Fortress Investment Group LLC
Form 10-Q
August 14, 2007
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2007

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission File Number: 001-33294

Fortress Investment Group LLC

(Exact name of registrant as specified in its charter)

Delaware	20-5837959
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1345 Avenue of the Americas, New York, NY	10105
(Address of principal executive offices)	(Zip Code)

(212) 798-6100
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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 preceding 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 the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of ''accelerated filer and large accelerated filer'' in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate 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 last practicable date.

Class A Shares: 94,597,646 outstanding as of August 10, 2007.

Class B Shares: 312,071,550 outstanding as of August 10, 2007.

FORTRESS INVESTMENT GROUP LLC

FORM 10-Q

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DEFINED TERMS

As used in this Quarterly Report on Form 10-Q, unless the context otherwise requires:

‘‘Assets Under Management,’’ or ‘‘AUM,’’ refers to the assets we manage, including capital we have the right to call from our investors pursuant to their capital commitments to various funds. Our AUM equals the sum of:

(i) the net asset value, or ‘‘NAV,’’ of our private equity funds and hedge funds plus the capital that we are entitled to call from investors pursuant to the terms of their capital commitments to those funds;
(ii) the NAV of managed accounts; and
(iii) the market capitalization of the common stock of each of our publicly traded alternative investment vehicles, which we refer to as our ‘‘Castles’’.

We earn management fees pursuant to management agreements on a basis which varies from Fortress Fund to Fortress Fund (e.g., any of ‘‘net asset value’’, ‘‘capital commitments’’, ‘‘invested equity’’ or ‘‘gross equity,’’ each as defined in the applicable management agreement, may form the basis for a management fee calculation). Our calculation of AUM may differ from the calculations of other asset managers and, as a result, this measure may not be comparable to similar measures presented by other asset managers. Our AUM measure includes, for instance, assets under management for which we charge either no or nominal fees, generally related to our principal investments in funds as well as investments in funds by our principals, directors and employees. Our definition of AUM is not based on any definition of assets under management contained in our operating agreement or in any of our Fortress Fund management agreements.

‘‘Fortress,’’ ‘‘we,’’ ‘‘us,’’ ‘‘our,’’ and the ‘‘company’’ refer, (i) following the consummation of the reorganization and the Nor transaction, collectively, to Fortress Investment Group LLC and its subsidiaries, including the Fortress Operating Group and all of its subsidiaries, and, (ii) prior to the consummation of the reorganization and the Nomura transaction on January 17, 2007, to the Fortress Operating Group and all of its subsidiaries, in each case not including funds that, prior to March 31, 2007, were consolidated funds, except with respect to our historical financial statements and discussion thereof unless otherwise specified. Effective March 31, 2007, all of our previously consolidated funds were deconsolidated. The financial statements contained herein represent consolidated financial statements of Fortress Investment Group LLC subsequent to the reorganization and combined financial statements of Fortress Operating Group, considered the predecessor, prior to the reorganization. See Part I, Item 1, ‘‘Financial Statements.’’

‘‘Fortress Funds’’ and ‘‘our funds’’ refers to the private investment funds and alternative asset companies that are managed by the Fortress Operating Group.

‘‘Fortress Operating Group’’ refers to the combined entities, which were wholly-owned by the principals prior to the Nomura transaction and in each of which Fortress Investment Group LLC acquired an indirect controlling interest upon completion of the Nomura transaction (described below).

‘‘principals’’ refers to Peter Briger, Wesley Edens, Robert Kauffman, Randal Nardone and Michael Novogratz, collectively, who prior to the completion of our initial public offering and the Nomura transaction directly owned 100% of the Fortress Operating Group units and following completion of our initial public offering and the Nomura transaction own a majority of the Fortress Operating Group units and all of the Class B shares, representing a majority of the total combined voting power of all of our outstanding Class A and Class B shares. The principals' ownership percentage is subject to change based on, among other things, equity offerings by Fortress and dispositions by the principals.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Some of the statements under Part I, Item 2, ‘‘Management's Discussion and Analysis of Financial Condition and Results of Operations,’’ Part I, Item 3, ‘‘Quantitative and Qualitative Disclosures About Market Risk,’’ Part II, Item 1A, ‘‘Risk Factors,’’ and elsewhere in this Quarterly Report on Form 10-Q may contain forward-looking statements which reflect our current views with respect to, among other things, future events and financial performance. Readers can identify these forward-looking statements by the use of forward-looking words such as ‘‘outlook,’’ ‘‘believes,’’ ‘‘expects,’’ ‘‘potential,’’ ‘‘continues,’’ ‘‘may,’’ ‘‘will,’’ ‘‘should,’’ ‘‘seeks,’’ ‘‘approximately,’’ ‘‘predicts,’’ ‘‘intends,’’ ‘‘plans,’’ ‘‘estima negative version of those words or other comparable words. Any forward-looking statements contained in this report are based upon the historical performance of us and our subsidiaries and on our current plans, estimates and expectations. The inclusion of this forward-looking information should not be regarded as a representation by us or any other person that the future plans, estimates or expectations contemplated by us will be achieved. Such forward-looking statements are subject to various risks and uncertainties and assumptions relating to our operations, financial results, financial condition, business prospects, growth strategy and liquidity. If one or more of these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, our actual results may vary materially from those indicated in these statements. These factors should not be construed as exhaustive and should be read in conjunction with the other cautionary statements that are included in this report. We do not undertake any obligation to publicly update or review any forward-looking statement, whether as a result of new information, future developments or otherwise.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

FORTRESS INVESTMENT GROUP LLC
(PRIOR TO JANUARY 17, 2007, FORTRESS OPERATING GROUP – NOTE 1)
CONSOLIDATED AND COMBINED BALANCE SHEETS
(dollars in thousands, except share data)

	June 30, 2007 (Unaudited)	December 31, 2006
Assets		
Cash and cash equivalents	$ 321,445	$ 61,120

Cash held at consolidated subsidiaries and restricted cash	—	564,085
Due from affiliates	180,429	635,748
Receivables from brokers and counterparties	—	109,463
Investment company holdings, at fair value		
Loans and securities	—	6,874,748
Investments in affiliates	—	14,985,578
Derivatives	—	84,270
Other investments		
Loans and securities	—	317
Equity method investees	642,518	37,250
Options in affiliates	106,324	139,266
Deferred tax asset	475,091	2,808
Other assets	61,914	187,920
	$ 1,787,721	$ 23,682,573
Liabilities and Shareholders' Equity		
Liabilities		
Due to affiliates	$ 415,976	$ 15,112
Due to brokers and counterparties	—	187,495
Accrued compensation and benefits	213,767	159,931
Dividends payable	21,284	—
Other liabilities	37,333	152,604
Deferred incentive income	221,657	1,648,782
Securities sold not yet purchased, at fair value	—	97,717
Derivative liabilities, at fair value	2,652	123,907
Investment company debt obligations payable	—	2,619,456
Other debt obligations payable	350,000	687,153
	1,262,669	5,692,157
Commitments and Contingencies		
Principals' and Others' Interests in Equity of Consolidated Subsidiaries	358,392	17,868,895
Shareholders' Equity		
Class A shares, no par value, 1,000,000,000 shares authorized, 94,597,646 shares issued and outstanding	—	—
Class B shares, no par value, 750,000,000 shares authorized, 312,071,550 shares issued and outstanding	—	—
Paid-in capital	293,185	—
Retained earnings (accumulated deficit)	(126,385)	—
Fortress Operating Group members' equity	—	119,561
Accumulated other comprehensive income (loss)	(140)	1,960
	166,660	121,521
	$ 1,787,721	$ 23,682,573

See notes to consolidated and combined financial statements

FORTRESS INVESTMENT GROUP LLC
(PRIOR TO JANUARY 17, 2007, FORTRESS OPERATING GROUP – NOTE 1)

CONSOLIDATED AND COMBINED INCOME STATEMENTS (Unaudited)
(dollars in thousands, except share data)

	Three Months Ended June 30, 2007	Three Months Ended June 30, 2006	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006
Revenues				
Management fees from affiliates	$ 118,678	$ 29,568	$ 161,965	$ 74,544
Incentive income from affiliates	132,961	15,789	177,189	75,771
Other revenues	16,480	19,101	36,265	35,499
Interest and dividend income – investment company holdings				
Interest income	—	208,804	243,713	376,813
Interest income from controlled affiliate investments	—	14,189	4,707	28,346
Dividend income	—	1,056	7,436	4,312
Dividend income from controlled affiliate investments	—	39,762	53,174	103,015
	268,119	328,269	684,449	698,300
Expenses				
Interest expense				
Investment company holdings	—	127,442	132,620	245,690
Other	6,711	12,338	18,731	19,195
Compensation and benefits	187,783	100,000	405,300	183,445
Principals agreement compensation – Note 7	242,659	—	380,933	—
General, administrative and other	23,603	27,014	62,908	50,285
Depreciation and amortization	2,184	1,620	4,193	3,186
	462,940	268,414	1,004,685	501,801
Other Income				
Gains (losses) from investments				
Investment company holdings				
Net realized gains	—	22,211	86,264	72,848
Net realized gains from controlled affiliate investments	—	501,703	715,024	522,460
Net unrealized gains (losses)	—	(173,461)	(19,928)	(223,163)
Net unrealized gains (losses) from controlled affiliate investments	—	174,787	(1,428,837)	1,045,180
Other investments				
Net realized gains (losses)	(1,735)	(1,154)	54	(114)
Net realized gains from affiliate investments	9,452	—	145,493	—
Net unrealized gains (losses)	(396)	(2,392)	(677)	(2,941)
Net unrealized gains (losses) from affiliate investments	(36,338)	(23,357)	(167,166)	58,029
Earnings from equity method investees	7,231	524	7,427	2,420
	(21,786)	498,861	(662,346)	1,474,719
Income (Loss) Before Deferred Incentive Income, Principals' and Others' Interests in Income of Consolidated Subsidiaries and Income Taxes	(216,607)	558,716	(982,582)	1,671,218
Deferred incentive income	—	(109,701)	307,034	(261,407)
Principals' and others' interests in loss (income) of consolidated subsidiaries	166,485	(489,164)	702,016	(1,314,536)
Income (Loss) Before Income Taxes	(50,122)	(40,149)	26,468	95,275

Income tax expense	(5,009)	(2,126)	(19,456)	(7,270)
Net Income (Loss)	$ (55,131)	$ (42,275)	$ 7,012	$ 88,005
Dividends declared per Class A share	$ 0.2250		$ 0.3924	
			January 1 through January 16	
Earnings Per Unit – Fortress Operating Group				
Net income per Fortress Operating Group unit		$ (0.12)	$ 0.36	$ 0.24
Weighted average number of Fortress Operating Group units outstanding		367,143,000	367,143,000	367,143,000
			January 17 through June 30	
Earnings Per Class A share – Fortress Investment Group				
Net income (loss) per Class A share, basic	$ (0.59)		$ (1.43)	
Net income (loss) per Class A share, diluted	$ (0.66)		$ (1.43)	
Weighted average number of Class A shares outstanding, basic	94,894,636		89,226,434	
Weighted average number of Class A shares outstanding, diluted	406,966,186		89,226,434	

See notes to consolidated and combined financial statements

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FORTRESS INVESTMENT GROUP LLC
(PRIOR TO JANUARY 17, 2007, FORTRESS OPERATING GROUP – NOTE 1)
CONSOLIDATED AND COMBINED STATEMENT OF MEMBERS' AND SHAREHOLDERS' EQUITY (Unaudited)
FOR THE SIX MONTHS ENDED JUNE 30, 2007
(dollars in thousands)

	Class A Shares	Class B Shares	Paid-In Capital	Retained Earnings (Accumulated Deficit) (Subsequent to January 16, 2007)	Fortress Operating Group Members' Equity (Prior to January 17, 2007)	Accumulated Other Comprehensive Income (Loss)	Shar M E
Fortress Operating Group Members' equity – December 31, 2006	—	—	$ —	$ —	$ 119,561	$ 1,960	$
Distributions declared by Fortress Operating Group prior to January 17, 2007	—	—	—	—	(415,876)	—	(4

Reorganization and issuance of shares to Nomura	55,071,450	312,071,550	888,000	—	—	—	
Dilution impact of Nomura transaction	—	—	(912,437)	—	162,918	—	
Dividends declared after January 16, 2007 but prior to initial public offering	—	—	(2,474)	—	—	—	
Initial public offering of Class A shares	39,428,900	—	652,669	—	—	—	
Dilution impact of initial public offering	—	—	(490,648)	—	—	—	
Deferred tax effects resulting from acquisition of Fortress Operating Group units	—	—	89,026	—	—	—	
Director restricted share grant	97,296	—	54	—	—	—	
Dividends declared subsequent to initial public offering	—	—	(32,874)	—	—	—	
Capital increase related to equity-based compensation	—	—	103,507	—	—	—	
Dividend equivalents accrued in connection with equity-based compensation	—	—	(1,638)	—	—	—	
Comprehensive income							
Net income (loss)	—	—	—	(126,385)	133,397	—	
Foreign currency translation	—	—	—		—	97	
Net unrealized (loss) on derivatives designated as cash flow hedges	—	—	—	—	—	(8)	
Comprehensive income (loss) from equity method investees	—	—	—	—	—	(2,652)	
Allocation to Principals' and others' interests in equity of consolidated subsidiaries	—	—	—	—	—	463	
Total comprehensive income	—	—	—	—	—	—	
Shareholders' equity – June 30, 2007	94,597,646	312,071,550	$ 293,185	$ (126,385)	$ —	$ (140)	$

See notes to consolidated and combined financial statements

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FORTRESS INVESTMENT GROUP LLC
(PRIOR TO JANUARY 17, 2007, FORTRESS OPERATING GROUP – NOTE 1)
CONSOLIDATED AND COMBINED STATEMENT OF CASH FLOWS (Unaudited)
JUNE 30, 2007
(dollars in tables in thousands, except share data)

	Six Months Ended June 30, 2007	2006
Cash Flows From Operating Activities		
Net income	$ 7,012	$ 88,005
Adjustments to reconcile net income to net cash used in operating activities		
Depreciation and amortization	4,193	3,186
Other amortization and accretion	1,275	2,775
Earnings from equity method investees	(7,427)	(2,420)
Distributions of earnings from equity method investees	4,211	5,873
(Gains) losses from investments	669,773	(1,472,299)
Deferred incentive income	(311,174)	261,407
Principals' and others' interests in income of consolidated subsidiaries	(702,016)	1,314,536
Deferred tax expense	2,484	4,420
Options received from affiliates	(2,006)	(18,693)
Assignments of options to employees	1,717	—
Equity-based compensation	445,233	—
Cash flows due to changes in		
Cash held at consolidated subsidiaries and restricted cash	(166,199)	(517,641)
Due from affiliates	421,310	(123,023)
Receivables from brokers and counterparties and other assets	(9,106)	(102,902)
Due to affiliates	(8,380)	(48,074)
Accrued compensation and benefits	72,733	20,786
Due to brokers and counterparties and other liabilities	65,592	135,652
Investment company holdings		
Purchases of investments	(5,105,865)	(5,739,707)
Proceeds from sale of investments	3,398,739	4,304,223
Net cash used in operating activities	(1,217,901)	(1,883,896)
Cash Flows From Investing Activities		
Purchase of other loan and security investments	—	(232,194)
Proceeds from sale of other loan and security investments	317	163,210
Contributions to equity method investees	(94,751)	(373)
Proceeds from sale of equity method investments	29,071	—
Distributions of capital from equity method investees	39,906	269
Cash received on settlement of derivatives	132	—
Purchase of fixed assets	(7,136)	(5,193)
Net cash used in investing activities	(32,461)	(74,281)
Cash Flows From Financing Activities		
Borrowings under debt obligations	1,924,070	3,320,221
Repayments of debt obligations	(2,010,025)	(2,368,554)
Payment of deferred financing costs	(6,656)	(12,300)
Issuance of Class A shares to Nomura	888,000	—
Issuance of Class A shares in initial public offering	729,435	—
Costs related to initial public offering	(76,766)	—
Dividends paid	(16,542)	—
Fortress Operating Group capital distributions to Principals	(415,876)	(307,332)
Purchase of Fortress Operating Group units from Principals	(888,000)	—
Principals' and others' interests in equity of consolidated subsidiaries – contributions	3,215,372	2,499,422
	(1,832,325)	(1,127,791)

Principals' and others' interests in equity of consolidated subsidiaries – distributions		
Net cash provided by financing activities	1,510,687	2,003,666
Net Increase in Cash and Cash Equivalents	260,325	45,489
Cash and Cash Equivalents, Beginning of Period	61,120	36,229
Cash and Cash Equivalents, End of Period	$ 321,445	$ 81,718
Supplemental Disclosure of Cash Flow Information		
Cash paid during the period for interest (excluding interest paid by master funds while such funds were consolidated of $85.1 million and $162.5 million, respectively)	$ 63,944	$ 67,351
Cash paid during the period for income taxes	$ 28,407	$ 1,093
Supplemental Schedule of Non-cash Investing and Financing Activities		
Investment of amounts payable to employees into Fortress Funds	$ 15,072	$ 21,102
Dividends, dividend equivalents and Fortress Operating Group unit distributions declared but not yet paid	$ 47,272	$ —

See Note 1 regarding the non-cash deconsolidation transaction
See notes to consolidated and combined financial statements

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FORTRESS INVESTMENT GROUP LLC
(PRIOR TO JANUARY 17, 2007, FORTRESS OPERATING GROUP – NOTE 1)
NOTES TO CONSOLIDATED AND COMBINED FINANCIAL STATEMENTS (Unaudited)
JUNE 30, 2007
(dollars in tables in thousands, except share data)

1. ORGANIZATION AND BASIS OF PRESENTATION

Fortress Investment Group LLC (the ''Registrant,'' or, together with its subsidiaries, ''Fortress'') is a global alternative asset management firm whose predecessor was founded in 1998. Its primary business is to sponsor the formation of, and provide investment management services for, various investment funds and companies (the ''Fortress Funds''). Fortress generally makes principal investments in these funds.

Fortress has three principal sources of income from the Fortress Funds: management fees, incentive income, and investment income on its principal investments in the funds. The Fortress Funds fall into four primary business segments in which Fortress operates:

1) Private equity funds, which invest in debt and equity securities of public or privately held entities.
2) Liquid hedge funds, which invest in the global fixed income, commodities, currency and equity markets, and their related derivatives.
3) Hybrid hedge funds, which invest in undervalued, distressed and other less liquid investments, as well as investment funds managed by external managers.
4) Publicly traded alternative investment vehicles that Fortress refers to as the ''Castles,'' which are companies that invest in operating real estate and real estate related loans and securities (debt

and equity).

The accompanying consolidated financial statements include the following:

- subsequent to Fortress's reorganization and the inception of operations of Fortress Investment Group LLC on January 17, 2007, the accounts of Fortress Investment Group LLC and its consolidated subsidiaries, and
- prior to such reorganization and the inception of operations of Fortress Investment Group LLC, the accounts of eight affiliated entities under common control and management (''Fortress Operating Group'' or the ''predecessor'') and their respective consolidated subsidiaries. Each of the eight entities was owned either directly or indirectly by its members, Peter Briger, Wesley Edens, Robert Kauffman, Randal Nardone, and Michael Novogratz (the ''Principals'').

Reorganization of Fortress Operating Group

Fortress Investment Group LLC was formed on November 6, 2006 for the purpose of becoming the general partner of Fortress Operating Group, completing the Nomura Transaction (described below), and effecting a public offering of shares and related transactions (the ''Transactions'') in order to carry on the business of its predecessor, Fortress Operating Group, as a publicly traded entity. The Registrant completed the Nomura Transaction and commenced its operations on January 17, 2007 and completed its initial public offering on February 8, 2007. As a result of the Transactions, the Registrant acquired control of Fortress Operating Group and held, through two intermediate holding companies (FIG Corp. and FIG Asset Co. LLC), approximately 23.3% of the Fortress Operating Group limited partnership units and all of the general partner interests. The Principals retained the remaining 76.7% of the Fortress Operating Group limited partnership units and a 76.7% voting interest in the Registrant. All of the businesses engaged in by the Registrant continue to be conducted by Fortress Operating Group. The ownership percentages are subject to change based on, among other things, equity offerings by Fortress and dispositions by the Principals. As of June 30, 2007, the Fortress Operating Group units were owned as follows: Registrant 23.3%, Principals 76.7%.

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In January 2007, in connection with the Nomura transaction and the initial public offering, Fortress Operating Group was reorganized from eight limited liability companies, each having individual capital accounts for each of the Principals, into four limited partnerships, each having a unitized capital structure. The Principals were issued 367,143,000 non-voting limited partner interests in each of the four limited partnerships and the Registrant, through two intermediate holding companies, was issued the non-economic general partner interest in each of them. The Principals were also issued 367,143,000 non-economic Class B shares of the Registrant, of which 55,071,450 were cancelled in the Nomura transaction (see below). The term ''Fortress Operating Group unit'' is used to represent one limited partner interest in each limited partnership. A Fortress Operating Group unit is not a legal interest but is the term used to refer to the aggregate of one limited partnership interest in each reorganized Fortress Operating Group entity.

As the Registrant is a newly formed company, Fortress Operating Group is considered its predecessor for accounting purposes, and its combined financial statements have become the Registrant's historical financial statements. Also, because the Principals controlled Fortress Operating Group before the Transactions and control the Registrant after the Transactions, the Transactions have been accounted for as a reorganization of entities under common control. Accordingly, the Registrant has carried forward unchanged the value of assets and liabilities recognized in Fortress Operating Group's combined financial statements into its consolidated financial statements. When the Registrant purchased Fortress Operating Group units, from the Principals and directly from the Fortress Operating Group partnerships, it recorded the proportion of Fortress Operating Group net assets acquired at their historical carrying value and proportionately reduced the Principals' and others' interests in equity of consolidated subsidiaries. The excess of the amounts paid for the purchase of Fortress Operating Group units over the historical carrying value of the proportion of net assets acquired was charged to paid-in capital and is identified in the statement of members' and shareholders' equity as dilution.

FIG Corp. is a corporation for tax purposes. As a result, the Registrant is subject to income taxes on that portion of its income which flows through FIG Corp.

Following completion of the Transactions, substantially all of Fortress's expenses (other than (i) income tax expenses of the Registrant, FIG Corp. and FIG Asset Co. LLC (Note 5), (ii) obligations incurred under the tax receivable agreement (Note 5) and (iii) payments on indebtedness incurred by the Registrant, FIG Corp. and FIG Asset Co. LLC), including substantially all expenses incurred by or attributable solely to the Registrant, such as expenses incurred in connection with the Transactions, are accounted for as expenses of Fortress Operating Group.

Nomura Transaction

On December 18, 2006, the Principals entered into a securities purchase agreement with Nomura Investment Managers U.S.A., Inc., a Delaware corporation, or Nomura (whose ultimate parent is Nomura Holdings, Inc., a Japanese corporation), pursuant to which Nomura acquired a then 15% indirect stake in Fortress Operating Group for $888 million, all of the proceeds of which were paid to the Principals. On January 17, 2007, Nomura completed the transaction by purchasing 55,071,450 Class A shares of the Registrant for $888 million and the Registrant, in turn, purchased 55,071,450 Fortress Operating Group units, which then represented 15% of Fortress Operating Group's economic interests, and the sole general partner interest, from the Principals for $888 million.

Initial Public Offering (''IPO'')

On February 8, 2007, the Registrant completed an initial public offering of 39,428,900 of its Class A shares, including the underwriters' over allotment option, for net proceeds of approximately

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$652.7 million. The Registrant contributed the net proceeds from the offering to Fortress Operating Group in exchange for 39,428,900 Fortress Operating Group units. Fortress Operating Group applied those proceeds as follows: (a) to pay $250 million outstanding under its term loan facility, as required by the credit agreement (Note 4), and (b) to pay $85 million then outstanding under its revolving credit facility (Note 4), and intended to use the remaining proceeds (a) to fund $169 million of commitments to existing and future private equity funds, and (b) to use $149 million for general business purposes. As of June 30, 2007, $177.9 million of IPO proceeds remain unused, of which $67.7 million is intended for private equity capital commitments and $110.2 million is intended for general business purposes.

Following the IPO, Fortress adopted accounting policies with respect to new transactions as described in Notes 5, 7 and 8.

Consolidation and Deconsolidation of Fortress Funds

Certain of the Fortress Funds were consolidated into Fortress prior to the Transactions, notwithstanding the fact that Fortress has only a minority economic interest in these funds. Consequently, Fortress's financial statements reflected the assets, liabilities, revenues, expenses and cash flows of the consolidated Fortress Funds on a gross basis through the date of their deconsolidation, as described below. The majority ownership interests in these funds, which are not owned by Fortress, were reflected as Principals' and others' interests in equity of consolidated subsidiaries in the accompanying financial statements during periods in which such funds were consolidated. The management fees and incentive income earned by Fortress from the consolidated Fortress Funds were eliminated in consolidation; however, Fortress's allocated share of the net income from these funds was increased by the amount of these eliminated fees. Accordingly, the consolidation of these Fortress Funds had no net effect on Fortress's earnings from the Fortress Funds. For a reconciliation between the financial statements and the segment-based financial data that management uses for making operating decisions and assessing performance, see Note 10.

Following the IPO, each Fortress subsidiary that acts as a general partner of a consolidated Fortress Fund has granted rights, effective March 31, 2007, to the investors in the fund to provide that a simple majority of the fund's unrelated investors are able to liquidate the fund, without cause, in accordance with certain procedures, or to otherwise have the ability to exert control over the fund. The granting of these rights has led to the deconsolidation of the Fortress Funds from Fortress's financial statements as of March 31, 2007. The deconsolidation of the Fortress Funds has had significant effects on many of the items within these financial statements but has had no net effect on net income or equity. Since the deconsolidation did not occur until March 31, 2007, the income statement and the statement of cash flows for the six months ended June 30, 2007 are presented with these funds on a consolidated basis for three of the six months. The unaudited pro forma effects of the deconsolidation on these financial statements are described in Note 12.

The accompanying consolidated financial statements and related notes of Fortress have been prepared in accordance with accounting principles generally accepted in the United States for interim financial reporting and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared under U.S. generally accepted accounting principles have been condensed or omitted. In the opinion of management, all adjustments considered necessary for a fair presentation of Fortress's financial position, results of operations and cash flows have been included and are of a normal and recurring nature. The operating results presented for interim periods are not necessarily indicative of the results that may be expected for any other interim period or for the entire year. These financial statements

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should be read in conjunction with Fortress's combined financial statements for the year ended December 31, 2006 and notes thereto included in Fortress's annual report on Form 10-K filed with the Securities and Exchange Commission. Capitalized terms used herein, and not otherwise defined, are defined in Fortress's combined financial statements for the year ended December 31, 2006.

In connection with the reevaluation of certain transactions previously reported in 2006, Fortress has concluded that the classification of certain interest expense should be presented net of interest income, resulting in a $179 million reduction of both interest income and expense for the six months ended June 30, 2006. This reclassification had no net effect on Fortress's financial position, results of operations or liquidity, nor did it impact distributable earnings or segment (unconsolidated) revenues or expenses. Accordingly, Fortress has concluded that this reclassification is not material to its financial position taken as a whole.

2. MANAGEMENT AGREEMENTS AND FORTRESS FUNDS

Management Fees, Incentive Income and Related Profit Sharing Expense

On a pro forma basis (Note 12), as adjusted for the deconsolidation of the consolidated Fortress Funds as if it had occurred on January 1, 2007, Fortress recognized management fees and incentive income as follows:

	Six Months Ended June 30, 2007
Private Equity Funds	
Management fees	$ 62,294
Incentive income	211,942
Liquid Hedge Funds	
Management fees	68,062
Incentive income	158,199
Hybrid Hedge Funds	
Management fees	59,680
Incentive income	825
Castles	
Management fees	22,995
Management fees – options	2,006
Incentive income	17,905
Total	
Management fees	$ 215,037
Incentive income	$ 388,871

Incentive Income Subject to Annual Performance Criteria

(dollars in tables in thousands, except share data)

Incentive income from certain Fortress Funds is earned based on achieving annual performance criteria. Accordingly, this incentive income is recorded as revenue at year end (in the fourth quarter of each year) and has not been recognized for these funds during the six months ended June 30, 2007 and 2006. If the amount of incentive income contingent on achieving annual performance criteria was not contingent on the results of the subsequent quarters, $83.4 million and $53.2 million of additional

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incentive income from affiliates would have been recognized during the six months ended June 30, 2007 and 2006, respectively. These amounts are included as ‘‘undistributed’’ deferred incentive income in the table below.

Deferred incentive income from the Fortress Funds, subject to contingent repayment, was comprised of the following:

	June 30, 2007	December 31, 2006
Distributed – gross	$ 391,595	$ 252,774
Less: Recognized (A)	(169,938)	(9,473)
Distributed – unrecognized	$ 221,657	243,301
Undistributed (B)	1,030,065	1,405,481
Total	$ 1,251,722	$ 1,648,782

(A) All related contingencies have been resolved.

(B) On a consolidated basis, undistributed incentive income from the Fortress Funds is recognized on the balance sheet as deferred incentive income; on a deconsolidated basis subsequent to March 31, 2007, undistributed incentive income is no longer recorded and has been removed from the balance sheet.

As of June 30, 2007, Fortress has recognized and paid compensation expense under its employee profit sharing arrangements in connection with the $391.6 million of distributed incentive income. If the $1,030.1 million of undistributed incentive income were realized, Fortress would recognize an additional $317.2 million of compensation expense.

The change in deferred incentive income is summarized as follows:

	Distributed	Undistributed	Total
Deferred incentive income as of December 31, 2006	$ 243,301	$ 1,405,481	$ 1,648,782

Share of income (loss) of Fortress Funds	190,298	(375,416)	(185,118)
Recognition of previously deferred incentive income	(211,942)	—	(211,942)
Deferred incentive income as of June 30, 2007	$ 221,657	$ 1,030,065	$ 1,251,722

Recognized profit sharing compensation expense is summarized as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Private equity funds	$ 20,692	$ 24,992	$ 92,445	$ 34,406
Liquid hedge funds	58,499	15,849	87,446	43,054
Hybrid hedge funds	18,728	12,034	38,246	25,936
Castles	4,518	2,900	6,874	5,361
Total	$ 102,437	$ 55,775	$ 225,011	$ 108,757

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Principals’ and Others’ Interests in Consolidated Subsidiaries

This balance sheet caption was comprised of the following at June 30, 2007:

Employee interests in majority owned and controlled fund advisor and general partner entities	$ 59,648
Principals’ Fortress Operating Group units	294,512
Other	4,232
Total	$ 358,392

This income statement caption was comprised of shares of consolidated net income related to the following, on a pre-tax basis:

	Three Months Ended June 30, 2007	Six Months Ended June 30, 2007
	Actual	Actual

			Pro Forma (A)
Employee interests in majority owned and controlled fund advisor and general partner entities	$ 3,158	$ 6,000	$ 6,000
Third party investors in Fortress Funds	—	(460,615)	—
Principals' Fortress Operating Group units	(169,759)	(247,401)	(247,401)
Other	116	—	—
Total	$ (166,485)	$ (702,016)	$ (241,401)

(A) On a pro forma basis (Note 12), as adjusted for the deconsolidation of the consolidated Fortress Funds as if it had occurred on January 1, 2007.

Private Equity Funds

In January 2007, Fortress increased its capital commitment to one of its private equity funds by $80 million.

In February 2007, Fortress had its first closing of a new private equity Fortress Fund, Long Dated Value Fund III (''LDVF III''). A second closing was held in March 2007. A third and final closing was held in June 2007 resulting in total commitments of $345.1 million. Fortress, its affiliates and employees represent $22.3 million of the total commitments. Fortress will manage LDVF III under similar terms to the other private equity Fortress Funds.

In March 2007, $11.6 million of Fortress's remaining capital commitment to one of its private equity funds was extinguished.

In May 2007, Fortress formed a new private equity Fortress Fund known as Fortress Investment Fund V (''Fund V'') with total capital commitments from third-party investors of $4.0 billion. Fortress has committed to contribute to Fund V an amount equal to 1.5% of Fund V's total equity contributed by third party investors, or $60 million. In June 2007, Fortress formed two additional private equity funds for the purpose of co-investing alongside Fund V in either single or multiple transactions. In total, $2.0 billion was committed by investors to these two additional funds, of which $0.4 billion was committed by Fortress and its employees. Fortress has entered into management agreements with the

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Fund V entities and will manage Fund V and the related funds under essentially the same terms as the other private equity Fortress Funds, including management fees and incentive income.

In June 2007, Fortress formed a new private equity Fortress Fund known as Real Assets Fund with total capital commitments of $300.4 million. Fortress, its affiliates and employees represent $95.0 million of the total commitments. Fortress will manage Real Assets Fund under similar terms to the other private equity Fortress Funds.

Liquid Hedge Funds and Hybrid Hedge Funds

Approximately $383.8 million of distributions were made to the Principals during the period from January 1, 2007 through the date of the IPO from the net proceeds from collection of deferred fee receivables, earned in prior periods, related to the liquid and hybrid hedge funds. Following this distribution, all of the deferred fee arrangements were terminated. Subsequently, $27.4 million of net proceeds from all of the remaining deferred fee receivables were collected.

In February 2007, one of the then consolidated hybrid hedge funds raised $1.2 billion of capital commitments from existing and new limited partners, of which 18% was called in the first quarter of 2007 and 20% was called in the second quarter of 2007. During the capital commitment period, which expires on the earlier of when it is fully drawn or December 31, 2008, no other new third party investors will be permitted in this fund.

In February 2007, one of the consolidated hybrid hedge funds originated a $1.2 billion loan in connection with a transaction between two third parties. As part of the syndication of this loan, Fortress formed four managed account relationships totaling $425 million, whereby Fortress manages investments on behalf of third parties in exchange for fees, syndicated $300 million to a third party participant and retained the remainder in certain Fortress Funds. Fortress will earn incentive income from the managed account relationships based upon the performance of the underlying investment.

In June 2007, one of the liquid hedge funds, which had begun an orderly liquidation process after the completion of Fortress's initial public offering, liquidated its positions and all investors fully redeemed out of the fund, including $14.5 million redeemed to third party investors.

3. INVESTMENTS IN EQUITY METHOD INVESTEES

Investments in Equity Method Investees

Fortress holds investments in certain unconsolidated Fortress Funds which are accounted for under the equity method. Upon the deconsolidation of the consolidated Fortress Funds on March 31, 2007 (Note 1), these funds also became equity method investees. Fortress's maximum exposure to loss with respect to these entities is generally equal to its investment plus its basis in any options received from such entities as described below. In addition, unconsolidated affiliates also hold an ownership interest in certain of these entities. Summary financial information related to these investments is as follows:

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	Equity Held by Fortress		Fortress's Equity in Net Income (Loss)			
	June 30, 2007	December 31, 2006	Six Months Ended June 30,		Three Months Ended June 30,	
			2007	2006	2007	2006
Private equity funds, excluding NIH (A)	$ 270,768	$ (A)	$ (8,024)	$ (A)	$ (8,024)	$ (A)
NIH	6,834	8,213	(1,024)	794	(843)	(151)
Total private equity funds	277,602	8,213	(9,048)	794	(8,867)	(151)
Liquid hedge funds (A)	49,156	(A)	3,993	(A)	3,993	(A)
Hybrid hedge funds (A)	291,827	(A)	11,335	(A)	11,335	(A)
Newcastle	11,389	13,756	1,189	1,336	460	668
Eurocastle	11,062	11,844	(89)	204	309	(38)
Other	1,482	3,437	47	86	1	45
	$ 642,518	$ 37,250	$ 7,427	$ 2,420	$ 7,231	$ 524

(A) These entities were consolidated prior to March 31, 2007.

A summary of the changes in Fortress's investments in equity method investees is as follows:

	Six Months Ended June 30, 2007							
	Private Equity Funds		Liquid Hedge Funds	Hybrid Hedge Funds	Castles			
	NIH	Other			Newcastle	Eurocastle	Other	
Investment, beginning	$ 8,213	$ —	$ —	$ —	$13,756	$11,844	$ 3,437	$
Earnings from equity method investees	(1,024)	(8,024)	3,993	11,335	1,189	(89)	47	
Other comprehensive income from equity method investees	(355)	—	—	—	(2,110)	(187)	—	
Contributions to equity method investees	—	8,250	37,318	20,293	—	—	28,890	
Distributions of earnings from equity method investees	—	—	(1,849)	(869)	(1,446)	—	(47)	
Distributions of capital from equity method investees	—	—	(22,286)	(14,685)	—	(796)	(2,139)	(
Total distributions from equity method investees	—	—	(24,135)	(15,554)	(1,446)	(796)	(2,186)	(
Translation adjustment	—	—	—	—	—	290	—	
Sale of investments	—	—	—	—	—	—	(28,706)	(
Deconsolidation	—	270,542	31,980	275,753	—	—	—	5
Investment, ending	$ 6,834	$270,768	$ 49,156	$291,827	$11,389	$11,062	$ 1,482	$6
Ending balance of undistributed earnings	$ 4,555	$ —	$ 2,144	$ 10,466	$ 606	$ —	$ —	$

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The ownership percentages presented in the following tables are reflective of the ownership interests held as of the end of the respective periods. For tables which include more than one Fortress Fund, the ownership percentages are based on a weighted average by total equity of the funds as of period end.

	Private Equity Funds excluding NIH	Newcastle Investment Holdings LLC ("NIH")	
	June 30, 2007	June 30, 2007	December 31, 2006
Assets	$ 14,285,265	$ 433,942	$ 457,436
Liabilities	(797,662)	(305,157)	(315,732)
Equity	$ 13,487,603	$ 128,785	$ 141,704
Equity held by Fortress	$ 270,768	$ 6,834	$ 8,213
Ownership (A)	2.0%	4.8%	4.8%

	Six Months Ended	Six Months Ended June 30,	
	June 30, 2007	2007	2006
Revenues and gains (losses) on investments	$ (1,477,818)	$ (2,876)	$ 33,427
Expenses	(102,040)	(9,844)	(16,843)
Net Income (Loss)	$ (1,579,858)	$ (12,720)	$ 16,584
Fortress's equity in net income (loss)	$ (8,024) (B)	$ (1,024)	$ 794

	Liquid Hedge Funds	Hybrid Hedge Funds
	June 30, 2007	June 30, 2007
Assets	$ 7,618,740	$ 9,826,827
Liabilities	(159,915)	(3,293,357)
Minority interest	—	—
Equity	$ 7,458,825	$ 6,533,470
Equity held by Fortress	$ 49,156	$ 291,827
Ownership (A)	0.7%	4.5%

	Six Months Ended	Six Months Ended
	June 30, 2007	June 30, 2007
Revenues and gains (losses) on investments	$ 1,108,498	$ 623,181

Expenses	(541,936)	(191,000)
Net Income	$ 566,562	$ 432,181
Fortress's equity in net income	$ 3,993 (B)	$ 11,335 (B)

(A) Excludes ownership interests held by other Fortress Funds, the Principals, employees and other affiliates.

(B) The revenues and expenses of these entities were consolidated through March 31, 2007, the effective date of the deconsolidation (Note 1). As a result, the amounts shown for Fortress's equity in net income of these entities relate to the period subsequent to March 31, 2007.

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	Newcastle Investment Corp.		Eurocastle Investment Ltd.	
	June 30, 2007	December 31, 2006	June 30, 2007	December 31, 2006
Assets	$ 10,023,568	$ 8,604,392	$ 10,374,961	$ 7,295,320
Liabilities	(8,890,182)	(7,602,412)	(8,528,013)	(5,427,716)
Minority interest	—	—	(8)	(8)
Equity	$ 1,133,386	$ 1,001,980	$ 1,846,940	$ 1,867,596
Equity held by Fortress	$ 11,389	$ 13,756	$ 11,062	$ 11,844
Ownership, basic (A)	1.9%	2.2%	1.6%	1.6%
Ownership, diluted (A) (B)	4.5%	4.8%	10.0%	10.4%
Ownership by Fortress and affiliates, diluted (B)	14.4%	12.3%	28.5%	26.6%
Market value of shares owned (A) (C)	$ 25,715	$ 32,126	$ 46,600	$ 51,203

	Six Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Revenues	$ 374,016	$ 254,985	$ 346,862	$ 139,304
Expenses	(300,693)	(193,261)	(408,234)	(132,564)
Net gain on sale of investment property	—	—	51,564	—
Discontinued operations	(19)	225	—	—
Preferred dividends	(5,890)	(4,657)	—	—
Net Income (Loss)	$ 67,414	$ 57,292	$ (9,808)	$ 6,740
Fortress's equity in net income (loss)	$ 1,189	$ 1,336	$ (89)	$ 204

(A) Excludes shares owned by other Fortress Funds, the Principals, employees and other affiliates.

(B)

Fully diluted ownership represents the percentage of outstanding common shares owned assuming that all options are exercised.

(C) Based on the closing price of the related shares and, if applicable, the foreign currency exchange rate on the last day of trading in the applicable period.

Options in Affiliates

Fortress holds options to purchase additional shares of its equity method investees with carrying values as follows:

	June 30, 2007	December 31, 2006	Accounting Treatment
Newcastle options	$ 3,556	$ 2,950	Held at cost subject to impairment
Eurocastle options	102,768	136,316	Qualify as a derivative, held at fair value
	$ 106,324	$ 139,266	

The fair value of the Newcastle options as of June 30, 2007 was approximately $2.3 million.

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In January 2007, in connection with a capital raise, Newcastle issued 242,000 options to purchase shares of its common stock at $31.30 per share to Fortress, which were valued at $0.8 million. Fortress assigned 121,605 of these options to employees, recording compensation expense of $0.4 million. In addition, during May 2004 and January 2005, Newcastle issued 675,000 options (at a weighted average strike price of $27.63) to purchase shares of its common stock to Fortress. During March 2007, Fortress assigned 261,525 of these options to employees, recording compensation expense of $0.5 million.

During the six months ended June 30, 2007, Fortress assigned a total of 317,670 Eurocastle options, with a weighted average strike price of €19.24 per share, to certain of its employees. Fortress recorded compensation expense of $1.6 million and $3.3 million associated with the assignment of these options during the three and six months ended June 30, 2007, respectively.

In April 2007, in connection with a capital raise, Newcastle issued 456,000 options to purchase shares of its common stock at $27.75 per share to Fortress, which were valued at $1.2 million. Fortress assigned 162,450 of these options to employees and recorded compensation expense of $0.4 million. The Principals in their personal capacities purchased approximately $60 million in the aggregate of the shares sold in this offering directly from the underwriter at the public offering price.

Investments in Variable Interest Entities

As part of the deconsolidation of the consolidated Fortress Funds (Note 1), Fortress caused reconsideration events to occur in each of the variable interest entities in which it was deemed to be the primary beneficiary. As a result of these reconsideration events, Fortress is no longer considered the primary beneficiary of, and therefore does not consolidate, any of the variable interest entities in which it holds an interest. No other reconsideration events occurred during the six months ended June 30, 2007 which caused a change in Fortress's accounting.

The following table represents information as of June 30, 2007 regarding entities formed during the six months ended June 30, 2007 that were determined to be VIEs in which Fortress holds a variable interest:

	Fortress is not Primary Beneficiary	
Business Segment	Gross Assets	Fortress Investment
Private Equity Funds	$ 18,397	$(554)(A)
Liquid Hedge Funds	$ 6,750,470	$121,360 (B)

(A) Fortress's interest in Fund V is negative as a result of Fortress's share of the loss incurred on a derivative used to hedge the anticipated financing of the fund's first investment. Fortress will be required to fund this loss based on its capital commitment to this fund. No capital contributions have been made as of June 30, 2007.

(B) Includes $103.0 million of incentive income receivable. Also represents Fortress's maximum exposure to loss with respect to these entities.

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4. DEBT AND DERIVATIVE OBLIGATIONS

The following table presents summarized information regarding Fortress's debt obligations:

		Face Amount and Carrying Value			As of June 30, 2007			
Debt Obligation/Collateral	Month Issued	June 30, 2007	December 31, 2006	Contractual Interest Rate	Final Stated Maturity	Weighted Average Funding Cost	Weighted Average Maturity (Years)	Collate Carryi Valu
Credit agreement								

(dollars in tables in thousands, except share data)

Revolving debt (A)	May 2007	$ —	$ 85,000	LIBOR + 1.20% (B)	May 2012	0.00%	—	(
Term loan	May 2007	350,000	600,000	LIBOR + 1.20%	May 2012	6.73%	4.87	(
Delayed term loan (A)	May 2007	—	—	LIBOR + 1.20% (B)	Feb 2008	0.00%	—	(
Aircraft loan	Jun 2002	—	2,153	LIBOR + 2.25%	Repaid	0.00%	—	$ -
Total		$350,000	687,153			6.73%	4.87	
Consolidated Fortress Fund debt			2,619,456					
Total			$3,306,609					

(A) Approximately $194.1 million and $450 million were undrawn and available on the revolving debt and delayed term loan, respectively, as of June 30, 2007, including a $25 million letter of credit subfacility of which $5.9 million was utilized.

(B) Subject to unused commitment fees of 0.375% per annum (the unused commitment fee for the delayed term loan is 0.175% for the first 135 days after closing).

(C) Collateralized by substantially all of Fortress Operating Group's assets as well as Fortress Operating Group's rights to fees from the Fortress Funds and its equity interest therein.

In connection with a repayment of a prior credit facility, deferred loan costs of $3.1 million were written off to interest expense in June 2006. In connection with the repayment of a portion of a prior term loan, $2.0 million of deferred loan costs were written off to interest expense in February 2007. In May 2007, Fortress entered into a new credit agreement to refinance its existing credit agreement, reduce the amount of interest and other fees payable under its credit facilities, and increase the amount of funds available for investments.

Management believes that for similar financial instruments with comparable credit risks, the stated interest rates of Fortress's debt as of June 30, 2007 approximate market rates. Accordingly, the carrying values outstanding are believed to approximate fair value.

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The following table presents summarized information regarding Fortress's derivative assets (obligations):

	Notional Amount	Fair Value	Longest Maturity June 30, 2007

	June 30, 2007	June 30, 2007	December 31, 2006	
Interest rate swaps, treated as hedges	$ —	$ —	$ 8	N/A
Foreign currency derivatives, treated as hedges	€ 8,648	(634)	(435)	Oct 30, 2007
Foreign currency derivatives, non-hedges	€ 27,552	(2,018)	(1,184)	Oct 30, 2007
Consolidated Fortress Fund derivatives, net		—	(38,018)	
Total		$ (2,652)	$ (39,629)	

5. INCOME TAXES AND TAX RELATED PAYMENTS

Prior to January 17, 2007, Fortress, as a partnership, generally had not been subject to U.S. federal income tax but certain of its subsidiaries had been subject to the New York City unincorporated business tax (''UBT'') on its U.S. earnings based on a statutory rate of 4%. One subsidiary of Fortress was subject to U.S. federal corporate income taxes. Certain subsidiaries of Fortress are subject to income tax of the foreign countries in which they conduct business. In connection with the Nomura transaction and the initial public offering (Note 1), Fortress was reorganized. Fortress was established as a publicly traded partnership and also established a wholly owned corporate subsidiary. Accordingly, a substantial portion of Fortress's income earned by the corporate subsidiary is subject to U.S. federal income taxation and taxed at prevailing rates. The remainder of Fortress's income is allocated directly to its shareholders and is not subject to a corporate level of taxation.

The Nomura transaction involved Fortress's purchase of Fortress Operating Group units from the Principals and an election by certain Fortress Operating Group entities under Section 754 of the Code, resulting in the tax basis of the assets owned by Fortress Operating Group to increase. Fortress established a deferred tax asset of $454.8 million for the expected tax benefit associated with the difference between the book value of net assets and the tax basis of net assets, based on an estimated combined marginal federal and state tax rate of approximately 39.4 % and the expectation, based on an analysis of expected future earnings, that it is more likely than not that this benefit will be realized. The establishment of the deferred tax asset increased additional paid in capital as the transaction giving rise to the increase in tax basis was between Fortress and its shareholders. The deferred tax asset described above reflects the tax impact of payments expected to be made under the tax receivable agreement (described below), which further increase Fortress's deferred tax benefits and the estimated payments due under the tax receivable agreement.

As a result of the contribution of $578.3 million of the net proceeds of the initial public offering by FIG Corp. to the capital of Fortress Operating Group, a temporary difference arose between the carrying value of Fortress Operating Group for financial reporting purposes and that for income tax purposes. A gross deferred tax asset of $24.6 million has been recorded to reflect the deferred tax effects of the tax basis over financial reporting basis.

The tax effects of temporary differences have resulted in deferred income tax assets and liabilities as follows:

	June 30, 2007	December 31, 2006
Deferred tax assets	$ 475,091	$ 2,808
Deferred tax liabilities (A)	$ 7,883	$ 12,989

(A) Included in Other Liabilities.

For the period January 17, 2007, the reorganization date, through June 30, 2007, an estimated annual (January 17, 2007 through December 31, 2007) negative effective tax rate of (16.13%) was used to compute the tax provision on the Registrant's income subject to U.S. federal, state and local income taxes. Fortress incurred a loss before income taxes for financial reporting purposes, after deducting the compensation expense arising from the Principals' forfeiture agreement (Note 7). However, this compensation expense is not deductible for income tax purposes. Also, after the reorganization, a portion of Fortress's income is not subject to U.S. federal corporate income tax but is allocated directly to Fortress's shareholders.

The actual effective tax rate for the period ended June 30, 2007 is significantly different than the effective tax rate above primarily because (i) all of the income earned by the predecessor prior to January 17, 2007 was earned through partnerships and only subject to the New York City UBT; and (ii) significant income was earned by the predecessor prior to January 17, 2007 as compared to a loss incurred by the Registrant for the period from January 17, 2007 through June 30, 2007.

As a result of the foregoing, Fortress's effective tax rate for GAAP reporting purposes may be subject to significant variation from period to period.

Tax Receivable Agreement

The Principals have the right to exchange each of their Fortress Operating Group units for one of the Class A shares. The Fortress Operating Group entities intend to make an election under Section 754 of the Internal Revenue Code, as amended, which may result in an adjustment to the tax basis of the assets owned by Fortress Operating Group at the time of an exchange. The exchanges may result in increases in tax deductions and tax basis that would reduce the amount of tax that the corporate taxpayers (i.e. FIG Corp.) would otherwise be required to pay in the future. Additionally, the further acquisition of Fortress Operating Group units from the Principals, such as in the Nomura transaction (Note 1), also may result in increases in tax deductions and tax basis that would reduce the amount of tax that the corporate taxpayers would otherwise be required to pay in the future. The corporate taxpayers entered into a tax receivable agreement with each of the Principals that provides for the payment to an exchanging or selling Principal of 85% of the amount of cash savings, if any, in U.S. federal, state, local and foreign income tax that the corporate taxpayers actually realize (or are deemed to realize in the case of an early termination payment by the corporate taxpayers or a change of control, as defined) as a result of these increases in tax basis. Such payments are expected to occur over approximately the next 15 years. In connection with the Nomura transaction and related tax effects, a $390 million capital decrease and offsetting liability to the Principals was recorded with respect to the tax receivable agreement. Such amount is a component of the deferred tax effects reflected in the Statement of Members' and Shareholders' Equity. No further liability was recorded during the period ended June 30, 2007, nor were any payments made during that period. Although the

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tax receivable agreement payments are calculated based on annual tax savings, for the period ended June 30, 2007 the payments which would have been made pursuant to the tax receivable agreement, if such period was calculated by itself, were $7.5 million.

Recently Adopted Accounting Pronouncement

We adopted the Financial Accounting Standards Board's Interpretation No. 48, ''Accounting for Uncertainty in Income Taxes, an interpretation of SFAS No. 109'' (''FIN 48''), effective January 1, 2007. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in financial statements and requires the impact of a tax position to be recognized in the financial statements if that position is more likely than not of being sustained by the taxing authority. The adoption of FIN 48 did not have a material effect on our consolidated financial position, liquidity or results of operations.

6. RELATED PARTY TRANSACTIONS

	Management Fees and Incentive Income		Dividends and Distributions		Total	
Due from Affiliates	June 30, 2007	December 31, 2006	June 30, 2007	December 31, 2006	June 30, 2007	December 31, 2006
Private equity funds	$ 30,590	$ —	$ —	$ 26,315	$ 30,590	$ 26,315
Castles	27,738	47,832	830	1,297	28,568	49,129
Liquid and hybrid hedge funds	115,301	500,889	—	—	115,301	500,889
Unconsolidated subsidiaries of liquid hedge fund subsidiaries	—	—	—	19,309	—	19,309
Subtotal	$ 173,629	$ 548,721	$ 830	$ 46,921	174,459	595,642
Other					5,970	40,106
Total					$ 180,429	$ 635,748

Due to Affiliates	June 30, 2007	December 31, 2006
Private equity funds		
– Payments on behalf of Fortress Funds	$ —	$ 14,123
Principals		
– Tax receivable agreement – Note 5	390,383	—
– Distributions payable on Fortress Operating Group units	24,927	—
Other	666	989
	$ 415,976	$ 15,112

In February 2007, Fortress entered into a preliminary agreement with two employees who were departing from Fortress to form their own investment management company. Fortress received a profits interest in their management company, and, as part of the transaction, a Fortress Fund received certain rights to invest at discounted fee rates in the fund being formed by the departing employees, and committed to invest $200 million in that fund subject to certain conditions. The transaction was approved by the advisory board of the Fortress Fund.

In March 2007, a departing Fortress employee entered into a sourcing agreement with a Fortress Fund pursuant to which the Fortress Fund agreed to make contingent payments to the former employee based on the employee sourcing future transactions for that Fortress Fund.

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In March 2007, one of the Portfolio Companies leased office space to a company owned by one of the Principals. The Principal pays approximately $0.2 million per annum in rent to the Portfolio Company.

In March 2007, in conjunction with the deconsolidation (Note1), Fortress transferred its general partner interests in certain CDO Portfolio Companies to certain Fortress Funds for $6.5 million.

In connection with the IPO, Fortress entered into a tax receivable agreement with the Principals, as described in Note 5, and the Principals entered into a forfeiture agreement with each other, as described in Note 7. The Principals, employees, directors and Fortress Funds have and continue to make investments in Fortress Funds.

In June 2007, Fortress sold two investments to Real Assets Fund, a private equity Fortress Fund. Fortress received $29.1 million from the sales and recorded gains aggregating $0.4 million.

7. EQUITY-BASED COMPENSATION

Fortress currently has seven categories of equity-based compensation which are accounted for as described in the table below. A total of 115,000,000 Class A shares have been authorized for issuance under Fortress's equity-based compensation plan. RSUs are Class A restricted share units which entitle the holder to receive Class A shares on various future dates if the applicable service conditions, if any, are met. LTIP means long-term incentive plan.

Granted To	Type of Award	Service Conditions	Entitled to Dividends	Accounting	June 30, 2007 Shares/Units Outstanding	Weighted Average Grant Date Estimated Value per	Weighted Average June 30, 2007 Estimated

		(A)	(B)			Share/Unit	Value per Share/Unit
Employees	RSUs	Yes	Yes	Fair value at grant date (D) expensed over service period.	23,730,308	$18.50	N/A
	RSUs	Yes	No	Fair value at grant date (D) discounted for the non-entitlement to dividends, expensed over service period.	16,544,710	14.96	N/A
	RSUs	No	Yes	Fair value at grant date (D) discounted for post-vesting restrictions (delivery of shares as described in (B)), expensed at grant date.	394,286	22.11	N/A
	RSUs	No	No	Fair value at grant date (D) discounted for the non-entitlement to dividends and further discounted for post-vesting restrictions (delivery of shares as described in (B)), expensed at grant date.	642,313	11.50	N/A
	LTIP (C)	Yes (C)	(C)	Fair value at grant date, based on a valuation model, expensed over service period.	2,857,143	7.24	N/A
Directors	Restricted Shares	Yes	Yes	Fair value at grant date (D) expensed over service period.	97,296	18.50	N/A
Employees of our Private Equity Funds	RSUs	Yes	No	Fair value at grant date (D) discounted for the non-entitlement to dividends, expensed over service period. Subsequent changes in fair value, through the vesting date, expensed over remaining service period with a cumulative catch-up adjustment in the period of change.	8,695,819	15.00	$18.16

(A) Generally, such awards vest 25% at each of January 1, 2010, 2011, 2012, and 2013 (for employees) and 33-1/3% after each of our annual meetings in 2008, 2009 and 2010 (for directors). Certain employees (primarily those hired after the IPO) have different vesting schedules.

(B) Vested Class A shares will be delivered to employee grant recipients 25% at each of, or within no more than six months after, January 1, 2010, 2011, 2012, and 2013. Director restricted shares were delivered effective on the grant date. Certain awards entitle the recipient to receive dividend equivalent payments prior to such delivery dates.

(C) Represents a profits interest in respect of certain Fortress Operating Group units that have a maximum value that corresponds to 2.9 million Fortress Operating Group units, granted by one of the Principals to one of Fortress's employees at the date of the IPO. The profits interests have a five-year cliff-vesting service condition.

(D) For awards granted in connection with the IPO, the fair value is based on the IPO price. For awards granted subsequent to the IPO, the fair value is based on the closing price on the grant date of Fortress's Class A shares.

The aggregate fair value of each of the RSU grants which are subject to service conditions is reduced by an estimated forfeiture factor (that is, the estimated amount of awards which will be forfeited prior to vesting). The estimated forfeiture factor is based upon historic turnover rates within Fortress, adjusted for the expected effects of the grants on turnover and other factors in the best judgment of management. The estimated forfeiture factor is updated at each reporting date. The estimated forfeiture factor as of the grant date and as of June 30, 2007 was 16% for unvested RSU awards that are entitled to dividends and 19% for unvested RSU awards that are not entitled to dividends. Since Fortress's initial public offering in February 2007, neither the actual forfeiture rate nor any other factors have caused a change in managements forfeiture expectations or assumptions.

The volatility assumption used in valuing certain awards, as described below, was based on five-year historical stock price volatilities observed for a group of comparable companies, since Fortress does not have sufficient historical share performance to use its own historical volatility, adjusted for management's judgment regarding expected volatility. Since Fortress's IPO in February 2007, its actual volatility has exceeded the volatility assumption used. To the extent that this trend continues, and management's judgment concerning volatility is changed, Fortress would adjust the volatility assumption used. The risk-free discount rate assumptions used in valuing certain awards were based on the applicable U.S. treasury rate of like term. The dividend yield assumptions used in valuing certain awards were based on Fortress's actual dividend rate at the time of the award; the dividend growth rate used with respect to one type of award was based on management's judgment and expectations.

The discount related to RSUs which do not entitle the recipients to dividend equivalents prior to the delivery of Class A shares was based on the estimated present value of dividends to be paid during the vesting period, which in turn was based on an estimated initial dividend rate (between 2.25% and 3.68% based on the actual dividend rate on the grant date), an estimated dividend growth rate (20%) and a risk-free discount rate (between 4.45% and 5.17% based on term).

The discount related to RSUs with no service conditions which are subject to the delayed delivery of Class A shares, which occurs in periods subsequent to the grant date, was based on the estimated value of a put option on such shares over the delayed delivery period since essentially this would be the value of owning, and being able to trade, those shares during the delayed delivery period rather than having to wait for delivery. This estimated value was in turn derived from a binomial option pricing model based on the following assumptions: volatility (35%), term (equal to delayed delivery period), dividend rate (between 2.96% and 3.68% based on grant date) and risk-free discount rate (between 4.54% and 4.79% based on term).

The estimated fair value of the LTIP award was estimated using a Monte Carlo simulation valuation model with the following assumptions: volatility (35%), term (equal to vesting period), and risk-free discount rate (4.71%) of like term.

Each of these elements, particularly the forfeiture factor and the volatility assumptions used in valuing certain awards, are subject to significant judgment and variability and the impact of changes in such elements on equity-based compensation expense could be material.

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The following table sets forth information regarding equity-based compensation activities during the six months ended June 30, 2007.

	RSUs		Restricted Shares	LTIP	Total Equity-Based Compensation Expense
	Employees	Non-Employees			
Issued at IPO	42,375,371	8,358,011	97,296		
Issued subsequent to IPO	768,402	500,000	—		
Forfeited	(1,832,156)	(162,192)	—		
Outstanding at June 30, 2007 (A)	41,311,617	8,695,819	97,296		
Expense incurred during the six months ended June 30, 2007	$ 54,015	$ 8,478	$ 233	$ 1,574	$ 64,300
Expense incurred during the three months ended June 30, 2007	$ 24,533	$ 4,664	$ 149	$ (251)	$ 29,095

(A) Excludes 3,600 RSUs approved for issuance to employees whose employment began after June 30, 2007.
Fortress will further recognize compensation expense on its non-vested equity-based awards of $818.8 million, with a weighted average recognition period of 5.50 years.

The Principals entered into an agreement among themselves (the ‘‘Principals Agreement’’) which provides that, in the event a Principal voluntarily terminates his employment with Fortress Operating Group for any reason prior to the fifth anniversary of the IPO, a portion of the equity interests held by that Principal as of the completion of the IPO will be forfeited to the Principals who are employed by Fortress Operating Group generally as of the date that is six months after the date of such termination of employment. As a result of the service requirement, the fair value of Fortress Operating Group units subject to the risk of forfeiture of $4,763 million will be charged to compensation expense on a straight-line basis over the five year service period, including $380.9 million and $242.7 million during the six and three months ended June 30, 2007, respectively.

When Fortress records equity-based compensation expense, including that related to the Principals Agreement, it records a corresponding increase in capital. Of the total increase in capital during the six months ended June 30, 2007 from equity-based compensation arrangements of $445.2 million, $103.5 million increased Fortress’s paid-in capital, as reflected in the Statement of Members' and Shareholders' Equity, and $341.7 million increased Principals' interests in equity of consolidated subsidiaries corresponding to the Principals' interest in the equity-based compensation expense.

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8. EARNINGS PER SHARE

As a result of Fortress's reorganization in January 2007 (Note 1), Fortress has calculated its earnings per share for two different periods within the six months ended June 30, 2007. For the first period, prior to the reorganization on January 17, 2007, the calculation is based on the income and outstanding units of Fortress Operating Group, which was owned by the Principals as described in Note 1, as if such units had been outstanding from the beginning of the period. For the second period, subsequent to the reorganization and commencement of operations of the Registrant, the calculation is based on the consolidated income of Fortress from January 17, 2007 through June 30, 2007 and the Class A shares outstanding for such period.

The computations of net income per Fortress Operating Group unit are set forth below:

	January 1 through January 16, 2007	
	Basic	Diluted
Weighted average units outstanding		
Fortress Operating Group units outstanding	367,143,000	367,143,000
Total weighted average units outstanding	367,143,000	367,143,000
Net income per unit is calculated as follows:		
Net income	$ 133,397	$ 133,397
Dilution in earnings of certain equity method investees	—	—
Net income available to Fortress Operating Group unitholders	$ 133,397	$ 133,397
Weighted average units outstanding	367,143,000	367,143,000
Net income per unit	$ 0.36	$ 0.36

The computations of basic and diluted net income (loss) per Class A share are set forth below:

	January 17 through June 30, 2007	
	Basic	Diluted

(dollars in tables in thousands, except share data)

Weighted average shares outstanding		
Class A shares outstanding	89,004,200	89,004,200
Fully vested restricted Class A share units with dividend equivalent rights	222,234	222,234
Fortress Operating Group units exchangeable into Fortress Investment Group LLC Class A shares(1)	—	—
Class A restricted shares and Class A restricted share units granted to employees and directors (eligible for dividend and dividend equivalent payments)(2)	—	—
Class A restricted share units granted to employees (not eligible for dividend and dividend equivalent payments)(3)	—	—
Total weighted average shares outstanding	89,226,434	89,226,434

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	January 17 through June 30, 2007	
	Basic	Diluted
Basic and diluted net income (loss) per Class A share		
Net income (loss)	$ (126,385)	$ (126,385)
Dividend equivalents declared on non-vested restricted Class A share units	(1,617)	(1,617)
Dilution in earnings of certain equity method investees	—	—
Add back Principals' and others' interests in loss of Fortress Operating Group, net of assumed corporate income tax at enacted rates, attributable to Fortress Operating Group units exchangeable into Fortress Investment Group LLC Class A shares(1)	—	—
Net income (loss) available to Class A shareholders	$ (128,002)	$ (128,002)
Weighted average shares outstanding	89,226,434	89,226,434
Basic and diluted net income (loss) per Class A share	$ (1.43)	$ (1.43)

	Three Months Ended June 30, 2007	
	Basic	Diluted
Weighted average shares outstanding		
Class A shares outstanding	94,500,350	94,500,350
Fully vested restricted Class A share units with dividend equivalent rights	394,286	394,286
Fortress Operating Group units exchangeable into Fortress Investment	—	312,071,550

Group LLC Class A shares(1)		
Class A restricted shares and Class A restricted share units granted to employees and directors (eligible for dividend and dividend equivalent payments)(2)	—	—
Class A restricted share units granted to employees (not eligible for dividend and dividend equivalent payments)(3)	—	—
Total weighted average shares outstanding	94,894,636	406,966,186

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	Three Months Ended June 30, 2007	
	Basic	Diluted
Basic and diluted net income (loss) per Class A share		
Net income (loss)	$ (55,131)	$ (55,131)
Dividend equivalents declared on non-vested restricted Class A share units	(1,048)	(1,048)
Dilution in earnings of certain equity method investees	—	—
Add back Principals' and others' interests in loss of Fortress Operating Group, net of assumed corporate income tax at enacted rates, attributable to Fortress Operating Group units exchangeable into Fortress Investment Group LLC Class A shares(1)	—	(212,759)
Net income (loss) available to Class A shareholders	$ (56,179)	$ (268,938)
Weighted average shares outstanding	94,894,636	406,966,186
Basic and diluted net income (loss) per Class A share	$ (0.59)	$ (0.66)

(1) The Fortress Operating Group units not held by Fortress (that is, those held by the Principals) are exchangeable into Class A shares on a one-to-one basis. These units are not included in the computation of basic earnings per share. These units enter into the computation of diluted net income (loss) per Class A share when the effect is dilutive using the if-converted method. Under the if-converted method the Principals' and others' interests in income (loss) of Fortress Operating Group attributable to the units, net of assumed corporate income tax, is added to the net loss in the numerator of the computation and the Class A shares available from the assumed conversion of the Fortress Operating Group units, as if it had occurred at the beginning of the period, is added to the denominator. For the year-to-date period, the effect of including the units would have been antidilutive. The weighted average number of Fortress Operating Group units outstanding for the periods from January 17, 2007 through June 30, 2007 and the three months ended June 30, 2007 were 312,071,550 units.

(2)

(dollars in tables in thousands, except share data)

Restricted Class A shares granted to directors and certain restricted Class A share units granted to employees are eligible to receive dividend or dividend equivalent payments when dividends are declared and paid on our Class A shares and therefore participate fully in the results of our operations from the date they are granted. They are included in the computation of both basic and diluted pro forma earnings per Class A share using the two-class method for participating securities, except during periods of net losses in accordance with EITF 03-6, ''Participating Securities and the Two-Class Method under FASB Statement No. 128.'' The weighted average restricted Class A shares and share units eligible to receive dividend or dividend equivalent payments outstanding for the periods from January 17, 2007 through June 30, 2007 and the three months ended June 30, 2007 were 83,733 and 97,296 shares and 20,572,005 and 23,730,308 share units, respectively.

(3) Certain restricted Class A share units granted to employees are not entitled to dividend or dividend equivalent payments until they are vested and are therefore non-participating securities. These units are not included in the computation of basic earnings per share. They are included in the computation of diluted earnings per share when the effect is dilutive using the treasury stock method. As a result of the net loss incurred for the period, the effect of the units on the calculation is anti-dilutive for the periods. The weighted average restricted Class A share units which are not entitled to receive dividend or dividend equivalent payments outstanding for the

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periods from January 17, 2007 through June 30, 2007 and the three months ended June 30, 2007 were 21,993,462 and 25,705,670 share units, respectively.

The Class B shares have no net income (loss) per share as they do not participate in Fortress's earnings (losses) or distributions. The Class B shares have no dividend or liquidation rights. Each Class B share, along with one Fortress Operating Group unit, can be exchanged for one Class A share, subject to certain limitations. The Class B shares have voting rights on a pari passu basis with the Class A shares. The number of Class B shares outstanding did not change subsequent to the IPO.

Fortress's dividend paying shares and units were as follows:

	Weighted Average		
	Three Months Ended June 30, 2007	Six Months Ended June 30, 2007	June 30, 2007
Class A shares	94,500,350	81,136,426	94,500,350

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Restricted Class A share units (A)	394,286	202,589	394,286
Restricted Class A shares	97,296	76,331	97,296
Restricted Class A share units	23,730,308	18,753,486	23,730,308
Fortress Operating Group units	312,071,550	316,939,744	312,071,550
Total	430,793,790	417,108,576	430,793,790

(A) Represents fully vested restricted Class A share units which are entitled to dividend equivalent payments.

9. COMMITMENTS AND CONTINGENCIES

Indemnifications — In the normal course of business, Fortress and its subsidiaries enter into operating contracts that contain a variety of representations and warranties and that provide general indemnifications. In addition, subsidiaries of Fortress that act as general partners (or in similar capacities) of Fortress Funds enter into guarantees of certain obligations of such funds in the case of fraud by Fortress employees or under similar circumstances. Fortress's maximum exposure under these arrangements is unknown as this would involve future claims that may be made against Fortress that have not yet occurred. However, based on experience, Fortress expects the risk of material loss to be remote.

Debt Covenants — Fortress's debt obligations contain various customary loan covenants. These covenants do not, in management's opinion, materially restrict Fortress's investment or financing strategy at this time. Fortress was in compliance with all of its loan covenants as of June 30, 2007.

Litigation — Fortress is, from time to time, a defendant in legal actions from transactions conducted in the ordinary course of business. Management, after consultation with legal counsel, believes the ultimate liability arising from such actions that existed as of June 30, 2007, if any, will not materially affect Fortress's results of operations, liquidity or financial position.

On September 15, 2005, a lawsuit captioned David T. Atkins et al. v. Apollo Real Estate Advisors, L.P. et al. was brought on behalf of current and former limited partners in certain investing partnerships related to the sale of certain facilities to Ventas Realty Limited Partnership (''Ventas'') against a number of defendants, including one of the Portfolio Companies and a subsidiary of Fortress (''FIG''). FIG was the investment manager of consolidated Fortress Funds that were controlling

shareholders of the Portfolio Company during the relevant time periods. The suit alleges that the defendants improperly obtained certain rights with respect to such facilities from the investing partnerships. The plaintiffs have asked for damages in excess of $100 million on each of nine counts, as to which FIG is a defendant on seven counts, including treble damages with respect to certain counts. Fortress has filed an action to have itself removed as a named defendant in this case. The Portfolio Company has filed a motion to dismiss the claims and continues to vigorously defend this action. Fortress believes that the resolution of this action will not have a material adverse effect on its financial condition, liquidity or results of operations.

In addition, in the ordinary course of business, the Fortress Funds are and can be both the defendant and the plaintiff in numerous actions with respect to bankruptcy, insolvency and other types of proceedings. Such lawsuits may involve claims that adversely affect the value of certain financial instruments owned by the Fortress Funds. Although the ultimate outcome of actions cannot be ascertained with certainty, Fortress believes that the resolution of any such actions will not have a material adverse effect on its financial condition, liquidity or results of operations.

Private Equity Fund and Other Capital Commitments — Fortress has remaining capital commitments to certain of the Fortress Funds which aggregated $458.3 million at June 30, 2007. These commitments can be drawn by the funds on demand.

Incentive Income Contingent Repayment — Incentive income received from certain Fortress Funds, primarily private equity funds, is subject to contingent repayment and is therefore recorded as deferred incentive income, a liability, until all related contingencies have been resolved. The Principals guaranteed the contingent repayments to certain funds and Fortress has indemnified the Principals for any payments to be made under such guarantees. Furthermore, one of the private equity funds (NIH) is entitled to 50% of the incentive income from another private equity fund (Fund I). Fortress is contingently liable under a guarantee for any contingent repayment of incentive income from Fund I to NIH. Fortress expects the risk of loss on each of these indemnifications and guarantees to be remote.

Minimum Future Rentals — Fortress is a lessee under operating leases for office space located in New York, Dallas, San Diego, Los Angeles, San Francisco, Atlanta, Toronto, Geneva, Sydney, Hong Kong, Tokyo, Frankfurt, Munich and London.

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The following is a summary of major lease terms:

	New York Leases	Other Leases
Lease end date	Dec-2016	Various dates through Apr-2012
Current annual rent	$6,725	$5,985
Scheduled rent changes	Year 5 to $6,840; Year 9 to $5,725	Varies by lease
Escalations	Generally, a fixed percentage of the landlord’s annual operating expenses	Generally, a fixed percentage of the landlord’s annual operating

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	and tax expense.	expenses and tax expense.
Free rent periods	6 – 9 months	4 – 12 months
Leasehold improvement incentives	$3,186	$497
Renewal periods	None	5-year option on one lease, remainder have none

Minimum future rental expense under these leases is as follows:

July 1 to December 31, 2007	$ 6,689
2008	13,180
2009	12,604
2010	12,163
2011	9,135
2012	6,038
Thereafter	22,857
Total	$ 82,666

Rent expense recognized on a straight-line basis during the six months ended June 30, 2007 and 2006 was $7.4 million and $3.7 million, respectively, and during the three months ended June 30, 2007 and 2006 was $3.8 million and $1.6 million, respectively, and was included in General, Administrative and Other Expense.

10. SEGMENT REPORTING

Fortress conducts its management and investment business through the following four primary segments: (i) private equity funds, (ii) liquid hedge funds, (iii) hybrid hedge funds, and (iv) Castles. These segments are differentiated based on their varying investment strategies.

The amounts not allocated to a segment consist primarily of interest income earned on short term investments, certain general and administrative expenses and all interest expense incurred with respect to corporate borrowings.

Management makes operating decisions and assesses performance with regard to each of Fortress's primary segments based on financial data that is presented without the consolidation of any Fortress Funds. Accordingly, segment data for these segments is reflected on an unconsolidated basis,

even for periods prior to the deconsolidation (Note 1). Management also assesses Fortress's segments on a Fortress Operating Group and pre-tax basis and therefore adds back the interests in consolidated subsidiaries related to Fortress

Operating Group units (held by the Principals) and income tax expense.

Management assesses the net performance of each segment based on its ''distributable earnings.'' Distributable earnings is not a measure of cash generated by operations which is available for distribution. Rather, distributable earnings is a supplemental measure of the value created during any period which management uses in its determination of its periodic distributions to its dividend paying share and unit holders (Note 8). Distributable earnings should not be considered as an alternative to cash flow, in accordance with GAAP, as a measure of Fortress's liquidity, and is not necessarily indicative of cash available to fund cash needs (including distributions).

''Distributable earnings'' for the existing Fortress businesses is equal to net income adjusted as follows:

Incentive Income

(i) a. for Fortress Funds which are private equity funds, adding (a) incentive income paid (or declared as a distribution) to Fortress, less an applicable reserve for potential future clawbacks if the likelihood of a clawback is deemed greater than remote (net of the reversal of any prior such reserves that are no longer deemed necessary), minus (b) incentive income recorded in accordance with GAAP,

b. for other Fortress Funds, at interim periods, adding (a) incentive income on an accrual basis as if the incentive income from these funds were payable on a quarterly basis, minus (b) incentive income recorded in accordance with GAAP,

Other Income

(ii) with respect to income from certain principal investments and certain other interests that cannot be readily transferred or redeemed:

a. for equity method investments in the Castles and private equity funds as well as indirect equity method investments in hedge fund special investment accounts (which generally have investment profiles similar to private equity funds), treating these investments as cost basis investments by adding (a) realizations of income, primarily dividends, from these funds, minus (b) impairment with respect to these funds, if necessary, minus (c) equity method earnings (or losses) recorded in accordance with GAAP,

b. subtracting gains (or adding losses) on stock options held in the Castles,

c. subtracting unrealized gains (or adding unrealized losses) from consolidated private equity funds,

(iii) adding (a) proceeds from the sale of shares received pursuant to the exercise of stock options in certain of the Castles, in excess of their strike price, minus (b) management fee income recorded in accordance with GAAP in connection with the receipt of these options,

Expenses

(iv) adding or subtracting, as necessary, the employee profit sharing in incentive income described in (i) above to match the timing of the expense with the revenue,

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(v) adding back equity-based compensation expense (including Castle options assigned to employees, RSUs (including the portion of related dividend equivalents recorded as compensation expense), restricted shares and the LTIP),

(vi) adding back compensation expense recorded in connection with the forfeiture arrangements entered into among the principals (Note 7),

(vii) adding the income (or subtracting the loss) allocable to the interests in consolidated subsidiaries attributable to Fortress Operating Group units, and

(viii) adding back income tax expense and any expense recorded in connection with the tax receivable agreement (Note 5).

Management believes only the incentive income related to realized fund income should be considered available for distribution, subject to a possible reserve, determined on a fund by fund basis, as necessary, for potential future clawbacks deemed to have more than a remote likelihood of occurring. As such, distributable earnings generally includes incentive income to the extent it relates to paid or declared distributions from Fortress Funds' investments that have been monetized through sale or financing.

The computation of the clawback reserve, if any, takes into account, among other factors, the amount of unrealized incentive income within a given fund since, on an overall fund basis, this unrealized incentive income would have to suffer a complete loss before the realized portion becomes subject to contingent repayment. This type of incentive income is not recorded as revenue for GAAP purposes, under the revenue recognition method Fortress has selected, until the possibility of a clawback is resolved. This GAAP method is not completely reflective of value created during the period which is available for distribution as it disregards the likelihood that any contingent repayment will in fact occur.

Distributable earnings is limited in its usefulness in measuring earnings because it recognizes as revenues amounts which are subject to contingent repayment, it ignores significant unrealized gains and it does not fully reflect the economic costs to Fortress by ignoring certain equity-based compensation expenses. Management utilizes distributable earnings as well as net income in its analysis of the overall performance of Fortress and notes that the two measures are each useful for different purposes.

Total segment assets after consolidation are equal to total GAAP assets adjusted for:

(i) the difference between the GAAP carrying amount of equity method investments and their carrying amount for segment reporting purposes, which is generally fair value for publicly traded investments and cost for nonpublic investments,

(ii) employee portions of investments, which are reported gross for GAAP purposes (as assets offset by Principals' and others' interests in equity of consolidated subsidiaries) but net for segment reporting purposes, and

(iii) the difference between the GAAP carrying amount for options owned in certain of the Castles and their carrying amount for segment reporting purposes, which is intrinsic value.

Summary financial data on Fortress's segments is presented on the following pages, together with a reconciliation to revenues, assets and net income for Fortress as a whole. Fortress's investments in, and earnings from, its equity method investees by segment are presented in Note 3.

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Fortress's depreciation expense by segment was as follows:

	Private Equity Funds	Liquid Hedge Funds	Hybrid Hedge Funds	Castles	Unallocated	Total
Six Months Ended June 30,						
2007	$ 482	$ 1,211	$ 1,229	$ 426	$ 845	$ 4,193
2006	$ 337	$ 866	$ 1,040	$ 319	$ 624	$ 3,186
Three Months Ended June 30,						
2007	$ 243	$ 631	$ 653	$ 212	$ 445	$ 2,184
2006	$ 173	$ 444	$ 534	$ 160	$ 309	$ 1,620

Note that distributable earnings for the periods presented includes earnings (losses) on deferred fee arrangements (Note 3), net of any employee share, as presented in the table below. All of these deferred fees have been collected. The deferred fee arrangements were terminated in 2007 (Note 2) and therefore these earnings (losses) are not reflective of ongoing operations and will not contribute to distributable earnings subsequent to the termination date.

	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006
Liquid hedge funds	$ 1,926	$ 25,597
Hybrid hedge funds	—	4,524
Total	$ 1,926	$ 30,121

	Private Equity Funds	Liquid Hedge Funds	Hybrid Hedge Funds	Castles	Unallocated	Fortress Unconsolidated Subtotal
June 30, 2007 and the Six Months Then Ended						
Segment revenues						
Management fees	$ 62,616	$ 69,341	$ 60,720	$ 22,746	$ —	$ 215,423
Incentive income	190,298	158,199	84,369	17,905	—	450,771
Segment revenues – total	$ 252,914	$ 227,540	$ 145,089	$ 40,651	$ —	$ 666,194
Pre-tax distributable earnings	$ 176,204	$ 112,102	$ 71,716	$ 20,706	$ (17,891)	$ 362,837
Total segment assets	$ 265,784	$ 149,735	$ 255,295	$ 196,765	$ 860,320(A)	$ 1,727,899

	Fortress Unconsolidated Subtotal	Consolidation of Fortress Funds	Eliminations	Reconciliation to GAAP	Fortress Consolidated
Revenues	$ 666,194	$ 317,114	$ (269,607)	$ (29,252)	$ 684,449
Pre-tax distributable earnings /net income	$ 362,837	$ (326,375)	$ 326,375	$ (355,825)	$ 7,012
Total assets	$ 1,727,899	$ —	$ —	$ 59,822	$ 1,787,721

(A) Unallocated assets include cash of $321 million and deferred tax assets of $475 million.

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June 30, 2007 and the Six Months Then Ended
Reconciling items between segment measures and GAAP measures:

Adjustments from segment revenues to GAAP revenues	
Adjust management fees*	$ 325
Adjust incentive income	(61,793)
Adjust income from the receipt of options	2,006
Other revenues*	30,210
Total adjustments	$ (29,252)

* Segment revenues do not include GAAP other revenues; GAAP other revenues are included elsewhere in the calculation of distributable earnings.

Adjustments from pre-tax distributable earnings to GAAP net income		
Adjust incentive income		
Incentive income received from private equity funds, subject to contingent repayment	$ (138,822)	
Incentive income received from private equity funds, not subject to contingent repayment	(51,476)	
Incentive income accrued from private equity funds, no longer subject to contingent repayment	211,942	
Incentive income received from hedge funds, subject to annual performance achievement	(83,437)	
Reserve for clawback	—	
		(61,793)
Adjust other income		

Distributions of earnings from equity method investees**	(12,326)	
(Earnings) losses from equity method investees**	(19,248)	
Unrealized (gains) losses on options in equity method investees, treated as derivatives	(24,456)	
Adjust income from the receipt of options	2,006	
		(54,024)
Adjust employee compensation		
Adjust employee equity-based compensation expense (including Castle options assigned)	(67,363)	
Adjust employee portion of incentive income from private equity funds, accrued prior to the realization of incentive income	(19,657)	
		(87,020)
Adjust Principals' equity-based compensation expense		(380,933)
Adjust non-controlling interests related to Fortress Operating Group units		247,401
Adjust income taxes		(19,456)
Total adjustments		$ (355,825)
Adjustments from total segment assets to GAAP assets		
Adjust equity investments from fair value	$ (49,963)	
Adjust equity investments from cost	42,812	
Adjust investments gross of employee portion	56,431	
Adjust option investments to intrinsic value	10,542	
Total adjustments	$ 59,822	

** This adjustment relates to all of the Castles, private equity Fortress Funds and hedge fund special investment accounts in which Fortress has an investment. On an unconsolidated basis, each of these funds is accounted for under the equity method.

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	Private Equity Funds	Liquid Hedge Funds	Hybrid Hedge Funds	Castles	Unallocated	Fortress Unconsolidated Subtotal
Three Months Ended June 30, 2007						
Segment revenues						
Management fees	$ 35,852	$ 38,400	$ 31,707	$ 11,841	$ —	$ 117,800
Incentive income	—	112,920	38,264	14,217	—	165,401
Segment revenues – total	$ 35,852	$ 151,320	$ 69,971	$ 26,058	$ —	$ 283,201
Pre-tax distributable earnings	$ 28,437	$ 79,029	$ 28,007	$ 15,030	$ (7,247)	$ 143,256

	Fortress Unconsolidated Subtotal	Reconciliation to GAAP	Fortress Consolidated
Revenues	$ 283,201	$ (15,082)	$ 268,119
Pre-tax distributable earnings / net income	$ 143,256	$ (198,387)	$ (55,131)

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Three Months Ended June 30, 2007
Reconciling items between segment measures and GAAP measures:

Adjustments from segment revenues to GAAP revenues		
Adjust management fees*		$ 325
Adjust incentive income		(32,376)
Adjust income from the receipt of options		1,195
Other revenues*		15,774
Total adjustments		$ (15,082)

* Segment revenues do not include GAAP other revenues; GAAP other revenues are included elsewhere in the calculation of distributable earnings.

Adjustments from pre-tax distributable earnings to GAAP net income		
Adjust incentive income		
Incentive income received from private equity funds, subject to contingent repayment	$ —	
Incentive income received from private equity funds, not subject to contingent repayment	—	
Incentive income accrued from private equity funds, no longer subject to contingent repayment	5,502	
Incentive income received from hedge funds, subject to annual performance achievement	(37,878)	
Reserve for clawback	—	
		(32,376)
Adjust other income		
Distributions of earnings from equity method investees**	(2,433)	
(Earnings) losses from equity method investees**	(8,098)	
Unrealized (gains) losses on options in equity method investees, treated as derivatives	(29,606)	

Adjust income from the receipt of options	1,195	
		(38,942)
Adjust employee compensation		
Adjust employee equity-based compensation expense (including Castle options assigned)	(28,934)	
Adjust employee portion of incentive income from private equity funds, accrued prior to the realization of incentive income	(19,657)	
Adjust employee portion of incentive income from one private equity fund, not subject to contingent repayment	(569)	
		(49,160)
Adjust Principals' equity-based compensation expense		(242,659)
Adjust non-controlling interests related to Fortress Operating Group units		169,759
Adjust income taxes		(5,009)
Total adjustments		$ (198,387)

** This adjustment relates to all of the Castles, private equity Fortress Funds and hedge fund special investment accounts in which Fortress has an investment. On an unconsolidated basis, each of these funds is accounted for under the equity method.

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	Private Equity Funds	Liquid Hedge Funds	Hybrid Hedge Funds	Castles	Unallocated	Fortress Unconsolidated Subtotal
Six Months Ended June 30, 2006						
Segment revenues						
Management fees	$ 37,647	$ 40,423	$ 36,032	$ 15,010	$ —	$ 129,112
Incentive income	96,176	70,909	53,507	6,469	—	227,061
Segment revenues – total	$ 133,823	$ 111,332	$ 89,539	$ 21,479	$ —	$ 356,173
Pre-tax distributable earnings	$ 95,080	$ 77,626	$ 38,088	$ 2,072	$ (20,707)	$ 192,159

	Fortress Unconsolidated Subtotal	Consolidation of Fortress Funds	Eliminations	Reconciliation to GAAP	Fortress Consolidated
Revenues	$ 356,173	$ 611,901	$ (146,944)	$ (122,830)	$ 698,300
Pre-tax distributable earnings / net income	$ 192,159	$ 1,464,335	$ (1,464,335)	$ (104,154)	$ 88,005

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Six Months Ended June 30, 2006
Reconciling items between segment measures and GAAP measures:

Adjustments from segment revenues to GAAP revenues	
Adjust management fees*	$ 330
Adjust incentive income	(143,887)
Adjust income from the receipt of options	18,692
Other revenues*	2,035
Total adjustments	$ (122,830)

* Segment revenues do not include GAAP other revenues; GAAP other revenues are included elsewhere in the calculation of distributable earnings.

Adjustments from pre-tax distributable earnings to GAAP net income		
Adjust incentive income		
Incentive income received from private equity funds, subject to contingent repayment	$ (96,176)	
Incentive income accrued from one private equity fund, not subject to contingent repayment	5,460	
Incentive income accrued from hedge funds, subject to annual performance achievment	(53,171)	
Reserve for clawback	—	
		(143,887)
Adjust other income		
Distributions of earnings from equity method investees**	(5,069)	
(Earnings) losses from equity method investees**	10,625	
Unrealized (gains) losses on options in equity method investees, treated as derivatives	24,004	
Adjust income from the receipt of options	18,692	
		48,252
Adjust employee compensation		
Adjust compensation expense for assigned Castle options	65	
Adjust employee portion of incentive income from one private equity fund, not subject to contingent payment	(1,337)	
		(1,272)
Adjust income taxes		(7,247)
Total adjustments		$ (104,154)

** This adjustment relates to all of the Castles, private equity Fortress Funds and hedge fund special investment accounts in which Fortress has an investment. On an unconsolidated basis, each of these funds is accounted for under the equity method.

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	Private Equity Funds	Liquid Hedge Funds	Hybrid Hedge Funds	Castles	Unallocated	Fortress Unconsolidated Subtotal
Three Months Ended June 30, 2006						
Segment revenues						
Management fees	$ 25,143	$ 21,619	$ 19,355	$ 7,401	$ —	$ 73,518
Incentive income	71,167	15,940	25,004	3,622	—	115,733
Segment revenues – total	$ 96,310	$ 37,559	$ 44,359	$ 11,023	$ —	$ 189,251
Pre-tax distributable earnings	$ 69,169	$ 6,410	$ 16,884	$ 254	$ (16,202)	$ 76,515

	Fortress Unconsolidated Subtotal	Consolidation of Fortress Funds	Eliminations	Reconciliation to GAAP	Fortress Consolidated
Revenues	$ 189,251	$ 348,285	$ (114,227)	$ (95,040)	$ 328,269
Pre-tax distributable earnings/net income	$ 76,515	$ 464,948	$ (464,948)	$ (118,790)	$ (42,275)

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Reconciling items between segment measures and GAAP measures:

Adjustments from segment revenues to GAAP revenues	
Agjust management fees*	$ 330
Adjust incentive income	(96,768)
Adjust income from the receipt of options	—
Other revenues*	1,398
Total adjustments	$ (95,040)

* Segment revenues do not include GAAP other revenues; GAAP other revenues are included elsewhere in the calculation of distributable earnings.

Adjustments from pre-tax distributable earnings to GAAP net income		
Adjust incentive income		
Incentive income received from private equity funds, subject to contingent repayment	$ (71,167)	
Incentive income accrued from one private equity fund, not subject to contingent repayment	(1,052)	
Incentive income accrued from hedge funds, subject to annual performance achievment	(24,549)	
Reserve for clawback	—	
		(96,768)
Adjust other income		
Distributions of earnings from equity method investees**	(3,212)	
(Earnings) losses from equity method investees**	5,542	
Unrealized (gains) losses on options in equity method investees, treated as derivatives	(22,472)	
Adjust income from the receipt of options	—	
		(20,142)
Adjust employee compensation		
Adjust compensation expense for assigned Castle options	—	
Adjust employee portion of incentive income from one private equity fund, not subject to contingent payment	257	
		257
Adjust income taxes		(2,137)
Total adjustments		$ (118,790)

** This adjustment relates to all of the Castles, private equity Fortress Funds and hedge fund special investment accounts in which Fortress has an investment. On an unconsolidated basis, each of these funds is accounted for under the equity method.

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11. SUBSEQUENT EVENTS

In the third quarter of 2007, private equity Fortress Funds distributed approximately $56 million of incentive income, net of employee allocations, to Fortress related to an investment realization event which occurred in late June 2007.

12. PRO FORMA FINANCIAL INFORMATION

The unaudited pro forma financial information presented below was derived from the application of pro forma adjustments to the combined and consolidated financial statements of Fortress, as applicable, to give effect to the deconsolidation of the consolidated Fortress Funds. The deconsolidation transaction occurred effective March 31, 2007 as described in Note 1. The unaudited pro forma balance sheet information as of December 31, 2006 has been prepared as if this transaction had occurred on December 31, 2006. The unaudited pro forma income statement and statement of cash flows information for the six months June 30, 2007 have been prepared as if this transaction had occurred on January 1, 2007.

The primary effects of the deconsolidation transaction on Fortress's financial position, results of operations and liquidity are the following:

- Fortress no longer records on its balance sheet and income statement the gross assets, liabilities, revenues, expenses and other income of the deconsolidated Fortress Funds, along with the related interests of the fund investors in the equity and net income of these funds.
- Fortress reflects its investment in these funds on its balance sheet using the equity method of accounting, rather than eliminating the investment in consolidation.
- Fortress will include the management fees and incentive income earned from these funds on its income statement rather than eliminating the revenue in consolidation.
- Fortress will record its equity in the income of these funds using the equity method of accounting. However, it will not record any equity in income arising from incentive income arrangements to the extent that the incentive income is subject to contingent repayment until the contingency is resolved. Therefore, Fortress no longer needs to record deferred incentive income with respect to these funds for incentive income that it is not yet distributed.
- Fortress will also remove the cash flow activities of the deconsolidated funds from its statement of cash flows and replace them with its cash contributions to and distributions from the deconsolidated funds, which previously were eliminated in consolidation. This would not have any effect on Fortress's overall net change in cash for the period; however, it would result in significant changes to Fortress's operating, investing and financing cash flow categories.

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The unaudited pro forma effects of the deconsolidation of the Fortress Funds on the December 31, 2006 balance sheet information are as follows:

	As of December 31, 2006		
	Combined	Deconsolidation Adjustments	Pro Forma Deconsolidated
Assets			
Cash and cash equivalents	$ 61,120	$ —	$ 61,120
Cash held at consolidated subsidiaries and restricted cash	564,085	(564,085)	—
Due from affiliates	635,748	50,336	686,084
Receivables from brokers and counterparties	109,463	(109,463)	—
Investment company holdings, at fair value	21,944,596	(21,944,596)	—
Other investments			—
Loans and securities	317	—	317
Equity method investees	37,250	452,143	489,393
Options in affiliates	139,266	—	139,266
Deferred tax asset	2,808	—	2,808
Other assets	187,920	(118,200)	69,720
	$ 23,682,573	$ (22,233,865)	$ 1,448,708
Liabilities and Members' Equity			
Liabilities			
Due to affiliates	$ 15,112	$ (14,660)	$ 452
Due to brokers and counterparties	187,495	(187,495)	—
Accrued compensation and benefits	159,931	—	159,931
Other liabilities	152,604	(95,413)	