 31, 2010. As part of the settlement, we received a full release that no other amounts were due under any of the provisions of the purchase agreement. The settlement resulted in extinguishment of principal and accrued interest totaling \$0.05 million, which was recorded in other income.

On February 28, 2010, we entered into an agreement with our Chief Operating Officer (“COO”) to convert \$1.3 million of the outstanding note balance held by him into equity at a conversion price of \$2.00 per share, resulting in the aggregate issuance of 625,000 shares of our common stock. The amount of the excess of the conversion price of \$2.00 over the market price at \$0.56 on the date of conversion totaling \$0.9 million has been recorded as additional paid-in capital. The shares will be subject to a Registration Rights Agreement between us and the COO. The terms on the remaining principal balance of \$2.8 million were amended reducing the interest rate under the note to 4%, providing for the payment of certain amounts of accrued interest over time, providing for interest-only payments under the note until April 1, 2012, providing for eight principal payments in the amount of \$125,000 each beginning on April 1, 2012, and providing for a final payment of all remaining amounts of principal and interest due under the note on April 1, 2014. The note amendment also provides for the acceleration of all amounts due under the note upon a change of control of the Company or the death of the COO.

There were no other non-cash activities during the three and nine months ended September 30, 2011 and 2010, respectively.

## Adjusted EBITDA

A reconciliation of Adjusted EBITDA to net income:

	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2011	September 30, 2010	September 30, 2011	September 30, 2010
Net income	\$ 112,818	\$ 465,682	\$ 3,097,241	\$ 609,916
Interest (income) expense, net	27,440	30,052	62,023	92,657
Income tax expense (benefit)	-	-	-	-
Depreciation and amortization	59,233	84,017	179,730	271,817
EBITDA	\$ 199,491	\$ 579,751	\$ 3,338,994	\$ 974,390
Stock based compensation	87,549	98,052	429,715	453,396
Other income (expense), net	-	-	(919,084 )	-
Lease exit costs	-	-	(33,062 )	19,888
Provision for bad debts	-	-	90,000	-
Adjusted EBITDA	\$ 287,040	\$ 677,803	\$ 2,906,563	\$ 1,447,674

Adjusted EBITDA decreased \$0.4 million to \$0.3 million in the three months ended September 30, 2011 from \$0.7 million for the three months ended September 30, 2010. The decrease was primarily driven by reduction in gross profit for the three months ended September 30, 2011. Please refer to the preceding discussion within this “Results of Operations” section.

Adjusted EBITDA increased \$1.5 million to \$2.9 million in the nine months ended September 30, 2011 from \$1.4 million for the nine months ended September 30, 2010. The increase was primarily driven by increased gross profit for the nine months ended September 30, 2011. Please refer to the preceding discussion within this “Results of



Operations” section.

18

---

Adjusted EBITDA is a supplemental financial measure not defined in GAAP. We define Adjusted EBITDA as net income before interest expense, income taxes, depreciation and amortization, impairment loss on goodwill and other intangibles, net, stock-based compensation, other income (expense), net, lease exit costs, and provision for bad debts. We present Adjusted EBITDA because we believe this supplemental measure of operating performance is helpful in comparing our operating results across reporting periods on a consistent basis by excluding items that may, or could, have a disproportionate positive or negative impact on our results of operations in any particular period. We also use Adjusted EBITDA as a factor in evaluating the performance of certain management personnel when determining incentive compensation. We believe that the line item on the consolidated statement of operations entitled “net income” is the most directly comparable GAAP financial measure to Adjusted EBITDA. Since Adjusted EBITDA is not a measure of performance calculated in accordance with GAAP, it should not be considered in isolation of, or as a substitute for, net income as an indicator of operating performance or any other GAAP financial measure. Adjusted EBITDA, as calculated by us, may not be comparable to similarly titled measures employed by other companies. In addition, this measure does not necessarily represent funds available for discretionary use and is not necessarily a measure of our ability to fund our cash needs. As Adjusted EBITDA excludes certain financial information that is included in net income attributable to the Company, users of this financial information should consider the type of events and transactions that are excluded. Our non-GAAP performance measure, Adjusted EBITDA, has certain material limitations as follows:

It does not include impairment loss on goodwill and other intangibles, net. Because we utilize goodwill and other intangibles to generate revenues in our operations, this is a periodic and ongoing cost of our operations.

It does not include stock-based compensation. Stock based compensation is a necessary and ongoing part of our costs and has assisted us in reducing our cash compensation to attract and retain our workforce who support and generate revenues. Stock-based compensation will remain a key element of our overall compensation program.

It does not include provision for bad debts. Provision for bad debts is necessary as we take credit risk with customers and is an ongoing part of our operations.

It does not include other income (expense). Other income (expense) is necessary as it is an ongoing part of our operations.

It does not include lease exit costs. Lease exit costs are necessary as we manage the utilization of space based on our work force requirements and it's an ongoing part of our operations.

It does not include interest expense. Because we have borrowed money to finance some of our operations, interest is a necessary and ongoing part of our costs and has assisted us in generating revenue.

It does not include taxes. The payment of taxes is a necessary and ongoing part of our operations.

It does not include depreciation and amortization. Because we must utilize property, plant and equipment and intangible assets in order to generate revenues in our operations, depreciation and amortization are necessary and ongoing costs of our operations.

Other companies in our industry may calculate Adjusted EBITDA differently than we do, limiting its usefulness as a comparative measure.

## Liquidity and Capital Resources

We had \$7.5 million and \$11.0 million of unrestricted cash and cash equivalents at September 30, 2011 and December 31, 2010, respectively. During the nine months ended September 30, 2011, we have financed our operations primarily with cash on hand.

Our current corporate focus is centered on growing our cash reserves and net income, while attempting to organically grow profitability and corresponding cash flow. While our cash has declined \$3.5 million from year end, our total working capital has increased \$3.1 million to \$8.4 million at September 30, 2011 from \$5.3 million at December 31, 2010. In response to the downturn in the economy during the past several years and continuing in 2011, we worked to increase project utilization and realign selling, general and administrative expenses through cost cutting measures. While we have experienced a decline in revenue this year from the prior year, we aim to increase sales productivity by realigning our sale focus and supporting productivity measures through further implementation of sales reporting tools. Our efforts to maintain and grow profitability include closely monitoring our costs relative to actual and anticipated revenues and may make further reductions to operating costs.

In an effort to improve our capitalization and liquidity in 2010, we sought to restructure scheduled debt repayments with our creditors. In addition to the added liquidity from the proceeds of the sale of Rubicon, we eliminated scheduled debt repayments through debt forgiveness of approximately \$0.5 million owed to the COO. On February 28, 2010, we improved our net worth through the principal conversion of \$1.3 million of principal due on a seller note to our COO. Furthermore, the principal repayment of the remaining \$2.7 million was amended to begin in the second quarter of 2012. To add further liquidity, we may seek an operating line of credit to complement normal course of business working capital demands, which may also enhance our bonding capability.

As a result of the cost reduction efforts to realign operations with decreased anticipated revenues undertaken through 2010, the resulting operating profitability and the prior year financial restructuring of the \$4.0 million note to our COO, we believe that our current cash and cash equivalents and expected future cash generated from operations will satisfy our expected working capital, capital expenditure and investment requirements and financing obligations including through the next twelve months. The next twelve month financing obligations are anticipated to total approximately \$0.3 million related to debt services of existing seller notes. Any excess cash from operations after investing and scheduled financing commitments will be used to increase cash reserves and strategically invest in growing a productive sales force. If we experience an increase in revenue, we will attempt to maximize a fixed operating structure and attempt to take a measured approach in any increase to selling, general and administrative costs to support that additional revenue.

Subsequent to the quarter end on November 8, 2011, the Company entered into a one year revolving credit facility for added liquidity to be used for working capital purposes. The revolving facility makes available up to a maximum of \$2.0 million of credit with a borrowing base of 80% of eligible receivables at an interest rate of 30 day LIBOR plus 225 basis points. The lender has a first lien on all Company assets and the line is subject to certain financial covenants. See Note 8 of the financial statements for further detail.

We may elect to secure additional capital in the future, at acceptable terms, to further improve or add to our liquidity or fund acquisitions. The amounts involved in any such transaction, individually or in the aggregate, may be material. To the extent that we raise additional capital through the sale of equity securities, the issuance of such securities could result in dilution to our existing stockholders. If we raise additional funds through the issuance of debt securities, the terms of such debt could impose additional restrictions on our operations.

#### Off Balance Sheet Arrangements

As of September 30, 2011, we do not have any off balance sheet arrangements.

#### Item 3. Quantitative and Qualitative Disclosures about Market Risk.

The information called for by this item is not required as we are a smaller reporting company.

#### Item 4. Controls and Procedures.

Our management performed an evaluation under the supervision and with the participation of our Chief Executive Officer (principal executive officer) and our Chief Financial Officer (principal financial officer) of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended) as of September 30, 2011. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that as of September 30, 2011, our disclosure controls and procedures were effective.

#### Changes in Internal Control over Financial Reporting

There were no changes in the Company's internal control over financial reporting for the third quarter of 2011 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting as such term is defined in Rule 13a-15 and 15d-15 of the Securities Exchange Act of 1934, as amended.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

We are not a party to any material litigation in any court, and management is not aware of any contemplated proceeding by any governmental authority against us. From time to time, we are involved in various legal matters and proceedings concerning matters arising in the ordinary course of business. We currently believe that any ultimate liability arising out of these matters and proceedings will not have a material adverse effect on our financial position, results of operations or cash flows.

Item 1A. Risk Factors.

In addition to the other information set forth in this Form 10-Q, you should carefully consider the factors discussed in Part I, “Item 1A: Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2010, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks that we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q and, in particular, our Management’s Discussion and Analysis of Financial Condition and Results of Operations set forth in Part I—Item 2 contain or incorporate a number of forward-looking statements. These forward-looking statements can be identified by the use of forward-looking terminology, including the words “believes,” “anticipates,” “plans,” “expects” and similar expressions that are intended to identify forward-looking statements. You should read such statements carefully because they discuss our future expectations, contain projections of our future results of operations or of our financial position, or state other forward-looking information. There are a number of factors that could cause actual events or results to differ materially from those indicated by such forward-looking statements, many of which are beyond our control, including the factors set forth under “Item 1A. Risk Factors” of our 2010 Annual Report on Form 10-K

Any or all of our forward-looking statements in this Quarterly Report on Form 10-Q may turn out to be wrong. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Many factors mentioned in our discussion in this Quarterly Report on Form 10-Q will be important in determining future results. Consequently, no forward-looking statement can be guaranteed. Actual future results may vary materially. In addition, the forward-looking statements contained herein represent our estimate only as of the date of this filing and should not be relied upon as representing our estimate as of any subsequent date. While we may elect to update these forward-looking statements at some point in the future, we specifically disclaim any obligation to do so to reflect actual results, changes in assumptions or changes in other factors affecting such forward-looking statements.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

Monthly Period During the Three	Total Shares	Average Price Paid	Total Shares Purchased as Part of Publicly Announced	Approximate Dollar Amount of Shares Yet To Be Purchased Under

Edgar Filing: Fortress International Group, Inc. - Form 10-Q

Months Ended September 30, 2010	Purchased (a)	per Share	Plans	Plans
July 1, 2011-July 31, 2011	-	\$ -	-	-
August 1, 2011- August 31, 2011	127,877	1.85	-	-
September 1, 2011-September 30, 2011	-	-	-	-
Total	127,877	\$ 1.85	-	-

(a) All of these shares were acquired from associates to satisfy tax withholding requirements upon the vesting of restricted stock.

Item 3. Defaults upon Senior Securities.

Not applicable.

Item 4. (Removed and Reserved).

Item 5. Other Information.

Not applicable.

Item 6. Exhibits.

10.1 Credit agreement, among Fortress International Group, Inc., Innovative Power Systems, Inc., VTC LLC, Total Site Solutions Arizona, LLC, Alletag Builders, Inc. and Wells Fargo Bank, National Association, is incorporated herein by reference to the Form 8-K filed with the SEC by Company on November 9, 2011.

10.2 Revolving Line of Credit Note, made by Fortress International Group, Inc., Innovative Power Systems, Inc., VTC LLC, Total Site Solutions Arizona, LLC, Alletag Builders, Inc. payable to the order of Wells Fargo Bank, National Association, is incorporated herein by reference to the Form 8-K filed with the SEC by Company on November 9, 2011.

31.1\* Certification of Fortress International Group, Inc. Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2\* Certification of Fortress International Group, Inc. Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1‡ Certification of Fortress International Group, Inc. Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

---

\* Filed herewith.

‡ Furnished herewith.



SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FORTRESS INTERNATIONAL GROUP, INC.

Date: November 14, 2011

By: /s/ Thomas P. Rosato  
Thomas P. Rosato  
Chief Executive Officer  
(Authorized Officer  
and Principal Executive Officer)

Date: November 14, 2011

By: /s/ Timothy C. Dec  
Timothy C. Dec  
Chief Financial Officer (Authorized  
Officer  
and Principal Financial Officer)