

Fortress International Group, Inc.
Form 10-Q
November 15, 2010

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, 2010

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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, 2010 14,268,494

FORTRESS INTERNATIONAL GROUP, INC.

Table of Contents

	Page
PART I - FINANCIAL INFORMATION	
Item 1. Financial Statements	2
Condensed Consolidated Balance Sheets as of September 30, 2010 and as of December 31, 2009	2
Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2010 and September 30, 2009	3
Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2010 and September 30, 2009	4
Notes to Condensed Consolidated Financial Statements	5
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	12
Item 3. Quantitative and Qualitative Disclosures about Market Risk	19
Item 4T. Controls and Procedures	19
PART II - OTHER INFORMATION	
Item 1. Legal Proceedings	20
Item 1A. Risk Factors	20
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	20
Item 3. Defaults upon Senior Securities	21
Item 4. Removed and reserved.	21
Item 5. Other Information	21
Item 6. Exhibits	21
SIGNATURES	22

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

FORTRESS INTERNATIONAL GROUP, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

	(Unaudited)	
	September 30, 2010	December 31, 2009
Assets		
Current Assets		
Cash and cash equivalents	\$ 11,189,104	\$ 2,263,146
Contract and other receivables, net	18,020,122	14,196,772
Costs and estimated earnings in excess of billings on uncompleted contracts	769,779	1,056,543
Prepaid expenses and other current assets	819,066	1,007,371
Total current assets	30,798,071	18,523,832
Property and equipment, net	418,797	612,569
Goodwill	3,811,127	3,811,127
Other intangible assets, net	60,000	60,000
Other assets	46,748	246,218
Total assets	\$ 35,134,743	\$ 23,253,746
Liabilities and Stockholders' Equity		
Current Liabilities		
Notes payable, current portion	\$ 276,415	\$ 183,679
Accounts payable and accrued expenses	16,076,516	8,038,658
Billings in excess of costs and estimated earnings on uncompleted contracts	9,530,804	6,536,752
Total current liabilities	25,883,735	14,759,089
Notes payable, less current portion	-	152,343
Convertible notes, less current portion	2,750,000	4,000,000
Other liabilities	152,308	186,905
Total liabilities	28,786,043	19,098,337
Commitments and Contingencies	-	-
Stockholders' Equity		
Preferred stock- \$.0001 par value; 1,000,000 shares authorized; no shares issued or outstanding	-	-
Common stock- \$.0001 par value, 100,000,000 shares authorized; 13,882,738 and 13,142,962 issued; 13,415,580 and 12,846,709 outstanding at September 30, 2010 and December 31, 2009, respectively	1,388	1,314
Additional paid-in capital	65,146,118	63,442,796
Treasury stock 467,158 and 296,253 shares at cost at September 30, 2010 and December 31, 2009, respectively	(1,079,992)	(959,971)
Accumulated deficit	(57,718,814)	(58,328,730)
Total stockholders' equity	6,348,700	4,155,409
Total liabilities and stockholders' equity	\$ 35,134,743	\$ 23,253,746

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

2

FORTRESS INTERNATIONAL GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	(Unaudited) For the Three Months Ended		(Unaudited) For the Nine Months Ended	
	September 30, 2010	September 30, 2009	September 30, 2010	September 30, 2009
Results of Operations:				
Revenue	\$ 21,000,377	\$ 10,093,152	\$ 60,770,283	\$ 39,098,772
Cost of revenue	17,753,803	7,971,151	51,859,226	32,695,686
Gross profit	3,246,574	2,122,001	8,911,057	6,403,086
Operating expenses:				
Selling, general and administrative	2,666,823	2,580,812	7,936,667	10,232,936
Depreciation and amortization	84,017	100,154	271,817	305,975
Amortization of intangibles	-	6,325	-	919,227
Impairment loss on goodwill and other intangibles	-	-	-	10,254,910
Total operating costs	2,750,840	2,687,291	8,208,484	21,713,048
Operating income (loss)	495,734	(565,290)	702,573	(15,309,962)
Interest income (expense), net	(30,052)	(55,321)	(92,657)	(143,381)
Income (loss) from continuing operations before income taxes	465,682	(620,611)	609,916	(15,453,343)
Income tax expense	-	-	-	-
Net income (loss) from continuing operations	465,682	(620,611)	609,916	(15,453,343)
Income (loss) from discontinued operations, net of taxes	-	640,366	-	(2,311,174)
Net income (loss)	\$ 465,682	\$ 19,755	\$ 609,916	\$ (17,764,517)
Basic Earnings (Loss) per Share:				
Net income (loss) from continuing operations, net of tax	\$ 0.03	\$ (0.05)	\$ 0.05	\$ (1.22)
Income (loss) from discontinued operations, net of taxes	-	0.05	-	(0.18)
Net income (loss)	\$ 0.03	\$ 0.00	\$ 0.05	\$ (1.40)
Diluted Earnings (Loss) per Share:				
Net income (loss) from continuing operations, net of tax	\$ 0.03	\$ (0.05)	\$ 0.04	\$ (1.22)
Income (loss) from discontinued operations, net	-	0.05	-	(0.18)

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

of taxes

Net income (loss)	\$	0.03	\$	0.00	\$	0.04	\$	(1.40)
-------------------	----	------	----	------	----	------	----	--------

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

3

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

	(Unaudited)	
	For the Nine Months Ended	
	September 30, 2010	September 30, 2009
Cash Flows from Operating Activities:		
Net income (loss)	\$ 609,916	\$ (17,764,517)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	271,817	309,934
Amortization of intangibles	-	1,476,171
Impairment loss on goodwill and other intangibles	-	13,062,133
Provision for doubtful accounts	-	1,025,083
Stock and warrant-based compensation	453,396	1,393,098
Extinguishment of contract liabilities	-	(269,217)
Other non-cash income, net	(36,484)	2,935
Changes in operating assets and liabilities:		
Contracts and other receivables	(3,823,350)	8,784,073
Costs and estimated earnings in excess of billings on uncompleted contracts	286,764	877,104
Prepaid expenses and other current assets	(91,451)	7,714
Other assets	199,470	(54,190)
Accounts payable and accrued expenses	8,074,342	(12,573,806)
Billings in excess of costs and estimated earnings on uncompleted contracts	2,994,052	(3,222,745)
Other liabilities	(34,597)	(82,597)
Net cash provided by (used in) operating activities	8,903,875	(7,028,827)
Cash Flows from Investing Activities:		
Purchase of property and equipment	(78,045)	(112,638)
Proceeds from repayment of note in connection with the sale of certain assets and liabilities of Rubicon	279,756	-
Payment of earnout in connection with the acquisition of Rubicon	-	(700,000)
Payment of earnout in connection with the acquisition of Innovative	-	(353,187)
Net cash provided by (used in) investing activities	201,711	(1,165,825)
Cash Flows from Financing Activities:		
Payments on notes payable	(4,915)	(31,288)
Payment on seller notes	(54,692)	(1,808,507)
Purchase of treasury stock	(120,021)	(48,718)
Net cash used in financing activities	(179,628)	(1,888,513)
Net increase (decrease) in cash	8,925,958	(10,083,165)
Cash, beginning of period	2,263,146	12,448,157
Cash, end of period	\$ 11,189,104	\$ 2,364,992
Less: Cash associated with discontinued operations	-	212,943
Cash, end of period from continuing operations	\$ 11,189,104	\$ 2,152,049
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 277,570	\$ 126,444

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

Cash paid for taxes	-	116,411
Supplemental disclosure of non-cash financing activities:		
Promissory notes, issued to an officer, converted to commonstock	\$ 1,250,000	\$ -
Promissory notes payable issued in connection with the acquisition of Rubicon	-	550,000

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 for the three and nine months ended September 30, 2010 and 2009 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, 2009, 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.

During the year ended December 31, 2009, the Company experienced a significant and unexpected decrease in its revenues, caused by delays in starting projects or cancellations thereof resulting in a significant loss and negative cash flows from operations. The Company has taken actions to address the liquidity concerns that this caused.

Based on an unexpected lack of new 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 achieve positive cash flows from operations and align costs with forecasted revenues in the future, the Company voluntarily 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.

Due to the downturn in the economy, which had an adverse impact on the Company’s existing customers, financial security and stock value, the Company suspended its strategy of growth through acquisition in 2009. The corporate focus is 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.

The Company further sought to restructure 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 to the former sellers of Rubicon. 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 Mr. Gerard Gallagher, our President and Chief Operating Officer (COO). Furthermore, the principal repayment of the remaining \$2.8 million originally scheduled to begin payment on March 1, 2010 was amended to begin in the second quarter of

2012. As a result of these note restructurings, at December 31, 2009 short term debt obligations were reduced \$2.3 million and in turn our short-term liquidity substantially improved.

As a result of the cost reduction efforts to realign operations with decreased anticipated revenues, the added liquidity from the sale of Rubicon, and the financial restructuring of the \$4.0 million seller note, management believes that our current cash and cash equivalents and expected future cash generated from operations will satisfy the Company's expected working capital, capital expenditure and investment requirements through the next twelve months.

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

Recently Issued Accounting Pronouncements

In October 2009, Accounting Standards Update No. 2009-13, Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements a consensus of the FASB Emerging Issues Task Force was issued. The objective of this Update is to address the accounting for multiple-deliverable arrangements to enable vendors to account for products or services (deliverables) separately rather than as a combined unit. Vendors often provide multiple products or services to their customers. Those deliverables often are provided at different points in time or over different time periods. Subtopic 605-25, Revenue Recognition-Multiple-Element Arrangements, establishes the accounting and reporting guidance for arrangements under which the vendor will perform multiple revenue-generating activities. Specifically, this Subtopic addresses how to separate deliverables and how to measure and allocate arrangement consideration to one or more units of accounting. The amendments in this Update will affect accounting and reporting for all vendors that enter into multiple-deliverable arrangements with their customers when those arrangements are within the scope of ASC Subtopic 605-25. The amendments in this Update significantly expand the disclosures related to a vendor's multiple-deliverable revenue arrangement. The objective of the disclosures is to provide information about the significant judgments made and changes to those judgments and about the application of the relative selling-price method affects the timing of the revenue recognition. The amendments in this Update will be effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. The Company does not anticipate that the adoption of this standard, which will be in effect for the Company beginning January 1, 2011, will have any significant impact on its results of operations or financial position.

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

(2) Accounts Receivable, net

The Company had accounts receivable allowances for doubtful accounts of \$0.5 million at September 30, 2010 and December 31, 2009. Bad debt expense for the three months ended September 30, 2010 and 2009 was zero. Bad debt expense for the nine months ended September 30, 2010 and 2009 was zero and \$1.0 million, respectively.

Included in accounts receivable was retainage associated with construction projects totaling \$0.9 million and \$0.5 million at September 30, 2010 and December 31, 2009, respectively.

The Company earned approximately 79% and 25% of its revenue from one and two customers for the three months ended September 30, 2010 and 2009, respectively. The Company earned approximately 68% and 29% of its revenue from one and two customers for the nine months ended September 30, 2010 and 2009, respectively. Accounts receivable from these customers at September 30, 2010 and December 31, 2009 was \$13.2 million and \$3.8 million, respectively.

Additionally, two customers, comprising 81% and 70% of the Company's total revenue for the three and nine months ended September 30, 2010, respectively, were purchased during the nine months ended September 30, 2010. We are unable to determine the effect that the mergers may have on continued business with these customers although to date we have continued to perform previously contracted work and bid new opportunities.

(3) Extinguishment of Liabilities

During the nine months ended September 30, 2009, the Company finalized the extinguishment of approximately \$0.3 million. During 2009, pursuant to a contract assignment, two different subcontractors relieved the Company of its obligation due to vendors which had been previously recorded by the Company. The Company's customer has not made payments under the contract and these vendors will pursue collection remedy independently and without recourse to the Company pursuant to the terms of the contract assignment. The Company recorded the extinguishment of liabilities for the amount due to two vendors as a reduction to accounts payable and a reduction to cost of sales of \$0.3 million during the nine months ended September 30, 2009.

(4) Discontinued Operations

On December 29, 2009, the Company completed the sale of substantially all of the assets and liabilities of Rubicon for total consideration of \$1.8 million consisting of \$0.8 million in cash proceeds, net of transaction costs, a \$0.6 million note receivable and \$0.4 million in forgiveness of actual obligations and potential liabilities related to 2008 and 2009 earn-outs to the former owners and management of Rubicon. The Company is in the process of reviewing the buyer's working capital calculation as outlined in the purchase agreement and received scheduled note payments through October 2010. Additionally, the Company is entitled to contingent consideration in the form of an earn-out equal to 7.5% of gross profit on designated projects during a one year period commencing on the close date. At September 30, 2010, the Company was reviewing an initial earn-out calculation and payment of \$0.04 million for the six months ended June 30, 2010; however, the Company had not recorded the gain pending its completed review.

For all periods presented, the Company classified Rubicon, which focused on construction management and equipment integration, as discontinued operations as the Company has no ongoing involvement with the business component that has distinguishable operations and financials from the rest of the entity. We sold this business to enhance the Company's liquidity, while maintaining similar service capabilities. Associated results of operations, financial position and cash flows are separately reported for all periods presented.

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

	For the Three Months Ended September 30, 2009	For the Nine Months Ended September 30, 2009
Revenue	\$ 5,912,589	\$ 21,917,718
Income (loss) from operations of discontinued businesses, before taxes	640,366	(2,311,174)
Income tax expense	-	-
Income (loss) from operations of discontinued businesses	\$ 640,366	\$ (2,311,174)

7

FORTRESS INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Information for business components included in discontinued operations is as follows:

(5) Basic and Diluted Net Loss per Share

Basic and diluted net loss per common share is computed as follows:

	Three Months Ended September 30,					
	2010			2009		
	Income	Shares	\$ per Share	Income	Shares	\$ per Share
BASIC EARNINGS (LOSS) PER SHARE						
Income (loss) from continuing operations	\$ 465,682	13,415,580	\$ 0.03	\$ (620,611)	12,675,630	\$ (0.05)
EFFECT OF DILUTIVE SECURITIES						
Unvested restricted stock	-	813,658	-	-	-	-
DILUTED EARNINGS (LOSS) PER SHARE	\$ 465,682	14,229,238	\$ 0.03	\$ (620,611)	12,675,630	\$ (0.05)
	Nine Months Ended September 30,					
	2010			2009		
	Income	Shares	\$ per Share	Income	Shares	\$ per Shares
BASIC EARNINGS (LOSS) PER SHARE						
Income (loss) from continuing operations	\$ 609,916	13,252,624	\$ 0.05	\$ (15,453,343)	12,665,242	\$ (1.22)
EFFECT OF DILUTIVE SECURITIES						
Unvested restricted stock	-	830,656	0.01	-	-	-
DILUTED EARNINGS (LOSS) PER SHARE	\$ 609,916	14,083,280	\$ 0.04	\$ (15,453,343)	12,665,242	\$ (1.22)

Unvested restricted stock units for 87,167 and 700,000 shares of common stock, respectively, that were outstanding at September 30, 2010 were not included in the computation of diluted net loss per common share for the three and nine months ended September 30, 2010, as they vest at \$3.00 per share 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.

Unvested restricted stock, convertible unsecured promissory notes, options to purchase units and warrants for 1,120,601; 533,333; 700,000 and 15,710,300 shares of common stock, respectively, that were outstanding at September 30, 2009 were not included in the computation of diluted net loss per common share for the three and nine months ended September 30, 2009, as their inclusion would be anti-dilutive.

(6) Employee Benefit Plans

Restricted Stock

For the three months ended September 30, 2010 and 2009, the Company recorded non-cash compensation expense included in selling, general and administrative expense associated with vesting awards of \$0.1 million and \$0.4 million, respectively, and in cost of revenue recorded zero and \$0.1 million, respectively.

For the nine months ended September 30, 2010 and 2009, the Company recorded non-cash compensation expense included in selling, general and administrative expense associated with vesting awards of \$0.4 million and \$1.1 million, respectively, and in cost of revenue recorded \$0.1 million and \$0.3 million, respectively. For the nine months ended September 30, 2010 and September 30, 2009, the Company granted 90,000 and 568,764 shares of restricted stock, respectively, and restricted stock units of zero and 20,000, respectively, under the 2006 Omnibus Incentive Compensation Plan (Stock Plan).

On June 6, 2010, shareholders approved a 950,000 increase to shares available for award under the Stock Plan. At September 30, 2010, there was approximately \$0.4 million of unrecognized stock compensation to be recognized over a weighted period of approximately six months.

(7) Options to Purchase Shares of Common Stock

At December 31, 2009, options to purchase 700,000 shares of common stock at a purchase price of \$7.50 per share were outstanding. These options expired July 13, 2010 and subsequently the Company has no outstanding options to purchase units or warrants.

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

(8) Income Taxes

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, 2010 and December 31, 2009, 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.

(9) Notes Payable

	September 30, 2010	December 31, 2009
Convertible, unsecured promissory note, due 2012 (4.0%)	\$ 2,750,000	\$ 4,000,000
Unsecured promissory note, due 2010 (6.0%)	120,572	120,572
Unsecured promissory note, due 2010 (6.0%)	155,843	210,535
Vehicle notes	-	4,915
Total debt	3,026,415	4,336,022
Less current portion	276,415	183,679
Total debt, less current portion	\$ 2,750,000	\$ 4,152,343

For the nine months ended September 30, 2010 and 2009, the Company made principal repayments of \$0.06 million and \$1.8 million, respectively.

On February 28, 2010, the COO entered into an agreement with the Company to convert \$1.3 million of the outstanding note held by the COO 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 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 annual 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. Based on the

amended principal repayment terms, the \$4.0 million note was classified as long-term at December 31, 2009.

9

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

(10) 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 COO. S3 Integration provides commercial security systems design and installation services as a subcontractor to the Company.

Chesapeake Systems, LLC (Chesapeake Systems) is 9% owned and significantly indebted to the Company's Chief Executive Officer. 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 COO. 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. Prior to April 1, 2009, the Company's Chief Executive Officer owned 55% of CTS.

L.H. Cranston Acquisition Group, Inc. (Cranston) was 25% owned by the Company's Chief Executive Officer until the sale of his interest on February 28, 2009. Cranston is a mechanical, electrical and plumbing contractor that acts, directly or through its subsidiary L.H. Cranston and Sons, Inc., as subcontractor to the Company on a project-by-project basis.

Telco P&C, LLC is 9% 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 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 COO. TPR Group Re Three leases office space to the Company under the terms of a real property lease to TSS/Vortech. An independent valuation of the lease determined the lease to be at fair value.

Chesapeake Tower Systems, Inc. (Chesapeake) is owned 100% by the Company's Chief Executive Officer. During the second quarter 2009 and concurrent with an expiring leased facility, the Company entered into a new lease for approximately 25,000 square feet of combined office and warehouse space from Chesapeake. The lease commitment is for five years (Initial Term) with a two-year renewal option (Renewal Term). During the Initial Term, annual rent is \$124,000, plus operating expenses. If the Company elects to extend the lease, annual rent increases by the greater of i) fair market rental as defined in the lease, or ii) 3% increase in each year of the Renewal Term. Additionally, Chesapeake provided \$150,000 for tenant improvements and relocation costs. An independent appraisal of the lease determined the lease to be at fair value.

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, 2010 and 2009. 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, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Revenue				
CTS Services, LLC	\$ 23,902	\$ -	\$ 23,902	\$ 2,000
Telco P&C, LLC	93,764	84,395	559,099	153,660
Chesapeake Mission Critical, LLC	9,031	20,660	20,531	177,318
Total	\$ 126,697	\$ 105,055	\$ 603,532	\$ 332,978
Cost of Revenue				
CTS Services, LLC	\$ -	\$ 380,975	\$ 134,109	\$ 1,881,913
Chesapeake Systems, LLC	-	-	-	-
Chesapeake Mission Critical, LLC	47,490	240,261	135,257	298,541
S3 Integration, LLC	240,649	37,377	540,936	375,974
LH Cranston & Sons, Inc.	-	-	-	269,749
Telco P&C, LLC	-	-	37,278	72,556
Total	\$ 288,139	\$ 658,613	\$ 847,579	\$ 2,898,733
Selling, general and administrative				
Office rent paid on Chesapeake sublease agmt	\$ -	\$ -	\$ -	\$ 136,538
Office rent paid on Chesapeake Tower Systems	50,664	30,999	125,682	41,332
Office rent paid to TPR Group Re Three, LLC	122,047	93,642	323,901	295,496
Total	\$ 208,394	\$ 124,641	\$ 485,266	\$ 473,366

	September 30, 2010	December 31, 2009
Accounts receivable/(payable):		
CTS Services, LLC	\$ 16,155	\$ 104,065
CTS Services, LLC	1,400	(104,528)
Chesapeake Mission Critical, LLC	9,000	2,000
Chesapeake Mission Critical, LLC	-	(124,425)
Chesapeake Tower Systems, Inc.	-	-
Telco P&C, LLC	204,789	39,813
Telco P&C, LLC	(53,450)	(52,373)
LH Cranston & Sons, Inc.	-	-
S3 Integration, LLC	(62,983)	(3,425)

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

TPR Group RE Three, LLC		-		-
Total Accounts receivable	\$	229,944	\$	145,878
Total Accounts (payable)	\$	(115,033)	\$	(284,751)

11

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.

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.

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.

Based on an unexpected lack of new contracts and continued customer delays experienced at June 30, 2009 and through December 31, 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.

The Company's strategic growth through acquisitions was suspended due to the downturn in the economy, the impact this had on the Company's existing customer base, and as well as the impact it had on the Company's own financial security and common stock value. The corporate focus is 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.

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.

12

Notwithstanding this increased competition, we believe there are high barriers to entry in our sector for new competitors due to our specialized technology service offerings which we deliver to our customers, our top secret clearances, and our turnkey suite of deliverables offered. 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. We believe these barriers and 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 and can-not be certain that our current margins will be sustained. Furthermore, given the environment, to the extent the volume of our contracts further decrease, we may have to take additional measures to reduce our operating costs through additional reductions in general, administrative and marketing costs, including potential reductions in personnel and related 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, 2010, we had authorizations to proceed with work for approximately \$17.5 million, or 50% of our total backlog of \$35.1 million. At December 31, 2009, we had authorizations to proceed with work for approximately \$39.9 million, or 85% of our total backlog of \$47.1 million.

Approximately \$27.3 million, or 78% of our backlog, relates to three customers at September 30, 2010 and \$32.5 million, or 69%, to three customers at December 31, 2009. Additionally, two customers, who comprised 50% and 73% of our total backlog at September 30, 2010 and December 31, 2009, respectively, were purchased during the nine months ended September 30, 2010. We are unable to determine the effect that the mergers may have on continued business with these customers although to date we have continued to perform previously contracted work and bid new opportunities.

As of September 30, 2010, our backlog was approximately \$35.1 million, compared to approximately \$47.1 million at December 31, 2009. We believe that approximately 50% of the backlog at September 30, 2010 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, 2010 and December 31, 2009, respectively.

(In millions)

	September 30, 2010	December 31, 2009
Technology consulting	\$ 10.5	\$ 1.4
Construction management	13.0	33.8

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

Facilities management		11.6		11.9
Total	\$	35.1	\$	47.1

13

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. As there have been no significant revisions, please refer to our Annual Report and Form 10-K for a description of our critical accounting policies that affect the more significant estimates and judgments used in the preparation of our financial statement.

Recently Issued Accounting Pronouncements

In October 2009, Accounting Standards Update No. 2009-13, Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements a consensus of the FASB Emerging Issues Task Force was issued. The objective of this Update is to address the accounting for multiple-deliverable arrangements to enable vendors to account for products or services (deliverables) separately rather than as a combined unit. Vendors often provide multiple products or services to their customers. Those deliverables often are provided at different points in time or over different time periods. Subtopic 605-25, Revenue Recognition-Multiple-Element Arrangements, establishes the accounting and reporting guidance for arrangements under which the vendor will perform multiple revenue-generating activities. Specifically, this Subtopic addresses how to separate deliverables and how to measure and allocate arrangement consideration to one or more units of accounting. The amendments in this Update will affect accounting and reporting for all vendors that enter into multiple-deliverable arrangements with their customers when those arrangements are within the scope of ASC Subtopic 605-25. The amendments in this Update significantly expand the disclosures related to a vendor's multiple-deliverable revenue arrangement. The objective of the disclosures is to provide information about the significant judgments made and changes to those judgments and about the application of the relative selling-price method affects the timing of the revenue recognition. The amendments in this Update will be effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. We do not anticipate that the adoption of this standard, which will be in effect for the Company January 1, 2011, will have any significant impact on our results of operations or financial position.

Results of operations for the three months ended September 30, 2010 compared with the three months ended September 30, 2009.

Revenue. Revenue increased \$10.9 million to \$21.0 million for the three months ended September 30, 2010 from \$10.1 million for the three months ended September 30, 2009. The increase was driven primarily by a \$12.2 million increase in construction management services attributable primarily to a large contract and offset in part by a \$1.4 million decrease in facilities management services.

Cost of Revenue. Cost of revenue increased \$9.8 million to \$17.8 million for the three months ended September 30, 2010 from \$8.0 million for the three months ended September 30, 2009. The increase was driven primarily by a \$10.7 million increase in construction management services attributable to a large contract, offset in part by a decrease of \$0.9 million in facilities management services.

Gross Margin Percentage. Gross margin percentage decreased to 15.5% for the three months ended September 30, 2010 compared to 21.0% for the three months ended September 30, 2009. The decrease in gross margin is attributable to a greater proportion of total sales being derived from lower margin construction management services during the three months ended September 30, 2010 as compared to September 30, 2009.

Selling, general and administrative expenses. Selling, general and administrative expenses increased \$0.1 million to \$2.7 million for the three months ended September 30, 2010 from \$2.6 million for the three months ended September 30, 2009. The increase is primarily driven by an increase in variable commission and bonus compensation. Based on the improved operating results and prospects based on improvement we have seen in our operating environment, in the beginning of the third quarter we returned nonexecutive employees to their original salaries and anticipate the increase will result in an annual increase in selling, general and administrative costs of \$0.4 million. 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, 2010 compared to \$0.1 million for the three months ended September 30, 2009.

Amortization of intangible assets. Amortization expense remained consistent at zero for the three months ended September 30, 2010 compared to zero for the three months ended September 30, 2009. During the three months ended September 30, 2010 and 2009, there were no amortizable assets, as they were deemed impaired and reduced to zero during the three months ended June 30, 2009.

Interest income (expense), net. Our interest income (expense), net remained consistent at (\$0.03) million for the three months ended September 30, 2010 compared to (\$0.1) million for the three months ended September 30, 2009.

Income (Loss) from discontinued business, net of tax. We recorded gain from discontinued operations of zero for the three months ended September 30, 2010 as compared to \$0.6 million for the three months ended September 30, 2009. We sold substantially all of the assets and liabilities of Rubicon on December 29, 2009.

Results of operations for the nine months ended September 30, 2010 compared with the nine months ended September 30, 2009.

Revenue. Revenue increased \$21.7 million to \$60.8 million for the nine months ended September 30, 2010 from \$39.1 million for the nine months ended September 30, 2009. The increase in revenue was driven by a \$21.8 million increase in our construction management services as we added a significant development project and completed another during the nine months ended September 30, 2010.

Cost of Revenue. Cost of revenue increased \$19.2 million to \$51.9 million for the nine months ended September 30, 2010 from \$32.7 million for the nine months ended September 30, 2009. The increase in revenue was driven by a \$19.9 million increase in our construction management services as we added a significant development project during the nine months ended September 30, 2010. During the nine months ended September 30, 2009, the Company had approximately \$0.3 million of extinguishment of contract liabilities reducing cost of sales by a corresponding amount.

Gross Margin Percentage. Gross margin percentage declined to 14.7% for the nine months ended September 30, 2010 compared to 16.4% for the nine months ended September 30, 2009. Excluding the \$0.3 million reduction in cost of sales for the extinguishment of contract liabilities during the nine months ended September 30, 2009, gross margin decreased to 14.7% for the nine months ended September 30, 2010 compared to 15.6% during the nine months ended September 30, 2009. The remaining decrease in gross margin is attributable to a greater proportion of total sales being derived from lower margin construction management services during the nine months ended September 30, 2010 as compared to September 30, 2009.

Selling, general and administrative expenses. Selling, general and administrative expenses decreased \$2.3 million to \$7.9 million for the nine months ended September 30, 2010 from \$10.2 million for the nine months ended September 30, 2009. The decrease is primarily driven by \$1.0 million decrease in salaries and related costs of benefits and non-cash compensation due to a reduction in headcount. The remaining decline of \$1.3 million is attributable to a decrease in provision for bad debt expense and rent of \$1.0 million and \$0.2 million. Based on the improved operating results and prospects based on improvements we have seen in our operating environment, in the beginning of the third quarter 2010 we returned nonexecutive employees to their original salaries and anticipate the increase will result in an annual increase in selling, general and administrative costs of \$0.4 million. 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 \$0.3 million for the nine months ended September 30, 2010 compared to \$0.3 million for the nine months ended September 30, 2009.

Amortization of intangible assets. Amortization expense decreased \$0.9 million to zero for the nine months ended September 30, 2010 from \$0.9 million for the nine months ended September 30, 2009. During the nine months ended September 30, 2010, there were no amortizable assets, as they were deemed impaired to zero during the nine months ended September 30, 2009.

Impairment loss on goodwill and other intangibles, net. We did not record any impairment losses during the nine months ended September 30, 2010. During the nine months ended September 30, 2009, we had experienced continued operating losses and a decline in market value and accordingly conducted analyses of our operations in order to identify any impairment in the carrying value of the goodwill and other intangibles related to our business. Analyzing our business using both an income approach and a market approach and an evaluation of customer relationship relationships, we determined that the carrying value exceeded the current fair value of our business and customer related intangibles, resulting in goodwill and other intangible impairment of \$10.3 million for the nine months ended September 30, 2009.

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

Interest income (expense), net. Our interest income (expense), net remained consistent at (\$0.1) million for the nine months ended September 30, 2010 compared to (\$0.1) million for the nine months ended September 30, 2009.

Income (loss) from discontinued business, net of tax. We recorded loss from discontinued operations of zero for the nine months ended September 30, 2010 as compared to \$2.3 million for the nine months ended September 30, 2009. We sold substantially all of the assets and liabilities of Rubicon on December 29, 2009.

16

Adjusted EBITDA from Continuing Operations

A reconciliation of Adjusted EBITDA from continuing operations to net income (loss) from continuing operations:

	(Unaudited) For the Three Months Ended		(Unaudited) For the Nine Months Ended	
	September 30, 2010	September 30, 2009	September 30, 2010	September 30, 2009
Adjusted EBITDA from continuing operations	\$ 677,803	\$ (100,786)	\$ 1,447,674	\$ (1,676,668)
Impairment loss on goodwill and other intangibles, net	-	-	-	(10,254,910)
Stock-based compensation	(98,052)	(358,025)	(453,396)	(1,128,099)
Lease exit costs	-	-	(19,888)	-
Provision for bad debts	-	-	-	(1,025,083)
EBITDA from continuing operations	\$ 579,751	\$ (458,811)	\$ 974,390	\$ (14,084,760)
Interest (income) expense, net	(30,052)	(55,321)	(92,657)	(143,381)
Income tax expense (benefit)	-	-	-	-
Depreciation and amortization	(84,017)	(100,154)	(271,817)	(305,975)
Amortization of intangibles	-	(6,325)	-	(919,227)
Net income (loss) from continuing operations	\$ 465,682	\$ (620,611)	\$ 609,916	\$ (15,453,343)

Adjusted EBITDA from continuing operations increased \$0.8 million to \$0.7 million in the three months ended September 30, 2010 from (\$0.1) million for the three months ended September 30, 2009. The increase was primarily driven by increased gross profit and curtailment of selling, general and administrative expenses for the three months ended September 30, 2010. Please refer to the preceding discussion within this “Results of Operations” section.

Adjusted EBITDA from continuing operations increased \$3.1 million to \$1.4 million in the nine months ended September 30, 2010 from (\$1.7) million for the nine months ended September 30, 2009. The increase was primarily driven by increased gross profit and curtailment of selling, general and administrative expenses for the nine months ended September 30, 2010. Please refer to the preceding discussion within this “Results of Operations” section.

Adjusted EBITDA from continuing operations is a supplemental financial measure not defined in GAAP. We define Adjusted EBITDA from continuing operations as net income from continuing operations before interest expense, income taxes, depreciation and amortization, impairment loss on goodwill and other intangibles, net, stock-based compensation, lease exit costs, and provision for bad debts. We have presented Adjusted EBITDA from continuing operations because we believe it is an important supplemental measure of operating performance. We believe that the line item on the consolidated statement of operations entitled “net income from continuing operations” is the most directly comparable GAAP financial measure to Adjusted EBITDA from continuing operations. Since Adjusted EBITDA from continuing operations 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 from continuing operations as an indicator of

operating performance or any other GAAP financial measure. Adjusted EBITDA from continuing operations, 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 from continuing operations 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 from continuing operations, 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. Therefore, any measure that excludes impairment loss on goodwill and other intangibles, net has material limitations.
- It does not include stock-based compensation. Because we have issued stock based compensation as a component of employee total 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. Therefore, any measure that excludes stock-based compensation has material limitations.
- It does not include provision for bad debts. Because provision for bad debts is necessary as we take credit risk with customers and an ongoing part of our operations, any measure that excludes provision for bad debts has material limitations.
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. Therefore, any measure that excludes interest expense has material limitations;
- It does not include taxes. Because the payment of taxes is a necessary and ongoing part of our operations, any measure that excludes taxes has material limitations; and
- 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. Therefore, any measure that excludes depreciation and amortization has material limitations.

Financial Condition, Liquidity and Capital Resources

	For the Nine Months Ended September 30,		
	2010	2009	Change
Net income (loss)	\$ 609,916	\$ (17,764,517)	\$ 18,374,433
Adjustments to reconcile net income (loss) to net cash provided by (used in) operations:			
Amortization of intangibles	-	1,476,171	(1,476,171)
Impairment loss on goodwill and other intangibles	-	13,062,133	(13,062,133)
Stock and warrant-based compensation	453,396	1,393,098	(939,702)
Provision for doubtful accounts	-	1,025,000	(1,025,000)
Extinguishment of liabilities	-	(269,217)	269,217
Other non-cash items	235,333	312,952	(77,619)
Net adjustments to reconcile net income for non-cash items	688,729	17,000,137	(16,311,408)
Net change in working capital	7,605,230	(6,264,447)	13,869,677
Cash provided by (used in) operations	8,903,875	(7,028,827)	15,932,702
Cash provided by (used in) investing	201,711	(1,165,825)	1,367,536
Cash used in financing	(179,628)	(1,888,513)	1,708,885
Net increase (decrease) in cash	\$ 8,925,958	\$ (10,083,165)	\$ 19,009,123

Cash and cash equivalents increased \$8.9 million to \$11.2 million at September 30, 2010 from \$2.3 million at December 31, 2009. The increase was primarily attributable to \$8.9 million provided by operating activities, \$0.2 million provided by investing activities, offset by \$0.2 million used in repayment of notes payable.

Operating Activity

Net cash provided by operating activities increased \$15.9 million to \$8.9 million for the nine months ended September 30, 2010 from \$7.0 million used in operating activities for the nine months ended September 30, 2009. For the nine months ended September 30, 2010, cash generated from operations was \$8.9 million, which was primarily driven by \$7.6 million of cash generated by working capital. The cash generated from working capital was attributable primarily to an increase in accounts payable, accrued expenses and billings in excess of costs and estimated earnings on uncompleted contracts as we billed ahead on projects during the nine months ended September 30, 2010.

Investing Activity

Net cash provided by investing activities increased \$1.4 million to \$0.2 million for the nine months ended September 30, 2010 from \$1.2 million used in investing activities for the nine months ended September 30, 2009. For the nine months ended September 30, 2010, there were approximately \$0.3 million of payments received on the note issued in the sale of Rubicon. For the nine months ended September 30, 2009, there were approximately \$1.1 million of acquisition related earn out payments and there were no such payments for the nine months ended September 30, 2010.

Financing Activity

Net cash used in financing decreased \$1.7 million to \$0.2 million for the nine months ended September 30, 2010 from \$1.9 million for the nine months ended September 30, 2009. For the nine months ended September 30, 2010, financing activities consisted primarily of treasury stock repurchases associated with payment of taxes on the vesting of restricted stock held by employees as compared to \$1.8 million of scheduled seller note repayments during the nine

months ended September 30, 2009.

Non-Cash Financing Activity

On February 28, 2010, we entered into an agreement with our Chief Operating Officer (COO) to convert \$1.3 million of the outstanding note held by the COO 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 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 annual 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. Based on the amended principal repayment terms, the \$4.0 million note was classified as long-term at December 31, 2009.

During the nine months ended September 30, 2009, in connection with the purchase of Rubicon, we issued to the sellers \$0.6 million of unsecured promissory notes bearing interest at 6% per annum and repayable over a one-year term. The notes were issued in association with the achievement of certain profit targets, as defined in the purchase agreement, for the year ended December 31, 2008.

Liquidity and Capital Resources

We had \$11.2 million and \$2.3 million of unrestricted cash and cash equivalents at September 30, 2010 and December 31, 2009, respectively. During the nine months ended September 30, 2010, we have financed our operations primarily with operating cash flows driven by changes in working capital and cash on hand.

Based on an unexpected lack of new contracts and continued customer delays during 2009, we 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 voluntarily 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.

Due to the downturn in the economy, which had an adverse impact on our existing customers, our own financial security and stock value, we suspended our strategy of growth through acquisitions in 2009. Our corporate focus became centered on preserving cash, achieving positive cash flow and discontinuing or selling operations that threatened that focus. We engaged an investment bank to assist us 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.

We further 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 \$0.6 million owed to the former sellers. 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. As a result of note restructuring, at December 31, 2009 short term debt obligations were reduced \$2.3 million and in turn our short-term liquidity substantially improved.

During the three and nine months ended September 30, 2010, our operating results have improved as we generated net income of \$0.5 million and \$0.6 million, respectively. Additionally, we have seen some improvement in our operating environment and as a result have returned our nonexecutive employees to their original salaries in an effort to retain them. 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.

As a result of the overall cost reduction efforts to realign operations with decreased anticipated revenues, the added liquidity from the sale of Rubicon, and the 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 through the next twelve months. 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. We may elect to secure additional capital in the future, at acceptable terms, to improve 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. Although 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 through the next twelve months, failure to obtain additional financing, if necessary, could have a material adverse impact our business, financial condition and earnings.

Off Balance Sheet Arrangements

As of September 30, 2010, 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) or 15d-15(e) of the Securities Exchange Act of 1934, as amended) as of September 30, 2010. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that as of September 30, 2010, our disclosure controls and procedures were ineffective.

Changes in Internal Control over Financial Reporting

During the three months ended September 30, 2010, the Company developed a remediation plan with the objective of remediating material weaknesses previously disclosed at December 31, 2009. The Company is finalizing formal documentation of policies and procedures and has begun to automate various controls related to revenue recognition.

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, 2009, 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 2009 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.

Not applicable.

Item 3. Defaults upon Senior Securities.

Not applicable.

Item 4. (Removed and Reserved).

Item 5. Other Information.

Not applicable.

Item 6. Exhibits.

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 15, 2010

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

Date: November 15, 2010

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